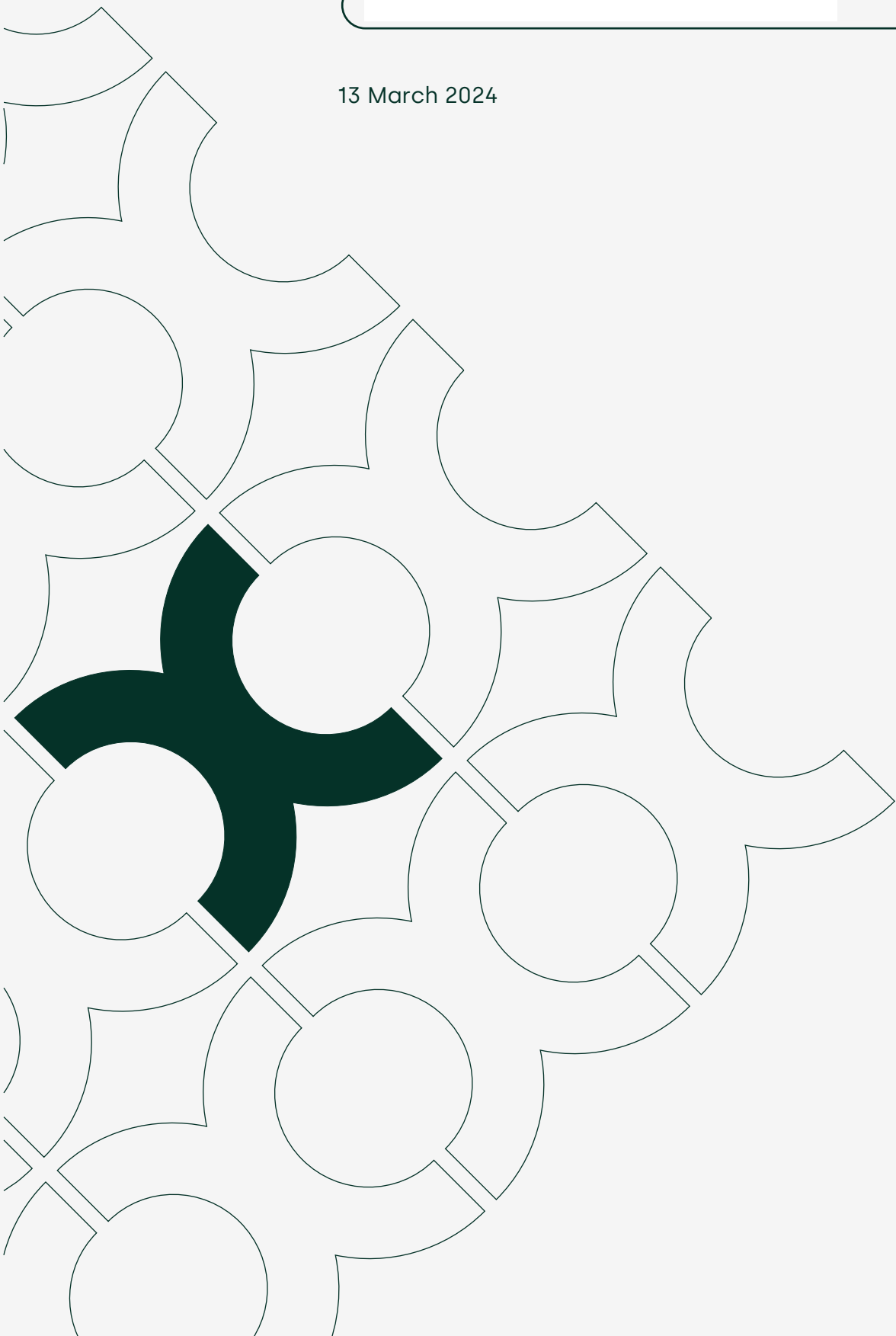


AlphaTheta Corporation/Serato: response to the NERA report



13 March 2024



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1 Executive summary

- 1.1 In support of AlphaTheta Corporation's Clearance Application before the New Zealand Commerce Commission ('the Commission') for its proposed acquisition of Serato, AlphaTheta Corporation retained NERA Economic Consulting ('NERA') to prepare an economic report to show that the transaction would not pose competition concerns. The report prepared by NERA focused on the assessment of the likelihood of unilateral and vertical effects resulting from the transaction. NERA's conclusions were that the merged entity would not be able to unilaterally increase prices or reduce quality, and that it would have neither the ability nor the incentive to vertically foreclose competitors.
- 1.2 In practice, NERA provided little additional evidence over what ATC had already submitted to the Commission. The main arguments in the report were speculative and they relied on debated claims previously made by ATC. Furthermore, despite the limited publicly available evidence, it is clear that the economic analysis performed by NERA does not withstand close scrutiny.
- 1.3 This report evaluates NERA's arguments and presents the main concerns that they raise from an economics perspective.
- 1.4 First, the market shares presented by NERA do not paint an accurate picture of the DJ software market. They overestimate the presence of developers of DJ mobile applications, and they underestimate Serato's market presence. This is because mobile app users of cross-platform developers are counted as part of the DJ desktop software market.¹ Additionally, the inclusion of developers of mobile applications in the relevant market of DJ desktop softwares is not adequately justified.
- 1.5 Second, NERA's claims around product homogeneity and the ability of DJ software providers to reposition their products remain largely superficial and speculative. For example, the addition of more features to one's software is unlikely to be enough to reposition it to the high-end market,

¹ New Zealand Commerce Commission (2024), 'AlphaThetaSerato – Statement of Issues', 7 February, p. 12, para. 56.

as DJs appear to value the quality of the experience and full integration above features alone.²

- 1.6 Third, the evidence presented by NERA and its economic analysis does not rule out an input foreclosure theory of harm (contrary to what NERA suggest in their report). By overestimating the alternatives available to Serato and by drawing speculative conclusions on the switching behaviour of customers, NERA erroneously concluded that the merged firm would not have the ability to engage in an input foreclosure strategy.
- 1.7 The NERA report also does not show that the merged entity would not have an incentive to engage in input foreclosure. []. NERA's analysis is also undermined by two methodological shortcomings: not engaging with partial foreclosure strategies; and the omission of a sizeable additional benefit that the merged firm would stand to gain via an input foreclosure strategy (the subscription fees of Serato users on non-ATC hardware that decide to switch to rekordbox by remapping their current hardware), although this last point requires accepting ATC and NERA's view on MIDI mapping.

² NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 2.2.3, p. 22, para. 80.

2 Introduction

2A Description of the transaction

- 2.1 On 10 October 2023, AlphaTheta Corporation ('ATC') submitted a Clearance Application to the Commission for its proposed acquisition of all shares of Serato Audio Research Limited (henceforth 'Serato'). On 26 October 2023, the Commission published its Statement of Preliminary Issues where it stated that the proposed transaction would be assessed according to the substantial lessening of competition framework set out in its Mergers and Acquisitions Guidelines.³
- 2.2 ATC and Serato are both global firms present in the DJ software segment of the music industry. ATC is also present globally in the DJ hardware segment. The transaction can therefore be described both as a horizontal acquisition, since the parties overlap in the DJ software segment, and as a vertical acquisition, since DJ software and DJ hardware are vertically related products.⁴
- 2.3 As set out in its Statement of Issues released on 7 February 2024, the Commission is currently investigating whether the proposed transaction could substantially lessen competition by giving rise to horizontal unilateral effects in the DJ software market and vertical effects between the software and hardware markets.⁵
- 2.4 At the time of writing, the merging Parties, inMusic Brands, Inc. (henceforth 'inMusic') and other stakeholders have already submitted multiple documents to express their views to the Commission on the proposed acquisition.

³ New Zealand Commerce Commission (2023), 'AlphaThetaSerato – Statement of Preliminary Issues', 26 October, p. 3, para. 11.

⁴ New Zealand Commerce Commission (2023), 'inMusic – Submission in response to Statement of Preliminary Issues', 8 November, chapter II, section s, pp. 10–11.

⁵ New Zealand Commerce Commission (2024), 'AlphaThetaSerato – Statement of Issues', 7 February, pp. 1–2, paras 7–9.

2B Background and instructions

- 2.5 On 28 November 2023, ATC made a Cross-submission to the Commission accompanied by the expert report commissioned from NERA.⁶ The NERA report purports to address the Commission's concerns regarding potential horizontal unilateral and vertical effects stemming from the proposed acquisition.
- 2.6 The NERA report concluded that the proposed acquisition is unlikely to cause horizontal unilateral effects, and it put forward two main arguments in support of this claim.⁷ First, NERA argued that barriers to entry or expansion into the DJ software market are likely to be low.⁸ Second, according to NERA the merged firm is unlikely to unilaterally increase prices, reduce quality and/or reduce innovation due to the substantial competitive pressure exerted by existing players in the DJ software market as well as by players active in adjacent markets: developers of DJ apps for mobile devices, DJ hardware manufacturers, and developers of music production software.⁹
- 2.7 The NERA report also concluded that the merged entity is unlikely to have the ability or the incentive to leverage ownership of Serato to foreclose its rivals in the DJ hardware market. With regard to the ability to foreclose, NERA argued that Serato does not possess substantial market power and that its software is not an essential input. As to the incentive to foreclose, NERA performed a vertical arithmetic exercise designed to estimate the 'critical diversion ratio'—i.e. the proportion of Serato users on non-ATC hardware that would have to switch to ATC hardware for the (full) foreclosure strategy to be profitable. The results of its analysis suggested that the merged firm is unlikely to have the incentive to foreclose suppliers of low-end DJ hardware.¹⁰

⁶ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, https://comcom.govt.nz/__data/assets/pdf_file/0033/336939/NERA-Cross-submission-on-Statement-of-Preliminary-Issues-28-November-2023.pdf. AlphaTheta Corporation/Serato Audio Research Limited, 'Cross-submission by AlphaTheta Corporation in relation to submissions made in response to Statement of Preliminary Issues', https://comcom.govt.nz/__data/assets/pdf_file/0027/336933/AlphaTheta-Cross-submission-on-Statement-of-Preliminary-Issues-28-November-2023.pdf.

⁷ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 2.2.4, p. 22, para. 83.

⁸ *Ibid.*, section 2.1, p. 5, paras 12–15.

⁹ *Ibid.*, section 1, pp. 1–2, paras 4(a)–4(b).

¹⁰ *Ibid.*, section 3.3.2, p. 42, para. 181.

- 2.8 inMusic is a supplier of DJ hardware under three brands. It is also the developer of Engine DJ, a free software embedded in inMusic's all-in-one hardware devices. Since the Commission launched its formal merger inquiry on the transaction, inMusic has made a number of submissions to raise its concerns around the anticompetitive effects raised by the merger between ATC and Serato. On 12 December 2023, inMusic filed a submission to the Commission responding to a number of the arguments made in the NERA report on the basis of factual evidence. inMusic has also rebutted in detail the evidentiary base and arguments put forward by ATC (as reported in publicly available documents from the case register), when it considered that such evidence did not provide a correct representation of the reality of the market.
- 2.9 Oxera has been engaged to provide an economic assessment of the arguments and analysis presented in the NERA report. Oxera's assessment takes full account of the evidentiary base presented by inMusic in previous submissions and, where necessary, presents new evidence necessary for supporting the economic arguments.

2C Introduction to Oxera

- 2.10 Oxera is a leading European economics consultancy with offices in Amsterdam, Berlin, Brussels, Hamburg, London, Milan, Oxford, Paris and Rome. Established in 1982, Oxera has a reputation for independence, integrity and analytical excellence among companies, policymakers, regulators and lawyers.
- 2.11 Oxera has a long history of advising firms involved in complex merger cases, encompassing unilateral, coordinated and vertical theories of harm. Oxera's economists have advised clients in merger filings before the European Commission and the Competition and Markets Authority in the UK, as well as across a number of other jurisdictions globally.

