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Summary

Anti-monopoly laws play an important role to protect the market economy and maintain healthy environment for competition. After China joined WTO, the anti-monopoly problems are becoming more and more obvious. Anti-monopoly rules are needed urgently. It is inspiring that finally the Draft Anti-monopoly Law was passed preliminarily by the State Council in June 2006 after a more than ten years' gestation. The proposed Anti-monopoly Law provides the definition of both relevant product market and relevant geographic market. However, the principles and process of defining the market still remain a big gap to fill. Market definition is crucial in competition law. Without a definition of the relevant market, it is impossible to determine market share or assess market power. The absence of the notion of relevant market will make the implementation of Anti-monopoly Law extremely difficult and might cause divergence of the decisions of anti-monopoly authority as well as the judgments given by different courts.

Market definition is a tool to identify and define the boundaries of competition between firms. It serves to establish the framework within which competition rules are applied. The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining those undertakings' behaviour and of preventing them from behaving independently of effective competitive pressure. It is from this perspective that the market definition makes it possible to calculate market shares that would convey meaningful information regarding market power for the purposes of assessing dominance and merger or for the purposes of applying other anti-monopoly rules.

The US is the pioneer of anti-trust law. Europe has learned a lot from the US within this field. After many years of interaction between the two legal systems, the notions of relevant market seem to be quite similar to some extent, but there are still fine differences in many important aspects.

It is no doubt that the Chinese legislators will make analysis to the 1997 EC Commission's notice on the definition of the relevant market and the 1992 US Horizontal Merger Guidelines. The legislators will try to transplant suitable parts of the notion in both legal systems into the Chinese legislation.

This thesis is going to introduce systematically the notions of relevant market in both the EC and the US perspectives through legislation study and case law study. Then a comparison will be made between EC and the US of several important aspects and respective proposals will be made to the Chinese legislation.

Preface

I chose Sweden for my master study because of her beauty. I chose Lund University because of her long history and high reputation. Time flies by. After this thesis, my master study will come to an end.

I chose relevant market as my thesis topic because I had a good time in the competition law course. I find competition law really interesting and I would like to work in this field in the near future.

Here I would like to express my deep gratefulness to Prof. Hans Henrik Lidgard, my tutor, together with other professors from whom I have gained precious knowledge. And also thank you to all of my classmates from whom I have learned a lot.

Thank you to Sweden and Lund University for having chosen me as a master candidate. Thank you to my dear parents and girlfriend for supporting my choice to study abroad.

We choose the world and the world belongs to us.

Lund, Sweden, May 2007

Xin Song

Abbreviations

CFI	Court of First Instance
EC	European Community
ECJ	European Court of Justice
ECR	European Court Report
M&A	Mergers and Acquisitions
OJ	Official Journal (of the European Communities)
US	United States (of America)
WTO	World Trade Organization

1 Introduction

1.1 General

Market definition is a tool to identify and define the boundaries of competition between firms. It serves to establish the framework within which competition rules are applied. The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining those undertakings' behaviour and of preventing them from behaving independently of effective competitive pressure. It is from this perspective that the market definition makes it possible to calculate market shares that would convey meaningful information regarding market power for the purposes of assessing dominance and merger or for other purposes of applying anti-monopoly rules.¹

1.2 Purpose

The main purpose of this thesis is to introduce and compare the notions of relevant market in EC and the US and then make several suggestions to the Chinese legislation. The author will try to clarify the notions of relevant market in both legal systems on the basis of legislations and case laws. After a comparison of several important issues between the EC and the US perspectives, proposals will be made to the establishment of the notion of relevant market in China.

1.3 Method

In order to pursue the purposes set above, several methods including translation, demonstration, interpretation, analysis and comparison will be used in this thesis. Due to the fact that most of the Chinese citations and references in this thesis have no English version, they are translated by the author. The translated materials are only for legal studies within the scope of this thesis. The author has no responsibility for the accuracy of the translations when the translated materials are used by others. The author is going to breakdown the legislations and to demonstrate the previous cases and will in certain circumstances interpret them or make analysis in order to make them easy to understand. Through demonstration, interpretation and analysis of legislations and case laws, this thesis is going to clarify the fundamental concepts concerning the defining of relevant market in both EC and the US. Then, through the comparison and analysis of the notions in

¹ Commission Notice on the definition of the relevant market for the purposes of Community competition law [1997] OJ C372/5, Paragraph 2.

both perspectives, several proposals are to be made to the Chinese legislation in this field once China is about to establish the notion of relevant market.

1.4 Delimitation

Within the limitation of the foregoing purposes pursued, this thesis is to seek for clarification of fundamental rules in respect with market definition under EC and the US competition laws. It is limited to the extent of definition of relevant market, competitive constrains, process of defining the market, criteria for defining the market and the methods that are being used by the EC and the US courts to define a market. As regards to competition constrains, the thesis is limited to demand and supply substitutability. Potential competition, which actually represents an effective competitive constraint depend on the analysis of specific factors and circumstances related to the conditions of entry, will not be discussed in this thesis because it will not be carried out at the stage of defining market.

2 The Chinese Anti-monopoly Legislation

2.1 Why China Needs Anti-monopoly Legislation?

Some scholars argue that there is no need for China to adopt a new anti-monopoly law currently since the domestic companies are still small in comparison with the European or the US counterparts. Thus, concentration should be encouraged but not restrained. This is partly right. However, what about the merging by the multinationals, the big business cruisers? Besides, the main task of anti-monopoly law is to maintain healthy competition on the domestic market and to protect the interests of consumers, so the scale of companies is irrelevant² other than the market power. Moreover, competition law is born to regulate not only excessively concentrative M&A but also the anti-competition agreements, concerted practices and abuses of dominance. What if the so-called “small companies” collaborate to restrict or distort competition on the market, which will diminish the interests of consumers?

Anti-monopoly laws play an important role to protect the market economy and maintain healthy environment for competition. With the establishment of socialist market economy and deepening of economic reform, problems arising from the lack of systematic anti-monopoly rules are becoming more obvious in China.

After China joined WTO, a new tide of mergers has come. The international beer giants have merged most of the domestic beer companies. L'ORÉAL spent only 50 days in merging MININURSE, a noted Chinese cosmetics company. More than 80% of the large format supermarkets are owned by multinational enterprises now. Recently, multinational enterprises have started to merge manufacturing companies and focus on the leading companies in the industries of engineering machinery and electric appliances etc.³ Several domestic markets such as photographic film, soft drinks, large format supermarkets, have seen great foreign investment. In some cases, the foreign owner approaches or has indeed had a dominant position in the given market.⁴ What if the foreign companies abuse their dominant position?

² Wang Xiaoye, A Right Time to Introduce Anti-monopoly Law, translated by the author, <http://www.antimonopoly.org/news/view.asp?articleid=81>.

³ Li Deshui, Beware of Monopolistic Transnational Mergers, translated by the author, http://news.xinhuanet.com/fortune/2006-03/07/content_4268827.htm.

⁴ Mark Williams, Adoption of the EC Competition Law Model—Is it a Trojan Horse for China?, An Exploration of China's Legislation on Competition, First Edition, SOCIAL SCIENCES ACADEMIC PRESS (CHINA), 2006, Page 338.

Due to all the above mentioned problems, a new anti-monopoly law is needed, urgently.

2.2 What Laws Does China Have Now?

Among all the current competition legislations, such as Anti-unfair Competition Law, Transitional Regulation on Prohibition of Monopolistic Pricing⁵ and Regulation on Prohibition of Public Enterprises' Anti-competitive Conducts⁶ etc, Regulation on Merger of Domestic Enterprises by Foreign Investors⁷ is the most important, together with the proposed Anti-monopoly Law of People's Republic of China⁸.

