



The Modernisation of DGIV

The Triumph of the SSNIP Test

The publication of the Commission's draft **Notice on the Definition of the Relevant Market** represents the decisive triumph of the SSNIP test for market definition.¹ SSNIP stands for "small but significant and non-transitory increase in prices". According to this test, a relevant market is the narrowest collection of products such that a hypothetical permanent monopolist over them would find it both possible and profitable to institute a SSNIP (specified as 5% to 10% price increase). This idea was pioneered at the US Department of Justice in 1982 and, as the box below shows, it has spread around the world. It now appears to be the agreed world-wide standard for defining antitrust markets.

SSNIP Test Now World-wide Standard for Market Definition

Officially

United States	1982	Merger Guidelines
European Union	1992	Nestlé/Perrier
	1997	draft Notice on Market Definition
Canada	1991	Merger Enforcement Guidelines
New Zealand	1996	Business Acquisitions Guidelines
Australia	1993	Market Dominance Guidelines (Telecoms)

Semi-Officially: (via Published Discussion Papers)

United Kingdom	1992
Italy	1995

The success of the SSNIP test is no accident. The question that it asks goes to the core of why we care about market definition in the first place. We can only answer the question of whether, for instance, a 70% share of a "market" is likely to give a company market power if that "market" is an economically meaningful market. The key question is whether substitution to other products or other geographic regions is a substantial, or only a trivial, limitation on the conduct of the parties offering those products. We want to include within the market everything that offers substitution to the products at issue for significant numbers of consumers and to exclude from the

market all those things that are not realistic substitutes. The SSNIP test is a convenient way of doing this.

Changing the Law

The draft Notice represents the triumph of the EU merger jurisprudence: about 500 published decisions in six years versus only about 30 formal decisions on Article 86 in 30 years. By sheer weight of numbers, as well as by the use of more modern techniques, the merger jurisprudence has exercised a kind of gravitational influence on the rest of DGIV. This has now led to the *de facto* surrender of the old guard - the new Notice applies to Articles 85 and 86 as well as to mergers.

In constitutional legal theory, the European Commission is just an administrative agency, not a legislature. The ultimate arbiters of the law are the courts and, especially, the European Court of Justice. But in practice the Commission, by sheer weight of decision-making over years of active practice, can make law and can have severe effects on business behaviour. In the draft Notice the Commission, in effect, changes the law. The changes include not only its own past practice but even some of the rules derived from famous precedent cases of the European Court of Justice. For example:

- **Similar product characteristics** (*United Brands*) and **similarity of intended use** (*Commercial Solvents*), long recited by Commission officials and Commission decisions as reasons for defining a market, are no longer an adequate basis for defining a market. The draft Notice states that "product characteristics and intended use are insufficient to conclude whether two products are demand substitutes".
- **Functional interchangeability of products** (*Continental Can*) suffers a similar fate. It does "not provide ... sufficient criteria [for market definition] because the responsiveness of customers to relative price changes may be determined by other considerations also".
- The holding by companies (or brands) of **different market shares in different national markets** will no longer be treated as evidence for the existence of national markets. Conversely nor will homogeneous market shares be treated as evidence for the existence of a wide geographic

¹ We were advisers to the Commission on the preparation of the Notice.

market. This change is good economics but contradicts the past practice of the Commission in numerous decisions and statements of objections.

Quantitative Techniques in the Draft Notice

A quantitative test such as the SSNIP test can be answered sensibly only by using quantitative techniques. In the draft Notice, the Commission notes specifically that it has a number of quantitative techniques which it will use and evaluate when they have been carried out in a manner that withstands serious critical scrutiny. They specifically mention elasticity estimates, correlation studies, Granger causality calculations, price convergence tests and trade flows tests. However, pride of place is given to *shock analysis*. The Commission notes that in some cases it is possible to analyse evidence relating to past events or shocks. The draft Notice states that “when available, this sort of information will normally be fundamental for market definition”.

We believe that this emphasis on shock analysis arises from the important role that it has played in market definition in at least two major mergers. In *Procter & Gamble/VP Schickedanz* the shock was the entry of a new product. By analysing the advertising response of other products it was possible to see which products appeared to be in the same market as the new entrant (and hence felt the need to respond to the entry) and which appeared to be in a separate market. In *Kimberly Clark/Scott* the response of prices in the UK and the Continent after the exchange rate shock of September 1992 suggested that the UK was in a separate relevant geographic market from the Continent.

Potential Difficulties with the SSNIP Test

Although the economic logic of the SSNIP test is clear, implementing the test is not always simple. Here we mention only two potential difficulties. The draft Notice indicates that the Commission is aware of both of them.

The first difficulty relates to the so-called “Cellophane fallacy”. It arises from the question of what is the base price level from which we should apply the 5% to 10% price increase? In merger cases, the concern is with the future and whether prices will rise above the current level in the future. Thus the relevant price level in merger cases is the current price level. However, this is not the relevant price level in an Article 86 case. Here the concern is that the current price might already have been substantially increased above the competitive level, so the correct price level from which to carry out the SSNIP test is the competitive price level. This means, as the draft Notice states, that it is perfectly possible that market

definitions will vary depending on whether the case is a merger case or an Article 86 case.²

The second difficulty relates to the treatment of the supply-side. No competition authority knows quite what to do about the supply-side. The problem is that if we define the market only on the demand-side, we may find that due to supply-side substitutability even a monopolist of a relevant market could not raise prices. But if we take account of the supply-side at the market definition stage, then where do we draw the line between supply-side substitutes and potential entrants? The Commission has steered a sensible middle course in the draft Notice. Supply-side substitutes whose “effects are equivalent to those of demand substitutes in terms of effectiveness and immediacy” will be included in the market definition.³ Where supply-side substitutability is not immediate and would require some additional investment and time, then supply-side substitutes will be treated like potential entrants and will not be included in the market definition.

There is a variety of other circumstances in which the SSNIP test either is very difficult to apply or gives uninformative results. Market definition, however carried out, gives rise to only presumptive, not final, answers.

Conclusion

DGIV appears to be coming into the modern world of sophisticated antitrust enforcement. The process of stating clearly the economic criteria for market definition and the techniques (most of them of American origin) that will be used for implementing the criteria has been described by one senior official as “the modernisation of DGIV”. We agree with this description and welcome the development. Conformity to international standards offers business less arbitrariness and more predictability, which can only be for the good.

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² Timing differences could also lead to different definitions - Article 86 looks to the past, merger control to the future.

³ This accords with Commission practice in the past. In *Dalgety/Quaker Oats* the Commission defined the market as all petfood even though you cannot feed dog food to your cat (cats are too choosy). Supply-side substitutability between producing cat and dog food is immediate (i.e. twenty minutes to change the ingredients).