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GEOGRAPHIC MARKET DEFINITION

-- Note by the European Union --

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More documents related to this discussion can be found at ww.oecd.org/daf/competition/geographic-market-definition.htm

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1. Introduction

1. Market definition (geographic and product) is a tool that allows an antitrust authority to identify in a systematic way the boundaries of competition between firms in their quest for customers. It identifies alternatives for customers of the undertakings concerned (e.g. the merging companies), and makes it possible to calculate market shares, which are a first indication of the competitive strength of companies in a market. This makes market definition the starting point for an analysis of competition forces.

2. The Commission's Notice on the Definition of the Relevant Market (hereafter referred to as "the Commission's Market Definition Notice" or "Market Definition Notice") defines a relevant geographic market as the geographic area in which the undertakings concerned offer their products and in which the conditions of competition are sufficiently homogeneous.[1]

3. In geographic market terms, therefore, the key question is whether after the merger,[2] competitors from other geographic areas will be able to exercise sufficient competitive pressure on the merging companies. Many companies operate on a global scale and compete with various suppliers in different parts of the world. However, market definition is essentially a customer-focused exercise: it is all about finding out what alternative suppliers are available to customers in a given area. If customers cannot rely on suppliers located outside of this area, those other suppliers are not part of the relevant geographic market.

4. Therefore, demand-side substitution will play the primary role in market definition. Supply-side substitution[3] can also play a role in market definition if it can happen in the short term without the companies incurring significant costs or risks.

5. Market definition is only the initial step of our analysis of the relevant transaction. In its competitive assessment, the Commission examines the competitive pressure of imports also from outside the market, barriers to entry and expansion of rivals and the expected price increase caused by the transaction. Here most supply-side considerations will be taken into account.

6. Finally, market definition is a factual and empirical exercise undertaken on a case-by-case basis. Defining a market is by its very nature a dynamic exercise. The Commission needs to predict the most likely developments after a merger and has to take possible future changes into account. Market definitions are not carved in stone, and are revised if evidence shows that circumstances have changed over time.

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1 Commission notice on the definition of the Relevant Market for the purposes of Community competition law, OJ C 372, 09.12.1997, p. 5.

2 In the Market Definition Notice, the Commission explain how it applies the concept of relevant product and geographic market in its enforcement of Community competition law. Throughout this paper, this methodology will normally be illustrated by the Commission´s merger control practice, in application of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the "EU Merger Regulation"; OJ L 24, 29.01.2004, p. 1).

3 That is, when suppliers from other areas are able to switch and market the relevant products in the relevant area in the short term.

7. Having recently reviewed its practice in geographic market definition, the Commission has found that the Commission's Market Definition Notice is sufficiently flexible to perform its role of defining the relevant geographic market for merger and antitrust purposes in the current globalised world.

8. In particular, the analysis of past Commission cases demonstrates that market definitions are in constant evolution and the Commission does not hesitate to adapt them over time if markets change. This flexibility also extends to the application of recent methodologies in geographic market definition that do not focus on national borders in assessing the competitive impact of a transaction, as will be exemplified by a recent case.

9. Finally, the findings of a Report on "Geographic Market Definition in European Commission Merger Control" which Professors Bruce Lyons and Amelia Fletcher (University of East Anglia) produced upon the Commission's request, endorse the Commission's approach to geographic market definition.

10. This paper will first will shed some light on the current debate regarding the EU practice in geographic market definition, in particular in the context of a globalised world. It will then go on to exemplify how the Commission's practice in geographic market definition has evolved notably with the development of the EU Internal Market and globalisation. Finally, a recent merger case where innovative techniques in geographic delineation beyond national boundaries were developed will be presented.

2. Globalisation and the debate around the Commission's practice

11. The increasing cross-border nature of mergers notified to the Commission reflects the globalising economy. Indeed, data based on the origin of company headquarters suggests that the percentage of notified mergers taking place in only one Member State has declined from 25% to less than 12% between 2004 and 2015. Conversely, the percentage of mergers notified to the Commission that involve non-EU companies has increased from 36% to 61% in the same time period.[4]

12. The fact is that nowadays many companies operate on a global scale and compete with various suppliers in different parts of the world. Certain stakeholders argue that the Commission often fails to taken sufficient account of this development and that it tends to define geographic markets too narrowly.

