



**ANTITRUST CLIENT BRIEFING**

# Market Definition Notice Under Review

20 July 2021

# At a Glance

*The European Commission (EC) has published a [Staff Working Document](#) that summarises the findings of its evaluation of the 1997 [Commission Notice on the definition of the relevant market for the purposes of Community competition law](#) (the Market Definition Notice or Notice) to confirm whether it is still fit for purpose and up to date. With the publication of the Staff Working Document, the EC now has all the facts on the table to decide whether to revise the Notice, and if so, how.*

## Key points

*“We need to analyse the market and the boundaries of the market where companies compete. The Market Definition Notice is very useful in that context. The evaluation has confirmed that it provides clarity and transparency to stakeholders on how we approach market definition. The basic principles of the Market Definition Notice, based on the case law of the EU courts, remain sound today. At the same time the evaluation indicates that the Notice does not fully cover recent evolutions in market definition practice, including those related to the digitalisation of the economy. We will now analyse if and how the Notice should be revised to address the issues we have identified.”* Commissioner Vestager, 12 July 2021

- The Market Definition Notice remains highly relevant by providing clarity and transparency to businesses and stakeholders.
- The basic principles laid down in the Market Definition Notice, which are based on the EC’s decisional practice and the case law of the EU courts will not change radically.
- The main changes to the Market Definition Notice will focus on adapting the 1997 Notice to the new world of digitalisation, and will include:
  - Digital markets
  - The use and purpose of the small, significant, non-transitory increase in price test (the SSNIP test) in defining relevant markets
  - The assessment of geographic markets in conditions of globalisation and import competition
  - Quantitative techniques
  - The calculation of market shares
  - Non-price competition (including innovation)
- As regards the coherence of the Notice, there is a need for more clarity about the differences and the role of market definition in antitrust (backward looking) and merger assessments (forward looking), the possibility to define different markets for the same economic activity, and whether a market definition analysis is always needed.
- At this stage of the review, the EC does not propose any options as regards the content of possible changes.

- Challenge for the EC looking forward: How will the modernised Notice allow for the necessary flexibility to adapt to the fast-developing innovative markets and maintain its relevance in the long run?

## Background

Since the adoption of the Notice in 1997, undertakings' business models and practices have considerably transformed. The increasing globalisation and the digitalisation of the economy raise new challenges for markets the latter, evolving quickly. In December 2019, Commissioner Vestager announced that the two-decades-old Market Definition Notice would need to be reviewed in order to reflect these significant changes.

The EC officially launched the evaluation of the Market Definition Notice in March 2020. It collected evidence to understand how the Notice has performed since its adoption in 1997, including contributions from stakeholders after a public consultation launched in June 2020. In addition, the EC consulted the EU national competition authorities (NCAs) and engaged with experts and representatives from stakeholder groups. Finally, the EC requested an external evaluation [support study](#), published in June 2021, which reviewed practices in other jurisdictions as well as legal and economic literature, in relation to four specific aspects of market definition: digitalisation, innovation, geographic market definition, and quantitative techniques.

## What is the Market Definition Notice?

Market definition covers two aspects: the product market and the geographic market. The objective of defining the relevant market is to identify the competitive constraints that the undertakings involved face by identifying their competitors that are able to constrain their business decisions. Market definition is of essential significance in both antitrust enforcement (Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU)) and merger control, as it allows measuring market power.

The Market Definition Notice provides guidance on how the EC applies the concept of relevant product and geographic market in its enforcement practice. It codifies the EC's past practice as well as guidance provided by the EU courts. The Notice increases the transparency of the EC's policy and decision making. It also helps businesses to better anticipate the possibility that the EC may raise competition concerns:

- The Notice sets out the main elements underlying the definition of the relevant product and geographic market and considers the types of competitive constraints to be taken into account at the market definition stage:
  - Demand-side substitution, where the customers are in a position to switch easily to available substitute products or services or to suppliers located elsewhere
  - Supply-side substitution, if its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy because most suppliers are able to switch their sales to the relevant products or areas and market them in the short term without incurring significant additional costs or risk.
- The Notice describes the evidence the EC relies on to define the relevant product and geographic market, explains how the EC calculates market shares, and addresses certain specific practical market definition issues that may arise in particular cases.