2.2.1 Regulation on Merger of Domestic Enterprises by Foreign Investors

This Regulation was adopted in 2003⁹ and was revised in 2006. The Regulation has its purposes provided in Article 3¹⁰, to prevent excessive concentrations and anti-competition practices, to protect the order of market economy and public interests and to avoid the loss of state-owned assets.

Section 5 of the Regulation is Prior Notification. Article 51 provides that foreign investors shall make notification to Ministry of Commerce and State Administration for Industry and Commerce prior to the merger when any of the following conditions is met:

[...] (3) any party of the merger has a market share of more than 20% in China's domestic market; or

(4) the merger will lead the market share of any party of the merger in China's domestic market to exceed 25%.

Article 53 deals with the situations where foreign investors shall submit the blue print of the merger to Ministry of Commerce and State Administration for Industry and Commerce, and market share requirements are also provided.

The Regulation says nothing about the market definition but deals with the calculation of market shares. How can the market share be calculated correctly without first defining the relevant market? This will cause a big

⁵ Unofficial translation, translated by the author.

⁶ Ibid.

⁷ Ibid. Chinese version available at <http://www.law-china.com/zhuanti/newsd.asp?id=10007>.

⁸ Version of November 2005.

⁹ This Regulation was initially called Transitional Regulation on Merger of Domestic Enterprises by Foreign Investors (unofficial translation, translated by the author) before the revision in 2006.

¹⁰ Unofficial translation. All the provisions cited from this Regulation are translated by the author.

problem for the anti-monopoly authorities and the courts to implement this Regulation and grant too much discretion to them.

2.2.2 Draft Anti-monopoly Law

The Anti-Monopoly Law drafting team was established more than ten years ago. The main obstacle against the emergence of this law is the legislators' will. There have been great numbers of discussions when it is the right time to introduce this law. It is inspiring that finally the Draft Anti-monopoly Law was passed preliminarily by the State Council in June 2006. Now, it is time.

This law has its purpose provided in Article 1¹¹, to prevent monopolistic conduct, maintain market competition, protect the interests of consumers and the public, and promote healthy development of the socialist market economy.

The Draft has six main sections: general provisions, anti-competition agreements, abusive conducts of a dominant position, concentrations, the anti-monopoly authority and legal liability.

We are pleased to see there is market definition in Article 4 of the Draft. Relevant market is defined as the scope or area within which the undertakings compete to provide relevant products or services during a certain period. Relevant product market is defined as a certain market made up of a group of products which are regarded as substitutable due to the products' characteristics, their prices and their intended use. Relevant geographic market is defined as a geographic range in which undertakings supply products or consumers buy products and within which the conditions of competition are basically homogeneous.

The Draft provides many situations where calculation of market share is needed, such as the determination of a dominant position and appraisal of concentrations.

Article 13 provides that the following factors shall be taken into account when determining a dominant position:

- (1) market share of the undertaking and the other undertakings in competition in the relevant market; [...]

- (6) the conditions of entry into the relevant market by other undertakings; and [...].

Article 14 provides that undertakings are directly held to be in a dominant position when any of the following conditions is met:

¹¹ No official English version of Draft Anti-monopoly Law of China is available. All the provisions cited from this Draft are translated by the author.

- (1) the market share of one undertaking in the relevant market exceeds 1/2 of the whole market;
- (2) the joint market share of two undertakings in the relevant market exceeds 2/3 of the whole market; or
- (3) the joint market share of three undertakings in the relevant market exceeds 3/4 of the whole market.

Article 25 provides that the Anti-monopoly Authority shall make a decision prohibiting a concentration which will substantially eliminate or restrain competition in the relevant market. When the Anti-monopoly Authority decides whether or not to prohibit a concentration, the decision shall be based on the following factors:

- (1) the market shares of the undertakings participating in the proposed concentration in the relevant market and their power to control the market; and
- (2) the extent of concentration in the relevant market; and
- (3) the effect on competition the proposed concentration will cause in the relevant market; and [...].

Defining the relevant market will be the initial step of determining a dominant position or appraising concentrations but how to define it and what rules to follow are still questions.

2.3 Absence of the Notion of Relevant Market

The current competition legislation addresses market share but does not say a word on market definition. The proposed Anti-monopoly Law provides the definition of both relevant product market and relevant geographic market, which is an inspiring step. However, the principles and process of defining the market still remain a big gap to fill.

In 2006, there was a very controversial merger case *SEB SA/SUPOR*. This is the first case of anti-monopoly investigation after the revised Regulation on Merger of Domestic Enterprises by Foreign Investors.

The French company SEB SA is one of the world leading companies of cookware and Electrical Appliances. SUPOR is the most famous cookware company in China, whose market share of pressure cooker is over 50%. In August 2006, the two companies signed a merger framework through which SEB will acquire 52% to 61% of the shares in SUPOR.

According to Article 51 of the Regulation, this concentration in question should be notified to the anti-monopoly authorities if any party of the merger has a market share of more than 20% in China's domestic market, or the merger will lead the market share of any party of the merger in China's domestic market to exceed 25%.

SEB has a very small market share in China but SUPOR enjoys a 50% to 70% market share of pressure cooker. The disputed point was the market definition. SUPOR argued that the relevant product market should be the market of cookware instead of pressure cooker because people can use a pressure cooker, a pan or a pot to cook food. SUPOR's market share of cookware was less than 10% and thus it was not compulsory to notify the merger to the anti-monopoly authorities. The other undertakings in the cookware industry argued that SUPOR was intended to broaden the relevant product market in order to avoid the prior notification.

The Ministry of Commerce started the procedure of investigation but gave no reasoning on the market definition. The merger was approved in April 2007. Still we have no idea about the basis of this decision. Whether the relevant product market is the market of cookware or the one of pressure cooker? Or the relevant product market is the one of pressure cooker and SUPOR enjoys a dominant position on that market but it will never have the monopoly power because the low entry barriers of the market. Moreover, the definition of relevant geographic market was left untouched. After the analysis of notion of relevant market, we will come back to this case and carry out some academic discussions.

The absence of the notion of relevant market will make the implementation of Anti-monopoly Law extremely difficult and might cause divergence of the decisions of anti-monopoly authority as well as the judgments given by different courts.

It is certain the legislators will introduce an implementing regulation or guideline to explain the whole notion of relevant market. In addition, it is no doubt that analysis will be made to the 1997 EC Commission's notice on the definition of the relevant market and the 1992 US Horizontal Merger Guidelines¹². The legislators will try to transplant suitable parts of the notion in both legal systems into the Chinese legislation.

Hereafter, this thesis is going to analyze the legislations and case-laws in both EC and the US perspectives and make a comparison to show what China may learn from the two counterparts.

¹² US Department of Justice and the Federal Trade Commission, 1992 Horizontal Merger Guidelines (revised in 1997), <http://www.usdoj.gov/atr/public/guidelines/hmg.htm>.

3 Several Economic Concepts

Before the explanations of defining a relevant market, it might be necessary to introduce several economic concepts first since the competition authorities are nowadays using economic analysis when defining a relevant market.