3 Response to the assessment of unilateral effects in the NERA report

- 3.1 NERA made an attempt to address the unilateral concerns laid out in the Statement of Preliminary Issues at a very general level. Its report makes two overarching arguments in support of its claim that a unilateral price increase or quality reduction will be unlikely post merger. First, along the lines of what was argued in ATC's Clearance Application, NERA argued that barriers to entry or expansion into the DJ software market are low. Second, it makes the case that the merged entity would face significant competitive constraints from existing desktop DJ software developers as well as from mobile app providers, DJ hardware providers and music production software providers that could, in its view, easily enter the DJ software market.¹¹
- 3.2 Notably, NERA did not adequately discuss the closeness of competition between the DJ software offerings of the merging Parties. Closeness of competition is a crucial economic parameter for the assessment of horizontal mergers, as shown by economic theory and case law alike.¹² The only mention of closeness of competition is made in paragraphs 71 and 82 of the report, where NERA writes that 'Serato and rekordbox are closely-positioned'.¹³
- 3.3 This section addresses the arguments in the NERA report, first by explaining (in section 3A) why the market shares relied upon by NERA are inadequate and underestimate the position of the entity resulting from the merger in the DJ software market; and second by addressing (in section 3B) the superficial and speculative nature of the discussion around the alleged homogeneity of DJ software packages.

¹¹ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, pp. 1–2, para. 4(b).

¹² New Zealand Commerce Commission (2022), 'Merger and acquisitions Guidelines', May, section 3.3.1.

¹³ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, sections 2.2.2–2.2.3, pp. 21–22, paras 71 and 82.

3A The market shares presented by NERA do not paint an accurate picture of the DJ software market

3A.1 NERA's market shares overestimate the market presence of developers of DJ mobile applications

3.4 The NERA report makes reference to two sets of market shares initially presented by ATC in previous submissions: the first is estimated based on a market that includes both DJ desktop software and mobile apps, and results in Serato being the sixth-largest player;¹⁴ the second set relies on a market that includes only DJ software, and results in Serato being the second-largest player, after Algoriddim. In NERA's view, these market shares indicate that Serato is not a 'must-have' DJ software, since a 'must-have' DJ software would be used by the majority of users.¹⁵

3.5 The market shares referred to by NERA present a diluted view of Serato's and rekordbox's position. First, despite itself indicating that DJ software and mobile apps do not exert a competitive constraint on each other, NERA makes reference to market shares that include both DJ software and mobile apps. Second, the DJ software-only market shares reported by NERA include both DJ software and mobile app sales of cross-platform players, thereby overestimating their market presence.

3A.2 No adequate justification for the inclusion of developers of mobile applications

3.6 The NERA report makes reference to market shares that include mobile applications only in passing. However, in doing so, it implies that DJ software and mobile apps could be considered part of the same market.

3.7 The NERA report is somewhat vague with respect to market definition, which it does not address explicitly. However, in light of ATC's submissions explicitly suggesting that mobile apps are part of the same relevant market as DJ software,¹⁶ the inclusion in the NERA report of market shares

¹⁴ These shares are taken directly from AlphaTheta Corporation (2023), 'Serato Clearance Application', 10 October, section 6.8, pp. 26–27.

¹⁵ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, p. 34, para. 146.

¹⁶ According to ATC, 'there is a high degree of demand-side substitutability between' specialist DJ desktop software applications and DJ Apps designed for mobile devices. (AlphaTheta Corporation (2023), 'Serato Clearance Application', 10 October, p. 19, para. 5.25).

both including and excluding mobile apps appears to be implicitly attempting to keep the door open to ATC's argument.

- 3.8 ATC, however, did not provide any substantive evidence showing that DJs would switch from desktop software to mobile apps, and indeed NERA suggests that mobile applications would not be suitable for all groups of players. Further, according to the NERA report it is reasonable to '[...] expect the merged entity's desktop products to face more competitive constraints from other desktop developers than from mobile-only developers'.¹⁷
- 3.9 The Commission has also concluded that 'apps do not appear to be sufficiently close substitutes for laptop applications to be included in the relevant product market' in its Statement of Issues.¹⁸
- 3.10 inMusic has presented evidence from the Digital DJ Tips 2023 Global DJ Census¹⁹ showing that only 1.53% of its respondents use mobile apps,²⁰ which suggests that mobile apps are not a good substitute for desktop software applications, since their usage is low among DJs.
- 3.11 ATC dismissed the Digital DJ Tips Global DJ Census because it considered that the share of mobile app users from the Census was substantially lower than the share of mobile users of ATC's DJ software Apps (rekordbox and WeDJ), measured on ATC's own data. On this basis, ATC concluded that this survey was not representative of the global population of DJs.²¹ ATC therefore turned to an alternative data source which, in its view, provided a more representative picture of the market.
- 3.12 There are a number of reasons to be sceptical of ATC's criticism of the Digital DJ Tips Global DJ Census.
- 3.13 First, ATC's main ground for dismissing the survey implicitly assumes that the distribution of mobile app usage among ATC users is reflective of the global distribution across the entire population of DJs. However, there is

¹⁷ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, p. 29, para. 108.

¹⁸ New Zealand Commerce Commission (2024), 'AlphaThetaSerato – Statement of Issues', 7 February, p. 4, para. 26.

¹⁹ The biggest DJ survey of its kind, conducted every year since 2014 by Digital DJ Tips. In 2023 the survey had almost 20,000 respondents from all over the globe.

²⁰ Digital DJ Tips 2023 Global DJ Census, p. 29.

²¹ AlphaTheta Corporation (2023), 'Serato Clearance Application', 10 October, section 6.9(a), p. 27.

no reason why this should be the case. On the contrary, the survey reflects the opinion of DJs who are committed to the activity, as opposed to occasional users.

- 3.14 The survey was prepared by a reputable institution within the DJ industry, which is explicitly advertised on Serato's website and is financed by a number of DJ hardware manufacturers including Pioneer DJ.²² According to Serato's website, Digital DJ Tips is a 'global DJ school with 36,000 students in 163 countries [that] runs Europe's biggest DJ technology website, DigitalDJTips.com',²³ and the survey is addressed to the entire community of DJs focused around the Digital DJ Tips school.²⁴
- 3.15 Second, ATC may have overestimated the share of mobile app users among its customers, which is based on counts of Monthly Active Users ('MAUs') of mobile apps and desktop software. MAU counts are, however, prone to overestimating the number of users of mobile apps, if many users access them sporadically and do not use the app as a primary platform.²⁵ This point is particularly problematic considering that the acquisition of rekordbox and WeDJ desktop software apps gives automatic (and free) access to the mobile app version of these two software packages, so we would expect that at least some users (who primarily use the DJ desktop software) occasionally try the free version of the mobile app.²⁶
- 3.16 Finally, even if one were to consider that the Digital DJ Tips Global DJ Census was unrepresentative (which, for the reasons indicated above, ATC's arguments as submitted so far have not demonstrated) because perhaps it is too focused on older, more experienced DJs²⁷ who are less likely to use mobile apps, the survey would still be informative for the assessment of vertical effects (which we discuss more in detail in section 4): experienced DJs are more likely to purchase DJ hardware, and they are

²² Digital DJ Tips 2023 Global DJ Census, p. 2.

