

Market Definition Does Not Yield Evidence of Class-Wide Impact

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Market definition is a first step in nearly all antitrust and merger cases. It is used as a screen to assess the potential for market power of firms at the center of an antitrust inquiry or a merger review. If a dominant share is found or market concentration is high, there may be potential for consumer harm and further review is warranted. Otherwise, market power is less likely and the potential for consumer harm is low.

Market definition is only a form of indirect evidence to assess the potential for market power, or used as circumstantial evidence when direct measures are not possible.¹ The exercise lacks fine precision and opposing parties can often disagree, substantially, on the appropriate definition. In spite of these concerns, its use is nearly ubiquitous and discussed at all stages of antitrust matters, including at the earliest point of litigation – the class certification stage.

Defining markets so early in the process can be useful if the purpose is to screen for potential market power and weed out cases unlikely to succeed on merits and thereby avoiding costly litigation. In practice, however, there have been cases where market definition has been used more broadly as a type of evidence for which it is not well suited.

Leitzinger and Lamb (2007) argue that market definition can be used at the class certification stage, not as an early market power screen, but rather as sufficient proof that the predominance issue has been met in regards to proof of harm.² Analyzing actual prices paid by individual class members is not

¹ "The Role of Market Power in Statutory Antitrust Offenses." *Market Power Handbook: Competition Law and Economic Foundations*. 2nd ed. ABA Section of Antitrust Law, 2012, pp. 19-20.

² Leitzinger & Lamb write, "We believe that relevant market analysis - along with its accepted analytical framework, modes of proof, and standards for evidence-may be the answer. In particular, there is compelling economic logic to suggest that proof of the relevant market (combined with a showing proposed class members were participants within that market) should be sufficient to meet the predominance requirement as to proof of injury." Jeffrey Leitzinger & Russell L. Lamb, "The Predominance Requirement for Antitrust Class Actions – Can Relevant Market Analysis Help?" *Economics Committee Newsletter*, ABA Section of Antitrust Law, Volume 7, Number 1, Spring 2007.

necessary, they argue. Instead, they claim once the relevant product and geographic markets are defined and market shares calculated, if the firms in question have large market shares, then, as a matter of theory, firms should have market power and would be able to raise prices. Specifically, and problematically, they then assume firms would necessarily raise prices on *every* and *all* customers. Hence *all* customers who purchased the products in question in the relevant market are properly part of the class.

This is not an appropriate application of market definition. Market definition cannot provide evidence of common, class wide impact.

There are two general reasons for this. First, the market definition exercise lacks the precision necessary to address impact on the customer by customer level necessary at the class certification stage. A complaint typically defines the set of class members as all those that purchased the product between two points in time. The proposed class is thus broad and in many cases unlikely to fall in a single relevant market. It is unlikely each member will have a very similar set of alternate supply options, and many may have purchased items where defendants hold no market power at all. In our experience there is a tendency for an expert in support of class certification to build the market definition around the class' purchases and include the entire class as a minimum, even when that is not appropriate. In reality, class members can and often do differ substantially from one another and the investigation into these differences remains paramount.

The second issue is that the market definition method does not actually show impact at all, not to any particular customer, let alone to the class in common. The method assumes harm since the class buys product from the defendants and defendants are assumed to hold market power over that product. But in a true market definition exercise exceptions abound, for example, large buyers may hold buyer power and their continued purchases during the alleged conspiracy period may not be at an inflated price at all. Only an individualized analysis, focusing on actual prices paid against the 'but for', would reveal whether individual customers were in fact impacted.

Market Definition Is Not a Proper Tool for Accessing Common Impact

The Mismatch Between Class Members in the Complaint and the Actual Defined Market

According to the Merger Guidelines, the relevant market is the smallest set of products and geographical region, surrounding the product(s) in question, that a hypothetical monopolist of all products in that set and region could raise prices by a small but significant and non-transitory amount over current levels.³ The relevant market can also be restricted to certain buyer types or channels of

³ Horizontal Merger Guidelines, § 4.1. U.S. Department of Justice and the Federal Trade Commission, issued August 19, 2010.

distribution, so, for example, the same *physical* product can be in or out of the *relevant* market depending on who buys it or how it is sold.⁴

Even with this guidance, market definition is by its nature an imprecise exercise, an issue that is exacerbated when used at the class certification stage to identify common impact. The hypothetical monopoly test laid out in the Guidelines is, after all, based on a hypothetical, so sometimes empirical estimation gives way to qualitative arguments about which products or areas should be “in” or which should be “out”. Opposing parties can disagree, significantly, as to the proper market definition, and these broad-brushstroke “in” and “out” decisions can have a significant impact on the size of the relevant market, and implications for market power.

