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GEOGRAPHIC MARKET DEFINITION

-- Note by Argentina --

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-- ARGENTINA --

1. Introduction

1. This contribution addresses the methodologies used by Argentina's competition authority (Comisión Nacional de Defensa de la Competencia, hereinafter "CNDC") to define geographic markets. The note focuses on the definition of geographic markets as part of the process of assessing competitive effects of mergers and acquisitions. In particular, the note reviews a selection of cases and approaches used by the CNDC to characterize markets with a geographic scope that is broader than national, that is, regional or global.

2. Section two reviews geographic market definition according to the CNDC Guidelines for the Control of Economic Concentrations.[1] Section three discusses how the existence of MERCOSUR influences the market definition process. Section four summarizes the main analytical tools used to delineate geographic boundaries and reviews a selection of CNDC cases. Finally, section five presents conclusions and future challenges for Argentina and the CNDC.

2. Geographic market definition according to the CNDC guidelines

3. Argentina's competition law does not impose any particular restriction on geographic market definition. The CNDC Guidelines state that once the relevant product market has been defined, the next step is to define the relevant geographic market. The latter is defined, based on the SSNIP test, as the smallest region in which a single provider would find it profitable to impose a small but significant and non-transitory increase in price. Of particular importance for this purpose is the analysis of demand substitution. If consumers in the area in which the merging firms operate can acquire a product in an alternative (nearby) geographic area, then it is reasonable to consider both areas as part of the same geographic market. In this sense, the CNDC Guidelines follow the same criteria for assessment of geographic markets -and market definition in general- included in the merger guidelines of the majority of competition law jurisdictions around the world. The evaluation of imported products is also specified in CNDC Guidelines. These imports are considered potential competitors of the relevant product. According to the Guidelines, CNDC must check the current import tariffs (and their projected reduction when included in trade liberalization agreements), non-tariff restrictions to trade (e.g. quality standards), transportation costs, and other issues that could affect market contestability by imported products.

4. In the majority of cases analyzed by the CNDC, geographic markets are defined at the national or local level. There are, however, a number of CNDC decisions where it was considered appropriate to define broader geographic markets. Specifically, in the 2000-2015 period there were close to 60 out of 1200 cases in which the relevant geographic market was defined beyond national frontiers, that is, cases where markets were classified as *at least national*, regional, or global. More than half of these cases belong to the 2012-2015 period, meaning that cases analyzed by CNDC with broad geographic scope became more prevalent in recent years.

1. "Lineamientos para el Control de las Concentraciones Económicas", CNDC, *available at* http://www.mecon.gov.ar/download/cndc/lineamientos.pdf.

3. The role of MERCOSUR in defining geographic markets

5. The existence of MERCOSUR, the Common Market of the South, determines certain trade flows and tariff policies -the establishment of a common external tariff and a zero intrazone tariff- that directly influence the definition of geographic markets. MERCOSUR was created in 1991 by Argentina, Brazil, Paraguay, and Uruguay. In subsequent phases, Venezuela was incorporated as full member and currently Bolivia is in the process of adherence.[2] In the competition arena, Argentina has competition defense agreements with MERCOSUR members and with Brazil, where the main goals are in the field of cooperation and exchange of information among competition authorities.[3]

6. The foreign trade structure imposed by MERCOSUR determined that, in a number of CNDC decisions, the relevant geographic market was constituted by MERCOSUR or a subgroup of country members. For instance, when analyzing the acquisition by Petrobras of almost 60% of Perez Companc's capital stock (2002)[4], an independently owned energy company in Latin America, the CNDC concluded that, for the case of several final petrochemical products, the scope of the geographic market was at least regional.[5] The creation of MERCOSUR drastically changed the dynamic of the petrochemical industry and firms in Argentina and Brazil increasingly started considering MERCOSUR members as part of a unique market. In Petrobras/Perez Companc, the main factors taken into account to define the geographic market were: (i) the high volume of imports and exports as a percentage of domestic production (referred to as the "openness index"), (ii) the origin-destination structure of Argentina's foreign trade; and (iii) the relevance of Brazil's imports in complementing domestic supply. For the case of basic and intermediate petrochemical products, on the other hand, the relevant market was defined as local since, for the most part, those products were consumed internally and the openness index was low.

