Competition Primers for ASEAN Judges

Developed as part of the AANZFTA Competition Law Implementation Program

Market definition in competition law

1. Introduction

1.1 This primer is intended to:

a. be a principles-based document for use by members of the judiciary in each of the Member States of the Association of Southeast Asian Nations ('ASEAN');

b. provide a practical and informative guide for judges focusing on challenges and issues faced in defining markets in the course of making and reviewing decisions under competition laws in ASEAN Member States; and

c. assist in developing competition law precedent, which increases legal certainty, promotes efficiency and fosters consistency and predictability within ASEAN Member States, and ultimately contributes to shaping sound competition policy.

1.2 The primer has been developed in the context of the differences in and the varying stages of development of competition laws in the ASEAN Member States. It is not intended to provide country-specific information.

1.3 This primer has been developed by judges of the Federal Court of Australia for judges in the ASEAN Member States, in close cooperation with the OECD. It is one in a series of competition law primers developed at the initiative of the ASEAN Australia New Zealand Free Trade Area Competition Committee as a part of the Competition Law Implementation Program ('CLIP').

2. The concept of a 'market'

2.1 Competition law is concerned with the protection of competition, or rivalry, between firms engaged in trade or commerce. The law generally seeks to prevent commercial conduct or transactions that may harm competition in the supply or acquisition of products (in this primer, the term "products" is used to encompass both goods and services).

2.2 The word "market" is used to describe the area of trade or commerce in which competition occurs. The market can also be described as the "field of rivalry" between firms, whereby firms compete against each other to supply or acquire products. In the application of competition law, the market that is the subject of a competition assessment is often referred to as the "relevant market".

2.3 Identifying and describing a relevant market in which competition occurs may be necessary in competition law for a number of reasons:

a. First, competition law may prohibit conduct that harms or diminishes competition in a market. Defining the relevant market—the area in which competition occurs—is the first step in analysing whether the conduct in question will harm or diminish that competition.

b. Second, competition law may prohibit certain types of agreements between competitors in a market. Defining the relevant market may help determine whether the parties to the agreement are competitors.

c. Third, competition law may require calculation of market shares. For example, a law may specify a particular market share above which a firm may be considered to be dominant or to have market power.[1] In other jurisdictions, market share may be one factor in the assessment of whether a firm has a substantial degree of market power. Market shares may also be relevant to whether conduct, such as a merger, must be notified to the relevant competition authority, and to the calculation of penalties for contravening conduct. In a merger control context, market shares are sometimes used to determine whether or not in-depth scrutiny of a merger is required. In the case of vertical agreements, market shares may be relevant to qualification for safe harbours or exemptions. Defining the relevant market is a necessary first step to calculate market shares.

2.4 Market definition is an economic concept and has been incorporated into the competition laws of ASEAN countries in different ways. In some jurisdictions, market definition is a statutory prerequisite on the competition authority in the enforcement of the law, or a requirement to define the relevant market may be established in the case

[1] See *Competition Primers for ASEAN Judges 2018*, Primer IV at [6.1] – [6.4].

law. In other jurisdictions, there is no legal obligation to define the "relevant market", though it may still be necessary in practice (e.g. to establish a dominant position). Some countries have chosen to incorporate the term "relevant market" into their competition laws, and the notion of relevant market may also be included in the implementing regulations which accompany competition laws.

2.5 Therefore, market definition plays an important role in the assessment of market power in many jurisdictions. However, market shares have to be considered together with other factors when making an overall assessment in a particular case (see factors in paragraph 4.6). Market definition may have a more limited role in hard core cartel cases.

2.6 If a relevant market is incorrectly defined, the assessment of the effect of particular conduct on competition—or of whether a firm is dominant in the relevant market—will be affected. If the market is defined too narrowly, important competitive constraints are not taken into account and market power is overstated, or products that in fact constrain each other are not considered in the market at all. If the market is defined too broadly, products are considered competitive constraints that in fact do not substantially constrain the behaviour of firms.

