Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

15-Nov-2016

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Working Party No. 3 on Co-operation and Enforcement

GEOGRAPHIC MARKET DEFINITION

-- Note by BIAC --

28-29 November 2016

This document reproduces a written contribution from BIAC submitted for Item 3 of the 124th meeting of the OECD Working Party No. 3 on Co-operation and Enforcement on 28-29 November 2016.

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

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JT03405432

-- BIAC --

1. The Business and Industry Advisory Committee to the OECD ("BIAC") appreciates the opportunity to submit the following comments to the OECD Competition Committee Working Party No. 3 on Co-operation and Enforcement ("WP3"), for its session on the definition of geographic markets across national borders.

1. Introduction

2. BIAC thanks the Secretariat for a detailed and considered Background Paper[1]. We agree with many of the points raised, and with the overall conclusion that geographic market definition, while capable of being a challenging exercise, nonetheless represents an important discipline in the assessment of both mergers and potential competition law infringements, even in cases where no formal conclusion is reached. More particularly, BIAC agrees with much of the Background Paper's description of the various analytical approaches to defining a relevant geographic market and the challenges associated with each.

3. This paper therefore focuses on a number of specific points raised by the Secretariat in the Background Paper, in the specific context of the definition of cross-border geographic markets and with a focus on the practicalities of geographic market definition from a business standpoint.

4. In addition to the content of this paper, BIAC has previously explored the subject of Market Definition more generally in a paper submitted to the Competition Committee's Policy Roundtable of June 2012[2] ("2012 BIAC Market Definition Paper"). Many of the general points made in that paper remain relevant to consideration of cross-border geographic market definition.

2. The concept and necessity of geographic market definition

5. BIAC agrees with the general proposition that defining the relevant geographic market can be a fact-intensive and complex exercise. However, as the Background Paper points out[3], market definition remains an important frame of reference in fundamental merger analysis and, in many jurisdictions, is an indispensable element of considering a prohibition or requiring a modification to a merger. BIAC also submits that, even in cases raising limited substantive issues, the process of considering the relevant geographic market – even where the precise market definition is left open and/or time and resources are limited –constitutes a useful discipline in an agency's broader review of a merger.

1 DAF/COMP/WP3(2016)5 dated 30 September 2016.

2 See pages 395-406 of DAF/COMP(2012)19 dated 11 October 2012.

3 Background Paper, para. 1.

6. The process of defining the relevant geographic market, especially where there are cross-border elements to consider, can lead to impacts beyond the jurisdiction. This risk exists not only, as the Background Paper points out[4], where a geographic market is defined too broadly, but also where a market is defined too narrowly. For example, companies in a particular industry sector (and their advisors) will look to the past decisional practice of an agency at an early stage in evaluating whether a proposed transaction is likely to raise competition concerns. An overly narrow market definition, in an environment where it is generally acknowledged that most mergers do not harm competition, runs the risk of discouraging potentially beneficial merger activity. Given the necessity of obtaining clearances in all jurisdictions in which merger approvals are required, the position taken by a single jurisdiction can make a significant difference globally - potentially for many years in the absence of new decisions on the market concerned[5].

7. BIAC therefore agrees that a well-designed approach to the process of geographic market definition, preferably outlined in published guidelines and carried out in a consistent and transparent manner, is needed. This is especially important when determining which of the many analytical approaches should be employed by an agency, and the relative weight apportioned to each (in order to avoid, for example, the suspicion that approaches have been chosen in order to "reverse-engineer" a particular outcome).

8. BIAC also supports the view of the Secretariat[6] that, given broader economic and technological trends (see below), guidelines should expressly address an agency's substantive approach to cross-border market definition, consistent with principles of due process and comity.

9. Consistency between jurisdictions, where possible, is helpful and strongly encouraged by BIAC. This is especially the case where the relevant geographic market crosses borders. The International Competition Network's (ICN) *Merger Guidelines Workbook*[7] and particularly the *Recommended Practices for Merger Analysis*[8] ("Recommended Practices") constitute welcome steps towards harmonisation and a good starting point for agencies looking to refine their analytical processes or draft guidelines for the first time. While it remains possible for agencies in different jurisdictions to reach different conclusions as to market definition in the same case (for example due to significant economic differences, brand preferences or trade barriers), it is particularly important that the analytical approach adopted is comparable. The Recommended Practices provide the basis for such comparability.

