Supply Substitution, Relevant Market and Divestiture

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This article illustrates an apparent contradiction of the National Commission for the Defense of Competition (CNDC) of Argentina regarding the treatment of supply side substitution.[1] Using a recent merger as an example, it is shown below that the CNDC does not appear to be consistent in its consideration of supply side substitution. Specifically, supply side substitution is considered by the CNDC in the definition of the relevant market, but it is ignored when it establishes a divestiture as a remedy for the anti-competitive effects of the merger. As a consequence of this apparent contradiction, divestitures proposed by the CNDC are smaller than they would be in the absence of this apparent error, probably making divestiture ineffective as a remedy.

Supply Substitution and Relevant Market in the Literature

To start analyzing the effects of a merger, one of the first tasks is the definition of the relevant market. To this end, the concept of demand side substitution is generally used, within the framework of the so-called SSNIP test.[2] This test attempts to identify which is the smallest set of products for which a hypothetical monopolist could profitably impose a small, but significant and non-transitory, price increase. In this way, the relevant market includes all those goods or services that, from the consumer's point of view, are considered sufficient substitutes for each other.

In this context, the literature shows some controversies regarding the role that supply side substitution can play. Unlike demand side substitution, supply side substitution implies considering as possible substitutes the goods or services that could enter the market, in the event that a company currently absent decides to participate in response to a price increase. In this way, supply side substitution implies taking into account the competitors currently absent from the market, but who could become real competitors if prices rose enough. Thus, some authors argue that in the definition of the relevant market, supply side substitution must play a leading role.

For example, Clemens and Özcan (2018) argue that in certain mergers that have involved important players in the digital world, the focus of the competition authorities has been largely on analyzing substitution on the demand side, without considering in depth substitution on the supply side.[3] These authors cite as an example the merger between Facebook and WhatsApp, in which the European Commission analyzed in detail the substitution on the demand side, concluding that messaging services and social networks are different enough. However, Clemens and Özcan emphasize that the possibility of WhatsApp eventually entering the social media market was not carefully analyzed by the authority.

[1] This is a translation and a shorter version of the original article: Sabbioni (2020), "Sustitución de Oferta, Mercado Relevante y Desinversión", El Dial, Suplemento de Defensa de la Competencia, Buenos Aires, Argentina. Available at https://www.eldial.com/nuevo/suple-competencia.asp.

[2] SSNIP refers to a Small, Significant and Non-transitory Increase in Price.

[3] Clemens, Georg and Özcan, Mutlu (2018), The Relevance of Supply Side Substitutability for 'Big Data'. Concurrences Review N° 4-2018, Art. N° 88128.

According to them, by not considering this possibility, the European Commission perhaps underestimated WhatsApp's ability to collect and process data, which could have helped it enter the social media market.[4]

On the contrary, other positions relegate supply side substitution to a secondary role. For example, Baker (2007) states that the definition of the relevant market should be made only from the point of view of demand substitution.[5] This author does not rule out considering also supply side substitution, but he suggests that this should be done in other instances of the analysis. In turn, Coate and Fischer (2008) suggest that although the U.S. Merger Guidelines seem to consider only demand side substitution, in reality these guidelines also take into account supply side substitution, in the sense of considering it when identifying which companies are participating in the market.[6] A good summary of this controversy is provided by Padilla (2001).[7]

CNDC: Supply Substitution and Relevant Market

This debate about the role of supply substitution was present in the evaluation of the recent merger between Cablevisión and Telecom, by the National Commission for the Defense of Competition (CNDC) of Argentina.[8] When defining the relevant market for residential Internet access service, the CNDC explicitly took into account substitution on the supply side.[9] More concretely, the CNDC defined the relevant geographic market as local; that is, the CNDC argued that each urban conglomerate was a separate geographic market. Accordingly, this definition resulted in dozens of potentially problematic geographic markets, given the simultaneous presence of the two merging entities.

As the CNDC explained, in the entire urban conglomerate there is substitution on the supply side, because within this area the companies can quickly extend their coverage just by making marginal additions to their networks. The CNDC then noted that there is high demand side substitution in the areas of the urban agglomerate with overlapping networks, and a high supply side substitution throughout the entire agglomerate.[10] Thus, the CNDC concluded that in order to define the relevant geographic market,

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[4] In addition to the Facebook and WhatsApp merger, Clemens and Özcan (2018) also caution that the British competition authority (Office of Fair Trading, OFT) did not carefully consider the possibility of supply side substitution in its analysis of the acquisition of Waze by Google. Thus, this concentration also could have resulted in the elimination of a potential competitor by way of supply side substitution.

[5] Baker, Jonathan (2007), Market Definition: An Analytical Overview. Antitrust Law Journal, Vol. 74, No. 1, pp. 129-173.

[6] Coate, Malcolm and Fischer, Jeffrey (2008), A Practical Guide to the Hypothetical Monopolist Test for Market Definition. Journal of Competition Law and Economics, Vol 4, No. 4, pp. 1031–1063. These authors note that, according to the Merger Guidelines, for a company to be considered as a possible substitute on the supply side, it must be able to enter the market (from the point of view of the product or from the point of view of geography) within a year at most.