2.7 Markets are usually defined by two dimensions: the product that is being traded; and the geographic area in which it is being traded.

2.8 The boundaries of the relevant market are usually determined by the possibility of substitution by buyers and sellers in response to changing prices. Substitution refers to switching by customers and suppliers between products and between geographic sources of supply. For example, if a grocery store increased the price of ripe bananas, its customer might choose to buy unripe bananas from that store, to travel to another store, or to buy a different fruit (e.g. mangoes). In each case, the customer would be substituting between products (ripe/unripe bananas and mangoes) or sources of supply (the first and second stores).

2.9 Substitution by a customer between different products and sources of supply is known as "demand-side substitution". Assessment of demand-side substitution plays a critical role in market definition.

2.10 Similarly, a supplier can engage in substitution when they can profitably use their existing resources to supply a new product, or to expand their supply of a product into a new geographic area, quickly and without significant investment. For example, a bakery which had previously only sold bread might begin selling cakes as well. Alternatively, a baker which delivered bread and cakes in one suburb might begin delivering them into a neighbouring suburb.

2.11 Substitution by suppliers between products and geographic locations is known as "supply-side substitution". Some jurisdictions consider supply-side substitution when defining the relevant market. However, other jurisdictions only consider supply-side substitution when assessing competitive effects (see para 3.11).

3. The task of market definition

3.1 The task of identifying the relevant market is called "market definition". In the real world, trading activity is not divided neatly into clearly delineated markets. Markets will commonly overlap, to some degree, with other markets. The object of market definition is to determine the competitive constraints faced by a firm for its products or services and to provide the clearest picture of the competitive processes affecting the relevant area of trade. Recognising that markets may not be clearly delineated, it is sometimes possible to exercise flexibility in defining a relevant market, or leave the question of precise market definition open, and still accurately assess the impact of conduct on competition.

3.2 A practical approach to market definition begins with the trading conduct that is the subject of complaint and the area of trade in which that conduct occurs. For example, in the case of a merger, this will typically require identifying the area of trading "overlap" between the merger parties. In matters concerning an agreement or other trading conduct, this will require identifying the trade that is affected by the agreement or conduct. Usually, particular products and geographic areas are affected by the conduct being examined.

3.3 The next step is to consider the competing products and sources of supply for the products in question. In particular, what *products* are substitutes for those products (are mangoes substitutes for bananas?), and over what *geographic area* does substitution occur (one province? Several provinces? An entire country?). This question is first asked narrowly: what are the closest substitutes? It is then repeated, each time a little less narrowly, until all relevant substitute products and geographic regions have been identified. The product and geographic dimensions are typically undertaken separately. Typically, the characteristics of the product, its transport costs, regulatory and trade barriers, consumer preferences and market dynamics can play a relevant role in the analysis.

3.4 Assessing demand-side substitution requires considering customers' willingness and ability to switch between different products and geographic regions in response to different prices or quality of products. For example, a customer wanting to eat fruit might substitute a mango for a banana, but might not be prepared to travel very far to buy it. However, a customer may be prepared to travel for an hour or longer to buy more expensive products (such as a television), or may be able to buy some products (such as books) online from suppliers who are located several hours' travel away, or even in another country, but can send the product by mail.

3.5 Whether customers are willing to substitute one product or source of supply for another is usually a question of degree. Two products or sources of supply are regarded as being in the same market if they are close substitutes. That means that the first product or source of supply acts as a close competitive constraint on the second product or source of supply.

3.6 The test that is commonly applied for these purposes is the hypothetical monopolist test (HMT). The HMT determines the smallest area in product and geographic space within which a hypothetical current and future profit-maximising monopolist could effectively exercise market power. In general, the exercise of market power by the hypothetical monopolist is characterised by the imposition of a small but significant and non-transitory increase in the price (SSNIP)[2]. Typically, a price increase in the order of 5 to 10% is used as the measure of "small but significant". Transitory price increases are ignored because it is common in markets to have brief fluctuations in prices. The relevant question is whether customers would switch to another product or source of supply in response to a non-transitory increase in price. If customers would switch, the second product or source of supply is a competitor of the first product or source of supply, and they are regarded as being part of the same market.

