

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON MARKET DEFINITION

-- Note by the Delegation of Germany --

This note is submitted by the delegation of Germany to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 13-14 June 2012.

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ROUNDTABLE ON MARKET DEFINITION

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1. In most national economies it is generally acknowledged that in principle competition produces the best overall economic results. Competition leads to considerable benefits for the economy as a whole. All market players – producers, traders, service providers and, in particular consumers – benefit from price and cost reductions, improvements in quality, possibilities of choice or technical advancement. However, market power enjoyed by one or few companies can distort the competitive process and reduce the benefits consumers and society at large may gain from competition. Therefore, most jurisdictions have competition control regimes aimed at protecting society and consumers from potential harm caused by companies enjoying market power. Analysing market power and the negative competitive effects such market power may bring about can be a very complex and difficult task for competition authorities. The tools and methods used for this analysis are continuously evolving.

2. The roundtable will deal with recent discussions relating to the role and necessity of market definition as a first step in the analysis. The Bundeskartellamt considers suggestions to substitute market definition with other assessment tools as an interesting but somewhat artificial debate from both an economics and a legal point of view. An assessment of potential anti-competitive effects on the affected markets by using adequate and feasible methods can only be carried out within the framework of an overall assessment of all relevant factors while taking into account the time limits, resource and other constraints a competition authority faces.

3. This contribution is structured as follows: The first part describes the relevance of market power and market definition. In the second part, two cases of the Bundeskartellamt will be presented which concern types of markets that are often described as being less susceptible to the definition of a relevant market and the type of analysis conducted by the Bundeskartellamt. The possibilities to use assessment tools other than market definition will be discussed in the third part, and the fourth part provides a conclusion.

1. Relevance of market power and market definition

4. The legal criterion for prohibiting a merger under the German merger control regime is whether it will create or strengthen a dominant position, as stipulated in Section 36 (1) of the German Act against Restraints of Competition (ARC). Also Section 19 (1) ARC states: “The abusive exploitation of a dominant position by one or several undertakings is prohibited”. The enforcement of competition law in Germany therefore requires in many cases an assessment of „dominance“. The analysis undertaken by the Bundeskartellamt is therefore often divided into two steps: first, the definition of the relevant product, geographic and temporal markets and second, the assessment of dominance and the resulting anti-competitive effects on these markets.

5. Dominance exists if a company has no competitors or is not exposed to any substantial competition, or if it has a paramount market position in relation to its competitors (Section 19 (2) ARC). The term “dominance” can be associated with the concept of “market power” applied in economic theory.

A company with market power faces comparatively few competitive constraints, i.e. they are not sufficient to ensure that rivalry disciplines its commercial behaviour.

6. Absolute and relative market shares are a widely accepted starting point for determining market power,¹ and often they are also the starting point for an analysis by the Bundeskartellamt.² In most markets, an enterprise's absolute market share is an important factor that allows for initial conclusions about its scope of action. High market shares suggest that the ability of the opposite side of the market to switch to other undertakings is limited and that the enterprise concerned has an increased scope of action. The greater the difference between an enterprise's market share and that of its largest competitor, and the more fragmented the market shares of its other competitors, the greater the likelihood that the market (share) leader has a scope for restrictive action.

7. According to the ICN Dominance/Substantial Market Power report 2008³, the vast majority of jurisdictions consider market shares in their assessment of dominance. When a relevant market can be defined with some accuracy, market shares provide an initial indicator of whether a firm has market power and the degree of such power. This first assessment can also act as an initial screening mechanism, allowing competition authorities to separate cases which are very unlikely to have anti-competitive effects from those where further analysis may be required. Such screening mechanisms are particularly relevant for proceedings with time limitations, such as first phase merger proceedings, where the Bundeskartellamt has to decide within one month after notification whether to clear the merger or to initiate second phase proceedings.

8. Consequently, market definition plays a crucial role in the assessment of market power in many jurisdictions. It is generally acknowledged, however, that market shares have to be placed in perspective by other factors when making an overall assessment of the relevant competition conditions and market power in a particular case. Other factors to consider include the market position and market behaviour of competitors, barriers to entry or expansion, competition by imperfect substitutes, buyer power, economies of scale and scope/network effects, access to upstream markets/vertical integration, durability of market power, market maturity/vitality, access to essential facilities and the financial resources of the firm and its competitors.

2. Market shares as a factor in the analysis of anti-competitive effects

9. It has been claimed that there are cases where the significance of market shares is only very limited or an unambiguous definition of the relevant market is not feasible. Amongst others, two-sided markets and markets with differentiated products have frequently been identified in the literature and practice as examples where the traditional approach to market definition and market power may not provide an adequate assessment. However, the Bundeskartellamt has been able to successfully assess also these types of markets using the well established methodology.