## Main orientations of the EC's evaluation

Commissioner Vestager stated that the basic principles of the Market Definition Notice (i.e. competitive constraints, demand substitution, supply substitution and potential competition) remain sound. The EC's market definitions continue to be guided by the definitions of product and geographic markets on the basis of demand-side and supply-side substitutability, relying on short-term and effective constraints in that assessment. In other words, these basic principles will not change radically.

Similarly, there will be some continuity in the principles to define the scope of geographic markets despite the growing ease of global trading.

The most significant changes to the Notice will concern digital markets.

### The supply substitution and potential competition

The Notice explains that **supply-side substitution** may be taken into account when defining markets, only when its effects are equivalent to demand-side substitution in terms of immediacy and effectiveness. Substitutability must therefore be looked at not only from the supply-side but also from the demand-side, which remains, in principle, the most effective assessment criterion.

According to the EC, this approach reflects the international consensus among the competition authorities to emphasise demand-side substitution.

However, the evaluation's results show that:

- On the one hand, some stakeholders suggested an alignment of the EC's practice with the practice in the United States, where supply-side substitutability is explicitly excluded from market definition, and taken into account at the competitive assessment stage. Professors Fletcher and Lyons supported this view when they analysed the EC's approach to market definition in 2017.
- On the other hand, other stakeholders, particularly those active in digital products, suggested changes to the framework and noted that the EC should broaden the concept of supply-side substitutability by considering it to the same extent as demand substitution. This approach would better account for significant innovation and technological developments. However, the EC dismisses this approach in its evaluation document as it conflicts with its practice and EU case law.

Ultimately, the EC's changes to supply-side substitution likely will be minor and will include: (i) specifying the situations in which supply-side substitutability is applicable to market definition, for example, in connection with the concepts of "significant additional costs", "short term", "effectiveness and immediacy", and "most suppliers", as the evaluation results show that the Notice's explanations of supply-side substitutability lack clarity; and (ii) adding more examples and references from EU case law to clarify those terms.

Similar to supply-side substitution, the EC plans to maintain its current approach as regards **potential competition**, which the Notice currently analyses at the competitive assessment stage.

Although some stakeholders argued that potential competition should be considered at the market definition stage, the EC considers its approach in line with the practice of NCAs and EU case law.

### The scope of geographic markets in conditions of globalisation and import competition

The evaluation results indicate that, overall, the Notice adequately describes the assessment of geographic markets in the context of globalisation, including in markets where there is increased competitive pressure from imports. The approach set out in the Notice also allows the EC to reflect market developments.

As before, the EC envisages only limited changes to its practice. This outcome may disappoint some political figures and stakeholders that called for a relaxation of the EU competition rules as regards geographic market definition, asking for wider market definitions, including more global markets. The prohibited Siemens/Alstom merger, in which the relevant geographic market was not considered global as the EC did not take into account competition from China, was pivotal in prompting this debate.

Conversely, other stakeholders advocated for continued rigorous competition law enforcement to the benefit of European businesses and consumers, arguing that competition promotes competitiveness.

To this debate, the EC responds that its methodology regarding geographic market definition complies with established case law of the EU courts and its practice.

The EC acknowledges, however, that the Notice could outline explicitly the concept of competitive pressure from imports. The Notice could also refer to the possibility of defining global markets more precisely. Moreover, while the Notice already includes an explicit reference to increased market integration in the EU, it does not include explicit references to the EC's practice on global markets.

## The development of digital markets

The EC agrees that the current market definition tools may not be fully effective in addressing concerns raised by the developments of the digital economy. Therefore, the Notice must be significantly updated in order to reflect these changes.

In this respect, the EC notes that:

- There is a high level of concentration of economic power in digital markets that highlights the need for vigilance in competition enforcement;
- To estimate the precise share of the digital economy in overall gross domestic product is challenging. In particular, the role of online platforms is constantly increasing due to upward trends in e-commerce;
- The technological convergence of products and services is prompting changes to the nature of competition in individual products/services that integrate those clustered offers;
- When innovation plays a significant role, this should be reflected more accurately in market definitions and in the assessment of the competitive effects.

