

REFLECTIONS ON THE EC'S EVALUATION OF ITS MARKET DEFINITION NOTICE

Response to the EC's consultation

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In response to the growing digitisation and globalisation, the European Commission (the EC) is currently evaluating its Market Definition Notice, which it originally published in 1997. This article details our reflections on the direction and scope of the changes that the EC may wish to consider. In our opinion, notwithstanding the changes brought about by digitisation and globalisation, the principles of market definition outlined in the notice remain pertinent. However, given the new challenges of market definition in digital markets, there is now a need for practical guidance on the collection and assessment of evidence in these markets. Specifically, given the limitations of the longstanding methodologies, coupled with the need to respond to the evolving nature of markets, there is a role for the EC to provide the proactive thought leadership on 'what good looks like'. In fact, this is in the gift of the Chief Economist's Team (CET), which may be best placed to spearhead this by looking beyond the immediate updates to the notice to consider a long-term programme of work that looks to progress our understanding of these markets and identify methodologies to assess competition concerns in them.

1. The EC is considering an update to its market definition notice to reflect the changes in the functioning of markets as a result of digitisation and globalisation

The EC originally published the '*Commission Notice on the definition of relevant market for the purposes of Community competition law*' in 1997 with the objective to provide transparency and guidance on its application of the concept of relevant product and geographic markets in the enforcement of competition law.¹

However, over twenty years since, it is currently evaluating the need to update the guidance to reflect changes, such as globalisation and digitisation, which mean that many markets work differently from the way they used to.² In doing so, the Commission's aim is to ensure that "*the guidance it gives is accurate and up to date, and sets out a clear and consistent approach to both antitrust and merger cases across different industries, in a way that's easily accessible*".³

¹ Please see: [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN).

² Please see: <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12325-Evaluation-of-the-Commission-Notice-on-market-definition-in-EU-competition-law>.

³ '[Defining markets in a new age](#).' Margrethe Vestager Speech at Chillin' Competition Conference, Brussels, 9 December 2019.

2. The EC must, as the first step, choose the nature of the guidance that it wishes to provide because this matters, not only in considering the need for a revision, but also the focus of any updates

It is largely uncontroversial that effective guidance from the EC needs to cover the following:

- (a) explain the issue it is seeking to address;
- (b) set out the available options for doing so;
- (c) discuss the practical application of the options (and, particularly, what good (and, bad) looks like); and
- (d) consider the conditions under which one may choose one option over another.

This is necessary for the guidance to achieve its stated objective of increasing transparency and providing clarity of application and, therefore, to ensure consistency of approach between cases and certainty for businesses and their advisers.

However, in practice, there are various ways in which one might achieve this. This determines the nature of the guidance depending on the level of detail that the EC chooses to provide on (b) to (d) above. Specifically, it can:

- (i) set out the broad principles for consideration of (b) to (d);
- (ii) detail the specific practical steps for assessment in (b) to (d); and
- (iii) (to a varying degree) balance each of (i) and (ii).

For instance, for the guidance on product market definition, the EC could choose to:

- As (i), with the aim to set out the broad principles:
 - set out the principles for consideration of demand- and supply-side effects;
 - describe the various approaches available for consideration of the above; and
 - explain that it usually focusses on demand-side effects and identify conditions under which it might be important to consider supply-side effects.
- As (ii), with the aim to detail the specific practical steps for assessment:
 - detail the various methodologies for collection and assessment of evidence;
 - detail the steps it takes for the development of evidence under each approach; and
 - specify the conditions under which it would use one over the other.
- As (iii), with the aim to balance both considerations:
 - describe the available approaches for collection and assessment of evidence;
 - provide a suggested template for each of the approaches; and
 - lay out the framework for the choice between each of them.

The choice between the above is not straightforward because there are pros and cons associated with each of the above. Specifically, if the guidance is too general, then it fails to provide the necessary clarity on the EC's assessment of cases, and therefore cannot ensure consistency of approach between cases and certainty for businesses. On the other hand, if the guidance is too specific and prescriptive, then the EC cannot be as responsive to the specifics of a case as well as the changing nature of markets.

Therefore, **before the EC considers the need for and the extent of revisions required to the Market Definition Notice, it first needs to establish the nature of the guidance it wishes to provide**, and specifically where on the above scale it wants its guidance to be.