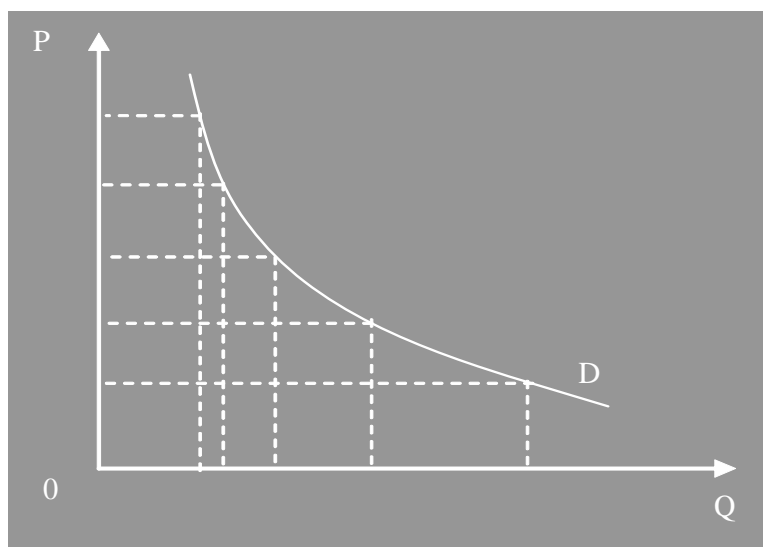
3.1 Price Elasticity of Demand

Price elasticity of demand, or own-price elasticity of demand, is a measure of the responsiveness of quantity demanded of a good or service to a percentage change in its own price.

The formula used to calculate the coefficient of price elasticity of demand is:

$$E_d = \left| \frac{\% \text{ change in quantity demanded of product } X}{\% \text{ change in price of product } X} \right| = \frac{\Delta Q_d / Q_d}{\Delta P_d / P_d}.$$

For a normal good¹³, a price increase results in a drop in the quantity demanded by consumers. See Graph 1.



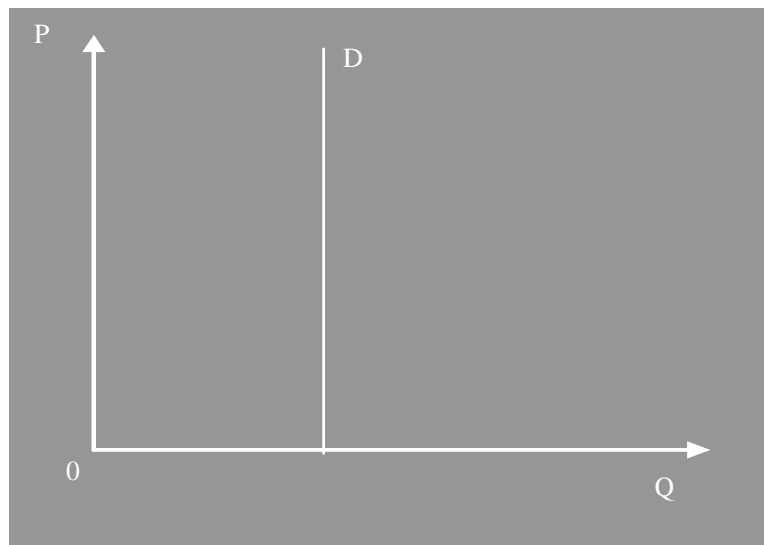
Graph 1

The demand for a good is relatively inelastic when the quantity demanded does not change much with the price change. Goods and services for which no substitutes exist are generally inelastic.¹⁴ When a certain product has no

¹³ Price Elasticity of Demand, from Wikipedia, http://en.wikipedia.org/wiki/Price_elasticity_of_demand. It may be possible that quantity demanded for a good rises as its price rises, even under conventional economic assumptions of consumer rationality. Two such classes of goods are known as Giffen goods or Veblen goods. Another case is the price inflation during an economic bubble.

¹⁴ Ibid.

substitutes and is “absolutely” necessary, the value of the elasticity will be zero. See Graph 2.



Graph 2

3.2 Cross-price Elasticity of Demand

Cross-price elasticity of demand is a measure of the responsiveness of the quantity demanded of one good or service (product Y) to a percentage change in the price of another one (product X).

The formula used to calculate the coefficient of cross-price elasticity of demand is:

$$E_c = \left| \frac{\% \text{ change in quantity demanded of product Y}}{\% \text{ change in price of product X}} \right| = \frac{\Delta Q_y / Q_y}{\Delta P_x / P_x}$$

Where the two goods are substitutes, the cross-price elasticity of demand will be positive. That is to say, when the price of product X goes up, the quantity demanded of product Y will increase. For example, in response to an increase in the price of oranges, the demand for apples will rise and then oranges and apples will be considered as substitutes.

Where the two goods are complements, cross-price elasticity of demand will be negative. That is to say, when the price of product X goes up, the quantity demanded of product Y will decrease. For example, gasoline and cars are complements. If the price of gasoline increases, the demand for cars will drop.

Where the two goods are independent, the cross-price elasticity of demand will be zero. That is to say, the price change of product X will cause no change in quantity demanded of product Y. For example, oranges and cars are independent. The price increase of oranges will have no effect on the quantity demanded of cars.

This method is being used by the competition authorities to identify if two products are considered interchangeable by the customers and thus belong to the same relevant market. Usually the price increase of product X is supposed to be very small, below 10%, which means the diversion ratio is high enough to conclude that product Y is one substitute of product X.

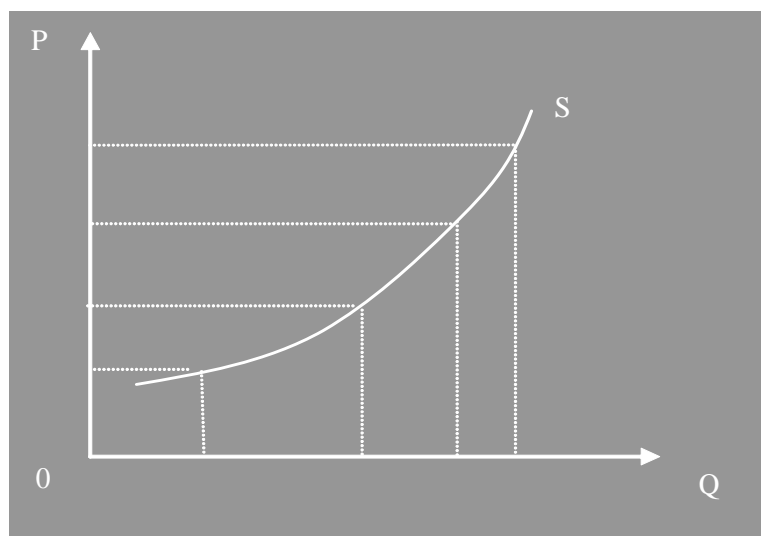
3.3 Price Elasticity of Supply

Price elasticity of supply is a measure of the responsiveness of quantity supplied of a good or service to a percentage change in its own price.

The formula used to calculate the coefficient of price elasticity of supply is:

$$E_s = \left| \frac{\% \text{ change in quantity supplied of product } X}{\% \text{ change in price of product } X} \right| = \frac{\Delta Q_s / Q_s}{\Delta P_s / P_s}$$

In most cases, the price elasticity of supply is positive because a price increase is likely to increase the quantity supplied to the market. See Graph 3.

