



2020 Evaluation of the Commission Notice on the definition of the relevant market for the purposes of Community competition law

- Contribution by the Bundeskartellamt -

The European Commission has launched an evaluation of its 1997 market definition notice. While the fundamental principles of demand substitution and supply substitution remain to be decisive for market definition today, there has also been substantial development over the past 23 years. Digitalization has enabled new business models presenting novel issues for market definition, and also academic and practical thinking about market definition has progressed considerably since 1997.

I. Fundamental principles remain relevant

The 1997 notice refers to Regulations No. 17 and No. 4064/89 to define the relevant product market as comprising “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” (para 7). This is because “demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product” (para 13). “Basically, the exercise of market definition consists in identifying the effective alternative sources of supply for the customers of the undertakings involved, in terms both of products/services and of geographic location of suppliers” (para 13). “Supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy” (para 20).

These four sentences continue to build the core of market definition today and should be retained and reinforced when revising the 1997 notice. They are fully consistent

with the settled German case law on market definition¹, the so-called “*Bedarfsmarktkonzept*”. German case law applies these fundamental principles in a logically consistent way to a variety of specific questions. The concept embraces tailoring market definition to the theory of harm at stake. For example, when suppliers’ market power is evaluated, the market is defined primarily from the perspective of customers, whereas for the evaluation of buyers’ market power (e.g. food industry), it is the suppliers’ perspective (e.g. farmers) that matters more.² The principles of the *Bedarfsmarktkonzept* apply equally in geographic market definition. In horizontal mergers the geographic market is defined to comprise the area where the factual alternatives available to customers are reduced, so that the market area consists of the customers directly affected by the merger.³ The concept can naturally be applied in situations in which market participants cannot be distinctly categorized into supplier or buyer, e.g. in multi-sided markets where multiple different sides or users groups interact with the platform operator and with each other. The concept thus also offers a straight-forward solution to defining zero-price markets,⁴ and may provide a valuable guideline when revising the notice.

II. Room for improvement of the 1997 Notice

Despite these fundamental principles remaining still correct and top priority, there is, of course, room for improving the market definition notice. The new notice should reflect digitalization, explain the role of market definition, deprioritize the SSNIP test and align geographic market definition with product market definition principles.

1. Reflecting digitalization

Digitalization gave rise to networks and platforms connecting users or user groups. Accordingly, the analysis of direct and indirect network effects plays a prominent role in many recent competition law cases. Network effects may result in high switching

¹ Important judgements by the Federal Court of Justice on market definition issues include: decision of 23.6.2020, KVR 69/19, *Facebook*; decision of 11.12.2018, KVR 65/17, *Edeka/Kaiser’s Tengelmann*; decision of 4.3.2008, KVR 21/07, *Soda-Club II*; decision of 16.1.2008, KVR 26/07, *Bad Neustadt district hospital*; decision of 25.9.2007, KZR 33/06, *Munich district heating*; decision of 16.1.2007, KVR 12/06, *National Geographic II*; decision of 12.11.2002, KZR 11/01, *Equipment for firefighting trains*; decision of 27.4.1999, KZR 54/97, *Taxi ambulance services*.

² Cf. e.g. Federal Court of Justice, decision of 12.11.2002, KZR 11/01, *Equipment for firefighting trains*; Düsseldorf Higher Regional Court, decision of 1.7.2015, VI-Kart 8/11 (V), *Sow slaughtering*.

³ Cf. e.g. Federal Court of Justice, decision of 16.1.2008, KVR 26/07, *Bad Neustadt district hospital*.

⁴ Cf. e.g. Federal Court of Justice, decision of 23.6.2020, KVR 69/19, *Facebook*.

barriers and, thereby, affect both the definition of the relevant market as well as the competitive assessment. The new business models presented novel issues for market definition, such as how to treat zero-price offers, how many markets to define in multi-sided markets and when to classify undertakings as a 'supplier' or a 'customer'. Obviously, the 1997 notice does not yet reflect these developments.

There has been some debate as to whether free-of-charge offers should be considered as (part of) an antitrust market. It is true that where there are payments between a supplier and a customer there always exists an antitrust market. But the inverse conclusion should not be drawn. At least in multi-sided markets, where the provision of a free service is part of a business activity pursuing commercial purposes, zero-pricing should not hinder a market to be defined.⁵ For a free-of-charge antitrust market to 'exist' it should not be a requirement that it must essentially be a bundle that comprises a good with a positive value for the customers (i.e. the platform service) and a good with a negative value for the customers (i.e. ads, use of their data) which can be viewed akin to a 'payment' for the platform service. The reason is that in multi-sided markets, setting a price of zero for one customer group may make perfect sense for the platform provider also if the service does not come along with any negative good tied to it. In other cases, the reason for a service being offered for free may be that the company initially tries to build a large user base which may entail a zero-price-strategy over several years before pricing is finally introduced.