3. In our opinion, the principles outlined in the notice as it stands remain pertinent to date, and so, no revisions are needed if the EC wants its guidance to be at that end of the scale

In its existing guidance, as published in 1997, the EC essentially set out a broad framework for its assessment of the boundaries of competition between firms (i.e. it likely chose (i) on the scale above). Specifically, the guiding principles set out in the notice can be summarised as follows:

- First, the boundaries of the market are primarily determined on the basis of the extent of customer substitution between products. In particular, taking the relevant product market as an example, the notice sets out that the market comprises of “*all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products’ characteristics, their prices and their intended use*”.⁴
- Second, price is important, but only one of the factors relevant to determining the extent of customer substitution. However, in practical terms, the SSNIP test provides the most clear evidence to identify the boundaries of the market.⁵ In particular, the notice details that “*The exercise of market definition focuses on prices for operational and practical purposes, and more precisely on demand substitution arising from small, permanent changes in relative prices. This concept can provide clear indications as to the evidence that is relevant in defining markets*”.⁶
- Third, the key factors relevant to market definition vary depending on the nature of the industry under consideration. In particular, the notice identifies several conditions under which the scope of the assessment may vary in order to account for the specific features of the industry. For instance, it suggests that:
 - (i) supply-side substitutability is relevant to the assessment of market definition in cases where its effect on the competitive pressures faced by firms is immediate, for instance, in industries with companies selling differentiated products (i.e. a range of qualities or grades of the same or similar product);⁷ and
 - (ii) the scope of the assessment may be different for different kind of cases such that the “*market might be different when analysing a concentration, where the analysis is essentially prospective, from an analysis of past behaviour*”.⁸

⁴ Please see paragraph 7 in [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN).

⁵ The SSNIP test is a speculative experiment to help understand the impact on demand of a small, significant, non-transitory increase in price.

⁶ Please see paragraph 15 in [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN).

⁷ Please see paragraphs 20 to 22 in [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN).

⁸ Please see paragraph 12 in [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN).

Over twenty years on, **these principles continue to serve as a relevant guide to defining the boundaries of market even in the age of increased globalisation and digitisation.** In fact, they have guided practitioners towards the development of methodologies in order to reflect the changing features of the markets under consideration. In particular, over this period, practitioners have developed methodologies to manage various challenges including:

- availability of data;
- nature of the purchase process (for instance, in case of bidding markets); and
- format of sales (for instance, integrated products); etc.

4. However, since it is widely accepted that defining economic markets in digital industries is challenging, there is now a need for more practical guidance on the collection and assessment of evidence in these markets

It is now widely accepted that **market definition in digital industries, and especially for platforms, is inherently challenging.** For instance, in a speech at the Chillin' Competition Conference in 2019, Commissioner Vestager pointed out that *"The changes that we're going through – especially digitisation – are also creating new challenges for defining product markets – for working out which products consumers are willing to substitute for each other"*.⁹ These challenges stem from the typical nature of these industries which are characterised by:¹⁰

- (a) rapid innovation: which means that customer substitution options can also change rapidly such that static definitions of relevant product or geographic markets become difficult;
- (b) significant network effects: which means that changes on one side of the platform have an impact on the other side(s) of the platform such that identifying the impact of a price change on the firm becomes complex;
- (c) zero prices: at least for customers on one side of the platform which means that the traditional SSNIP test cannot be applied; and
- (d) ecosystems: where some firms compete to capture 'access to customers' as opposed to sales of individual products and services such that traditional definitions of relevant 'product' markets become irrelevant.

Therefore, while the principles of market definition set out in the notice remain pertinent, **there is now a need for practical guidance on the collection and assessment of evidence considering the features of markets today** (i.e. the EC should move towards (ii) on the scale above).

5. Specifically, since there is no 'perfect' method for market definition in these industries, there is a role for proactive thought leadership from the EC regarding 'what good looks like'

In response to the abovementioned challenges, although academics and practitioners have suggested a range of techniques to help delineate the boundaries in these markets, each of them have their own challenges and there continues to be much debate about the 'best' way. These techniques include:

⁹ *'Defining markets in a new age.'* Margrethe Vestager Speech at Chillin' Competition Conference, Brussels, 9 December 2019.

¹⁰ *'Competition Policy for the digital era: Final Report.'* Jacques Crémer; Yves-Alexandre de Montjoye and Heike Schweitzer (2019).

- Using the SSNDQ test. Some academics and practitioners have suggested using an SSNDQ test as an alternative to the SSNIP test in zero-price markets to assess the impact on demand of a small, significant, and non-transitory decrease in quality.¹¹ However, in practice, product quality can be difficult to observe and measure in most cases and, therefore, understanding the impact of 5-10% decrease in quality is often not practically feasible.¹²
- Using product characteristics. In some cases, including in its pivotal investigation of Google in relation to more favourable positioning of its own comparison shopping service, the EC has primarily based the definition of the relevant product markets on the features of the services offered by the various suppliers in the industry.¹³ However, this approach has been criticised for lacking the technical rigour expected for the definition of economic markets in 'traditional' industries.¹⁴
- Using experiments. Several practitioners have also attempted to use experimental techniques such as surveys to identify the extent of customer substitution between the various products within the industry. However, in digital markets, such experiments are less able to capture customer feedback since the inherent challenges related to visualising hypothetical scenarios (even in terms of prices) are further exacerbated when respondents are expected to visualise hypothetical scenarios in terms of changes in features or quality.