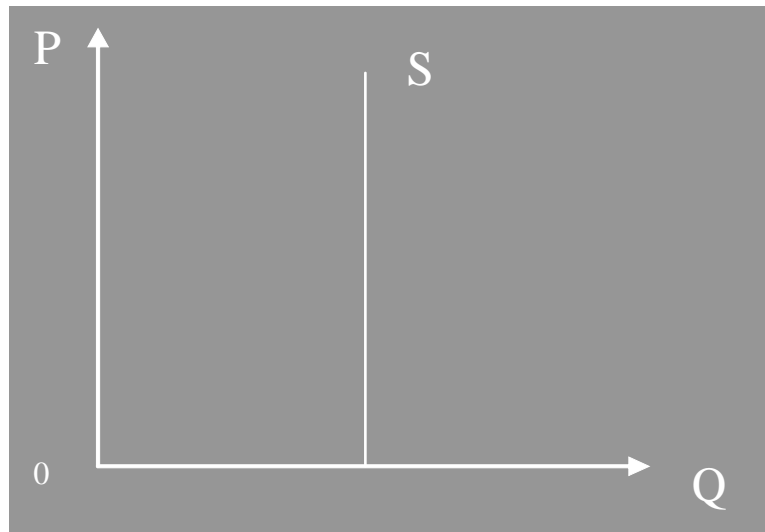


Graph 3

If the value of the price elasticity of supply is very high, it shows that there are great supply-side substitutions of a relevant product, which means firms that are not currently producing or selling the relevant product in the relevant market are likely to supply the product within a short period and without the expenditure of significant sunk costs, or potential competitors are likely to enter the market without entry barriers, in response to a price increase.

If the value of this elasticity is zero, in another word, the curve is vertical, this means there are few supply-side substitutions because firms that are not currently producing or selling the relevant product have to spend a very long period and significant sunk costs, or the potential competitors are facing

great entry barriers, such as the lack of technological capability or state monopoly, when they intend to supply the product. See Graph 4.



Graph 4

4 Notion of Relevant Market in the EC Perspective

4.1 The Commission Notice

The Commission of the European Communities adopted a notice on the definition of the relevant market in 1997 in order to provide guidance as to how it defines the concept of relevant product and geographic market when applying Article 81 and 82 EC and the Merger Regulation.

The Commission expects to increase the transparency of its competition policy through the Notice and thus provide the undertakings with legal certainty when they are making decisions. The Notice has five main sections: definition of relevant market, basic principles for market definition, the process of defining the relevant market including evidence and criteria, calculation of market share and additional considerations.

4.2 Definition of Relevant Market

The definition of relevant market has two dimensions: relevant product market and relevant geographic market.

Relevant product market is defined as follows:

A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.¹⁵

Relevant geographic market is defined as follows:

The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those area.¹⁶

4.3 Principles for Market Definition

The Commission Notice provides three main competitive constraints that undertakings are subject to: demand substitutability, supply substitutability

¹⁵ See Commission Notice on the definition of the relevant market, Paragraph 7.

¹⁶ Ibid, Paragraph 8.

and potential competition. This thesis is going to discuss only demand and supply substitutability because potential competition, which actually represents an effective competitive constraint depend on the analysis of specific factors and circumstances related to the conditions of entry, will not be carried out at the stage of defining market.¹⁷

4.3.1 Demand Substitution

Demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product, in particular in relation to their pricing decisions. A firm or a group of firms cannot have a significant impact on the prevailing conditions of sale, such as prices, if its customers are in a position to switch easily to available substitute products or to suppliers located elsewhere.¹⁸

This approach starts with a hypothetical small (in the range 5 % to 10 %) but permanent relative price increase in the products and areas being considered and then asks whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to that price increase. If substitution were enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. This would be done until the set of products and geographical areas is such that small, permanent increases in relative prices would be profitable.¹⁹ This is known as the SSNIP²⁰ test.

Generally, the price to take into account will be the prevailing market price. This may not be the case where the prevailing price has been determined in the absence of sufficient competition.²¹ This is known as “Cellophane fallacy” which will be discussed later in the US section.

4.3.2 Supply Substitution

Supply substitution may also act as an immediate and effective disciplinary force when suppliers are able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices.²²

These situations typically arise when companies market a wide range of qualities or grades of one product. The Commission gives a practical example here — paper plants.²³ Paper is usually supplied in a range of different qualities, from standard writing paper to high quality papers. From

¹⁷ Ibid, Paragraph 24.

¹⁸ Ibid, Paragraph 13.

¹⁹ Ibid, Paragraph 17.

²⁰ SSNIP stands for a “small but significant and nontransitory” increase in price.

²¹ Ibid, Paragraph 19.

²² Ibid, Paragraph 20.

²³ Ibid, Paragraphs 21-22.

a demand point of view, different qualities of paper cannot be used for any given use, i.e. an art book cannot be based on lower quality papers. However, paper plants are prepared to manufacture the different qualities, and production can be adjusted with negligible costs and in a short time-frame. In the absence of particular difficulties in distribution, paper manufacturers are able therefore, to compete for orders of the various qualities. Under such circumstances, the Commission would not define a separate market for each quality of paper and its respective use. The various qualities of paper are included in the relevant market, and their sales added up to estimate total market value and volume.

The Notice also provides when supply-side substitutability would entail the need to adjust significantly existing tangible and intangible assets, additional investments, strategic decisions or time delays, it will not be considered at the stage of market definition.²⁴ As far as the author is concerned, this situation belongs to the third restraint — potential competition.

4.4 Relevant Product Market

4.4.1 Process of Defining the Relevant Product Market

On the basis of the preliminary information available or information submitted by the undertakings involved, the Commission will usually be in a position to broadly establish the possible relevant markets. The issue will often be to establish whether product A and product B belong or do not belong to the same product market. It is often the case that the inclusion of product B would be enough to remove any competition concerns.²⁵

The Commission will often contact the main customers and the main companies in the industry to enquire into their views about the possible reactions to hypothetical price increases and their views of the boundaries of the relevant market.²⁶

Product characteristics and intended use are insufficient to show whether two products are demand substitutes. Functional interchangeability or similarity in characteristics may not, in themselves, provide sufficient criteria, because the responsiveness of customers to relative price changes may be determined by other considerations as well. The Notice provides several types of evidence to define the relevant product market:²⁷

- (1) evidence of substitution in the recent past;

²⁴ Ibid, Paragraph 23.

²⁵ Ibid, Paragraph 26.

²⁶ Ibid, Paragraphs 33-34.

²⁷ Ibid, Paragraphs 36-43.

- (2) quantitative tests;
- (3) views of customers and competitors;

- (4) consumer preferences;

- (5) barriers and costs associated with switching demand to potential substitutes; and

- (6) different categories of customers and price discrimination.

4.4.2 Case Study

4.4.2.1 *Continental Can* [1973]

In *Continental Can*²⁸, after the acquisition of SLW in Germany, Continental Can acquired a Dutch can-packaging company TDV. The second merger was held by the Commission to be an abuse of a dominant position. According to the Commission, Continental Can, a dominant company, strengthened such position through a merger in such a way that real or potential competition in the goods concerned was in practice eliminated in a substantial part of the common market.²⁹

For the appraisal of SLW's dominant position and the consequences of the disputed merger, the definition of the relevant market is of essential significance.³⁰ The ECJ quashed the Commission's findings on defining the relevant product market in both perspectives of substitutes on the demand side and supply side.

Firstly, from the demand side, it cannot be concluded from SLW's market share, amounting to 70 to 80 per cent in meat cans, 80 to 90 per cent in cans for fish and crustacea and 50 to 55 per cent in metal closures with the exception of crown corks that this undertaking dominates the market for light metal containers. The decision, moreover, excluded the possibility of competition arising from substitute products, such as glass and plastic containers.³¹ In the decision, a "market for light containers for canned meat products", a "market for light containers for canned seafood", and a "market for metal closures for the food packing industry, other than crown corks", all allegedly by the Commission to be dominated by SLW and in which the disputed merger threatens to eliminate competition. However, nothing is said about how these three markets differ from the general market for light metal containers, namely the market for metal containers also for other products, such as fruit and vegetables, condensed milk, olive oil, fruit juices etc. In order to be regarded as constituting a distinct market, the products in question must be individualized, not only by the mere fact that they are used

²⁸ See Case 6-72, *Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities*, [1973] ECR 215.