10. The adoption of consistent guidelines not only helps agencies by better enabling cross-border discussions, but also presents a substantial benefit for both the merging parties and interested third parties in transactions requiring multiple merger reviews. With well over 100 jurisdictions now operating merger control regimes, it is not uncommon for transactions to trigger filings in 10 or more jurisdictions, each with their own distinct procedures, forms and documentation requirements. The adoption of a consistent approach, such as that advanced by the Recommended Practices, helps to reduce the substantial costs and time typically associated with the merger control process, as well as complexity for the parties involved in a merger[9].

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4 Background Paper, para. 3.

5 For example, it is not unusual to cite decisions of the European Commission dating back up to 20 years in present day merger reviews, in the absence of more recent cases dealing with a given market or sector.

6 Background Paper, para. 49.

7 *ICN Merger Guidelines Workbook*, International Competition Network, Merger Working Group, April 2006. Available from http://www.internationalcompetitionnetwork.org/uploads/library/doc321.pdf .

8 *ICN Recommended Practices for Merger Analysis*, International Competition Network, Merger Working Group, 2010. Available from http://www.internationalcompetitionnetwork.org/uploads/library/doc316.pdf .

9 This issue is addressed in more detail in the 2012 BIAC Market Definition Paper.

11. It is also helpful for both the parties to a potential merger, as well as interested third parties, to broadly understand the process an agency will adopt not only to substantive cross-border market definition, but also to consultation with agencies in other relevant jurisdictions. This understanding better enables both merging parties and third parties to ensure that information is provided on a timely basis to all relevant agencies in order to allow for an informed and timely discussion.

12. Finally, while Guidelines are helpful, as well as consistency with the ICN's Recommended Practices, where merger control maintains a judicial dimension BIAC encourages agencies to align guidelines with existing judicial precedent. By doing so, agencies reduce the possibility for conflict and divergent outcomes between the agency and the courts[10].

3. Evidence considered in current approaches to market definition

13. Subject to the points made above as to consistency of approach, BIAC encourages agencies – commensurate with their resources and experience - to consider a wide range of approaches and forms of evidence. This is an area where thinking, particularly by economists, continues to evolve. As a practical point, flexibility will in some cases prove essential, particularly where data is lacking or in jurisdictions or sectors where the available data is likely to be unreliable (for example, retail sales data in countries with significant infrastructure constraints may overstate the position in urban areas and/or sales taking place through larger retailers).

14. Equally data rich markets, such as those for traded commodities, may enable more innovative techniques to be applied. However, regard must be had to the timing constraints that usually prevail in merger review, and large scale data requests should be avoided unless there will be clear scope to make meaningful use of the data given the time and resources available. This is especially important when requiring data from third parties, such as competitors, customers and suppliers.

15. BIAC also encourages agencies to be realistic, both in terms of a party's ability to gather data and the agency's ability to make meaningful use of it, when assessing the data it will require parties to collate and submit. For example, a detailed request sent by an agency in Europe in English, to an SME customer in China, may be less effective in adducing meaningful information than a shorter set of questions focused on a description of the data (the SME typically collects and the form in which it is held and how it is used. In certain jurisdictions, trade associations and even government may be in a better position to provide data than individual market participants, particularly SMEs.

16. As an overarching point, BIAC believes that, both in selecting the analytical approaches to employ and in performing the analysis itself, agencies should base their views on hard evidence and data as far as possible (anecdotal evidence may be of some use in certain circumstances – see below). As discussed in the 2012 BIAC Market Definition Paper, transparency as to the approaches chosen (and why) becomes more important as the number of potential approaches continues to increase, with guidelines, as discussed above, enabling the agency to select and use the various approaches in a consistent and predictable manner.

10 This issue is explored in more detail in the 2012 BIAC Market Definition Paper.

4. Current approaches

17. Pricing analysis remains useful, especially where rich data is available (in some markets this may be the most substantive or reliable data). As the Secretariat rightly points out in the background Paper[11], there are well known limitations to the use of pricing data – the key being awareness of these rather than simply discounting pricing analysis as an approach. For example, in a global commodity market, divergent pricing between two countries could be the result of consumer preferences (suggesting separate geographic markets) or asymmetrical customer profiles (e.g. Country A has two large customers, while Country B has several hundred customers of varying size, the difference being accounted for by volume discounts and lower distribution costs, rather than by the existence of a separate geographic market).

18. Critical loss analysis is one tool commonly used to analyse pricing data[12]. This approach and its limitations are well explained by the Secretariat. In particular, the critique that, when margins are already high (and demand elasticity low), then critical loss analysis implies that a price increase will lead to fewer lost sales than when margins are low (and demand elasticity is high). While such limitations must be taken into account, BIAC submits that it would be inappropriate to abandon critical loss analysis simply because it fails to work well in all circumstances. Critical loss analysis continues to provide – in a wide range of cases - a useful and straightforward conceptual framework for market definition analysis, making use of what will often be the data set most readily available to an agency.