## Key areas in which the Market Definition Notice needs updating

### Digital markets

The EC's evaluation acknowledges that there are no explicit references in the Notice to:

- The new phenomena of **multi-sided platforms** and all the elements that may be taken into account when defining the relevant markets. These elements include: network effects and interdependency of demand on both sides (i.e., indirect network effects), pricing structure and pricing strategies, as well as multi- versus single-homing. The evaluation results also highlight the increasing importance of data and their effects on market definition, which is currently not explicitly reflected in the Notice.
- **Zero monetary prices**, which form an integral part of a platform's profit maximising strategy. According to the evaluation results, the fact that a product is offered at a zero monetary price does not imply that there is no market for that product, as long as zero monetary prices form part of an overarching commercial strategy of the platform.

- **E-commerce**, in particular as regards the substitutability between online and offline channels.
- **Digital ecosystems** which are typically characterised by a primary core product and several secondary (digital) products, whose complementarity is due to technological links or interoperability between product. They can be classified as aftermarkets.

## The use and purpose of the SSNIP test in defining relevant markets in the digital economy

The SSNIP test is a tool for assessing demand substitution. It consists of assessing whether a hypothetical monopolist — which owns all companies producing the product(s) which is/are the candidate(s) to constitute a relevant market — would find it profitable to increase price by a small but significant amount (in the range of 5% to 10%). If such a price increase is profitable, the candidate products constitute the relevant market. If such a price increase is unprofitable, the test indicates that the candidate market should be enlarged to include those alternative products to which the customers would switch.

Price is the key parameter of the SSNIP test, and an element that the Market Definition Notice heavily relies on.

However, this test cannot often be carried out in practice, especially when price is not the only parameter of competition. There is currently no guidance in the Notice on how to apply the test to markets when price is not the only parameter of competition.

This is true as regards the digital sector and, in particular, **zero monetary price service or product**, where the service or product is accessible for free, or as regards service or product where users pay with their own data.

As regards **two- or multi-sided markets**, the profitability of a SSNIP test should take into account any indirect network effects in multi-sided markets that result from the reaction of users on the other side of the market. These indirect network effects can give rise to feedback loops between the different sides of a platform, where the higher the number of users is on one side, the higher is the value that users on the other side attribute to the platform.

The EC's evaluation also identifies difficulties associated with the application of the SSNIP test in **bidding markets**, in particular the identification of the relevant starting price for the application of the test, given that each tender results in a different price.

The evaluation results suggest that further guidance or discussion of other models, such as the small but significant non-transitory decrease in quality test (SSNDQ) or the small but significant non-transitory increase in cost test (SSNIC), may be helpful.

## The assessment of geographic markets in conditions of globalisation and import competition

As mentioned [previously](#), this issue echoes the debated prohibition of the Alstom-Siemens merger.

The EC acknowledges that the assessment of geographic markets needs updating. However, the changes to the Notice are likely to be less radical than those expected by some stakeholders.

The concept of competitive pressure from imports could be further explained in the Notice. In addition, the Notice could include explicit references to the EC's practice on global markets and clarify more precisely the possibility of defining global markets.

Overall, the evaluation results suggest that the approach set out in the Notice allows the EC to reflect market developments, including by taking into account competition from imports.

## **Calculation of market shares**

The evaluation results indicate that the Notice overall provides correct, comprehensive, and clear guidance on the calculation of market shares (based on the value or volume of sales or in certain circumstances, on the basis of the capacity and reserves), including on the variables and sources most often used to calculate this indicator of market power.

However, the Notice does not provide comprehensive guidance on the EC's practice regarding the metrics that can be used in digital markets (i.e., services provided in multi-sided platforms, at a zero monetary price, in digital ecosystems and data markets), where the traditional volume and value metrics are not applicable or the best indicators. In this case, appropriate metrics would be the number of (i) active users, (ii) web visits, (iii) downloads, and (iv) number of transactions.

In addition, the treatment of in-house sales, situations where market participants are not active or located in the market (including imports) are not mentioned in the Notice with respect to the calculation of market shares.