²³ Serato, 'Digital DJ Tips', <https://serato.com/certified-dj-schools/digital-dj-tips>.

²⁴ 'As a leading global DJ school, every year here at Digital DJ Tips we conduct a unique survey with you, our community. We take a snapshot of your DJing, the gear you use, your favourite software and music, your aspirations, and more.' (Digital DJ Tips, 'Here Are The Results From Our 2023 Census, The Biggest DJ Survey In The World', <https://www.digitaldjtips.com/here-are-the-results-from-our-2023-census-the-biggest-dj-survey-in-the-world/>).

²⁵ MAUs stay the same if users log in only once a month or every day of the month. These are two drastically different levels of engagement that would not be reflected in MAU numbers.

²⁶ As made clear in the description of its subscription plans and in the FAQ page on its website, a rekordbox.com subscription grants users access to the mobile app version at no additional cost. A separate in-app subscription is available to unlock extra features (see rekordbox, 'Plans & pricing', <https://rekordbox.com/en/plan/>; and rekordbox, 'FAQ', <https://rekordbox.com/en/support/faq/in-app-subscription-ios/>).

²⁷ This criticism is presented by ATC in the AlphaTheta Corporation Serato Clearance Application, p. 28, para. 6.11.

therefore the ones who are likely to engage with DJ hardware manufacturers in the downstream market. Experienced DJs are also more likely to purchase high-end DJ hardware,²⁸ and this is the portion of the population that NERA identified as being more prone to vertical foreclosure.²⁹

3A.3 NERA's estimated shares underestimate Serato's market presence

- 3.17 The fact that Algoriddim is indicated as the largest player [] is surprising.³⁰ Algoriddim is a successful developer of DJ Mobile Apps and, since its entry into the DJ desktop software segment, it has gained limited traction.³¹ In its submission of 12 December 2023, inMusic has already addressed this argument, highlighting the discrepancy between NERA's figures and those in the 2023 Global Census.³²
- 3.18 The likely explanation for this result is a bias in the methodology that ATC applied for the estimation of market shares. When calculating these shares, for players that are only active in the DJ desktop software segments ATC only included sales in this segment, whereas for players that are active in both DJ desktop software and mobile apps (which include Algoriddim, but also rekordbox/WeDJ and CrossDJ/Mixvibes), ATC included sales from both segments.³³
- 3.19 As the Commission also acknowledges in the Statement of Issues, '[t]hese numbers [i.e. sales including both desktop applications and mobile apps] will likely underestimate the market share of the Parties on a laptop application only market, since the figures for some players (such as djay) will include app users'.³⁴

²⁸ Digital DJ Tips 2023 Global Survey, p. 32.

²⁹ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.2, p. 40, para. 174.

³⁰ Ibid, section 2.2, p. 15, para. 59.

³¹ See the 2023 Digital DJ Tips Global DJ Census, p. 40. None of the respondents indicated that Algoriddim was a software that they use to DJ. Even assuming that ATC's criticism that the Digital DJ Tips Global DJ Census is biased towards more experienced DJs, the survey shows at a minimum that Algoriddim is not a suitable substitute for the group of DJs that are likely to use high-end pieces of hardware.

³² New Zealand Commerce Commission (2023), 'inMusic – Cross-submission on Statement of Preliminary Issues', 12 December, section III(c)(ii), p. 9.

³³ The NERA report acknowledges this explicitly, where it clarifies that the reported shares are estimated '[...] retaining the cross-platform developers **including the proportion of their share contributed by mobile apps.**' (emphasis added). See NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 2.2, p. 15, para. 59.

³⁴ New Zealand Commerce Commission (2024), 'AlphaThetaSerato – Statement of Issues', 7 February, p. 12, para. 56.

3.20 To exemplify why this is the case, Table 3.1 below reports a worked example in which, for simplicity, it is assumed that only one of the competitors is active across platforms. Because only one competitor is active across platforms, only that competitor has sales in both columns. In line with the reality of Algoriddim (which is a successful mobile player with limited experience and success in the desktop segment) the mobile apps sales of the cross-platform player are substantially larger than the DJ desktop software sales. The last two columns of the table report the market shares resulting from this hypothetical example, including and excluding sales of mobile apps.

Table 3.1 Worked example on the inclusion of mobile apps sales to estimate market shares

Competitors	Sales (MAUs)			Market shares (%)	
	DJ desktop software	Mobile apps	Total	Excl. mobile apps	Incl. mobile apps
Cross-platform competitor	500	5,000	5,500	3%	24%
Desktop software-only competitor 1	5,000	0	5,000	29%	22%
Desktop software-only competitor 2	2,000	0	2,000	11%	9%
Other software-only competitors	10,000	0	10,000	57%	44%
Total	17,500	5,000	22,500	100%	100%

Source: Oxera

3.21 The worked example reported in the table shows how the inclusion of mobile apps sales can have a material impact on the market shares: the cross-platform competitor (which is a minor player in the DJ desktop software) becomes the largest player if sales of mobile apps are included; and the market position of the two largest players in the desktop software segment are artificially diminished (their combined market shares decrease from 40% to 31%).

3.22 As we do not have access to the data relied upon by NERA and to the methodology that NERA applied for the estimation of the market shares, we acknowledge that there may be other explanations for the discrepancy

of the shares against inMusic's expectations. We note, however, again that the data available in the Digital DJ Tips 2023 Global Survey indicates that Serato DJ is the most popular software with a global market share of 32.92%, closely followed by rekordbox (28.16%).³⁵ As explained above, we do not consider that ATC's *a priori* dismissal of the Digital DJ Tips 2023 Global Survey is appropriate; instead, further investigation of market shares is required and the representation of the market presented by NERA should not be accepted as is.