[7] This author explains that the considerations regarding supply side substitution can be made at three different moments: (i) when defining the relevant product or geographic market; (ii) by identifying the relevant players, once the relevant market has already been defined, but prior to calculating market shares; or (iii) when evaluating the chances of a new entry to the market, after defining the quotas. Additionally, Padilla differentiates between supply side substitution and potential market entry, depending on: (i) the time it takes for competitive supply pressure to materialize; (ii) the magnitude of the investment to be sunk in order to exert said competitive pressure; and (iii) whether or not the entrant takes into account the effect that their entry will have on prices. See Padilla, A. Jorge (2001), The Role of Supply Side Substitution in the Definition of the Relevant Market in Merger Control – A Report for DG Enterprise, European Commission, Madrid.

[8] Comisión Nacional de Defensa de la Competencia (2018), Dictamen Conc. 1507 (EX-2017-19218822- -APN-DDYME#MP), titled "Cablevisión S.A., Cablevisión Holding S.A., Telecom Argentina S.A., Fintech Media LLC y Fintech Telecom LLC S/ Notificación Art. 8 Ley No 25.156 (Conc. 1507)" as well as EX-2018-16212149- -APN-DGD#MP, from the docket of the Ministerio de Producción, titled: "Telecom Argentina S.A. y Universo TV S.A. S/ Análisis Propuesta de Desinversión en CONC.1507."

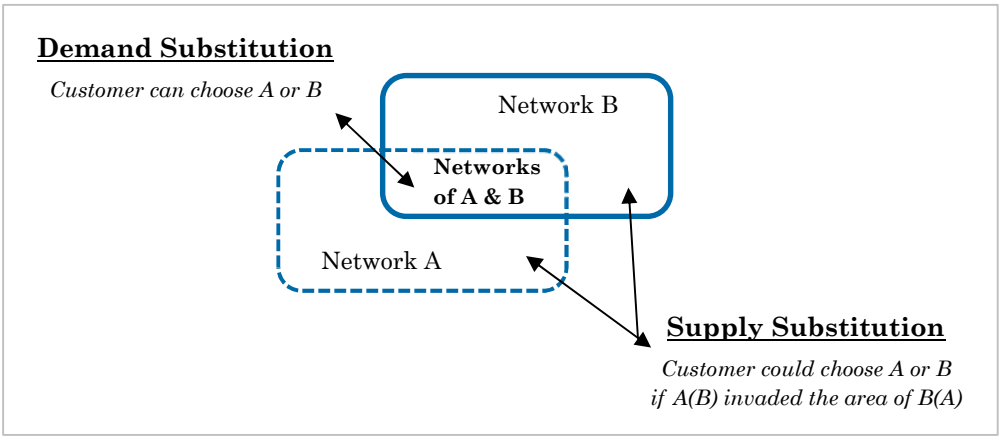
[9] CNDC (2018), Dictamen Conc. 1507, párrafos 221-222.

[10] See paragraphs 59-62 of Opinion Conc. 340 of 2003 (file S01: 0178180/2002 entitled: "Esmeralda Television SA, Venado Tuerto TV SA and TV Interactiva SAC380 S / Notification Art. 8 Law 25.156"), cited in turn in Opinion Conc. 1338 of 2017 (File No

the supply substitution that exists between all the areas of the geographic market is key, since any operator can expand its service area after a price increase in any other area in which today it is not present.

Figure 1 shows this distinction. The figure illustrates that there is substitution on the demand side only in the area where the networks overlap, while there is substitution on the supply side throughout the urban agglomerate—even in areas with only one network.

Figure 1. Demand and Supply Side Substitution in the Relevant Market



As the figure shows, there is demand side substitution in the areas with overlapping networks, while there is supply side substitution in the areas without overlapping networks.

CNDC: Supply Side Substitution and Divestiture

Despite considering supply side substitution in the definition of the relevant market, the CNDC seems to ignore it when proposing a remedy to mitigate the anti-competitive effects of the merger. More specifically, the CNDC does not consider supply side substitution when proposing that the merged entity transfer clients to a Third Party. The CNDC only required the divestiture of Telecom/Arnet clients located in areas where Cablevisión/Fibertel was also present: that is, in the area with overlapping networks. On the contrary, the CNDC did not require the divestiture of clients in areas where only the Telecom/Arnet network was present.

In this way, the decision seems contradictory, since substitution on the supply side is taken into account in the definition of the relevant market, but not when crafting the divestiture. If supply side substitution were considered both when defining the divestiture as well as when establishing the relevant geographic market, the CNDC should also have required the divestiture of customers located in areas where only Telecom/Arnet was present. Alternatively, if supply side substitution is not considered at the time of the divestiture, then the definition of the relevant market should have been more restricted, excluding the areas without overlapping networks.

S01: 0268071/2016 (Conc. 1338) BM-MA), entitled "San Luis Cable SA y TV CA S.A. S / Notification Art. 8º of Law 25.156, File No. S01: 0268071/2016), referenced for this purpose in Opinion Conc. 1507 under analysis.

Conclusion

The debate regarding the role of supply side substitution is present in the CNDC's analysis of an important recent merger, but in an apparently contradictory fashion. In terms of the literature, the CNDC seems to coincide with Clemens and Özcan (2018) when defining the relevant market, since it considers supply side substitution in that instance. On the contrary, the CNDC seems to ignore these authors when it establishes the divestiture, since at this stage supply side substitution is not taken into account.

While this distinction may appear to be no more than a technical consideration, its practical implications are important. As a result of the apparent contradiction, the required divestiture is smaller than it would be in the absence of the error. Thus, the divestiture is unlikely to be effective as a remedy. Given that competition law is an area where theory and practice enrich each other, academics will surely address the advantages and disadvantages of taking supply side substitution into account when defining the relevant market, but not at the time of delimiting the assets to be divested.

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