Static market shares are not a good indicator in rapidly evolving markets, in particular where innovation plays a strong role.

Finally, according to the evaluation results, the Notice does not discuss the time period to be applied when calculating market shares, in particular in the case of bidding markets or more generally in the case of infrequent purchases, where it may be appropriate to calculate market shares by reference to a longer period.

## **Non-price elements, including innovation**

The evaluation results indicate that the Notice correctly reflects EC practice on non-price elements as relevant for market definition, both in its product and geographic dimension, and that they can be essential when it comes to assessing product substitutability.

However, the results also suggest that the Notice lacks adequate guidance as regards market definition in markets with a heavy innovation component. This relates in particular to the definition of markets around key inputs such as innovation capabilities and to the question of whether competition from innovators outside a given product market could exert a significant constraint.

The evaluation results further indicate that competition authorities have mostly followed three main approaches, roughly identified depending on the nature of innovation that characterises the industry in question where innovation aspects are assessed as part of (i) existing product markets; (ii) separate technology markets for licensed/traded technologies; and (iii) separate innovation spaces or R&D hubs for non-traded innovation results.

## **Evidence used for market definition**

As a preliminary remark, the evaluation results suggest that the delineation between the ‘evidence’, ‘process’, and ‘additional considerations’ sections of the Notice should be rethought.

Although evidence used for market definition (such as quantitative techniques, barriers and switching costs, trade flows, or internal documents) is mentioned in the Staff Working Document, the evaluation is not conclusive on this point.

### **Quantitative techniques**

The Notice refers to different quantitative methods to determine the product market. These are: natural experiments, consumer surveys, price co-movement analysis, and more complex applications of the SSNIP test via estimation of the elasticity of demand. The evaluation results show that (i) more weight should be given to the economic analysis and the more sophisticated quantitative techniques relative to qualitative factors, and (ii) consumer surveys (provided they are rigorously performed to rule out bias) are a relevant source of evidence that should be used more often.

In addition, critical loss analysis should be mentioned in the Notice. Critical loss analysis is a methodology to implement the SSNIP test that has been used in some cases and that is relatively simple and not demanding in data (being mostly based on aggregate diversion ratios and margins).

Other aspects highlighted in the evaluation results that are not explicitly included in the Notice are that: (i) all these methods have their own strengths and also suffer from certain drawbacks, which makes their application case-specific; and (ii) they may be used as a complement to the qualitative evidence collected.

### **Barriers and switching costs**

Although the EC as well as other NCAs have considered other sources of barriers to entry and switching costs (such as the use of data, interoperability, privacy, network effects, ecosystems, and multi-homing that are becoming relevant in the context of digitalization), the Notice does not cover them.

### **Trade flows**

Trade flows are not conclusive for market definition, this is not expressly mentioned in the Notice. For example, the EC’s explains that considerable imports do not necessarily result in the expansion of a geographic market definition. While the lack of such imports does not necessarily prevent such expansion either, but all other relevant factors are considered together with import flows before the EC reaches a conclusion.

As regards the definition of the local markets (which are not referenced in the Notice), the Notice does not discuss the framework for defining them on the basis of catchment areas drawn around suppliers or customers. In its practice, the EC has applied the catchment area approach to defining the relevant geographic markets in cases in competition cases concerning bricks-and-mortar retailers, where location and transport costs are important considerations in consumer behaviour.

### **Companies’ internal documents**

The Notice makes certain references to internal documents of companies, such as market research studies, marketing studies, comparison of products and benchmarking, purchasing patterns of customers, research and development studies, or consumer preferences as a source of information



used by the EC to assess the factors relevant for market definition. Nonetheless, the way these internal documents are used is not mentioned in the Notice. The evaluation results also show that misinterpretations related to internal documents can occur. It can be expected that the EC will update the Notice in this respect.

## Next steps

<b>2021</b>	Analysis of the issues identified in the context of the evaluation and how to address them.
<b>End of 2021/2022</b>	The EC is expected to publish a draft Market Definition Notice for consultation.
<b>2022</b>	Expected adoption of a new notice.

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