3.7 Typically, in merger control cases, as well as in some abuse of dominance cases, the competition authority will take a prospective analysis, considering currently prevailing prices as a starting point for the SSNIP test. In other abuse of dominance cases, where the currently prevailing price has already been increased substantially above the competitive level, the competition authority will likely use the competitive (but-for the conduct) price as a benchmark price, and not the currently prevailing price.

3.8 While a useful tool, the SSNIP test may need to be adapted in certain circumstances, such as in two-sided markets. A two-sided market is a market in which a firm acts as a platform and sells two different products or services to two groups of customers, while recognising that the demand from one group of customers depends on the demand from the other group and, possibly, vice versa. Typical examples of two-sided platforms include social media platforms that sell content and advertising space, and payment card platforms, that sell the use of a card to consumers and a point-of-sale (POS) terminal to retailers. In such cases, an attempt to define the market assessing only one side of the market may disregard the competitive constraints exerted by the other side. So a SSNIP test in such cases should be undertaken on both sides of the market to avoid, for instance, markets being defined too narrowly, resulting in higher market shares and higher levels of concentration than is actually the case.

3.9 In the case of two-sided markets where 'free' products are offered to one side of the market, which are monetised on the other side of the market, such as social media

[2] Generally, the SSNIP can be applied to the prevailing price of the products. However, if a firm already has a complete or near monopoly over the relevant products, that firm's price may reflect a monopolistic, rather than competitive, price. In such cases it may be necessary for the SSNIP to be applied to an estimated competitive price rather than the firm's prevailing price.

platforms or general search services, a small but significant deterioration in quality might be used as an alternative test for considering whether customers would switch to competing services.

3.10 A number of quantitative economic tools exist that can help with market definition. The utility of such economic tools depends on the availability of the necessary data, the specificities of the case and legal or practical constraints.[3] These include those tools listed in Annex A.

3.11 The assessment of demand-side substitution is often considered key to defining markets. In some jurisdictions, such as in the European Union, supply-side substitution can also be considered in defining the relevant market where its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy. In other jurisdictions supply-side substitution is considered only at the stage of the competitive assessment – the U.S. Horizontal Merger Guidelines focus only on demand substitution at the market definition stage of the analysis, for instance.

3.12 Where supply-side substitution is considered as part of market definition, it is necessary to also consider how suppliers might respond to a SSNIP of the relevant products. A supplier will be in the same market as another supplier if, in response to such a price increase by the second supplier, the first supplier will commence supplying the relevant product, or commence doing so in the relevant area of supply, quickly and without significant investment. Supply-side substitution requires that the firms producing substitutes possess the necessary production facilities and the technological know-how, access to the necessary distribution channels and marketing and be able to restructure production quickly. Therefore, production and supply capacity tied up under long-term contracts may make supply substitution unlikely, for example.

3.13 Ordinarily, where activities at two stages in the supply chain are undertaken by different firms (e.g. by separate manufacturers and retailers), there will be separate functional markets (e.g. separate manufacturing and retail markets). However, in some cases it may be appropriate to identify a market which encompasses more than one functional level. This can be appropriate if participants at one functional level constrain participants at another functional level. For example, in an industry where many manufacturers are vertically integrated and also distribute and retail their own products, standalone retail businesses might be competitively constrained by the vertically integrated businesses. In those circumstances, it could be appropriate to define a market for the manufacturing, distribution and retailing of a particular product.

[3] For further information, see OECD (2012), Market Definition, http://www.oecd.org/daf/competition/Marketdefinition2012.pdf.

4. Features of a market

4.1 Once a market has been defined, the features of that market which influence the process of competition in that market can be described and need to be considered. This in turn facilitates an assessment of the effect of particular conduct on competition, or of whether a firm is dominant in the relevant market.

