

Evaluation of the Commission Notice on market definition in EU competition law

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We welcome the European Commission (“EC”) initiative to review the Commission Notice on the definition of relevant market for the purpose of Community competition law (“market definition notice”).

We believe that one of the review processes’ main goals should be to improve market definition – and the evaluation of market power – to reflect the empirical realities of an increasingly digital economy. In particular, the dynamic forces at play in the digital economy mean that market processes do not merely rein in substantial market power by product substitution, but also by the creation and reconfiguration of new channels of competition.

To that end, we make four concrete proposals, and explain how they would improve the existing state of play. Aware of the constraints bearing on the EC, we try to suggest realistic proposals, two on substance, two on procedure. Should you have any further questions, please do not hesitate to contact us.

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Proposal one: consider competitive pressure stemming from non-substitute products, services, and business models

In digital markets, products that are imperfect substitutes or complements compete against each other dynamically for user demand. Much anecdotal and empirical evidence shows that competitive pressure arises from non-substitute products, services, and business models that modify the relative preferences of users, raise the opportunity cost of present product consumption, and shift the demand curve inward. For example, users experienced lower relative utility from consumption of:

1. desktop computers with the introduction of mobile phones;
2. web browsers with the development of search engines; and
3. comparison shopping websites with the growth of merchant platforms.

Unfortunately, market definition methods that focus on static patterns of user substitution between rival goods or services tend to discount that dynamic constraint.

Misplaced focus on static patterns of substitution has been clearly in display in the *Google Android* decision.¹ Here, the EC held that Google did not compete with Apple in smartphone operating systems (“OS”) on the ground - amongst other things - that Apple’s iOS was not licensed to third party OEMs. The EC market definition seats inconsistently with unambiguous survey evidence showing that since Android entry, many consumers contemplate both ecosystems on equal footing in their purchasing decisions despite their distinct business models. The EC market definition also leads to curious

¹ European Commission, *Google Android*, Case AT.40099 (Jul. 18, 2018).

implications such as the idea that a merger between Apple and Google in smartphone OS would be *prima facie* unproblematic, absent clear horizontal overlaps.

The problems of static market definition are not mitigated by analysis of “*potential competition*.” The conventional assessment of potential competition determines whether firms in other markets or industries have incentives to *repurpose* assets to compete in close-to-perfect substitutes with established firms. In digital markets, firms often compete by supplying non-substitute products or highly imperfect ones. In particular, competitive pressure might be exercised by products relying on different technological infrastructures or supported by distinct business models.

Equally, focusing on repurposing might not fully account for the competitive pressure being *already* exercised by non-substitute products. For example, close scrutiny of distinct digital products and services’ coding might illuminate competitive relationship that a standard analysis of potential competition would simply ignore. We believe that accounting for it would give the EC a better take on market forces.² Blockchain and artificial intelligence (“AI”) are a case in point. The first is a bottom-up technology, while the second is top-down. Yet, both display a similar degree of technological capability to decrease fake news dissemination.

Against this background, we propose that the new market definition notice considers the competitive pressure exerted by complementary and non-substitute products, services, and business models in digital markets.

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Proposal two: consider the distinction between “tipped” and “untipped” markets in the market definition assessment

Markets with network effects (i.e., increasing returns on the demand-side) are prone to “tip”. In a market that has tipped, user demand is locked into one product due to high adoption of the same product by other users.³ Tipped markets display stability. With it, the uncertainty required to incentivise firms to deliver consumer welfare improvements is weakened.

By contrast, in markets that are untipped, firms compete under uncertainty. Dynamic constraints such as competitive entry in adjacent, neighboring, or complement product spaces create competitive pressure on established firms.

The distinction between tipped and untipped markets is critical in digital markets, where firms often compete by a process of indirect entry, and reconfigure existing channels of competition.

Unfortunately, rivalry-based structural analysis – still the dominant paradigm in antitrust proceedings – is unlikely to distinguish sensibly between tipped and untipped markets. Durable dominant shares and high entry barriers in network effects markets do not allow inference of a tipped market, because they do not capture the set of dynamic constraints typical of untipped markets. For example, antitrust relevant markets like the desktop OS market are typically considered tipped under a rivalry-based structural perspective. Nevertheless, it is plausibly untipped due to the pressure imposed

² Our point is that the antitrust and competition agencies should engage in close study of the code of digital products and services so as to better understand the technologies at stake. Absent such analysis, one might expect a risk of both type I but also type II errors.

³ Timothy Bresnahan, Joe Orsini & Pai-Ling Yin, *Demand Heterogeneity, Inframarginal Multihoming, and Platform Market Stability: Mobile Apps*, Mobile Innovation Group Working Paper, Stanford University (Sept. 2015).

by adjacent products like search engines, social networks, cloud computing services, home assistants, and perhaps video conferencing.