¹ In fact, this practice was considered to have sufficient international acceptance to be incorporated into the 2008 ICN Unilateral Conduct Working Group DOMINANCE/SUBSTANTIAL MARKET POWER ANALYSIS PURSUANT TO UNILATERAL CONDUCT LAWS Recommended Practices (available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc317.pdf>). The recommendations on assessment criteria state: "Market shares of the firm under investigation and its existing competitors, including their development during the past years, should be used as an indication or starting point for the dominance/substantial market power analysis".

² Cf. the new Guidance on Substantive Merger Control (available at http://www.bundeskartellamt.de/wEnglish/download/pdf/20110721-Guidance_Merger_Control.pdf)

³ ICN Dominance/Substantial Market Power report (available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc353.pdf>)

2.1 *Two-sided markets*

10. The significance of market shares (for individual markets) can be limited in so-called platform markets or markets that are linked by indirect network effects (both are sometimes referred to as **two-sided markets**). In two-sided markets, a supplier acts as an intermediary between different customer groups. For instance, a newspaper publisher can demand higher prices from advertisers depending on the number of its readers. In such cases, prices and quantities in both markets are interdependent. Therefore, the competitive constraints for intermediaries or platform operators are influenced by the market conditions and the interrelation between the markets concerned. In such cases it is thus not sufficient to assess the market position in one of the markets only.

11. Despite the complexity of two-sided markets, the Bundeskartellamt has been able to analyse such markets using its well established method of an overall assessment of competitive effects. The *Intermedia/Health & Beauty* merger⁴, which concerned cosmetics trade magazines, can serve as an example here. The Bundeskartellamt analysed the effects of the merger with regard to two related markets: the reader market and the advertising market. Indirect network effects between both markets were particularly important for the analysis of competitive effects, as publishers maximise their profit by balancing distribution and advertising revenues. The optimal combination of both revenues depends on price elasticity of demand, marginal costs on both markets and the strength of network effects. The competitive pressure exerted by products outside the relevant market (in this case: competitive pressure exerted by the internet on the reader market) was taken into account as well.⁵ In addition to these factors and the market shares of the merging parties on the reader and advertising market, the closeness as well as the degree of competition, superior access to both reader and advertising markets (due to the parties being organisers of important trade fairs), superior financial resources, market saturation and barriers to entry (due to advantages an incumbent can enjoy on such two-sided markets), as well as potential competition were analysed and evaluated in the overall assessment. The proposed merger was prohibited due to the expected creation of a dominant position and the resulting negative effects on the competitive process.

2.2 *Differentiated products*

12. Similarly, when differentiated products are concerned, market shares do not provide a clear indication of the effects of a merger on the companies' market power either. In this context, closeness of competition plays a particularly important role. It facilitates the assessment whether significant restraints on a company's competitive behaviour are eliminated as a consequence of its merger with a competitor. These effects can be more or less important than the change in market shares alone would indicate.

13. An example from the Bundeskartellamt's case practice in this respect is the *EDEKA/Tengelmann* merger⁶ in the food retail sector, which was cleared with remedies. The Bundeskartellamt defined the

⁴ BKartA, decision of 29.8.2008, B6-52/08 – *Intermedia/Health & Beauty* (available at: <http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion08/B6-52-08.pdf>)

⁵ Similarly, the Bundeskartellamt prohibited the joint venture between RTL interactive GmbH and Pro7Sat.1 Media AG for the creation and operation of an online video platform. As a result of the joint venture, so-called in-stream video advertising would have been dispersed via the newly created platform. Although the project would have chiefly affected the German TV advertising market, in-stream video advertising was considered the "closest substitute" to TV advertising from the perspective of advertisers, if not even as merging into the TV advertising market in the future. (See <http://www.bundeskartellamt.de/wEnglisch/download/pdf/Fallberichte/B06-094-10-ENGLISH.pdf?navid=45>).