Consequently, since there appears to be no 'perfect' method in these industries, **what is needed now is a practical way forward in these cases.** Specifically, there is a role for the EC to drive this thinking forward by:

- Firstly, taking a holistic view of the approaches that can be applied in these markets. Specifically, the EC should consider the full range of longstanding as well as 'novel' methodologies that can be applied in these markets. Importantly, this should not be limited by 'what has been done' but look towards 'what can practically be done'.
- Secondly, develop a shared understanding of the application of each of these approaches. Specifically, for consistency and efficiency, the EC should share a detailed understanding of the application of each of these approaches (i.e. explain 'what good looks like' in the specific context of developing evidence in these markets).
- Thirdly, create a framework for the application of the above approaches to individual cases. Specifically, it should consider the relative pros and cons of each of the approaches for individual cases (i.e. considering their specific features such as nature of the case, scale of impact of the parties, availability of existing information, stability of the industry, etc.).

¹¹ *'Policy Roundtables: The Role and Measurement of Quality in Competition Analysis.'* OECD (2013). Available here: <http://www.oecd.org/competition/Quality-in-competition-analysis-2013.pdf>.

¹² *'Competition Policy for the digital era: Final Report.'* Jacques Crémer; Yves-Alexandre de Montjoye and Heike Schweitzer (2019); page 45.

¹³ *'Competition Policy for the digital era: Final Report.'* Jacques Crémer; Yves-Alexandre de Montjoye and Heike Schweitzer (2019); page 45.

¹⁴ *'Competition Policy for the digital era: Final Report.'* Jacques Crémer; Yves-Alexandre de Montjoye and Heike Schweitzer (2019); page 45.

This kind of clarity is essential for the EC to meet its intention that “*Increased transparency will also result in companies and their advisers being able to better anticipate the possibility that the Commission may raise competition concerns in an individual case*”.¹⁵

6. In order to effectively achieve the necessary clarity, while also ensuring it can respond to the changing nature of these markets, the EC should consider developing an evolving programme of work that continues to expand our practical thinking

Alongside providing the necessary clarity, we acknowledge that it is also important that the guidance is not so prescriptive that the EC boxes itself into championing specific approaches, and therefore, cannot respond to the nature of individual cases. In particular, it needs to tread this balance carefully in digital industries, where the market is continuously evolving.

In our opinion, the most effective way of achieving this balance is to ensure that the guiding principles in the Market Definition Notice remain pertinent, while augmenting this with supplementary guidance which covers practical methodological issues. In fact, this is in the gift of the Chief Economist’s Team (CET), which would be best placed to spearhead this by looking beyond the immediate updates to the notice to consider a long-term programme of work that looks to progress our understanding of these markets and identify methodologies to assess competition concerns in them.

This role would allow the CET to be at the forefront of the development of practical solutions to the competition issues faced in these markets to the benefit of the wider competition community. This would involve the CET proactively and regularly sharing practical insights on:

- its understanding of functioning of digital markets;
- its evolving consideration of the practical approaches to market definition;
- templates and frameworks for application of ‘novel’ methodologies;
- tools for technical analyses such as merger simulations and survey design;
- examples of application of the various approaches in cases and any lessons;
- etc.

In practice, this programme of work would also require the CET to consider important additions to its expertise in economics to include:

- social researchers;
- behavioural economists;
- individuals with a better understanding of functioning of digital markets;
- people with experience of practical application of specific techniques;
- leaders with ideas on alternative methodologies suitable in these markets;
- etc.

¹⁵ Please see paragraph 5 in [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN).

7. Conclusion

Overall, in response to the EC's evaluation of the Market Definition Notice, we believe:

- The EC must, as the first step, choose the nature of the guidance that it wishes to provide because this matters, not only in considering the need for a revision, but also the focus of any updates. Specifically, it must choose between providing guidance that:
 - (i) simply sets out the broad principles for consideration of the issue at hand;
 - (ii) details the specific practical steps for assessment of markets; and
 - (iii) (to a varying degree) balances each of (i) and (ii).
- In our opinion, the principles outlined in the notice as it stands remain pertinent to date, and so, no revisions are needed if the EC wants its guidance to be at that end of the scale.
- However, since it is widely accepted that defining economic markets in digital industries is challenging, there is now a need for more practical guidance on the collection and assessment of evidence in these markets.
- In particular, although various techniques have been discussed to address the above challenges, there is no 'perfect' method, and there is a role for proactive thought leadership from the EC regarding 'what good looks like'. This clarity is necessary for the guidance to achieve its objective of ensuring consistency of approach between cases and certainty for businesses and their advisers.
- In order to effectively achieve the necessary clarity, while also ensuring it can respond to the changing nature of these markets, the EC should consider augmenting the guiding principles in the Market Definition Notice with an evolving programme of work that looks to progress our understanding of these markets and identify practical methodologies to assess competition concerns in them.
- This is in the gift of the Chief Economists' Team which can look beyond the immediate update to the Market Definition Guidance to take on the thought leadership required on this important issue. Specifically, this would require the CET to:
 - (a) regularly engage with the wider competition community to share insights;
 - (b) develop practical tools for the application of market definition techniques; and
 - (c) make additions to its expertise in economics to include individuals from other disciplines who not only have specific expertise in application of known techniques but can also identify other techniques relevant to these markets.

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