7. Another case where the CNDC defined a regional geographic market comprised of MERCOSUR countries was a 2007 operation in the stainless steel industry,[6] in which Steelmaker ArcelorMittal acquired Argentina's largest stainless steel distributor MT Majdalani y Cía.[7] and the CNDC authorized the transaction. What is interesting about this case is the analysis of imported products. CNDC observed that cold rolled steel was imported with no tariff from countries outside MERCOSUR and considered this scheme to be highly beneficial for competition. This was not the case for the highly concentrated market of hot rolled steel. This situation led the CNDC to issue a pro-competitive recommendation to Argentina's authorities in charge of MERCOSUR tariff negotiations asking for a reduction in hot rolled steel tariffs.

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2 MERCOSUR does not include any agreement on common currency, fiscal policy or other aspects of macroeconomic coordination.

3 MERCOSUR/CMC/DEC. Nº 43/10, *Acuerdo de Defensa de la Competencia del Mercosur*. Ley 26.622, 2010, *Acuerdo de Cooperación entre la República Argentina y la República Federativa del Brasil, relativo a cooperación entre sus autoridades de Defensa de la Competencia en la aplicación de sus leyes de Competencia*.

4 CNDC, Dictamen No 346/2003.

5 In this case, the geographic market was defined as involving MERCOSUR plus Chile.

6 Strictly speaking, the CNDC defined the geographic market for steel rolls as "at least national" in scope and emphasized the importance of MERCOSUR suppliers.

7 CNDC, Dictamen No 734/2009

4. Analytical tools used to define geographic markets

8. The CNDC uses different approaches to define geographic markets that are applied on a case by case basis and as part of an empirical exercise based in business realities. The criteria used to assess geographic boundaries is in general a mix of qualitative and quantitative considerations. Logistics and transport costs, openness index, international trade tariffs, imports, regulatory barriers, and consumer travel time are some of the main elements taken into account when defining geographic markets. Of similar importance are interviews with the parties involved in the market, including consumers, suppliers, and regulatory agencies

9. One of the main indicators used by the CNDC to determine a market's geographical scope is the openness index. Clearly, when the entire supply is imported, the relevant market is considered broader than national. CNDC has adopted a worldwide definition of the geographic market in some cases where imports came from different regions and countries in the world. This approach has been used in merger assessments concerning markets like potassium chloride[8] and pharmaceutical inputs.[9] There are instances also that the CNDC recognizes that markets have a broader than national scope but considers more appropriate to perform an analysis at the national level in order to capture the direct effects of the transaction over the national territory. For instance, in 2013 Volkswagen acquisition of Man,[10] the entire supply of marine diesel engines came from abroad but the merging parties acted as wholesale distributors in the national territory. In this particular market, final consumers were not able to obtain the product directly from foreign producers or distributors, which justified a national approach for geographic market definition.

10. A similar criterion has been applied in cases where the entire production is exported. For instance, the CNDC studied a merger in the mining industry where the entire local production of gold and silver was sold abroad.[11] In this kind of merger assessments the relevant geographic market has been defined as global. Aside from these extreme cases, when the openness index is close to 50% or more usually the main hypothesis has been to follow a "broader than national" criterion.[12] This approach has been used in some markets for which there is a well-established trade relationship at a regional level, but not so significant between the region and the rest of the world. This was the case in the already mentioned Petrobras/Perez Companc operation, where the openness index was the main variable used to assess geographic markets for petrochemical products.