²⁹ *Ibid*, Paragraph 28.

³⁰ *Ibid*, Paragraph 32.

³¹ *Ibid*, Paragraph 31.

for packing certain products, but by particular characteristics of production which make them specifically suitable for this purpose.³² Another part of the decision seems to confirm that the production of metal cans for meat and fish cannot be considered separately from the production of metal cans for other purposes and that, when considering the production of metal closures, crown corks must not be left out.³³ The contradiction indicated that the Commission's analysis of defining the market was not reliable. If Continental Can were to raise the prices significantly, it would be possible that its customers could turn to use glass or plastic containers, or to use other metal containers such as cans for fruits and vegetables instead.

Secondly, from the supply side, a dominant position on the market for light metal containers for meat and fish cannot be decisive as long as it has not been proved that competitors from other sectors of the market for light metal containers are not in a position to enter this market by a simple adaptation, with sufficient strength to create a serious counterweight.³⁴ Furthermore, some further contradictions also challenged the validity of the decision contested. In the Belgian market the Marie Thumas cannery through its subsidiary Eurocan makes metal containers for its own use and for sale to other consumers. And certain German firms who manufacture their own had begun to market their surplus output of metal containers. It can be concluded from all this that some undertakings which have begun to manufacture their own containers were able to overcome the technological difficulties, yet the decision does not contain any criteria for evaluating the power of competition of these undertakings.³⁵ Again, if Continental Can were to raise the prices above costs significantly, the other undertakings would join in to compete with it, which would render a loss of sales and make the initial price rise unprofitable.

The Commission had not sufficiently shown the facts and the assessments on which the decision is based, and thus the decision was annulled by the ECJ.

4.4.2.2 *United Brands* [1978]

In *United Brands*³⁶, the large banana producer United Brands Company (hereafter "UBC") was held by the Commission to have been abusing its dominant position by (1) refraining its distributor/ripeners from reselling its bananas while still green; (2) charging dissimilar prices for equivalent transactions; (3) imposing unfair prices on certain customers; and (4) refusing to supply in certain instances.³⁷

³² Ibid, Paragraph 33.

³³ Ibid, Paragraph 34.

³⁴ Ibid, Paragraph 33.

³⁵ Ibid, Paragraph 36.

³⁶ See Case 27/76, *United Brands Company and United Brands Continentaal BV v Commission of the European Communities*, [1978] ECR 207.

³⁷ Ibid, Paragraph 3.

In order to determine whether UBC had abused its dominant position which was forbidden under Article 86 EC (now Article 82 EC), the initial step was to define the relevant market. The Commission held that bananas constituted a distinct product market because they were an important part of the diet for certain consumers and their characters such as taste and softness were so different from other fruits. UBC challenges the analysis made by the Commission of the relevant product market.

The ECJ upheld the Commission's decision. It held that the ripening of bananas takes place the whole year round without any season having to be taken into account.³⁸ There is little seasonal substitutability in general between the banana and all the seasonal fruits as this only exists between the banana and two fruits (peaches and table grapes) in West Germany.³⁹ Two studies of Food and Agriculture Organisation show that the banana is only affected by the falling prices of peaches and table grapes during the summer months and mainly in July and then by an amount not exceeding 20%.⁴⁰ As far as concerns the two fruits available throughout the year (oranges and apples), the first are not interchangeable and in the case of the second there is only a relative degree of substitutability.⁴¹

The Court went on stating that the specific features of the banana and all the factors that influence consumer choice account for this small degree of substitutability. The banana has certain characteristics, appearance, taste, softness, seedlessness, easy handling, a constant level of production that enable it to satisfy the constant needs of an important section of the population consisting of the very young, the old and the sick.⁴² Bananas can hardly be regarded as interchangeable or substitutable with other fruits by the consumers who have a constant need for them.

The Court had taken into account bananas' characteristics, prices and intended use and finally concluded that the banana market is sufficiently distinct from the other fresh fruit markets.

4.4.2.3 *Michelin I* [1983]

In *Michelin I*⁴³, Michelin NV is the Netherlands subsidiary of the Michelin group. It is responsible for the production and sale of Michelin tyres in the Netherlands, where it has a factory for the production of new tyres for vans and lorries. The Commission in its decision declared that Michelin NV had abused its dominant position on the market in new replacement tyres for lorries, buses and similar vehicles by tying tyre dealers in the Netherlands to itself through the granting of selective discounts on an individual basis conditional upon sales "targets" and discount percentages and by applying

³⁸ Ibid, Paragraph 23.

³⁹ Ibid, Paragraph 28.

⁴⁰ Ibid, Paragraph 32.

⁴¹ Ibid, Paragraph 29.

⁴² Ibid, Paragraphs 30-31.

⁴³ See Case 322/81, *NV Nederlandsche Banden Industrie Michelin v Commission of the European Communities*, [1983] ECR 3461.

to them dissimilar conditions in respect of equivalent transactions. Michelin NV argued that the Commission wrongly considered that it had a dominant position inasmuch as it relied on its share of the relevant product market, particularly the definition of that market.⁴⁴

For the purposes of investigating the possibly dominant position of an undertaking on a given market, [...] an examination limited to the objective characteristics only of the relevant products cannot be sufficient: the competitive conditions and the structure of supply and demand on the market must also be taken into consideration.⁴⁵

Firstly, new original-equipment tyres should not be taken into consideration in the assessment of market shares because the particular structure of demand for such tyres characterized by direct orders from car manufacturers, competition in this sphere is governed by completely different factors and rules.⁴⁶

Secondly, at the user level there is no interchangeability between car and van tyres on the one hand and heavy-vehicle tyres on the other. Car and van tyres therefore have no influence at all on competition on the market in heavy-vehicle tyres.⁴⁷

From a demand perspective, the structure of demand for each of those groups of products is different. On the one hand, most buyers of heavy-vehicle tyres are trade users for whom the purchase of replacement tyres represents an item of considerable expenditure and who constantly ask their tyre dealers for advice and long-term specialized services adapted to their specific needs. On the other hand, for the average buyer of car or van tyres the purchase of tyres is just an occasional event.⁴⁸

From a supply perspective, there is no elasticity of supply between tyres for heavy vehicles and car tyres owing to significant differences in production techniques and in the plant and tools needed for their manufacture. The fact that time and considerable investment are required in order to modify production plant for the manufacture of light-vehicle tyres instead of heavy-vehicle tyres or vice versa means that there is no discernible relationship between the two categories of tyre enabling production to be adapted to demand on the market.⁴⁹

The ECJ held that the Commission was right to define the relevant product market of replacement tyres for lorries, buses and other heavy vehicles and to exclude tyres for cars and vans from that market.

⁴⁴ Ibid, Paragraphs 2-4.

⁴⁵ Ibid, Paragraph 37.

⁴⁶ Ibid, Paragraph 38.

⁴⁷ Ibid, Paragraph 39.

⁴⁸ Ibid, Paragraph 40.

⁴⁹ Ibid, Paragraph 41.