3B NERA's arguments around product homogeneity and the ability of DJ software providers to reposition are superficial and speculative

- 3.23 NERA argued that desktop software programs are 'relatively homogeneous' and that 'there is little variation in the functionality of different desktop software products'.³⁶ At the same time, it made the point that 'software can be differentiated based on price and pricing structure'.³⁷ However, according to NERA, the different price positioning of the various software packages is purely due to marketing activity, as a result of which some products (most notably Serato and rekordbox) are positioned as 'premium' and others are perceived as more 'basic'.³⁸
- 3.24 According to this reasoning, when presented with the choice between two products that are in principle the same, DJs decide to purchase the more expensive option as a result of advertising. The NERA report does not articulate why this would be the case.
- 3.25 As a matter of economics, this reasoning is difficult to accept: DJs are experienced users, they are informed about the details of the functionalities and performance of the various options available (a point that the NERA report also acknowledges),³⁹ and they are part of a community where users exchange experiences and information. As such, it is unlikely that DJs would be willing to simply decide to pay a higher price for a piece of software if equivalent (and cheaper) options were available.

³⁵ Digital DJ Tips 2023 Global Survey, p. 40.

³⁶ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, p. 16, section 2.2.1, para. 62.

³⁷ *Ibid.*, section 2.2.2, p. 20, para. 68.

³⁸ *Ibid.*, section 2.2.2, p. 21, para. 71.

³⁹ *Ibid.*, section 2.1.2.1, p. 11, para. 34.

- 3.26 In essence, as inMusic has already explained in its Cross-submission of 12 December 2023, the NERA report and ATC's previous submissions focus exclusively on functionalities and disregard differences in quality and performance between different software solutions. For some DJs, quality is of paramount importance and this is the likely driver of certain products being preferred and the enabler of the observed price differences. As we explain in section 4A.3 below, this is most likely to be the case for DJs who operate a DJ software in conjunction with DJ hardware.
- 3.27 For these DJs, it is also unlikely that the mere addition of new features to lower-end software packages is sufficient to persuade them to switch.⁴⁰ Investment in quality and full integration with main DJ hardware is also necessary to potentially convince DJs to change their preferred software.
- 3.28 For these reasons, the argument in the NERA report and ATC submissions, that other DJ software providers could easily and quickly reposition their products as a result of rebranding or a minor addition of features, appears to be speculative. These pieces of software and eventually new features need to be well developed and work seamlessly with hardware, and then they need to be tested and approved by the market. This is a process that is unlikely to be actionable in a short period of time and at low cost.

⁴⁰ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 2.2.3, p. 22, para. 80.

4 The evidence presented in the NERA report does not rule out an input foreclosure theory of harm

4.1 NERA's report addresses both vertical concerns in the Statement of Preliminary Issues: foreclosure of other DJ hardware suppliers (input foreclosure), and foreclosure of other DJ software suppliers (customer foreclosure). In this report we focus exclusively on input foreclosure, because the available evidence suggests that it is unlikely that the Parties would have the ability to engage in customer foreclosure post merger, as both ATC and inMusic make clear in their submissions.⁴¹

4A The evidence in the NERA report does not exclude the ability to engage in input foreclosure

4.2 NERA's assessment of the ability to foreclose focuses on attempting to demonstrate that Serato is not a 'must-have' input for inMusic and other hardware manufacturers and that, in the event that ATC foreclosed access to Serato, other hardware manufacturers could switch to other available alternatives.

4.3 NERA's assessment of Serato not being a 'must-have' software package hinges primarily on three arguments: (1) Serato's market shares do not suggest that Serato is a 'must-have product';⁴² (2) there are existing alternatives to Serato;⁴³ and (3) if ATC were to foreclose access to Serato, other players would expand into the DJ software market and create alternatives.⁴⁴

4.4 The evidence relied on in the NERA report to reach these conclusions does not appear to be sufficient to conclude that, post merger, ATC would not have the ability to foreclose competitors in the DJ software market. inMusic's submission of 12 December 2023 explains clearly why the NERA report relies on evidence that is often incomplete, partial or incorrect. We

⁴¹ New Zealand Commerce Commission (2023), 'inMusic, Cross-submission on Statement of Preliminary Issues', 12 December, section III(e), p. 12. New Zealand Commerce Commission, 'AlphaTheta Corporation – Serato Clearance Application', section 7.34, p. 43.

⁴² NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.1, p. 34, para. 146.

⁴³ *Ibid.*, section 3.3.1, p. 35, para. 148.

⁴⁴ *Ibid.*, section 3.3.1, p. 36, para. 150.

do not repeat those points here. This section focuses on the following three additional problematic elements of the NERA analysis.

- First, NERA's market shares underestimate Serato's market presence. This leads to a failure to recognise the market power that ATC would hold in the DJ software market post merger, and that ATC could exploit to engage in vertical foreclosure. Since this argument is already addressed elsewhere in this report (see section 3A.3), we do not discuss it further in this section.
- Second, NERA's analysis of available alternatives does not appropriately take into account the role of quality in relation to product differentiation and the constraints on hardware–software compatibility, leading to an incorrect assessment of the competitive constraints faced by rekordbox and Serato.
- Third, NERA's argument that DJs would not switch hardware due to its high cost relative to software is based on an incomplete assessment of the facts.

4A.2 NERA overestimates the alternatives available to Serato

4.5 According to the NERA report, the merged entity's pricing and quality decisions would continue to be constrained by existing alternative desktop DJ software packages, which it deems to be relatively homogeneous. Since desktop DJ software products have several overlapping features and their user interfaces are often laid out in a similar fashion, NERA concludes that there is little differentiation among competing options.⁴⁵

4.6 Further, NERA argued that mobile DJ software offerings would further constrain the merged firm's ability to raise prices or lower quality. According to the NERA report, 'quality differences between desktop and mobile apps do not appear to be material' and 'switching costs [...] are minimal',⁴⁶ meaning that DJs could comfortably make the desktop-to-mobile switch.⁴⁷

⁴⁵ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 2.2.4, p. 22.

⁴⁶ Ibid., section 2.3.1, p. 23.