13. In particular, there has been some debate on whether the Commission should give more weight to supply-side factors in defining relevant antitrust markets and whether wider relevant geographic markets should generally be considered, with a more determinant role for imports at the market definition stage, in order to fully capture global market dynamics in antitrust and merger cases.

14. In order to further investigate these points, DG COMP asked Professors Lyons and Fletcher to prepare an independent economic report on the topic of "Geographic Market Definition in European Commission Merger Control" (“the Report”).

15. Professors Lyons and Fletcher were asked, in particular, to evaluate DG COMP's approach to geographic market definition on the basis of a sample of ten recent merger cases: (i) M.5754 - Alstom/Areva; (ii) M.6203 - Western Digital/Hitachi; (iii) M.7220 - Chiquita/Fyffes; (iv) M.6471 - Outokumpu/Inoxum; (v) M.6924 - Refresco/Pride Foods; (vi) M.6905 - Ineos/Solvay; (vii) M.7155 - SSAB/Rautaruukki; (viii) M.5153 - Arsenal/DSP; (ix) M.5046 – Friesland/Campina; and (x) M.6541 – Glencore/Xstrata.

[4] Including deals where non-EU companies were involved in a cross-border merger together with EU companies, and deals between companies located outside EU. The origin of the company is determined by the country where the group is incorporated.

16. This sample of cases was chosen in order to allow for a meaningful assessment of the Commission's geographic market definition practice and therefore included mostly cases where the definition of the relevant geographic market played an important role in the assessment. Nine of these cases involved remedies (either at Phase I or Phase II), and in eight the parties had argued for a wider geographic market definition than the Commission ultimately adopted. As the authors noted, there was a deliberate element of bias in the selection of these cases, as the purpose of the study was to focus on contentious cases which might better reveal any potential weaknesses in the Commission's practice.

17. In their Report, which was delivered on 13 November 2015, the authors find that the Commission typically draws on a wide range of evidence for its findings, rarely relying on one single piece of evidence or economic analysis. They fully support this rounded and holistic approach to merger assessment.

18. The authors consider that geographic market definition should not be seen as an end in itself, but rather as providing a useful framework for the competitive analysis. It should be used to identify a geographically coherent group of customers for whose purchases suppliers located in the same geographic area or, possibly, also suppliers located at a greater distance, compete. Market shares and concentration indicators can be useful indicators of the likely competitive effects of a merger but they are only the first step in the competitive analysis thereof. Therefore, as long as the competitive assessment fully considers the competitive discipline provided by firms located outside the geographic market, defining narrow markets should not yield biased results.

19. Still, the authors recommend that the Commission should explain more clearly the intermediate and non-decisive role of market definition within the merger assessment process so that the attention paid to this issue is reduced, allowing for a greater focus by both parties and the Commission on what really matters: the competitive assessment.

20. Importantly, the authors believe that demand-side substitutability should play the primary role in geographic market definition while supply-side substitutability should rather be used at the stage of the competitive assessment and only play a role in widening markets in very limited circumstances, where it is immediate and costless and near universal across the suppliers.

21. The authors consider that the Market Definition Notice does not envisage a situation in which the potential for imports to come into a geographic area and constrain competition would result in the geographic market being widened to include the source of such imports. Nor should it, according to them. For instance, firms that import into the EEA will also be mostly selling into their home markets, which may have vastly different competitive constraints than the European market. Consequently, although their sales into the EEA should be incorporated into the European market, this should not necessarily imply that their home markets should also be incorporated into the relevant geographic market.

22. Therefore, they recommend that there should be greater clarity that supply-side substitution by imports will not be accepted as an argument for widening the relevant geographic market.

23. The authors disagree both with criticisms by stakeholders that the Commission's geographic market definition practice takes insufficient account of globalisation and with the specific suggestions made by these stakeholders to strengthen the weight of supply side factors in defining relevant geographic markets.

24. However, they suggest that, if the Commission is to take a stricter approach to supply-side substitutability at the market definition stage (by mainly relying on demand-side substitution), the importance of giving due focus to competitive constraints from outside the market within the competitive assessment will have to be emphasised. With that idea in mind, they support a greater focus on the analysis of "rapid entrants" and the consideration of capacity shares that incorporate swing capacity from outside the market.

25. They also suggest that the Commission should be more flexible in the use of non-political geographic market boundaries like isochrones, along the lines of what has been done in recent cases (see e.g. merger cement cases)[5] when it is distance rather than national characteristics that limits competition between suppliers.