4.4.2.4 Carnival Corporation/P&O Princess [2002]

In *Carnival Corporation/P&O Princess*⁵⁰, the merging parties are two of the four largest cruise operators worldwide.⁵¹ Carnival Corporation (hereafter “Carnival”) is a US-based company active worldwide in maritime cruise operation, offering a broad range of cruise brands. Carnival operates around 40 ships in various geographic areas around the world. The British undertaking P& O Princess plc (hereafter “POPC”) is also a company mainly active worldwide in maritime cruise operations, with around 20 ships, marketed under several brands. POPC is also active in river cruises.⁵²

Carnival intended to acquire full control of POPC by way of a public bid announced in 2001 and the proposed concentration was notified to the Commission in 2002.⁵³

In the process of defining the relevant product market, Carnival considered that the appropriate product market is the market for the provision of leisure travel, which includes a wide variety of alternative vacation options. It argued that a cruise holiday is substitutable for various other types of vacation such as a stay in a holiday club or an all-inclusive hotel resort, a package holiday, a skiing holiday or a tour in an exotic location. POPC held a similar view. But the Commission’s investigation pointed to a number of elements that distinguish oceanic cruises from other forms of holidays across Europe.⁵⁴

The Commission took the initial step with the consumers’ perceptions of the characteristics of cruising. A customer of an oceanic cruise buys a product that is distinct from any other holiday product in that it combines: (a) the experience of the sea; (b) the experience of travelling from one place to another in a multi-night sequence; (c) without the necessity of continuous re-packing; and (d) with a specific on-board experience of conviviality that is different from land-based group experiences. When asked for their consumers’ reasons for booking a cruise, travel agents mentioned three top reasons which, taken together, are specific to cruises: (1) the attraction of the itinerary and the sequence of destinations; (2) the all-inclusiveness of the services offered on board a ship; and (3) the fact that cruising does not require any packing nor unpacking to go from one place to another, thus constituting a very convenient way of holidaymaking. No other form of holiday can combine these three main attractions.⁵⁵

The Commission also considered that consumers’ distinct preferences for oceanic cruises are reflected in the information that they seek when first

⁵⁰ See Case No COMP/M.2706 — *Carnival Corporation/P&O Princess*, Commission Decision of 24 July 2002 declaring a concentration to be compatible with the common market and the functioning of the EEA Agreement, OJ L248/1.

⁵¹ *Ibid*, Paragraph 14.

⁵² *Ibid*, Paragraphs 4-5.

⁵³ *Ibid*, Paragraph 1.

⁵⁴ *Ibid*, Paragraphs 29-30.

⁵⁵ *Ibid*, Paragraphs 32-33.

contacting travel agents. When first contacting a travel agency, almost all customers who actually bought a cruise first requested a cruise brochure instead of requesting information on both cruise and other types of holidays. This indicated that their decision to go on a cruise had been largely taken before visiting the travel agent.⁵⁶

Consumer preferences played an important role in defining the relevant product market in this case. The Commission also considered the views of travel agents and competitors. A large majority of travel agents regarded oceanic cruises as belonging to a product market that is distinct from other forms of vacations and most of the Parties' closest cruise competitors both worldwide and in Europe viewed oceanic cruises as constituting at least one separate product market.⁵⁷

To some extent the Commission used to initially emphasize a detailed analysis of the characteristics of products but it is now very unusual for it to base its definition of market exclusively on a mere description of the characteristics of the product or service in question. The importance of the characteristics of the product is usually verified with the opinions expressed by clients and/or distributors in order to acquire as much information as possible about the preferences of consumers or clients.⁵⁸

4.4.2.5 France Télécom [2007]

In *France Télécom*⁵⁹, the French company France Télécom SA, formerly Wanadoo Interactive SA, established in Paris, provides high-speed internet services to residential customers in France. In 2003, the Commission found that it abused its dominant position and thus infringed Article 82 EC by charging for its eXtense and Wanadoo ADSL services predatory prices that did not enable it to cover its variable costs until August 2001 or to cover its full costs from August 2001 onwards, as part of a plan to pre-empt the market in high-speed internet access during a key phase in its development. The Commission ordered it to bring the infringement to an end and imposed a fine on it.⁶⁰

The decision defines the relevant product market as high-speed internet access. The products with which the infringement is concerned are internet

⁵⁶ Ibid, Paragraph 40.

⁵⁷ Ibid, Paragraphs 57-58.

⁵⁸ Edurne Navarro Varona, Andrés Font Galarza, Jaime Folguera Crespo and Juan Briones Alonso, *Merger Control in the European Union: Law, Economics and Practice*, Second Edition, OXFORD UNIVERSITY PRESS, 2005, Page 98.

⁵⁹ See Case T-340/03, *France Télécom SA v Commission of the European Communities*, Judgment of the Court of First Instance (Fifth Chamber, extended composition) of 30 January 2007, <http://europa.eu.int/eur-lex/lex/Notice.do?val=441780:cs&lang=en&list=447738:cs,447414:cs,441780:cs,441458:cs,437098:cs,436592:cs,436357:cs,435954:cs,435613:cs,433575:cs,&pos=3&page=1&nbl=449&pgs=10&hwords=relevant%20market~&checktexte=checkbox&visu=#texte>.

⁶⁰ Ibid, Paragraph 5.

access services based on ADSL technology (Wanadoo ADSL and eXtense).⁶¹

France Télécom sought annulment of the decision. It challenged the definition of relevant product market. It argued that high-speed and low-speed internet access belong to the same market because there is a certain degree of substitutability between high-speed and low-speed internet access and there is real competition between them. A mere difference in the degree of comfort or quality is not sufficient to distinguish between separate relevant markets when the nature of the use is similar.⁶²

The CFI upheld the Commission's decision. It stated that there is not a mere difference in comfort or quality between high- and low-speed access. Some applications available with high-speed access are simply not feasible with low-speed access, including, for example, the downloading of very voluminous video files or interactive network games.⁶³

As regards the differences in technical features and performances, a high-speed internet access modem cannot be used for low-speed internet access and vice versa. In addition, in the case of high-speed access, the connection is always on and the telephone line always available for making calls.⁶⁴

As regards the degree of substitutability, one way of making this determination can be viewed as a speculative experiment, postulating a hypothetical small but lasting change in relative prices and evaluating the likely reactions of customers to that increase. The Commission admits that low-speed and high-speed access indeed present some degree of substitutability. According to a survey carried out on behalf of the Commission, 80% of subscribers of high-speed access would maintain their subscription in response to a price increase in the range 5 to 10%. This high percentage of subscribers who would not abandon high-speed access in response to a price increase provides a strong indication of the absence of demand-side substitution.⁶⁵

Consequently, the CFI held that the Commission was right to define the relevant product market in question as that of high-speed internet access.

⁶¹ Ibid, Paragraph 6.

⁶² Ibid, Paragraphs 73-76.

⁶³ Ibid, Paragraph 82.

⁶⁴ Ibid, Paragraph 83.

⁶⁵ Ibid, Paragraphs 87-90.

4.5 Relevant Geographic Market

4.5.1 Process of Defining the Relevant Geographic Market

The initial working hypothesis will be checked against an analysis of demand characteristics (importance of national or local preferences, current patterns of purchases of customers, product differentiation/brands, other) in order to establish whether companies in different areas do indeed constitute a real alternative source of supply for consumers. The theoretical experiment is again based on substitution arising from changes in relative prices, and the question to answer is whether the customers of the parties would switch their orders to companies located elsewhere in the short term and at a negligible cost.⁶⁶

If necessary, a further check on supply factors will be carried out to ensure that those companies located in differing areas do not face impediments in developing their sales on competitive terms throughout the whole geographic market. The Commission will identify possible obstacles and barriers isolating companies located in a given area from the competitive pressure of companies located outside that area, so as to determine the precise degree of market interpenetration at national, European or global level.⁶⁷

The Notice provides several types of evidence to define the relevant product market:⁶⁸

- (1) past evidence of diversion of orders to other areas;
- (2) basic demand characteristics;
- (3) views of customers and competitors;
- (4) current geographic pattern of purchases;
- (5) trade flows/pattern of shipments; and
- (6) barriers and switching costs associated to divert orders to companies located in other areas.

⁶⁶ See Commission Notice on the definition of the relevant market, Paragraph 29.