11. An interesting case to analyze in the context of global geographic markets is the acquisition of Potasio Rio Colorado potash project in Argentina by Vale, a global mining company.[13] At the time of the acquisition, the potash project was in the feasibility stage and, if fully developed, would allow Argentina to become a major producer of potassium chloride. The relevant product market was viewed as a commodity with several global suppliers with low market share and zero import/export tariff rate. Interviews with national product buyers composed of fertilizer manufacturers revealed that changing suppliers was relatively easy, and that all potassium chloride purchases came from imports. Also, transport costs did not represent a competitive disadvantage for the different global suppliers. In this context, the CNDC

8 CNDC, Dictamen No 872/2011.

9 In particular, semi synthetic penicillin and cephalosporin. CNDC, Dictamen No 1186/2016.

10 CNDC, Dictamen No 993/2013.

11 CNDC, Dictamen No 1338/2016.

12 There is certainly not a fixed threshold for openness index. There can be cases where the openness index is below 50% but the relevant geographic market may still be defined with broader than national scope.

13 CNDC, Dictamen No 745/2011.

concluded that the relevant geographic market was global. Along the same lines, in a merger case in the digital marketing industry,[14] the CNDC identified a worldwide market based on the fact that digital marketing services could be developed in any geographical location and digital content could be delivered anywhere in the world through the Internet at zero cost. In addition, the merging parties provided their services to both domestic and foreign clients and the parties involved in the operation competed with local and international digital marketing companies. In relation to logistics and transport cost, an opposite case is the Minetti/Hormix merger in the concrete manufacturing industry,[15] where the CNDC defined the relevant geographic market as the area within a radius of 50km from the city of Córdoba (where the concrete plant was located) based on the concrete hardening process (which limits transportation time) and the high transport costs.

12. The competitive pressure of imports is another important factor to take into account when analyzing geographic markets, even if the level of imports is low. The CNDC investigated in 2004 an alleged abuse of dominant position and price discrimination in the market of urea commercialization by Profertil, a jointly-controlled investment between YPF[16] and Agrium (a worldwide leader in fertilizers).[17] Even though Profertil had a significant market share in the Argentine market (around 70%), the price charged was in line with the import parity price as consumers could easily buy urea from foreign competitors in response to a price increase. Urea did not have any legal, logistic, or tariff restrictions that limited imports into the country. Also, Profertil's participation in international markets was low and around 2%, making the firm a pure price taker for urea. These market features led the CNDC to conclude that geographic market for urea was essentially global.

13. Regulatory barriers can also condition geographic market definition. The CNDC analyzed a vertical integration between a reinsurance company (Aseguradores Argentinos Compañía de Reaseguros) and an insurance company (Orígenes Seguros de Retiro S.A. y Orígenes Seguros de Vida S.A.).[18] Reinsurance occurs when insurance companies purchase insurance from a third party (a reinsurer) as a means of risk management. Starting in 2011, Argentina's regulatory framework requires that insurance companies only contract with local reinsurance providers, that is, Argentinian reinsurers or subsidiaries of foreign companies based in Argentina. In this context, a market that would otherwise be defined as international, was considered national due to regulatory restrictions. Another case where government imposed regulations shaped geographic market definition was Panasonic acquisition of Sanyo in 2011.[19] Due to government incentives for national production in the electronics industry, including a combination of tax benefits, import duties, and product regulations, it was considered appropriate to analyze the transaction using a national framework.

14. Another important element to consider when delineating geographic markets is consumers' willingness to travel a certain distance to purchase a product or service as a response to a price increase. This reasoning was applied in the Fresenius/RTC horizontal merger, where the involved parties were two

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14 CNDC, Dictamen No 1117/2015.

15 CNDC, Dictamen No 175/2000.

16 YPF (Yacimientos Petrolíferos Fiscales) is Argentina's stated-owned energy company, engaged in the exploration and production of oil and gas, and the transportation, refining, and marketing of gas and petroleum products. When this case was reviewed by the CNDC, YPF's majority shareholder was the Spanish Repsol.