3. The Commission's approach to market definition has shown to be flexible and forward-looking

26. A review of the Commission's market definition practice reveals that the Commission's Market Definition Notice is sufficiently flexible and provides adequate guidance for defining the relevant geographic market for merger and antitrust purposes in the current globalised world.

3.1 Markets that change over time

27. The Commission's practice recognizes that market definition is by its very nature a *dynamic exercise*. The Commission needs to predict the most likely developments after a merger and has to take possible future changes into account. Market definitions are not carved in stone, and are revised if evidence shows that circumstances have changed over time.

28. Accordingly, in several instances the Commission revised its geographic market definition in subsequent cases dealing with the same market, because of developments affecting the nature of the market in question. This has usually led to a widening of the geographic scope of the relevant market: in no less than 61% of the Commission's merger decisions in 2012 and 2013, the Commission analysed geographic markets that were at least EEA-wide or wider. Ten years before this figure was 48%.

29. The Commission has increasingly been finding regional and EEA-wide markets rather than national markets. This is, amongst others, a result of the creation and development of the EU Internal Market over the past twenty years, which has led to a lowering of trade barriers, changing business practices, regulatory harmonization and lowering of transport and business costs at the EU-level.

30. For instance, when analysing Alstom's acquisition of the industrial and electrical equipment businesses of Areva in 2010[6], the Commission found that the markets for rail power systems had become at least EEA-wide, while in 2005 it had still found national markets when scrutinizing deals in the industry. This development has been largely brought about by the introduction of EU legislation fostering interoperability of rail networks and an increasing trend of setting up train services running though different Member States.

31. In other cases, technological innovation has driven the move towards a wider geographic market. For instance, advances in technology made the development of a market for digital distribution of music possible. Traditionally, the Commission considered the market for the wholesale of physical recorded music to be national. However, the advent of the internet and the possibility of digitally distributing music have fundamentally changed the way the music industry operates. Digital music distributors have increasingly offered a pan-European service and correspondingly EEA-wide agreements with record companies. Already in 2004, the Commission observed that the geographic scope of digital distribution of music was evolving beyond the national scope. This view was confirmed, first in 2008[7] and then in 2012, when the Commission assessed the competitive impact of proposed mergers both at EEA-wide and national levels and concluded that the market for digital distribution of music was evolving towards an EEA-wide market.[8]

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5 See cases COMP/M.7009 – Holcim/Cemex West, decision of 05/06/14, COMP/M.7054 – Cemex / Holcim Assets, decision of 09/09/14, COMP/M.7252 – Holcim/Lafarge, decision of 15/12/14 and COMP/M.7744 – Heilderbergcement/Italcementi, decision of 26/05/16

6 COMP/M.5754 - Alstom Holdings/Areva T&D, decision of 26/03/2010.

7 COMP/M.5272 – Sony/BMG, decision of 15/09/08.

8 COMP/M.6458 – Universal Music Group/EMI, decision of 21/09/12.

3.2 A recent case illustrating market delineation not focused on national borders

32. The Commission's flexible approach to market definition also extends to its *application of recent methodologies* in geographic market definition that do not focus on national borders in assessing the competitive impact of a transaction. This can be exemplified in a recent case where geographic market definition was a particularly important part of the assessment.

33. The proposed acquisition of Rexam PLC (Rexam, the United Kingdom) by Ball Corporation (Ball, the United States) was notified to the Commission on 15 June 2015. In January 2016, the Commission cleared this transaction subject to conditions.

34. Ball is a worldwide producer and supplier of metal packaging for beverage, food and household products. Ball is the leading beverage can manufacturer worldwide and the #2 in the EEA while Rexam's is the #2 beverage can manufacturer worldwide and the largest one in the EEA.

35. The transaction was set to take place in a highly concentrated European industry with only four main suppliers of beverage cans: Ball, Rexam, Crown, and Can-Pack. Moreover, it would have combined the activities of the two main suppliers and resulted in a new #1 supplier in Europe: producing approximately 2/3 of total beverage can supply in Europe.

36. The investigation highlighted the following relevant features of the beverage cans industry in Europe: (i) supply and demand conditions differ from one location to the next; (ii) customers tend to make most of their purchases within a maximum distance from their filling location plants; (iii) suppliers normally deliver the cans to customers’ locations; and (iv) prices are generally negotiated at the level of filling plants.

