



ANTITRUST CLIENT BRIEFING

The Future of Market Definition by the European Commission

30 March 2023

At a Glance

The European Commission (EC) has revamped the 1997 Commission Notice on the definition of the relevant market for the purposes of Community competition law (the 1997 Notice), and conducted a public consultation to gather feedback on the revised draft (the Draft Notice).

“Our rule book needs to be clear, accurate and up to date to ensure legal certainty and predictability for businesses. As the world has become more digitised and our economies are interconnected, some markets work differently today than they did in the past. The draft revised Market Definition Notice aims to reinforce sound principles that have stood the test of time, provide necessary clarifications and fill gaps in our guidance. Today we invite interested parties to comment on the proposed changes.” — Executive Vice-President, Competition Policy, Margrethe Vestager, 8 November 2022

Key Points:

- The Draft Notice retains the main principles of the 1997 Notice, but incorporates 25 years of EC decisional practice and case law of the EU courts, as well as guidance and clarifications on gaps identified in the [Staff Working Document](#) published in July 2021, such as:
 - The role of market definition and its general principles, including whether a market definition analysis is always needed, and the value of EC decisional precedents
 - The methodology in assessing demand substitution, including the use and purpose of the small, significant, non-transitory increase in price (SSNIP) test and its relevance in the context of zero monetary price products and highly innovative industries
 - The relevance and weight of supply-side substitution in defining markets
 - The definition of geographic markets in conditions of globalization and import competition
 - The approach to market definition in certain specific scenarios, including in the context of digitalization, with dedicated sections on the approach; e.g., in the presence of multi-sided platforms or digital ecosystems
 - The forward-looking application of market definition
 - The calculation and significance of market shares
 - The practical process of defining markets, including the source and type of substantive evidence the EC relies on to make its determination and their probative value.
- The Draft Notice provides updated guidance on the methodology used for market definition but does not curb the EC’s substantial flexibility in the application of the rules it sets out. The notice will therefore be useful for companies to determine the tools they may apply for market definition but it will hardly help them reach reliable conclusions when defining markets in borderline cases.

Background

The EC officially began evaluating the [1997 Notice](#) in March 2020, collecting evidence from stakeholders as well as EU national competition authorities (NCAs), experts, and representatives from stakeholder groups. It also started reviewing legal economic literature in particular with respect to four specific aspects of market definition: digitalization, innovation, geographic market definition, and quantitative techniques. On that basis, the EC published its [Staff Working Document](#) in July 2021 summarizing the findings of its evaluation (see this Latham [briefing](#)), and prepared the Draft Notice published for [consultation](#) on 8 November 2022.

The Role and General Principles of Market Definition

Market definition is only concerned with “immediate” competitive constraints

The Draft Notice provides that market definition primarily aims to identify the “immediate” competitive constraints that the undertakings involved face (§5), i.e., the competitive constraints from “within” the market (§14). By contrast, the competitive constraints from “outside” the market, such as potential competition, are taken into account at the stage of the competitive assessment (§14).

Potential competition is singled out as lacking the necessary “immediate and effective” characteristics from a market definition perspective (§25). These statements consolidate the EC’s previous position in the 1997 Notice, despite calls from some stakeholders for the EC to systematically consider potential competition at the market definition stage.

Market definition is not mandatory and the EC may not need to consider all alternatives in depth

The Draft Notice explains that “market definition is not a mandatory step in all assessments under Union competition law” (§7). Furthermore, “where required”, market definition is used “as a tool”, for example to assess market power or to calculate market shares, to “structure and facilitate the competitive assessment” (§7). In any event, the EC “does not need to reach a definitive conclusion on the precise scope of the market where the outcome of the Commission’s assessment would not change under different plausible market definitions” (§18). In that case, the EC will consider, as far as possible, a competitive assessment based on all plausible alternative market definitions although “the depth of its competitive analysis may vary”, for example to focus on those alternative markets if the overlaps are more substantial and the immediate competitive constraints are fewer (footnote 32). This position is in line with the 1997 Notice and the EC’s decisional practice.