⁴⁷ This statement is, however, inconsistent with NERA's own view that 'there is more differentiation between desktop and mobile software than between different pieces of desktop software' and that it expects the 'merged entity's desktop products to face more competitive constraints from other desktop developers than from mobile-

- 4.7 Based on the same premise, NERA also suggests that the merged firm will face a high degree of supply-side substitution as mobile DJ app providers could easily develop their own desktop software.⁴⁸ In a similar vein, it affirmed that DJ hardware manufacturers and music production software developers would have the incentive and the ability to create their own desktop offering in response to a price increase or quality decrease.⁴⁹
- 4.8 NERA's arguments rely on two key premises: (1) software features are the only (or the primary) determinants of software choices; and (2) any DJ software can be seamlessly integrated with any DJ hardware. Neither of these two premises is justified explicitly in the NERA report, but a detailed assessment of their validity is necessary for a correct assessment of ability to foreclose.
- 4.9 Regarding the first premise, an important element missing from the discussion in the NERA report is whether quality plays a role in creating a degree of differentiation between software solutions, as we have already discussed in detail in section 3C above.⁵⁰ In particular, functions and look may render DJ software packages homogeneous in the eyes of beginner DJs. For these users, who are less likely to use high-end DJ hardware, it may also be true that mobile apps can be a reasonable substitute for DJ desktop software packages. However, for experienced DJs, who are also more likely to perform in public, quality and (in particular) seamless integration of the chosen DJ hardware are likely to be as important as software functionalities.
- 4.10 The Digital DJ Tips 2023 Global Survey indicates that the main determinants for a DJ hardware purchase decision are quality and durability.⁵¹ As such, a user of DJ hardware is unlikely to switch to a DJ software with imperfect integration with the hardware if there is a risk that doing so will impair the quality of its work. Similarly, a DJ using software in combination with hardware will consider switching to a mobile app only if that guarantees a comparable level of performance.

only developers'. NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 2.3.5, p. 29, para. 108.

⁴⁸ Ibid., section 2.3.5, p. 29.

⁴⁹ Ibid., sections 2.3, 2.4 and 2.4, pp. 23–32.

⁵⁰ Horizontal differentiation refers to product differentiation that is not related to the product's quality or price. However, vertically differentiated products show concrete differences in prices and/or quality traits.

⁵¹ Digital DJ Tips 2023 Global Survey, p. 39.

- 4.11 This is why the second premise (ability to integrate seamlessly any DJ software with any DJ hardware) is important. In a hypothetical foreclosure scenario post merger, DJs using non-ATC hardware and relying on Serato could switch to alternative software only if the other software packages available in the market can function well with their hardware.
- 4.12 The NERA report does not address this point, and it appears to implicitly rely on ATC's view that the MIDI standard ensures that any MIDI-compatible software can be easily mapped to work with any piece of hardware that uses the MIDI protocol.⁵²
- 4.13 While MIDI compatibility does provide a certain level of interoperability with hardware, inMusic has explained in its submission that compatibility is different from integration: *compatibility* allows, in principle, any software to work with any hardware, but the outcome of such integration may be imperfect;⁵³ *integration* is the result of close collaboration between the software provider and the hardware manufacturer, to achieve the highest-quality outcome.⁵⁴ inMusic's views align with the stance taken by the Commission, which concludes that it is still 'unclear whether "MIDI-mapping" bypasses the need for integration'.⁵⁵
- 4.14 inMusic's experience of working closely with Serato to guarantee integration shows that achieving full integration is a complex and lengthy process.⁵⁶ Since different pieces of hardware are fully compatible with only a few software packages, DJs that had to switch away from Serato following foreclosure would have limited option (if any) to achieve the same level of performance with the existing hardware.

4A.3 The cost of hardware would not prevent switching

- 4.15 The NERA report states that, because of the high cost of DJ hardware, DJs will prefer to switch to a different software rather than change hardware

⁵² AlphaTheta Corporation (2023), 'Serato Clearance Application', 10 October, section 7.7, p. 37.

⁵³ New Zealand Commerce Commission (2023), 'inMusic – Cross-submission on Statement of Preliminary Issues', 12 December, section II(d), pp. 3–4.

⁵⁴ New Zealand Commerce Commission (2023), 'inMusic – Submission in response to Statement of Preliminary Issues', 8 November, sections II(i)-(vi), III(c)(i)(4)(a) and III(d).

⁵⁵ New Zealand Commerce Commission (2024), 'AlphaThetaSerato – Statement of Issues', 7 February, p. 27, para. 101.

⁵⁶ New Zealand Commerce Commission (2023), 'inMusic – Submission in response to Statement of Preliminary Issues', 8 November, sections II(s)(ii) and III(d).

in a hypothetical event of foreclosure.⁵⁷ However, this result is unlikely to hold if, as discussed above, the two premises underlying NERA's analysis do not hold.

- 4.16 Faced with an inability to achieve a similar level of quality and stability with existing non-integrated software packages, some DJs may not have any option other than to switch to a fully integrated software-hardware solution provided by ATC, which would be the safest alternative available, regardless of the cost of purchasing the new hardware. The DJs who are most likely to switch are the professional ones, who often play their music in public and for which quality and reliability are paramount features. These DJs are also the ones that are most likely to purchase more expensive DJ hardware, and therefore they are the least price-sensitive (and most profitable) group of customers.
- 4.17 Once they have switched to Pioneer DJ, these DJs are unlikely to wish to switch again to other hardware brands, to avoid incurring the cost of changing hardware again. This would harm non-ATC hardware manufacturers considerably since, as explained above and discussed more in section 4B, the customers who would switch are the most profitable customers of DJ hardware manufacturers.
- 4.18 DJs with lower requirements may try to continue using the existing hardware with sub-optimal alternative software packages. However, in the medium term, they may find it preferable to switch to ATC hardware. This could happen, for example, when they improve their skills and decide to upgrade to higher-functionality systems, or as part of the regular replacement cycle of their hardware. The 2023 Global DJ Census reports that 70% of respondents were planning to upgrade their set-up in the next 12 months.⁵⁸ Although it is unclear whether these DJs intended to upgrade their software or hardware, it seems unlikely that the proportion that were intending to upgrade their hardware was negligible.