As multi-sided markets involve distinct groups of customers, there are in principle two alternative approaches to capture their specific structure: Defining separate markets for different customer groups or defining a single market encompassing all customer groups. Defining separate markets can be done straightforward by capturing the competitive landscape on each 'side' of the market one after the other. In comparing the competitive forces identified within these separate markets, it is easy to identify whether the set of relevant product substitutes/competitors, the single- or multi-homing of the customer groups or the geographic scope differ across markets. In case of significant differences, typically separate markets should be defined.⁶ Conversely, defining separate markets for each customer group may not provide much additional insights, if these factors do not differ across market 'sides'. In particular, this may be the case where the different groups are inseparably linked by a platform interaction, e.g. a

⁵ Cf. e.g. Federal Court of Justice, decision of 23.6.2020, KVR 69/19, *Facebook*.

⁶ Cf. e.g. Bundeskartellamt case Facebook (B6-22/16).

transaction platform or a matching platform.⁷ Another issue to consider is the possible interplay with VBER, where a uniform market definition could rule out the classification of the market sides as a vertical chain according to Article 1 (1) of the VBER.⁸

Apart from adding paragraphs to the notice that explicitly deal with these novel questions, digitalization calls also for several detail revisions throughout the text. The 1997 notice has a quite strong focus on prices, as in several paragraphs reactions to price changes are described. However, demand substitution – and competition generally – is not limited to ensuring low prices. As evidenced by digital and other high-tech markets, innovation and high quality are just as important parameters of competition. Demand substitution should thus be understood and described as to include not only reactions to price changes.

2. Explaining the role of market definition

When a debatable detail of market definition arises in a specific case, a benchmark is needed to enable a decision one way or the other. The benchmark can only be derived from the goals that the market definition exercise pursues. However, the 1997 notice is too brief in touching upon the objectives of market definition and does not elaborate on the role that market definition should play in case assessment.

Views of the international competition law and economics community on the finality of market definition seem to have evolved considerably since 1997. While the brief reference in paragraph 2 of the notice is still correct, it fails to cover other important points which – as of today – may be classified as mainstream views: Market definition should not be viewed as a stand-alone exercise or even as an end in itself, it rather has an assisting role in informing the competitive analysis, i.e. market power analysis and/or effects analysis. It should help in examining the case-specific theories of harm.

These principles lead to a number of relevant practical consequences. One consequence is that the exact market definition can be left open in most cases, both in cases with and without concerns. For example, in Art. 101 cases the classification as a by-object infringement will not hinge on the exact market definition. Similarly, where a SIEC-finding is mainly based on high diversion ratios among the merging parties, any market definition will not add much to the analysis. Generally speaking, market power

⁷ Cf. e.g. Bundeskartellamt cases HRS hotel platform (B9-66/10), Parship/Elitepartner dating platforms (B6-57/15)

⁸ Cf. e.g. Bundeskartellamt case CTS ticketing platform (B6-132/14-2).

and effects analysis have gained weight in relation to market definition over the past years, and market definition has been left open increasingly often. Another implication of these principles is that market definition is specific to the case and specific to the theory of harm at stake. For example, investigating both a pricing theory of harm and an innovation theory of harm in a merger case will typically end up in using two different markets in parallel (a narrower “product market” and a wider “innovation space”). Another example is a vertical restraint that is applied identically throughout a country by a manufacturer. Even though retail markets are in principle narrower than nationwide, it will make no sense to analyze the definition of each local retail market separately. Finally, market definition’s function to assist and inform the competitive analysis entails that market definition does not claim universal truth and should not be overloaded by bringing in factors that rather belong to market power and effects analysis such as potential competition or buyer power.

3. Deprioritizing the SSNIP test

The SSNIP test is hardly ever applied in practice. Whereas in former years this fact was attributed mainly to its heavy data requirements, it has become evident over the past years that all hypothetical monopolist tests (HMTs), including the SSNIP test, suffer from serious conceptual shortcomings. While HMTs correctly place demand substitutability (e.g. cross-price elasticities) at the core of market definition, they mingle other factors into the market definition exercise, such as supplier margins, non-consumption decisions as well as assumptions on test candidates, price increase thresholds, or price levels and elasticities under “sufficient” competition. These additional factors are a distraction from market definition and cause a number of problems.