Market definition is a “case-by-case” affair

The Draft Notice grants the EC ample flexibility to determine the scope of the relevant product and geographic market(s):

- Market definition is first and foremost “based on the facts of the case” (§11)
- The EC “is not bound to apply the definition of a relevant market from its past decisions”, although it may start its analysis from these decisions and verify whether they can still be applied (§11)
- The outcome of the market definition analysis may differ depending on:
 - the type of analysis carried out (e.g., analysis of evidence of current or past market power in antitrust versus analysis of change in market power that may result from a merger) (§11); and
 - “even when the same products and geography are concerned”, (i) the parameters of competition (e.g., competition on price versus investments in product improvements, referring to *Dow/Dupont’s* “innovation competition” and “innovation spaces”); (ii) the undertakings involved (since the parties’ products serve as the starting point); and (iii) the period considered (e.g., the geographic market may change as the competition dynamics have changed over time, referring to *Metso/Svedala* compared to *Outotec/Metso*) (§15).

Product Market Considerations

As explained in this Latham [briefing](#), market definition continues to involve the definition of both product and geographic markets on the basis of demand-side and, to a certain degree, supply-side substitutability. This paradigm has not changed (see §§12 and 25), but the Draft Notice addresses certain adjustments or clarifications regarding the specific methodology to define relevant markets, including the points below.

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

In the 1997 Notice, price appeared as the key parameter of competition for the EC to consider in determining the scope of the relevant market, although it already implied that price was not the only relevant parameter of competition.

On that basis, the 1997 Notice explained that one way of determining whether products are part of one single relevant product market (or a specific area constitutes a relevant geographic market) is to “determine whether the parties’ customers would switch to readily available substitutes or suppliers

located elsewhere in response to a hypothetical small (in the range of 5% to 10%) but permanent relative price increase in the products and areas being considered” (§17). This test is commonly known as the SSNIP test for “small, significant, non-transitory increase in price.”

The Draft Notice extends the list of parameters of competition the EC considers in determining the scope of the relevant product (and geographic) market(s). It refers not only to price but also to a product’s “level of innovation, its quality in various aspects – such as, for example, its durability, sustainability, the value and variety of uses offered by the product, the image conveyed or the security and privacy protection afforded, as well as its availability, including in terms of lead-time, resilience of supply chains, reliability of supply and transport costs” (§12).

The Draft Notice adds that “when undertakings compete on parameters other than price, such as quality or level of innovation, this makes the application of the SSNIP test difficult, in particular in the context of zero monetary price products and highly innovative industries” (§32). Stakeholders specifically requested this acknowledgement in the context of the evaluation process, along with additional clarifications which, however, remain limited. The Draft Notice indeed mainly clarifies the following:

- The “small but significant non-transitory decrease of quality” (SSNDQ) test is a relevant alternative in the context of zero monetary price services or products (i.e., if the service or product is accessible for free, or if users pay with their own data) but “defining a precise quantitative standard of degradation of quality of the target product cannot constitute a pre-requisite for the application of the SSNDQ test [...]. All that matters is that the quality degradation remains small, albeit significant and non-transitory.” (footnote 47, referring to the *Google and Alphabet GC* judgment).
- There is, however, “no obligation for the Commission to apply the SSNIP test empirically, and other types of evidence are equally valid to inform market definition” (§33, and footnote 49, referring to the *HeidelbergCement and Schwenk Zement GC* judgment) including, in relation to zero monetary price services or products offered on multi-sided platforms, “product functionalities, intended use, evidence on hypothetical substitution and on competitive constraints based on industry views, barriers or costs of switching such as interoperability with other products or licensing features.” (§98)
- The SSNIP test may not apply in an abuse-of-dominance context (§32).

The Draft Notice does not specifically address the difficulties in applying the SSNIP test in bidding markets, or discuss the small but significant non-transitory increase-in-cost test, although stakeholders raised these issues during the evaluation process.

The relevance and weight of supply side substitution in defining relevant markets

The evaluation had revealed that some stakeholders suggested that supply-side substitutability be excluded from market definition and taken into account at the competitive assessment stage. Others, particularly from the digital sector, suggested that supply-side substitutability be considered for market definition purposes to the same extent as demand-side substitution.

In the Draft Notice, the EC confirms its previous approach that “supply substitution can also be relevant for the definition of the relevant market in some cases, namely when it is as immediate and effective as demand substitution” (§25). The Draft Notice also provides two examples of situations in which supply substitution can be considered relevant at the market definition stage.

1. The first situation is when “suppliers use the same assets and processes to produce related products that are not substitutes for customers, and where this leads to similar conditions of competition across the range of such related products” (§34). The “necessary” conditions for the market to be broadened on that basis are if “most, if not all, suppliers are able to switch

production between products in the range of related products, while incurring only insignificant additional sunk costs or risk, have the incentive to do so when relative prices or demand conditions change, and can market them effectively in the short term” (§35).