The imprecision is magnified when used in a class setting to establish common impact. Class definitions often proposed by plaintiffs in the complaint are defined as all entities that purchased the physical products in question from the defendants between two dates. For example, in a recent case involving the cement industry, the class was defined as “All Persons who purchased Ready-Mixed Concrete directly from a facility within the Central Indiana Area, at any time during the Class Period.”⁵ The expert will often take the class as given in the complaint, and use it as the starting point for a relevant market defined as the set of products purchased by class members in the named geographical areas. After concluding that all purchases are in the relevant market, the analysis would then seek to show whether defendant’s held market power in that market. If so, the expert might conclude that all customers were harmed in common.

But one of the key purposes of the class certification inquiry is to determine whether all entities in the proposed class were impacted, not that the “average” class member was impacted. It may be some customers in the class may have purchased items where the defendants do not hold market power, because they are in an area, for example, where supply alternatives are many.⁶ Or, perhaps a large customer has buyer power and can negotiate away any attempted increase in price. More subtly, it may be that in a particular area, supply alternatives are many for some customers, but not for other customers. It may be tempting to simply argue that these customers would not be included in the relevant market if market definition were properly conducted. But as a practical matter it is difficult, if not impossible, to determine if a particular customer, or set of customers, is precisely “in” or “out” of a product market for the purpose of assessing whether they were affected by an alleged anticompetitive arrangement. The only precise means for such a determination is through analysis of actual price effects.

⁴ The term ‘physical’ is used here to describe an actual product or service, for example ice cream or legal services. The same physical product may be in different product markets based on buyer types or sales channels. For example, ice cream sold at retail outlets may be in a different market than ice cream sold to supermarkets.

⁵ *In Re Ready-Mixed Concrete Antitrust Litigation*, Second Amended Consolidated Class Action Complaint, ¶ 37, March 9, 2007 (1:05-cv-00979-SEB-VSS).

⁶ For example, imagine a hypothetical customer in the Ready-Mix class described above that resided in a location hundreds of miles from the Central Indiana area, where alternative suppliers were plentiful. Assume further that the customer received a price concession from the facility in the Central Indiana area, thereby explaining the decision to not shift to a nearby supplier. A market definition exercise that concluded that all purchases from that area as in the relevant market, would fail to identify the unique situation facing that customer.

Leitzinger and Lamb point out that customers for whom the firms in question would not be able to raise prices should be excluded from the market definition in the first place. Indeed, the Guidelines allow for market definition to be restricted to specific groups of customers when price discrimination is possible and some customers would not face market power concerns. Leitzinger and Lamb should therefore conclude that groups of customers and individual customers who are not impacted should be removed from the proposed market, and from the proposed class.

However, in our experience, this type of analysis, down to specific customers – that takes into account the specific circumstances and supply options for each customer and would potentially reduce the class down from that defined in the complaint – is seldom undertaken in the class definition stage. This is the difficult but critical part of the inquiry. As a result, the market definition method for finding impact tends to become an all or nothing affair. The class, as defined, is all impacted (if aggregate market shares are high), or there is no evidence any are impacted (if they are not).

There is also the risk a circular argument with the Leitzinger and Lamb approach. Impact is never actually shown. Using qualitative arguments, it may be argued – or sometimes assumed – that most or all customers in the class are similar in their options and their purchases are best considered “in” the relevant market. Then, once the market is defined, and given a showing of high market shares, market power is assumed to follow and it is concluded that all customers “in” the market are impacted. This is circular. The conclusion that all customers were impacted depends closely on the original assumption that all customers were impacted (and hence in the market). Without actually looking for impact for each customer directly through prices, it is difficult to know in reality which individual customers had experienced a price increase and which did not.

The concern is the mismatch between how the class is initially defined (purchases of the *physical* product from defendants) and the way that market definition and market shares are calculated (based on the *relevant* product market). If an expert defines a *relevant* market for the purpose of satisfying the predominance issue, there is a temptation to describe the market as containing all of the purchases covered by the initial complaint – accepting that all of the buyers of the *physical* product are of the same region, buyer type, and distribution channel, that they hold the same set of alternative supply options, and that they have similar negotiating power.