17 CNDC, Dictamen N 436/2004.

18 CNDC, Dictamen No 1163/2015.

19 CNDC, Dictamen No 901/2011.

of the main dialysis service providers in Argentina[20]. Several geographic markets were defined as the area within a radius of 35km from a dialysis center. This was estimated to be the distance that a patient would be willing to travel in order to substitute one dialysis center for another. People going through dialysis usually receive treatment three times a week for an average of four hours, for which distance to a center is a crucial factor. Following the CNDC's decision, the acquiring firm was forced to sell five dialysis centers located in five cities in Argentina because the merger, if approved unconditionally by the CNDC, would have created monopolies in those cities.[21]

15. The CNDC has used isochrones[22] as a tool for defining geographic markets locally. In the analysis of the acquisition of Hoyts by Cinemark in the movie theater industry,[23] the CNDC defined the relevant geographic market as the area of influence around each movie theater.[24] A consumer survey revealed that proximity to a theater is what customers valued the most for more than 50% of respondents. In order to determine the area of influence of each theater, the CNDC estimated the approximate distance that a typical consumer would be willing to travel in response to a ticket price increase, and defined the relevant isochrones to be a five to six kilometer radius or a 20 minute drive, depending on population density.

5. Conclusions and future challenges

16. Argentina's competition authority follows the same criteria for assessment of geographic markets included in the competition assessment guidelines of the majority of the jurisdictions around the world. The CNDC uses various approaches to define geographic markets that are applied on a case by case basis and as part of an empirical exercise based in business realities.

17. Although in most cases, the CNDC has defined markets at the local or national level, cases with broader geographic scope are becoming more prevalent. Even though Argentina has competition protection agreements with MERCOSUR members and with Brazil, so far it has made no use of these agreements. Strengthening these ties, not only with MERCOSUR but with other competition authorities of the region and around the world, is a major challenge for the CNDC. In terms of geographic market definition, Argentina could benefit from this cooperation if, for instance, it facilitates obtaining data on markets and players outside of the CNDC's jurisdiction. The hope is that ties between the CNDC and other competition agencies will get stronger as Argentina achieves more independence of the competition enforcement authority. Concentrations involving internet-based retailers will become more and more common and the CNDC should be prepared to apply market definition methodologies that are appropriate for such markets.

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20 CNDC, Dictamen No 65/2000.

21 Another case in which this idea was applied is the acquisition by YPF of the only gas station located in one of the largest hubs of transportation services in Buenos Aires (known as Retiro) and owned by Dapsa. In this case, the CNDC defined the relevant geographic market as the five gas stations located within 15 blocks from the target. The merger was blocked because, within that area, YPF's market share would have increased from 66% to 88%. Had the CNDC defined a wider geographic market (for example, all gas stations in the city of Buenos Aires) that market share increase would have been much smaller, and the merger would have likely been approved.

22 An isochrones is a geographic area around a firm that is drawn based on distance or travel time.

23 The Hoyts/Cinemark case is analyzed in Fox, Eleanor M., and D. Daniel Sokol, eds. *Competition law and policy in Latin America*. Bloomsbury Publishing, 2009.

24 CNDC, Dictamen No 1120/2015.

18. Based on the previous discussion, two main challenges that the CNDC faces in terms of geographic market definition for the future have been identified. The first challenge is to develop a methodology of when a broader than national geographic market is appropriate that would consistently be used in the analysis of similar cases. The main choice that needs to be made is between defining a global relevant market versus a national market with imports (foreign suppliers) as one additional (effective or potential) competitor. The definition of a global relevant market suffers from some problems, in particular, (i) the need to define global market shares, for which information may not be easily available; and (ii) even when the market is defined as global, the CNDC's evaluation only relates to the effects within the Argentine borders. The alternative is to define a national market, but including imports as competitors. According to the CNDC Guidelines, potential immediate competitors (including existing imports) should be taken into account when calculating concentration indexes. Potential competitors (such as potential imports when trade barriers are low) should be taken into account when analyzing barriers to entry. In some cases, when structural analysis is not enough to reach a robust conclusion, it is important that the merger analysis be complemented by a price analysis that would incorporate the idea that imports do not need to have a large share in the market to be able to exert competitive pressure.

19. The second challenge is to improve the quality of the analysis in the sense of incorporating more quantitative tools and recent developments in defining whether the relevant geographic market goes beyond the national market. In particular, the introduction of complementary price analysis to incorporate the idea that imports can exert competitive pressure even when the existing volume of trade is low. In this sense, a more formal analysis of the relationship between domestic and international prices, complemented by cointegration and causality analysis, emerges as a natural candidate to go in this direction.