4.2 Key features of a market that should be considered in this respect include the following.

a. The number and size of competitors, and their market share (i.e. the degree of concentration in the market).

b. Barriers to entry, and the height of any such barriers.

c. Durability of market power.

d. Economies of scale, economies of scope or network effects (i.e. where the value of a product improves/increases by increasing the number of users of such product).

e. The extent of product differentiation and sales promotion.

f. The nature of the relationships between customers and suppliers, and any countervailing power of customers or suppliers in their dealings with each other.

g. The nature and extent of any vertical integration (i.e. instances at which a single firm operates at more than one level of the supply chain).

h. Any long-term contracts or other arrangements between firms which restrict their ability to function independently of each other.

i. The dynamic characteristics of the market, including growth, innovation and product differentiation.

4.3 Market definition can be a complex task and in some cases, market definition and market shares are less important. For example, markets where products are highly differentiated, bidding markets (i.e. markets in which players compete through auctions to be the supplier of a whole market of product or services, rather than for market shares), two-sided markets, aftermarkets and highly dynamic markets require additional considerations. In such markets, market shares are only an indicator of market power.

a. In differentiated product markets, the intensity of competition and substitution between products is a more important indicator of market power than market shares.

b. In bidding markets, where competition is “for the market” (i.e. for being the sole supplier of a whole market) and not “in the market”, more weight has to be placed on identifying the (potential) market participants, i.e. those suppliers that have the capacity to compete for the contract and can participate in future bidding competitions.

c. In two-sided markets, which serve two or more distinct groups of customers that would like to interact but cannot do so without the firm serving as a platform, market shares on one side of the market are only weak indicators of market power as competitive constraints from the other side might limit any existing pricing power. In such markets the competitive constraint exercised by the other side of the market needs to be considered to understand whether a firm has market power.

d. In markets characterised by primary and secondary products, such as printers and printer cartridges or cars and spare parts (known as aftermarkets), it may be necessary to define the market as a 'systems market' rather than two separate markets.

e. In highly dynamic markets, developments are often unpredictable, leading to the creation of new markets or the convergence of formerly separate markets. As a result, market boundaries may shift rapidly. In such industries it is not the price that is the main competitive parameter but innovation or the introduction of a new superior product.

5 Evidentiary sources

5.1 As for all competition cases, a court will apply the laws of its jurisdiction and its own rules of evidence to determine the nature and extent of the evidence required when defining a relevant market.

5.2 The types of evidence that may be relevant to market definition include the following:

a. characteristics of the products in issue, including the purpose they serve for customers and their price and other features;

b. the behaviour of customers and suppliers in buying and selling the products and their willingness to switch to alternative products or sources of supply – such evidence of demand-side substitution can be obtained by consumer surveys, for example, where consumers are asked how they have or would react to a SSNIP; and

c. empirical evidence from recent changes in the market structure and from past natural experiments (for example the entry of a new competitor in the past).

5.3 The views and practices of those operating in the relevant industry will often be the most useful evidence to assist the court in identifying a commercially realistic market definition. Competitors themselves may have collected data on demand-side substitution to identify their rivals. For example, board minutes or presentations, plans, strategies or other internal documents of a business may identify who they consider their customers to be, who they consider their competitors to be, and their past experience of gaining or losing customers in response to changes in price, quality or other features of their products or their competitors' products. In some cases, these types of documents may also contain a business' views about the market in which it operates. However, as a matter of language, the word "market" can be used in various ways, many of which do not reflect the economic concept of a market. Accordingly, caution is often required before relying on such evidence as identifying the relevant market for the purpose of competition law.

5.4 Expert evidence from economists and industry experts, former business executives, suppliers or distributors may also assist a court undertaking the task of market definition. An expert economist may give evidence on the meaning of relevant economic concepts (such as demand and supply-side substitution) and the extent to which they are observed on the facts of a particular case. An industry expert might give evidence on behaviours and practices in the relevant industry.