More importantly, the market definition procedure is biased towards the findings of tipped markets in many ways. In practice, market definition starts from the most extensive set of substitution possibilities to users, and progressively zeroes in on substitution possibilities that are as perfect as possible. One unintended effect of this approach is to transform market definition into a ‘slice and dice’ exercise. With eyes towards the best substitution possibilities, antitrust agencies and courts tend to discount indirect, external, and potential sources of competition informative of an untipped market.

In light of this, one possible way to improve our analytical framework consists in working with ‘good enough’ relevant market definitions that provide only moderate certainty about demand-side substitutability, and shift the focus of inquiry on whether the market is tipped or untipped. How to draw the line? It is commonly accepted that there is more business uncertainty in untipped than in tipped markets.⁴ With this, we propose that in addition to structural analysis, the EC should focus on *firm-level evidence of competitive pressure* to understand whether the market has tipped. Economics provides several methods to measure competitive pressure.⁵

In our view, the degree of competitive pressure bearing on a firm might be exposed by an explicit, systematic, and thorough consideration of investment and innovation efforts in the market definition assessment. Antitrust agencies like the EC enjoy broad fact-finding powers. Subject to adequate confidentiality, nothing prevents them from requiring investigated firms to provide data on R&D expenditure, hiring and compensation policies, corporate venture capital, and transactional activity. Other indicators of competitive pressure might include marketing expenditure, capital allocation choices, or intra-firm divisional competition. Moreover, antitrust agencies should require investigated firms to break down firm-level data by industry, markets, and product segments.

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Proposal three: consider outsourcing the market definition assessment to fact-finders distinct from case team

Market definition has been persistently criticized on the ground that it is outcome-driven. Where *prima facie* evidence suggests antitrust liability, the investigation might lean towards market definitions that overestimate market power. By contrast, where *prima facie* evidence suggests antitrust immunity, the investigation might lean towards market definitions that discount market power. Often, these dynamics are not the result of deliberate policy decisions. Instead, they originate in well-known cognitive limitations that distort human choices, like confirmation bias.⁶

We believe that a simple procedural innovation could lay to rest the critic of market definition instrumentalization. We propose that in every antitrust case, the market definition investigation should be conducted by a unit distinct from the case team investigating the suspected anticompetitive conduct (i.e., the “market definition unit”).⁷ The case team would remain free to work on its own market definition. In parallel, the market definition unit would produce its own findings, and provide them to the case team during the course of the investigation, and, in any case, well before the adoption of a

⁴ Harvey Leibenstein, *Allocative Efficiency vs. “X-Efficiency”*, 56 Am. Econ. Rev. 392 (1966).

⁵ Nicolas Petit, *Big Tech and the Digital Economy - The Monopoly Scenario* (Oxford University Press, 2020). For example, see John R Hicks, *The Process of Imperfect Competition*, 6(1) Oxford Economic Papers 41, 45 (1954).

⁶ Wouter P. J. Wils, *The Combination of the Investigative and Prosecutorial Function and the Adjudicative Function in EC Antitrust Enforcement: A Legal and Economic Analysis*, 27 World Competition 201 (2004).

⁷ We use here the term “unit” generically, noting that the process might well be organised under other institutional arrangements.

Statement of Objections (“SO”). The findings of the market definition unit might be indicative or mandatory, but should at any rate be published with the final decision.⁸ Alternatively, the EC could rely on other members of the ECN to carry out the market definition assessment.

The point of an early parallel market definition investigation, divorced from liability and remedy analysis, is to provide an accountable, impartial, and useful point of reference for the evaluation of market power in antitrust cases. This solution is superior to “review” or “devils’ advocates” panels that intervene *ex-post* when resources have already been sunk into a case.⁹

We are well aware that our proposal might entail practical difficulties. Decisional delays might be experienced if antitrust analysis is not commenced until there is a clear understanding of the market definition. Alternatively, decisional errors might be expected if antitrust analysis is started without a good picture of the relevant market. However, these are manageable problems that do not defeat the benefit of the proposed mechanism.

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Proposal four: consider creating an open-access database dedicated to market definitions

The EU institutions are committed to promoting open access to information. We support this commitment, and believe that the review of the market definition notice offers an opportunity to advance this agenda.

To this end, we propose that the EC creates an open-access database containing all the relevant product and geographic markets defined in the last 20 years. The database would cover both antitrust and merger cases. It would be regularly updated with new market definitions.

An open-access database on market definition is likely to improve legal certainty and reduce advisory, compliance, and learning costs for businesses, judges, and public authorities applying EU competition law. For the sake of clarity, the database could be constructed on the basis of the economic sectors’ compartmentalization established by the NACE classification CODE.

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⁸ As a provisional decision, it should not be subject to annulment proceedings.

⁹ Leading potentially to drastic outcomes like abandoning a case, because it is too late to correct the course of the antitrust analysis.