⁶⁷ Ibid, Paragraph 30.

⁶⁸ Ibid, Paragraphs 45-50.

4.5.2 Case Study

4.5.2.1 *United Brands* [1978]

In *United Brands*⁶⁹, UBC also challenged the analysis made by the commission of the relevant geographic market.

The Commission excluded France, Italy and the United Kingdom from the geographic definition of the market notwithstanding the significant presence of UBC in these states, because of the special circumstances relating to import arrangements and trading conditions and the fact that bananas of various types and origin are sold there.⁷⁰ UBC accepted this but argued that the Commission failed to take account of the differences in the conditions of competition in the other Member States which should have led it to come to the same conclusions.⁷¹

The Court upheld the Commission's decision stating that the six other states are markets which are completely free, although the applicable tariff provisions and transport costs are of necessity different but not discriminatory, and in which the conditions of competition are the same for all. From the standpoint of being able to engage in free competition these six states form an area which is sufficiently homogeneous to be considered in its entirety.⁷²

4.5.2.2 *Michelin I* [1983]

In *Michelin I*⁷³, the Commission found that the substantial part of the common market on which Michelin NV holds a dominant position is the Netherlands. The applicant maintained that the geographical definition of the market is too narrow.⁷⁴

The Commission alleged that the competition faced by Michelin NV is on the Netherlands market since tyre manufacturers have on the whole chosen to sell their products on the various national markets through the intermediary of national subsidiaries. The point to be made in this regard is that the Commission addressed its decision not to the Michelin group as a whole but only to its Netherlands subsidiary whose activities are concentrated on the Netherlands market. Moreover, Michelin NV's main competitors also carry on their activities in the Netherlands through Netherlands subsidiaries of their respective groups.⁷⁵

The Commission's allegation concerns Michelin NV's conduct towards tyre dealers and more particularly its discount policy. In this regard the commercial policy of the various subsidiaries of the groups competing at the

⁶⁹ The summary of facts, see Section 4.4.2.2.

⁷⁰ See Case 27/76, *United Brands*, Paragraph 38.

⁷¹ *Ibid*, Paragraph 40.

⁷² *Ibid*, Paragraphs 52-53.

⁷³ The summary of facts, see Section 4.4.2.3.

⁷⁴ See Case 322/81, *Michelin I*, Paragraph 23.

⁷⁵ *Ibid*, Paragraphs 24-25.

European or even the world level is generally adapted to the specific conditions existing on each market. In practice dealers established in the Netherlands obtain their supplies only from suppliers operating in the Netherlands.⁷⁶

The Court held that the Commission was therefore right to take the view that the competition facing Michelin NV is mainly on the Netherlands market and that it is at that level that the objective conditions of competition are alike for traders. Hence the relevant substantial part of the common market in this case is the Netherlands and it is at the level of the Netherlands market that Michelin NV's position must be assessed.⁷⁷ But what remained a pity was that no analysis was made of competitive forces from outside the Netherlands when defining the relevant market.⁷⁸

It had been commonly thought that the substantial part of the relevant market referred to in Article 82 EC had to comprise at least two of the larger Member States but this view had been abandoned since *Michelin I*.⁷⁹ One Member State like the Netherlands, or even just a small area in a Member State like the airports in Paris⁸⁰ could be held to a relevant geographic market.

4.5.2.3 *Aéroports de Paris* [2000]

In this case, *Aéroports de Paris* (hereinafter "ADP"), a public corporation governed by French law and enjoying financial independence, is responsible for the planning, administration and development of all the civil air installations which are centred in the Paris region and which seek to facilitate the arrival and departure of aircraft, to control traffic and to load, unload and groundhandle passengers, goods and mail carried by air, and also of all associated installations at Orly and Roissy-Charles-de-Gaulle (hereinafter "Roissy-CDG") airports.⁸¹

ADP charged different rates of fees among two of the aircraft catering services undertakings, AFS and OAT. In 1995, AFS lodged a formal complaint with the Commission and in 1998 the latter adopted a decision stating that ADP has infringed Article 86 of the EC Treaty by using its dominant position as manager of the Paris airports to impose discriminatory commercial fees in the Paris airports of Orly and Roissy-CDG on suppliers or users engaged in groundhandling or self-handling activities relating to catering (including the loading and unloading of food and beverages on aircraft), to the cleaning of aircraft and to the handling of cargo.⁸²

⁷⁶ Ibid, Paragraphs 26.

⁷⁷ Ibid, Paragraphs 27-28.

⁷⁸ Valentine Korah, *An Introductory Guide to EC Competition Law and Practice*, Eighth Edition, Hart Publishing, 2004, Page 101.

⁷⁹ Hans Henrik Lidgard, *Competition Classics, Material & Cases on European Competition Law and Practices 2006/2007*, Page 265.

⁸⁰ See Case T-128/98, *Aéroports de Paris v Commission of the European Communities*, [2000] ECR Page II-3929.

⁸¹ Ibid, Paragraphs 1-2.

⁸² Ibid, Paragraphs 3-17.

ADP argued that the definition of geographic market of Orly and Roissy-CDG was too narrow and the other large continental airports must be taken into consideration. The CFI did not agree. For most passengers leaving or arriving in the Paris region or other French regions, the air transport services using Orly and Roissy-CDG are not interchangeable with the services offered in other airports and that competition between airports is important only in so far as an airport forms a transit point for other destinations. But the proportion of traffic from Paris airports for which those airports are used as a transit point at Orly and Roissy-CDG are very low according to statistics. In those circumstances, the substitutability of the other airports is quite insufficient to support the contention that the geographical market in the present case extends to airports other than Orly and Roissy-CDG.⁸³

ADP also argued that the air carriers providing services from or to the Paris region are not required to use the groundhandling services offered at Orly and Roissy-CDG airports. The CFI disagreed. The possibility of obtaining supplies of meals in another airport is limited by the requirements of freshness and quality of the food, the storage capacity of the equipment and the fact that such choices are available only in the case of short-haul flights. Last, as regards freight services, since the applicant has not disputed the claim that a large proportion of freight is carried in the same aircraft as passengers, the choice of airport therefore depends mainly on passenger traffic, for which the other airports are not substitutable.⁸⁴

The CFI upheld the Commission's findings on the definition of geographic market.

4.5.2.4 Carnival Corporation/P&O Princess [2002]

In *Carnival Corporation/P&O Princess*⁸⁵, concerning aspects pointing towards a national geographic market, Carnival referred to divergent national holiday traditions, tastes and preferences (e.g. in regard to timing, or dining and drinking habits), languages, nationally targeted marketing, differing average prices, and substantial variations in the market presence of particular tour and cruise operators.⁸⁶

The Commission considered the relevant geographic markets for oceanic cruises to be national, as a result of the existence of the following factors:

(a) the market presence of cruise operators varies considerably from one Member State to another; (b) the penetration of the cruise holiday is different from one Member State to another; (c) distribution channels are different in Member States as both specialised cruise agencies and general travel agents operate on a predominantly national level; (d) marketing and promotions are usually run at national level; (e) pricing strategies and price

⁸³ Ibid, Paragraph 142.

⁸⁴ Ibid, Paragraph 143.

⁸⁵ The summary of facts, see Section 4.4.2.4.

⁸⁶ See Case No COMP/M.2706 — *Carnival Corporation/P&O Princess*, Paragraph 24.

levels are different in each Member State; and (f) some cruise brands are only or mainly marketed in certain Member States.⁸⁷

In this case, the Commission defined the relevant geographic markets first because there are a number of different characteristics in the nature of the product offered by the Parties and other operators in different countries. This shows that relevant geographic market is not necessarily to be defined after the defining of relevant product market. On the contrary, defining the relevant geographic market first will make the defining of relevant product market easier and clearer.