⁵⁷ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.2, pp. 41–42, para. 179.

⁵⁸ Digital DJ Tips 2023 Global Survey, p. 33.

4B The vertical arithmetic presented in the NERA report does not demonstrate that there is no incentive to engage in input foreclosure

- 4.19 To assess whether the merging parties have an incentive to foreclose other hardware manufacturers by foreclosing access to Serato, NERA conducted a vertical arithmetic analysis.⁵⁹
- 4.20 In this exercise, NERA found that it would, in principle, be more profitable for the merged entity to engage in vertical foreclosure in the high end of the market (identified as pieces of hardware with Serato Pro included).⁶⁰ This is because margins for high-end DJ hardware products are higher and therefore fewer consumers need to switch in order for foreclosure to be profitable.
- 4.21 NERA concluded, however, that foreclosure of customers in the high-end segments is difficult, because DJs would probably switch software instead of purchasing new expensive pieces of hardware and because, in any event, high-end pieces of hardware usually have embedded software.⁶¹
- 4.22 NERA also concluded that customers of lower-end hardware are unlikely to switch to Pioneer DJ hardware when they could switch software at a much lower monetary cost. Its explicit assumption here is that Serato users on non-ATC hardware must be relatively price-sensitive customers precisely because they elected not to purchase ATC equipment, the most expensive option on the market.⁶²
- 4.23 As discussed above in paragraph 4.16, the fact that software packages are cheaper does not automatically imply that most DJs would decide to switch software instead of hardware. In fact, it is likely that customers demanding seamless software integration and first class quality would be forced to change their physical equipment.

⁵⁹ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.2, p. 38.

⁶⁰ Ibid., section 3.3.2, p. 40, para. 174.

⁶¹ Ibid., section 3.3.2, p. 42, paras 180–181.

⁶² NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.2, pp. 41–42, para. 179.

- 4.24 Contrary to NERA's discussion, therefore, the vertical arithmetic analysis shows that ATC could indeed have an incentive to foreclose after having acquired Serato.
- 4.25 Further, the vertical arithmetic analysis relied on by NERA considers only an extreme scenario of total foreclosure, when in fact ATC could find it profitable to engage in more nuanced forms of partial foreclosure, which could eventually lead (in the medium/long term) to total foreclosure.⁶³

4B.1 The results of NERA's own vertical arithmetic indicate incentives to foreclose

- 4.26 The NERA report estimates a range of critical diversion ratios for different hardware categories and different price levels.⁶⁴ When we compare these critical diversion ratios with the estimated actual diversion from hardware competitors to ATC, [].
- 4.27 With the market shares for the DJ hardware market presented in the NERA report,⁶⁵ it is possible to construct estimates of what the actual diversion from competitor X to Pioneer DJ would be in a case of input foreclosure. We do this by calculating the diversion ratios implied by the market shares in the downstream market (i.e. the DJ hardware market) using the following formula:⁶⁶

$$D_{X-ATC} = ATC / (1 - MS_X)$$

- 4.28 Note that this formula implicitly assumes that the diversion to ATC would be proportional to its market share.
- 4.29 Figure 3.3 of the NERA report presents market shares by sales for the US DJ hardware market.⁶⁷ For the purpose of this calculation we assume, as NERA has done, that these market shares are representative of global market shares, even though we are aware that it is an approximation.

⁶³ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.2, p. 33, para. 138.

⁶⁴ Ibid., p. 41, Table 3.4.

⁶⁵ Ibid., p. 44, Figure 3.3.

⁶⁶ Valletti, T. and Zenger, H. (2021), 'Mergers with Differentiated Products: Where Do We Stand?', *Review of Industrial Organization*, **58**, p. 5.

⁶⁷ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, p. 44, Figure 3.3.

4.30 []⁶⁸ []⁶⁹

4.31 Additionally, we assume that the merged entity would decide to foreclose only Rane, Denon DJ and Numark, the three largest DJ hardware brands owned by inMusic. Finally, we assume, as NERA has done, that after the input foreclosure strategy is implemented there would be no switching to rekordbox. This is a conservative approach that will underestimate ATC's incentive to foreclose, as we explain in more detail in section 4B.3.

4.32 Given these assumptions, the estimated actual diversion ratios to Pioneer DJ implied by its market shares are the ones reported in the table below.

Table 4.1 Estimated actual diversion to Pioneer DJ implied by its market shares, as calculated by Oxera

Diversion ratios to Pioneer DJ implied by its market shares	2021	2022	2023

Source: Oxera calculations based on Figure 3.3 of the NERA report.

4.33 []⁷⁰ []

Table 4.2: Critical diversion ratio results for foreclosing DJ hardware suppliers, as calculated by NERA

Product category	Unit weighted average	Using the most expensive product	Using the cheapest product
All hardware category			
All-in-one			
Controller			
2 DJ player + mixer			
Mixer			

⁶⁸ []

⁶⁹ []

⁷⁰ []

4.34 As explained in the NERA report,⁷¹ actual diversion ratios that are higher than the critical diversion ratios estimated in the vertical arithmetic exercise would imply that ATC would have the incentive to foreclose its biggest rival inMusic after the transaction. [].

4B.2 NERA's analysis did not consider a partial foreclosure strategy

4.35 Vertical arithmetic is often applied in the assessment of vertical mergers, primarily because it is the simplest form of quantitative analysis of vertical mergers.⁷² Simplicity, however, comes at the cost that this analysis tests only for total foreclosure, meaning a situation where the upstream arm of a vertically integrated form stops supplying competitors to its downstream arm. However, it is often the case that, post merger, the vertically integrated entity will find it profitable to engage in more nuanced partial foreclosure, in the form of a price increase or a reduction in quality that is intended to raise rivals' costs in the downstream market.⁷³

4.36 In the case at hand, partial input foreclosure could take various forms. ATC could increase royalty fees charged on hardware supporting Serato; it could stop providing regular software updates on competitors' platforms; or it could stop investing in high-quality integration between Serato and non-ATC hardware.

4.37 Partial foreclosure may not have an immediate impact on existing users, but it would have two medium-term effects. First, new users, anticipating that the quality of integration between inMusic and Serato will be impaired in the future, may decide not to purchase inMusic products; and second, existing users, when deciding to upgrade or replace their existing hardware, may switch to ATC instead of continue using inMusic hardware.