Consider an example. In *FTC v. Cardinal Health and Bergin Brunswig* and *FTC v. McKesson Corp and Amerisource Health Corp*, where the FTC moved to block the two proposed mergers, considerable attention was given to market definition.⁷ Despite approximately 40 drug wholesalers, the combining parties were by far the largest national wholesalers. Additionally, besides wholesalers, a significant amount of drugs were found to be sold directly by manufacturers predominantly to large drug store chains.

⁷ U.S. District Court for the District of Columbia. 1998. Civil Action No. 98-595: *Federal Trade Commission (Plaintiff) v. Cardinal Health, Inc. and Bergen Brunswig Corp (Defendants)* and Civil Action No. 98-596: *Federal Trade Commission (Plaintiff) v. McKesson Corp. and Amerisource Health Corp. (Defendants)*.

Now imagine the same situation, but instead of the parties merging, there were allegations that the four firms had engaged in a market allocation scheme. A private class action complaint would likely read something like “all buyers of wholesale drugs and related services from defendants during the period.” If the plaintiff’s expert followed the market definition for predominance approach, the expert would likely be able to make good arguments that the firms competed with one another. Documents, data, and testimony, would all likely indicate that the four national firms viewed themselves as direct competitors, while potentially downplaying smaller regional players as a less significant threat. From this, the expert might therefore conclude that the four national wholesalers constitute a relevant market, and that direct supply, or regional suppliers would not be sufficient to defeat a price increase by a monopoly of national wholesalers. The market shares would be high, market power would be assumed to follow, and this would be used to support a finding of common impact among the class.

Such a conclusion would be not only premature but incorrect as not all buyers would be harmed. While the court’s ruling found that the four national wholesalers did compete in the same market and held a combined 77 percent share, this would not correspond to potential market power over all buyers. For example, the court noted that there were varying levels of regional competition and that “the eastern part of the United States will likely remain more competitive than the western half of the United States.”⁸ Additionally, the court stated regarding the relevant product market that “different classes of customers have varied ability to substitute the services currently provided by wholesalers” and that a “certain, yet significant, portion of the large retail chains can themselves reasonably provide a substitute for Defendants’ services.”⁹ This implies that while the wholesalers might hold market power in many locations and for some customers, this is far below a standard of showing that *all* customers would be harmed in common.

The market definition exercise is really best suited for identifying competing products in a relevant area, and then finding those firms that supply the product in that area. Indeed, in merger cases it is routinely the case that when considering a merger between two firms, that multiple potential markets may be considered, encompassing portions of the merging firms customers. Even after the overlapping markets are found, factors such as buyer power, or self-supply may be considered as a means which would prevent the exercise of market power. It is simply unlikely that a set of customers, as is identified at the complaint stage, will all be subject to the same set of channels of supply, have the same set of supply options, and have the same level of bargaining power.

The Hypothetical Monopolist Test

The fact that market definition is often conducted with only average prices and aggregate volume shifts – that is, without any customer specific information – highlights its lack of precision for the purpose of evaluating customer impact. Even when customer specific information is available, under the SSNIP test, the information is typically aggregated to the product and geographic level (using product-specific market shares and product-specific averages prices) when the analysis begins.

⁸ *Ibid.*

⁹ *Ibid.*

The use of aggregates hides the individual variation that may be inherent in customer pricing and volume movements. Take the standard SSNIP test with a threshold of 5%. The question for market definition is whether a price increase of 5% would result in sufficient volume loss to render the price increase unprofitable. It can be seen immediately that key individual issues have been ignored, for example, is the 5% price increase an average, or an across the board increase? Could it be 10% on some products and 0% on others? Could it be 10% on products sold to some customers but 0% on those sold to others?

Then consider 'volume loss.' Assume that the volume loss is small enough that the price increase is profitable. This may be fine for merger review, but those customers that could switch and avoid injury, are a crucial question in class. The 'critical' level of volume loss where the price increase is still profitable can be significant for firms where margins are low.¹⁰ In the class certification stage, these lost customers cannot be ignored as they may represent a significant portion of the class. Additionally, the temptation to conclude 'if they purchased during the class period, then by definition they are not part of the defecting volume' should be resisted. This is a flawed argument that simply assumes harm. Instead, it may be the case that there was in fact no increase in market power for those customers because they were not buying products in the relevant market, or perhaps they were able to use buyer power to prevent the price increase. These are the types of individual inquiries that must take place and that negate the use of market definition conclusions for class wide impact.