37. These features of a geographically differentiated market suggested that catchment areas around customer locations were the most appropriate way to assess competition in the can industry as they most closely reflected economic reality. For the purposes of the assessment of the case, the radius was defined in terms of transport distance for cans sold by Ball, Rexam and their main two competitors in the EEA. The Commission observed that 80% of all can sales took place within a maximum travel distance of approximately 700 km from a customer's filling location. The 80% cut was taken based on several elements such as replies of competitors and customers in the market investigation, and margin analysis. In any event, the Commission conducted robustness checks based on a radius of 900 km and 500km.

38. In order to define geographic markets, the Commission thus took the catchment area with a radius of 700 km around each customer filling location as a starting point. The Commission then concluded that the catchment areas around individual customer filling locations could be clustered together in broader geographic areas (regions) where these catchment areas were subject to sufficiently homogeneous competitive conditions.[9]

[9] Eventually nine regions were defined: Central Europe (Austria and Germany), Benelux, France, Italy, Iberia (Spain and Portugal), North East Europe (Poland, Czech Republic, Slovakia, Lithuania, Estonia and Latvia), South East Europe (Hungary, Slovenia, Croatia, Romania, Bulgaria, Greece and Cyprus), the Nordics (Denmark, Norway, Sweden, Finland, and Iceland) and the UK and Ireland. These regions were based on the Parties' own understanding of local market conditions, the sales pattern of the Parties and other more qualitative elements from the market investigation.

39. In order to assess the concentration in a region, the Commission calculated average concentration figures by averaging the concentration levels in the individual catchment areas. These were based on the weighted average capacity/volume shares of suppliers in each of the catchment areas located in that region, where the weights are given by the total sales made to the filling location at the centre of each catchment area. Moreover, the Commission also considered that geographic differentiation might well exist within a given region. Such differentiation was taken into account in the competitive assessment by using not only the average concentration figures for a region as described above, but also concentration figures for a subset of customers with particularly significant concentration effects, within the region.

40. When using the catchment-areas based clusters, it was found that the transaction would have led to high market shares and HHI[10]s (calculated both based on volumes and on capacity) in all clusters. In order to address the competition concerns identified, Ball committed to a substantial remedies package, consisting essentially in a reverse carve-out of Ball's existing European business, combined with the requirement of an upfront buyer. Strong cooperation with FTC and CADE also ensured coherence in a global remedies package that went beyond Europe. A conditional clearance decision was adopted on 15 January 2016.[11]

4. Conclusions

41. An examination of the Commission's market definition practice reveals that the Commission's Market Definition Notice is sufficiently flexible and provides adequate guidance for defining the relevant geographic market for antitrust purposes in the current globalised world.

42. The Report on "Geographic Market Definition in European Commission Merger Control", co-authored by Professors Lyons and Fletcher, endorses the Commission's approach. It recommends however that there should be greater clarity in Commission's decisions that market definition provides a useful framework for competitive analysis, but is not an end in itself. The authors further recommend that the Commission should take a stricter approach to supply-side substitutability at the market definition stage, by mainly relying on demand-side substitution, and addressing supply-side substitutability at the competitive assessment stage.

43. Furthermore, the analysis of past Commission cases demonstrates that market definitions are in constant evolution and the Commission does not hesitate to adapt them over time if markets change. The inherent features of some markets, however, do not allow for a wider definition, as the assessment is determined by objective market realities which the Commission and other worldwide competition agencies are bound to respect.

44. Finally, when it is relevant for the assessment of the case and the nature of the investigation and data collection permits it, the Commission's analysis of markets can rely on catchment areas and isochrones in a cross-border assessment of markets which do not focus on national boundaries.

10 The Herfindahl-Hirschman Index, that measures market concentration.

11 COMP/M.7567 - Ball/Rexam, decision of 15/01/2016. On 25 April 2016, Ball and Ardagh announced that the latter would be purchasing the assets that Ball committed to divest in order to obtain regulatory approvals for its acquisition of Rexam, including plants in Europe, the US and Brazil. On 17 June 2016, the Commission approved (i) Ardagh as the purchaser of the divestment business and (ii) Ardagh's acquisition of the divestment business: see COMP/M.8048 – Ardagh/Ball Rexam.