4.38 As explained in section 4A.3 above, low-end users may care less about quality, and they may decide to keep using inMusic or eventually switch to other low-end competitors, but high-end users (primarily professional DJs) are likely to gradually switch to ATC. As indicated in the NERA report, these

⁷¹ Ibid., section 3.3.2, p. 39, para. 160.

⁷² Salop, S.C. (2018), 'Invigorating vertical merger enforcement', *The Yale Law Journal*, pp. 1962–1994.

⁷³ Ibid.

are the most profitable users, and account for [] of inMusic's DJ hardware revenues.⁷⁴

- 4.39 Alternatively (or in conjunction with the degradation of service), ATC may negotiate higher royalty payments with inMusic for the supply of Serato. Due to the lack of equally high-quality alternatives,⁷⁵ higher royalties for Serato would reduce inMusic's competitiveness.
- 4.40 Following the price increase, inMusic would be forced to either increase the price of the bundled hardware/software offer, or absorb a reduction of its margins, which would affect its ability to invest in new products. Either option would damage its position in the market.
- 4.41 As discussed in section 4A.2, collaborating with DJ software providers to develop deep integration with an alternative software is a time-consuming activity, and market acceptance of the new software may also require time.⁷⁶ As such, even assuming that it is technically possible and financially viable to develop alternative software–hardware integration, by the time the software is on the market it is likely that ATC will have cemented its incumbency position even further. Of course it is also possible that the new software would never be fully 'accepted' by the market, as was the case for Engine and Virtual DJ.
- 4.42 The assessment of the incentives to engage in input foreclosure requires more sophisticated methods than vertical arithmetic.⁷⁷ [].

⁷⁴ Figure based on inMusic's internal data.

⁷⁵ See para. 3.28 above and also inMusic's Cross-submission on Statement of Preliminary Issues of 12 December 2023, section II(d), pp. 3–4.

⁷⁶ Based on InMusic's understanding of the market, there has been remarkably little change in the DJ software market in the last 20 years. At one point, Serato and Traktor were the dominant players, but Traktor lost ground. Virtual DJ has been around since 2003 but it has never been accepted by professional DJs in the same way as Serato has. Algoriddim has been around since 2006 but, as noted above, it still holds very little market share. inMusic launched Engine a few years ago but has also obtained very little market share. The only successful software to launch and gain significant market share is rekordbox, which was launched in 2009, but it cannot be ignored that rekordbox had Pioneer DJ's established brand reputation and resources behind it. In short, no one other than market-leader Pioneer DJ has been able to gain market acceptance for new DJ software in the last 15 years.

⁷⁷ More complex and accurate models to assess (partial) foreclosure incentives include vGUPPI models, bargaining leverage models, and full-blown merger simulations. (Zenger, H. (2020), 'Analyzing Vertical Mergers', *CPI Antitrust Chronicle*, October.)

4.43 After setting out the results of the vertical arithmetic analysis, the NERA report presented arguments to explain why total foreclosure would not be successful.⁷⁸

4B.3 The vertical arithmetic results do not consider switching towards rekordbox

4.44 NERA's vertical arithmetic implicitly assumes that, if Serato were to be made incompatible with non-ATC hardware, Serato users on non-ATC hardware would either switch to a competitor's software or buy ATC hardware and keep using Serato on their new ATC hardware. Therefore, the merged entity's gains from the (full) foreclosure strategy would be ATC hardware sales and subscription fees from Serato users who converted to ATC hardware.⁷⁹

4.45 With its approach, NERA is dismissing any switching from Serato to rekordbox of DJs wishing to retain their existing hardware (e.g. inMusic). This is in contrast to ATC's own view, according to which 'the paid version of rekordbox can be used with all of ATC's competitors' hardware that operate using the MIDI standard', a process deemed easy enough by ATC to make it a valid option for most consumers (which inMusic disputes, as explained in its Cross-submission on Statement of Preliminary Issues of 22 November 2023).

4.46 If NERA agrees with ATC's position on MIDI mapping and considers that the switch to rekordbox is possible, the merged entity would stand to gain an additional benefit from foreclosure: the subscription fees of Serato users on non-ATC hardware who decide to switch to rekordbox by remapping their current hardware. This assumes that the non-ATC equipment used by these DJs complies with the MIDI protocol, which ATC believes to be the case. Indeed, in the Clearance Application, ATC states that 'most DJ hardware manufacturers use the MIDI standard and many are starting to use HID (which is complementary to MIDI)'.⁸⁰

⁷⁸ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.2, pp. 41–42, paras 179–181.

⁷⁹ NERA Economic Consulting (2023), 'AlphaTheta Corporation/Serato: unilateral effects and foreclosure theories of harm', 27 November, section 3.3.2, pp. 38–39, para. 164.

⁸⁰ AlphaTheta Corporation (2023), 'Serato Clearance Application', 10 October, p. 33, section 6.23.

4.47 The responses to the 2023 Global Census survey []⁸¹ suggest that the diversion towards rekordbox would not be negligible. Therefore, if one adopts ATC and NERA's view on MIDI mapping,⁸² NERA's analysis omits a significant further incentive for ATC to adopt a foreclosure strategy, either total or partial. This additional incentive would lower the critical diversion ratio, making it more likely for any foreclosure strategy to be profitable.

⁸¹ []

⁸² AlphaTheta Corporation (2023), 'Serato Clearance Application', 10 October, pp. 15-16, section 5.16.

5 Summary

This report has evaluated the arguments put forward by NERA Economic Consulting in their November 27 report.

The evidence in the NERA report does not eliminate horizontal competition concerns. First, the market shares presented by NERA overestimate the presence of developers of DJ mobile applications, and they underestimate Serato's market presence. Second, NERA's claims around product homogeneity and the ability of DJ software providers to reposition their products are largely superficial and speculative.

The vertical arithmetic analysis in the NERA report does not rule out an input foreclosure theory of harm. By overestimating the alternatives available to Serato and by drawing speculative conclusions on the switching behaviour of customers, NERA erroneously concluded that the merged firm would not have the ability to engage in an input foreclosure strategy. The NERA report also does not show that the merged entity would not have an incentive to engage in input foreclosure. [].

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