5.5 Expert evidence is discussed in greater detail in the CLIP Competition Primer on 'Expert evidence'.

6 Examples of relevant market definitions

6.1 In Australia, courts have adopted the following market definitions in previous cases, based on the particular facts of, and the conduct in issue in, those cases.

a. In a case considering misuse of market power and other conduct by a newspaper owner, the court identified a market in the particular regional area in which the newspaper was sold, which it described as a market for the supply of regional newspapers which provided the services of providing information, news and advertising to persons within that area.[4]

b. In a case considering whether airlines had engaged in price fixing by reaching an understanding to impose certain fees and surcharges on the carriage of air cargo, the court identified that the relevant markets were markets for the service of flying cargo from individual ports of origin in Singapore, Hong Kong or Indonesia to individual destination ports in Australia.[5]

c. In a case considering whether the acquisition by a rail linehaul operator of a rail terminal would be likely to have the effect of substantially lessening competition in a market, the court identified a market for the supply of rail linehaul services for intermodal freight on particular corridors to a subset of customers for whom

[4] Described in *Rural Press v ACCC* (2003) 216 CLR 53 at [27]

[5] Described in *Air NZ v ACCC* (2017) 262 CLR 207 at [16].

neither road services nor sea services provided an effective substitute for rail linehaul services.[6]

6.2 In Europe, in several cases the European Commission adapted its market definition tools to markets with specific characteristics. For instance:

a. In a merger concerning the sale of branded deodorants, where product differentiation played an important role, the European Commission considered the degree of competitive constraints between male deodorants and non-male (female and unisex) deodorants, applying a simulation approach based on a model of demand estimation to assess patterns of customer substitution across different products in response to their changes in price.[7]

b. In a merger between two suppliers of seeds, pesticides and crops, when assessing the relevant markets for crop protection, the European Commission considered the "innovation spaces" (i.e. the level of products where innovation competition takes place) and their geographic dimension, in addition to the product markets.[8]

7. Related information sources

7.1 The following resources provide further information in relation to market definition. The material may be useful as a general reference for judges in the ASEAN Member States:

a. Decision of the Australian Trade Practices Tribunal in *Re Queensland Co-operative Milling Association Ltd* (1976) 25 FLR 169.

b. Brunt, "Market definition issues in Australian and New Zealand trade practices litigation" (1990) 18 Australian Business Law Review 86.

c. OECD (2012), Market Definition

d. OECD (2016), Defining Geographic Markets Across National Borders

[6] *ACCC v Pacific National* (No 2) [2019] FCA 669.
[7] Case M.5658 – *Unilever/Sara Lee*, European Commission decision of 17 November 2010.
[8] Case M.8084 – *Bayer/Monsanto*, European Commission decision of 21 March 2018.

Annex A. Quantitative economic tools

A number of quantitative economic tools exist that can help with market definition. The utility of such economic tools depends on the availability of the necessary data, the specificities of the case and legal or practical constraints.[9] These include:

(a) **Price correlation analysis**. It examines the extent to which the prices of two products move together over time. If the price of one product constrains the price of the other, the two price series usually have similar patterns. The interpretation of price correlation analysis raises complications, for instance how high does a correlation coefficient have to be for two products or geographic areas to be in the same relevant market?

(b) **Critical loss analysis**. It measures the minimum volume of sales that a hypothetical monopolist would need to lose to make a 5-10 % price increase unprofitable. The critical loss is compared to the actual loss the hypothetical monopolist would incur in response to the 5-10 % price increase to determine whether such a price increase would be profitable. If the actual loss is smaller than the critical loss, the price increase would be profitable for the hypothetical monopolist, which would be indicative of a relevant product market.

(c) **Natural experiment**. It analyses past events in a market to understand the competitive dynamics of that market. These past events include new product launches, market entry, advertising campaigns, input cost shocks or regulatory interventions.

(d) **Demand estimation**. It observes how consumer behaviour adapts to changes in the price of products, consumer income, or other variables that impact demand. In other words, it provides information about the prices and quantities that consumers are willing to demand by estimating demand elasticity.

[9] For further information, see OECD (2012), Market Definition, http://www.oecd.org/daf/competition/Marketdefinition2012.pdf.