2. The second example is that of bespoke products, which can be included in the same relevant product market “when the same suppliers can and generally do respond with offers to specifications of different customers” (§37).

The EC reiterates that, outside of these situations, supply-side substitution is taken into account only at the competitive assessment stage (§38).

Geographic Market Considerations

The evaluation results had shown that overall, the 1997 Notice adequately describes the assessment of geographic markets in the context of globalization, including in markets in which imports pose increased competitive pressure. In that context, the EC kept its changes in the Draft Notice to the bare minimum:

- more explicitly stating that “geographic markets can range from a local dimension to a global dimension depending on the conditions of competition the customers face” (§40);
- incorporating examples from its decisional practice of global markets having been defined, including the controversial *Siemens/Alstom* case, in which the relevant geographic market was considered to be global but excluding China, South Korea, and Japan (footnote 83), which was a pivotal element in the decision to prohibit the transaction; and
- outlining explicitly the concept of competitive pressure from imports (§§43-45), specifying that “the mere existence or possibility of imports in a given geographic area does not necessarily lead to widening the scope of the geographic market to the area where the imports originate” (§43); the test remains whether the customers face “sufficiently homogeneous conditions of competition” — if this test is not met, imports will still be taken into account at the stage of the competitive assessment (§44).

Market Definition in Specific Circumstances

The Draft Notice dedicates specific sections to market definition in specific circumstances, namely in the presence of (i) significant differentiation, (ii) price discrimination, (iii) significant investments in R&D, (iv) multi-sided platforms; and (v) after markets, bundles, and digital ecosystems. These proposals, which are new in the Draft Notice but in line with the EC’s recent decisional practice, are summarized below:

MARKET CHARACTERISTICS	POSSIBLE MARKET DEFINITION OPTIONS AND RELATED PROPOSALS
Differentiated products (§§84-87)	<ul style="list-style-type: none"> • Separate markets within a continuum of products — including products at the extreme of chains of substitution • One broad market including differentiated products — in which case, closeness of competition is considered at the competitive assessment stage, and considered a more reliable indicator than market shares
Price discrimination (§88)	<ul style="list-style-type: none"> • Can lead to a distinct group of customers constituting a distinct product market if three conditions are met: <ul style="list-style-type: none"> – It is clear which group a customer belongs to – Trade between customers or arbitrage is unlikely – The price discrimination is lasting

<p>Significant investments in R&D (§§89-93)</p>	<ul style="list-style-type: none"> • Pipeline products, depending on intended use and projected substitutability: <ul style="list-style-type: none"> – Part of an existing product and geographic market – New market limited to the pipeline products and substitutes (including where products are likely to be sold) • R&D processes related to earlier stages of research: <ul style="list-style-type: none"> – Identify “the boundaries within which undertakings compete in these early stages” (so-called “innovation spaces”) – Decisive factors include: nature and scope of the innovation efforts; the objectives of the different lines of research; the specialization of the different teams involved
<p>Multi-sided platforms (§§94-98)</p>	<ul style="list-style-type: none"> • Products offered by a platform as a whole, encompassing all or multiple user groups • Separate markets for the products offered on each side of the platform: <ul style="list-style-type: none"> – <i>Decisive factors include:</i> different undertakings offering substitutable products to different user groups; degree of product differentiation on each side (or each user group’s perception thereof); homing decisions; transaction or matching nature of a platform • Network effects are considered either at the market definition stage or in the competitive assessment • SSNIP test may be challenging such that the EC will need to rely on other elements for the assessment of substitution (see above)
<p>Digital ecosystems (§§99-103)</p>	<ul style="list-style-type: none"> • A market comprising both primary and secondary digital products or a bundle market; an approach which is more appropriate: <ul style="list-style-type: none"> – the more likely it is that customers take the whole-life costs into account when purchasing the primary product – the higher the expenditure on (or the value of) the secondary product(s) compared to the expenditure on (or the value of) the primary product – the higher the degree of substitutability between primary products and the lower the switching costs between primary products – when there are no or few suppliers specialized only in the secondary product(s) (§101) • Multiple markets (primary digital product versus secondary product further split into separate markets) • Dual markets (primary versus secondary digital product)

The Forward-Looking Application of Market Definition

The Draft Notice includes as a general principle of market definition that the EC may take into account “expected” “short-term or medium term” “transitions in the structure of the market when the case calls for a forward-looking assessment” (§16; the Commission does not specify when that might be the case).