⁶ BKartA, decision of 30.06.2008, B2 333/07 *EDEKA/Tengelmann* (available at: http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion08/B2-333-07_Internet.pdf)

relevant product market as the food retail market, as it had also done in previous decisions. This market comprises both food and non-food products the consumer typically expects to be able to purchase in retail. According to the assessment of the Bundeskartellamt, the food retail market cannot be further subdivided into different distribution channels. The market therefore comprises warehouse supermarkets (large stores offering a large range of food products, particularly from manufacturers' brands), full-line stores (middle to large sized stores offering the same sort of products as warehouse supermarkets), hard-discounters (stores with only a very basic layout offering a limited range of almost exclusively store-branded products at very low prices) and soft-discounters (also stores with only a basic layout but offering a larger range of products and more manufacturers' brands). While these stores all belonged to the same market, the different degree of competitive pressure exerted between them was taken into account in the overall assessment. In particular, the Bundeskartellamt found that the degree of competition was intense between the merging parties with regard to the operated types of stores. Other large competitors were not active in comparable segments and their ability to exert competitive pressure on the merged entity was therefore limited. The Bundeskartellamt also analysed the effect of the merger on procurement (upstream) markets, which it considered highly relevant because the procurement costs are decisive for profitability in the food retail sector.

3. The role of other assessment tools

14. Whether market power analysis on the basis of market definition has to be substituted by a different approach in general is doubtful. The methodology of defining markets and assessing market power has been refined over decades and has not been shown to be generally inadequate. Moreover, other assessment tools suggested as alternatives have their own shortcomings and may not be adequate or efficient in every case. One such alternative discussed in the literature is the upward-pricing-pressure test (UPP-test). However, tests like the UPP-test seem more elaborate and potentially resource-intensive for an initial screening of cases. Such an initial screening is necessary, for example, in the first phase of merger control proceedings with regard to the potential negative effects on competition. Other tools may also require different data, which may not be as readily available as the information needed for an initial market power assessment. For example, diversion ratios required for the UPP-test or data on marginal costs may be extremely difficult to obtain.⁷ Insofar as assumptions or presumptions are used as proxies for missing data, alternative tests can be as crude a tool as the initial estimation of market power based on market shares.⁸ Moreover, it seems likely that other tests would, just like the assessment of market power on the basis of market shares, in the majority of the cases not be sufficient in themselves, as they may also be unable to capture all potential anti-competitive effects at the same time. Therefore, also these alternative tests would have to be used as one factor in a number of relevant factors for an overall assessment of anti-competitive effects.

⁷ Even identifying the relevant costs is often an additional burden on competition authorities, as accounting records typically do not correspond to, nor readily reveal, the measure of cost relevant for the economic analysis. Moreover, one method to estimate diversion ratios relies on market shares, which in turn would also require a market definition.

⁸ Farrell and Shapiro, for example, discuss a presumed default level of marginal cost efficiencies generated by the merger, which might be incorporated in the UPP-test. See Farrell and Shapiro: *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, 2010 (electronic copy available at: <http://ssrn.com/abstract=1313782>). However, empirical research on efficiencies generated by mergers and passing-on rates to consumers cautions against such assumptions, see Lars-Hendrik Röller, Johan Stennek and Frank Verboven: *Efficiency gains from mergers* (available at: http://ec.europa.eu/dgs/competition/economist/efficiency_gains.pdf). The authors find no support for the general assumption that mergers create efficiencies. They conclude that merger control is necessary and efficiencies would need to be assessed on a case-by-case basis.

15. One may also argue that some alternative assessment tools will lead to legal uncertainty when compared to the market share approach. Companies are provided with an indication that there might be a competition law problem when they meet certain thresholds and they tend to have an idea of their market position (market shares) in the markets they operate in. They may also have a good idea of which competitors' products exert competitive pressure on them. If companies were required to apply other assessment tools, for example the UPP-test, when contemplating a merger, they would require information on prices and marginal costs concerning their competitor(s), as well as on diversion ratio(s). Some of the information needed for such a self-assessment may be considered confidential and the exchange even prohibited under competition law.

16. An additional problem may arise in court proceedings. The concept of market definition and how to establish market shares constitutes a widely accepted approach and courts have acquired large experience with it. Disputes therefore mainly concern the correct market definition, and not the validity of the concept itself. With other concepts and assessment tools, the question of whether a specific test could be applied to the specific case at hand would already be a matter of dispute. With the likely exchange of economic expert testimonies, court proceedings could become much more time consuming and costly. In the end, that could be to the detriment of consumers and society at large.

4. Conclusion

17. The Bundeskartellamt welcomes every opportunity to discuss and further complement its tools of assessment. With the envisaged introduction of the SIEC (significant impediment of competition) test into the German merger regime, in which the creation or strengthening of dominance will continue to be a main example, the legal context will slightly shift. The Bundeskartellamt expects that the overall assessment of competitive effects as currently conducted will be flexible enough to adapt to the new framework and to incorporate adequate tools and methods of analysis in accordance with the specific circumstances of the case at hand. To generally abandon the use of market definition for the sake of other analytical tools would, however, go beyond a useful improvement.