19. Import data is also useful and often easily available. In many cases, it is important to look at data over a number of years, not just at current import levels, in order to screen for one-off events (for example the temporary closure of a supplier due to a natural disaster). As the Background Paper describes, there are obvious issues to bear in mind with import data. For example, many commodities imported to Europe are initially sold into major ports such as Rotterdam, but are then resold (sometimes several times), sometimes stored for considerable periods, and ultimately consumed in a number of countries. As with pricing data, BIAC views the limitations of import data as issues for agencies and parties to bear in mind when using import data, rather than as a justification for discounting what can be a rich objective source of information.

20. Formulae such as *Elzinger/Hogarty*, cited in the Background Paper[13], are of interest but have significant limitations as the Secretariat makes clear. More traditional tests (such as SSNIP) also have limitations but (a) tend to reflect the underlying legal and judicial position; and (b) tend to be better understood by parties and agencies alike, especially in jurisdictions where competition law is less established. These tests, as well as more sophisticated economic methodologies such as co-integration or cross-elasticity studies, should in any event be considered in the verification of observed factual evidence, rather than as a substitute for such evidence.

21. Anecdotal information may have a role to play. For example, a company may have spare capacity, low production costs and a lack of economic or legal barriers to entry, but fail to act as a competitive constraint on a larger competitor due to a bad reputation for customer service or past safety concerns. As with each of the evidence-based approaches set out in the Background Paper, care must be taken not to rely on anecdotal information in isolation.

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11 Background Paper, paras. 18-20.

12 Discussed in the Background Paper at para. 7.

13 Background Paper, para. 39.

22. In BIAC's views, evaluation of potential increases in exports should consider both demand side and supply side substitution. While it is true that existing suppliers in a jurisdiction may be better placed to expand than new importers, having already surmounted any barriers to trading in the jurisdiction, new entry should not be discounted nor should the analysis be conducted based on a static "snapshot" of imports divorced from the reasons (including exchange rate fluctuations) for shifts in imports over time. While both the US and Canadian guidance[14] tend to treat such potential imports as a factor in the substantive competitive assessment rather than a factor in defining the relevant geographic market, the EU disagrees. Whichever approach is taken, BIAC believes that it is important to conduct an unbiased analytical assessment regarding potential supply side substitution, given trends such as increased automation, more flexible machinery and tooling in many industries and the advent of technologies such as 3D printing.

23. There is also a need, as demonstrated by the European Commission in *Glencore/Xstrata*[15], to take account of longer term shifts in supply and demand, such as the rise of Asia (and China in particular) over the last two decades as a preeminent location for many types of manufacturing.

24. The Background Paper refers to a number of further product characteristics that may be relevant to the assessment of geographic market definition. These include transport costs, language/culture, manufacturing location and distribution networks, after sales and ancillary service, switching costs and product customisation. BIAC broadly agrees with the treatment of these characteristics in the Background Paper, which of course constitute a non-exhaustive list.

25. BIAC is also in broad agreement with the Background Paper's discussion on the subject of "chains of substitution" and strongly supports the concept, for example in situations where rival producers are vertically integrated to different degrees (for example purchasing a finished rather than intermediate product).

5. Future challenges in geographic market definition

5.1 Variation in the treatment of foreign competition in merger assessment guidelines

26. As noted earlier in this paper, BIAC views consistency between guidelines across jurisdictions as preferable, in particular where these demonstrate convergence towards recognized global standards such as the ICN Recommended Practices.

27. However, while such convergence is highly desirable, absolute consistency in guidelines – at least in the short term – is unrealistic. Agencies must each work within the constraints of their own legal environment and jurisprudence. This divergence should not, of itself, mean that global geographic market definitions are discounted or abandoned.

28. As the market trends referenced below make clear, markets are increasingly global in nature. While there will be cases where the market is defined as very large (but not quite global), this will in many cases make little practical difference to the substantive assessment, while potentially complicating the data needed to make a substantive assessment.

29. Caution around wide relevant geographic markets should not, in BIAC's view, be used as justification (absent substantive evidence) of the view that the agency's own jurisdiction forms a distinct geographic market while the rest of the world forms a near-global market.

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14 Cited by the Secretariat in the Background Paper, para. 39.