HMTs suffer from a misleading dependency of margins. A high margin is a well-established indicator of market power, whereas, within the HMT, a high margin leads to a wide market definition suggesting just the opposite indication, i.e. low concentration and thus low market power. HMTs also incorporate non-consumption (ceasing to buy a product/service at all as opposed to switching to another product) as a reaction to a hypothetical price increase which is unrelated to demand substitution. Non-consumption is an aspect misplaced in market definition, rather it belongs to market power and effects analysis. It is ultimately also inconsistent with the HMT-concept itself as in the event of non-consumption no substitute can be identified to possibly enlarge the market. Furthermore, the results of HMTs depend on assumptions about starting points,

price increases, products/areas covered by these increases as well as groups of next-best substitutes which may render the results rather arbitrary. The well-known cellophane fallacy is ubiquitous. When there is insufficient competition, the competitive price (and the elasticities at these price levels) are inherently unknown, so that performing a HMT becomes a speculative exercise. As competition law is typically enforced in cases where there is insufficient competition, one can expect the cellophane fallacy to prevail in most enforcement cases. From an empirical perspective, HMTs suffer from an information paradox: In practice, the data needed to perform the test, notably cross-price elasticities for all product varieties concerned, is typically not available. And if these data were available, it would be straightforward to conduct a comprehensive effects analysis of the behavior at stake so that it would be unnecessary to define the market in the first place.

For these reasons, the SSNIP test described in paragraphs 15-19 of the 1997 notice should be de-prioritized. The fundamental concepts for market definition are demand substitution and supply substitution whereas the SSNIP test should be viewed only as a supplementary concept without decisive significance. In this vein, the Federal Court of Justice clarified that the SSNIP test is not a decisive criterion in market definition.⁹ The test has little meaning if it is not guaranteed that the initial price prevailed under competitive conditions.¹⁰ The Düsseldorf Higher Regional Court added that the SSNIP test is unqualified to justify a market definition that contradicts with demand substitutability¹¹ and that the SSNIP test is unreliable in multi-sided markets¹².

4. Aligning geographic market definition with product market definition principles

There is no evident reason why the basic principles of market definition should differ between its product and its geographic dimension. To the contrary, the well-established insight that demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product equally applies to geographic market definition. It is thus unclear, why the 1997 notice for geographic market definition seems to put more weight on supply side factors if compared to product market definition. The criterion for defining the geographic market provided in the notice (by

⁹ Cf. e.g. Federal Court of Justice, decision of 11.12.2018, KVR 65/17, *Edeka/Kaiser's Tengelmann*.

¹⁰ Cf. e.g. Federal Court of Justice, decision of 4.3.2008, KVR 21/07, *Soda-Club II*.

¹¹ Cf. e.g. Düsseldorf Higher Regional Court, decision of 23.8.2017, VI-Kart 5/16 (V), *Edeka/Kaiser's Tengelmann*.

¹² Cf. e.g. Düsseldorf Higher Regional Court, decision of 3.4.2019, VI-Kart 2/18 (V), *CTS*.

way of an ECJ citation) is rather vague, and the details provided further down the text about the evidence relied on do not offer clear answers either.

From a conceptual perspective, demand substitutability should be the key criterion also in geographic market definition.¹³ The straight-forward starting point for the geographic definition is a broad indication of geographic customer behavior, i.e. catchment areas, which in the next step (e.g. phase II proceedings) can be investigated in more detail. This goes hand-in-hand with quantitative techniques and IT tools available today. As opposed to 1997, it is nowadays increasingly often possible to retrieve a full, disaggregated inventory of all deliveries or customer journeys down to ZIP-code level for an in-depth evaluation. If retrievable, such granular data constitutes strong evidence for the definition of the relevant geographic market. It typically leads to a more precise geographic market definition and greatly assists in narrowing down any competition issues geographically. Another key advantage is that the large array of qualitative aspects referred to in the past – such as language barriers, transport costs or local customer preferences – will necessarily materialize in corresponding geographic patterns. The real data will reflect all these qualitative aspects so that discussions about the relative importance of each qualitative aspect become largely dispensable. The Bundeskartellamt has applied the data-driven, demand-oriented approach to geographic market definition in an increasing number of cases over the past years, and, so far, the approach has proven robust across various markets and industries.¹⁴

¹³ Cf. e.g. Federal Court of Justice, decision of 16.1.2008, KVR 26/07, *Bad Neustadt District Hospital*.

¹⁴ Bundeskartellamt case examples include cement (B1-47/17), hospital markets (e.g. B3-33/20), glass recycling (B4-31/17), professional horticultural supply (B2-63/17), wholesale of automotive spare parts (B9-48/15) and wheat milling (B2-112/14).