Defining Markets In Actual Practice

Further, the process of how markets are actually defined in antitrust raises concerns of using market definition for concluding class wide impact. In practice it is often difficult to find high quality transaction data that can be used to measure elasticities for use in the hypothetical monopolist test. As a result, it is not uncommon for practitioners to use several other sources such as customer surveys, feedback from trade publications, and company documents. These sources can be useful for determining a relevant set of competitors from the perspective of customers, the industry, and the combining firms. If the evidence points to firm B as the primary competitor of firm A, this would raise concern about the potential for some level of market power if the two firms were to merge, and would warrant additional scrutiny, perhaps in the form of a second request. At the end of the process it might be found that the concerns were unfounded in which case the merger would go through, or perhaps a consent decree would allow for remedies, such as the selling of a plant or product line, that would relieve antitrust concerns.

But that type of document based analysis cannot conclude that all of the customers, even if they buy the same type of products from firm A or B, are potentially impacted in common. The documents would only be a piece of evidence that the two firms may compete, and therefore may have the ability to raise prices on some set of customers. It does not follow that they could raise prices on all customers, as

¹⁰ Under critical loss analysis, the lower the profit margin the more volume the firm will tradeoff for a price increase. To see this consider an extreme example where a firm has sales of \$100 million, but profits are 0. Technically, the firm would be willing to sacrifice virtually all their sales for a price increase, provided the remaining sales earn a profit level greater than 0.

would be implied in a litigation context. The documents are simply not likely to be so detailed as to provide a complete picture of all of the customers that may or may not be affected. In fact, if documents did exist that discussed specific customer relationships, it might be that those relationships and pricing arrangements are highly individualized, but the absence of such documents does not imply uniform treatment.

Market Definition Is Not A Substitute for a Direct Test of Impact

A more relevant measure of customer impact is the difference between actual price paid after the anti-competitive act and an estimate of the but-for price that would have paid absent the act. Prices actually paid by class members are often easy to observe but can sometimes be complicated when prices are set by individual negotiations. Listed prices or posted prices may or may not reflect the true price class members pay and, importantly, prices may be similar or may differ substantially from one customer to the next. But-for prices for each customer are often estimated, and again may differ across class members. Customer impact is usually given by the difference between the actual and the but-for price, summed across purchases, but in some cases outcomes other than prices may be of interest as well. For example, reductions in customer choice or quality may also cause harm, whereas price increases combined with quality increases may not.

Market definition used to show common impact avoids actual price analysis by making a series of strong assumptions in its place. In the market definition stage, products, geographical areas, distribution channels, and even potentially groups of customers themselves are each categorized “in” or “out”, sometimes based on aggregate switching behavior or sometimes on qualitative argument alone. That different customers can experience different sets of supply alternatives and different degrees of competition even in the same place or at the same time highlights that the exercise – which ultimately produces a single set of market shares for the entire market – lacks a meaningful degree of precision for common impact.

Importantly, the expert claiming market power must claim that the exercise of market power applies uniformly across the class and would impact *all* or substantially all class members. This is a strong assumption, highlighted by the fact it is based on just a few market share calculations and no information on the prices class members actually paid. The problem is that even though class members differ in many ways – even those lumped together in the relevant market – once they are included in the market, all important differences are assumed away. So as long as market shares are high enough to assume market power, it is purely an assumption that no class member can avoid a price increase.

The uniformity assumption is troubling because it assumes away an important question at the class stage – whether customers’ individual characteristics and circumstances are similar enough that they would all be impacted in common.

Conclusion

Market definition has been proposed as a means for showing common impact among potential class members. The method would define a relevant market, and given a finding of high concentration,

would assume impact for *all* buyers that are in the relevant market. But as discussed above, the process of defining markets is not conducive for a determination of impact. Market definition is an inexact practice, often based on qualitative analysis, that is best used as a means for identifying groups of competitors, and as a preliminary screen for the potential of market power. By assuming impact to the class on the basis of high market shares and assuming that impact is uniform across all customers in the market, the market definition approach to evaluating impact assumes away the very questions that the class certification exercise is meant to answer. Hence, it should not be used and is no substitute for a showing of actual direct effects.