15 Case COMP/M.6541 Glencore/Xstrata, page 60. See also Background Paper, para. 40.

5.2 Market trends that pose challenges for geographic market definition

30. BIAC submits that many markets, as the Secretariat's paper suggests, are in fact becoming increasingly international in nature. This will not always mean that relevant geographic markets are global or even international in scope – for example, while AirBnB and Uber are well known and compete for business on a global level, the industries in which they participate (accommodation and transport services) are inherently local in nature. There are, however, plentiful examples of genuinely global markets at work – for example, Japanese online retailer Rakuten not only has several country-specific online stores, selling directly to consumers in those countries, but also provides a global website, available in multiple languages, enabling Japanese SMEs to market a board range of products directly to consumers worldwide. Examples also exist for wholesale distribution and the sale of components and intermediate products, such as the Chinese *Alibaba* series of websites.

31. Disruptive innovation and rapid technological change are likely to continue in the years ahead. Agencies, as well as multilateral groups such as the OECD and the ICN, may wish where possible to develop approaches that enable agencies to more rapidly understand such markets and the manner in which they can develop (for example the arrival of greater regulation once the disrupting players become established). Even so, there are likely to be tensions at times between the willingness of agencies to provide guidance that takes account of rapid change, and the underlying jurisprudence which may not move as quickly (or at all). In those circumstances, it remains important, from BIAC's standpoint, to ensure that guidance remains compatible with the views likely to be expressed by the courts in the event of an appeal.

32. BIAC notes, and is sympathetic to, the practical challenges that globalisation and rapid change bring for agencies. For example, in some "disrupted" markets the "disruptors" are SMEs, located outside the jurisdiction, who may not have or be unwilling to supply data. Gathering data across borders also raises language barriers. In some cases, the rise of technology has created enormous volumes of data, risking both the parties to a merger and the agency reviewing it becoming overwhelmed. In answer to all of these issues, BIAC recommends ongoing dialogue, both between agencies and with the parties to a merger, acknowledging the issues and looking for practical solutions. For example, the availability of machine translation enables at least straightforward queries to be issued to SMEs in any language. In some cases, trade associations or even the parties themselves may be able to assist.

33. Disruption does not always involve the arrival of new participants and marginalisation of existing players. For example, certain commodity markets have been disrupted by financialisation, introducing new ways of selling (for example through arbitrage or buying product via a trading screen rather than through face to face meetings and a signed standalone contract), without major disruption to the identity of the primary suppliers and traders.

34. Finally, while technology markets present especially innovative challenges to agencies, it is important to acknowledge that many markets remain 'traditional' in their structure and scope. Traditional approaches therefore retain their relevance, albeit with the generally well-known limitations outlined in the Background Paper. BIAC encourages agencies to retain tests such as SSNIP and critical price analysis – not least due to their familiarity and relative simplicity – while remaining open to alternative approaches.

6. Conclusion

35. BIAC views the process of defining a relevant geographic market, as well as market definition more generally, as remaining essential in providing a frame of reference for cases potentially raising substantive issue. Even where no firm conclusions need be reached, the process of market definition remains a useful discipline. While divergent guidance and the complexity of the analysis can prove daunting, especially for younger agencies, BIAC would encourage agencies to engage with geographic market definition analysis rather than seek to avoid it.

36. Agencies now have a wide range of potential approaches to defining the relevant geographic market, and in some cases an enormous amount of data and other evidence to draw upon. BIAC is broadly supportive of agencies making use of the full range of approaches and evidence, particularly where more traditional tests and approaches do not easily apply to the market under review. However, this flexibility must, in BIAC's view, be supported by an evidence-based approach and transparency both as to why particular approaches have been chosen, and as to the analysis itself. Lack of transparency in these circumstances risks encouraging the view (whether justified or not) that the agency is seeking to apply approaches that result in a particular desired outcome. Transparency has the broader benefit of enabling other agencies and market participants to learn for future cases. It also encourages consistency of approach.

37. Consistency can arguably best be delivered through the publication and application of guidelines, both as to the approach to be adopted and the substantive analysis itself. Where possible, and consistent with the underlying legislation and jurisprudence, BIAC encourages agencies to adhere to recognised global standards such as the ICN Recommended Practices. Guidelines should be regularly updated to take account of agency experience as well as new challenges and trends such as an increase in parties claiming the existence of cross-border markets.

38. Finally, BIAC acknowledges trends such as the globalisation of business and the rise of disruption across many industries. Indeed, businesses engaged in cross border trade, whether "disruptors" or "disrupted", are forced to deal with these and other issues on a daily basis, in some cases leading to rapid and radical changes in business models, organisation structures and performance. In reacting to these challenges, BIAC urges agencies to maintain a practical and open approach, in particular a willingness for dialogue with parties and other market participants - at an early stage - as to how the challenges might be addressed.