These transitions relate to structural market transitions affecting the general dynamics of demand and supply in a market as opposed to changes affecting individual undertakings or consumer offerings.

For the EC to take them into account, there must be “strong indications” that the change will take place with “sufficient probability”, based on “reliable” evidence that goes beyond “mere assumptions.” The EC does not, however, explain how these terms will be interpreted in practice.

The Calculation and Significance of Market Shares

The relevant metrics

The Draft Notice acknowledges that “depending on the specific products or on the specific industry in question, other metrics [than sales and purchases] can offer complementary or more useful information to determine market shares” (§107).

Catering to comments from stakeholders during the evaluation including in the digital space, the Draft Notice specifies in §107 that these metrics may include the following:

MARKET CHARACTERISTICS	POTENTIALLY RELEVANT METRICS
Bidding or innovative markets	<ul style="list-style-type: none"> the number of suppliers the number of tenders awarded
Digital markets (including when services are provided in multi-sided platforms, at a zero monetary price)	<ul style="list-style-type: none"> usage metrics such as (active) users the number of visits time spent or audience numbers the number of downloads and updates the number of interactions or volume or value of transactions concluded over a platform
Frequent and significant investments in R&D	<ul style="list-style-type: none"> the level of R&D expenditure the number of patents or patent citations

The Draft Notice also specifically addresses potential relevant alternative metrics for transport markets, the mining sector, markets characterized by the strategic importance of capacity, and markets with a high level of product differentiation (§§107-108).

The relevant period

The evaluation results had shown that the 1997 Notice did not properly discuss the period to be applied when calculating market shares, in particular in the case of bidding markets. The Draft Notice merely confirms that the EC generally relies on shares per year over three years and acknowledges that this period may depend on the specific market, including in relation to bidding markets. It does not specifically address the question of rapidly evolving markets from that perspective, but the continuum between R&D processes, for example, can lead to separate markets being defined at the outset (§111).

The Evidence Used for Market Definition

Based on the evaluation results, the EC dedicated in the Draft Notice separate sections to (i) the general methodology for defining markets (Section 2.2), (ii) the evidence to define markets (Sections 3.2 and 3.3), and (iii) the process of gathering and evaluating evidence (Section 3.4).

The key guiding principles in the Draft Notice include the following, yet again providing the EC significant flexibility this time in collecting and using evidence, supported by the General Court's case law:

1. The EC may rely on various categories and sources of evidence to define markets and the only test in evaluating evidence is whether it is "reliable."
2. The EC "does not need to obtain evidence on and assess all factors mentioned." Certain types of evidence "may be decisive in one case but of limited or no importance in other cases" and "in view of the need for speed and the very tight deadlines to which the EC is subject, it cannot be required to verify all the information it receives."
3. The EC "does not apply a rigid hierarchy of different sources of information or types of evidence."

Subsequently, the Draft Notice addresses in detail the probative value of certain types of quantitative techniques, trade flows, internal documents, etc.

Conclusion

The Draft Notice is welcome as updated information on the EC's methodology and tools to deal with market definition and substantive assessment, notably in certain specific circumstances but also more generally as systematic and useful compilation of case practice in the last 25 years. The detailed references and citations to cases are very helpful for users to provide context. Companies should not expect, however, to find guidance that is sufficiently precise and unequivocal to reliably define markets in borderline cases. In any event, we do not expect the final notice, which is expected to be published in a few months, to deviate largely from this draft.

Next Steps: Timeline

Q2 2023	EC to review comments on Draft Notice
Q3 2023	A new notice expected to be adopted

Contacts

If you have questions about this briefing, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Héctor Armengod

hector.armengod@lw.com
+32.2.788.6322
Brussels

Carles Esteva Mosso

carles.estevamosso@lw.com
+32.2.788.6266
Brussels

Adrien Giraud

adrien.giraud@lw.com
+33.1.40.62.20.25
Brussels / Paris

Jacques-Philippe Gunther

jacques-philippe.gunther@lw.com
+33.1.40.62.20.20
Paris

Sven B. Völcker

sven.voelcker@lw.com
+32.2.788.6242
Brussels

Marine Dewaele

marine.dewaele@lw.com
+32.2.788.6363
Brussels

Werner Berg

Knowledge Management Counsel
werner.berg@lw.com
+32.2.788.6151
Brussels

France-Hélène Boret

Knowledge Management Counsel
france-helene.boret@lw.com
+32.2.788.6323
Brussels

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