4.5.2.5 *France Télécom* [2007]

In *France Télécom*⁸⁸, the applicant did not challenge the definition of relevant geographic market. According to the Commission's decision⁸⁹, the Internet service providers operating on the high-speed Internet access market and the telecommunications operators active on the ADSL services market operate on a national basis. Even if at present some of their high-speed Internet access offerings are limited to specific areas because of technical deployment constraints, it is clear that all the providers pursue the same deployment and growth objectives at national level. Furthermore, prices are set at national level. Internet service providers provide a service aimed at the resident population within the national territory and are subject to national rules and regulations.

The relevant geographic market is accordingly defined as the French national market.

⁸⁷ Ibid, Paragraph 26.

⁸⁸ The summary of facts, see Section 4.4.2.5.

⁸⁹ See Case COMP/38.233 — Wanadoo Interactive, Commission's decision of 16 July 2003 relating to a proceeding under Article 82 of the EC Treaty, Paragraph 205, <http://ec.europa.eu/comm/competition/antitrust/cases/decisions/38233/en.pdf>.

5 Notion of Relevant Market in the US Perspective

5.1 1992 Horizontal Merger Guidelines

In 1992, the Department of Justice and the Federal Trade Commission (hereafter “Agency”) jointly issued Horizontal Merger Guidelines. The Guidelines provide instructions of defining relevant market in Section 1. The Guidelines provide guidance to market definition not only for the purpose of applying Horizontal Merger Guidelines but also for cases under the Sherman Act and the Clayton Act.

5.2 Definition of Relevant Market

A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a “small but significant and nontransitory” increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. Absent price discrimination, a relevant market is described by a product or group of products and a geographic area.⁹⁰

5.3 Relevant Product Market

5.3.1 Product Market Definition

Absent price discrimination, the product market is defined as a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products (“monopolist”) likely would impose at least a “small but significant and nontransitory” increase in price.⁹¹

5.3.2 Process of Defining the Product Market

The process begins with each product (narrowly defined) produced or sold by each defendant and one question is asked: what would happen if a hypothetical monopolist of that product imposed at least a “small but significant and nontransitory” increase in price, but the terms of sale of all other products remained constant? If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical

⁹⁰ See 1992 US Horizontal Merger Guidelines, Section 1.0.

⁹¹ Ibid, Section 1.11.

monopolist would not find it profitable to impose such an increase in price, then the product, as the next-best substitute for the defendant's product, is added to the product group.⁹²

The price increase question is then asked again for a hypothetical monopolist controlling the expanded product group. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the prices of any or all of the additional products under its control. This process will continue until a group of products is identified such that a hypothetical monopolist over that group of products would profitably impose at least a "small but significant and nontransitory" increase. Generally, the relevant product market is considered to be the smallest group of products that satisfies this test.⁹³

In most cases, a price increase will be five percent lasting for the foreseeable future. However, it depends on the nature of the industry, and at times, a price increase larger or smaller than five percent may be used.⁹⁴

In considering the likely reaction of buyers to a price increase, all relevant evidence should be taken into account, including, but not limited to, the following:

- (1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables;
- (2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;
- (3) the influence of downstream competition faced by buyers in their output markets; and
- (4) the timing and costs of switching products.

5.3.3 Additional Relevant Product Markets

A different analysis applies where price discrimination would be profitable for a hypothetical monopolist. Existing buyers sometimes will differ significantly in their likelihood of switching to other products in response to a "small but significant and nontransitory" price increase. If a hypothetical monopolist can identify and price differently to those buyers ("targeted buyers") who would not defeat the targeted price increase by substituting to other products in response to a "small but significant and nontransitory" price increase for the relevant product, and if other buyers likely would not

⁹² Ibid.

⁹³ Ibid.

⁹⁴ Ibid.

purchase the relevant product and resell to targeted buyers, then a hypothetical monopolist would profitably impose a discriminatory price increase on sales to targeted buyers. Thus, additional relevant product markets consisting of a particular use or uses by groups of buyers of the product will be added, for which a hypothetical monopolist would profitably and separately impose at least a “small but significant and nontransitory” increase in price.⁹⁵

5.3.4 Case Study

5.3.4.1 *Cellophane* [1956]

In *Cellophane*⁹⁶, the United States alleged that du Pont had monopolized the cellophane market in violation of Section 2 of the Sherman Act.⁹⁷ During that time, du Pont produced almost 75% of the cellophane sold in the United States, and cellophane constituted less than 20% of all “flexible packaging material” sales.⁹⁸ In order to measure du Pont’s market power, the primary question was what the relevant product was, the sole cellophane market or the flexible packaging market.

The Government asserted that cellophane and other wrapping materials are neither substantially fungible nor like priced and thus the market for other wrappings is distinct from the market for cellophane.⁹⁹ It also argued that the courts will not consider substitutes other than those which are substantially fungible with the monopolized product and sell at substantially the same price.¹⁰⁰

The Court admitted that cellophane combines the desirable elements of transparency, strength and cheapness more definitely than any of the others.¹⁰¹ But, despite cellophane’s advantages it has to meet competition from other materials in every one of its uses. For example, it shared the packaging market of food products with others. The over-all result was that at that time cellophane accounted for 17.9% of flexible wrapping materials, measured by the wrapping surface.¹⁰²

More over, a very considerable degree of functional interchangeability exists between these materials. Except as to permeability to gases, cellophane has no qualities that are not possessed by a number of other materials. Meat will do as an example of interchangeability and the substitute is Pliofilm.¹⁰³

⁹⁵ Ibid.

⁹⁶ See *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956).

⁹⁷ Ibid, at 378.

⁹⁸ Ibid, at 379.

⁹⁹ Ibid, at 380.

¹⁰⁰ Ibid, at 394.

¹⁰¹ Ibid, at 398.

¹⁰² Ibid, at 399.

¹⁰³ Ibid, at 399-400.

The Court also measured the cross-elasticity of demand between the materials. According to the Court, if a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market.¹⁰⁴ This was found to be true.¹⁰⁵

The Government stressed the fact that the variation in price between cellophane and other materials demonstrates they are noncompetitive. The Court held the price difference cannot be decisive since different producers need different qualities in wrappings and their need may vary from time to time as their products undergo change.¹⁰⁶

The Court concluded that cellophane's interchangeability with the other materials suffices to make it a part of this flexible packaging material market.

As Donald F. Turner pointed out, the *Cellophane* judgment was flawed. The Court's "reasonable interchangeability" test for defining the market with respect to distinctive substitutes could mean that distinctive substitutes showing a high cross-elasticity of demand at prices that have actually been charged are to be included in the market even though produced at a substantial margin of disadvantage. The producer with a substantial advantage in comparative preference-cost ratios has what the Court calls monopoly power to control prices or exclude competition. In this circumstance, the test would insulate many "true" monopolies from the impact of the antitrust laws.¹⁰⁷

Buyer price responsiveness to changes in cellophane prices establishes that other flexiwrap products are close substitutes only if competitive prices were in fact being charged for cellophane. But if du Pont already was charging a monopoly price for cellophane, the high cross-elasticity for cellophane may have signified only that du Pont could not have raised its price still further without a substantial sales loss. The Supreme Court failed to consider that a finding of high demand cross-elasticity may mean only that the firm already has exercised monopoly power by raising price to the profit-maximizing point. This is known as the "Cellophane fallacy". Thus

¹⁰⁴ Ibid, at 400.

¹⁰⁵ Ibid, at 401. Some users are sensitive to the cost of flexible packaging materials; others are not. Users to whom cost is important include substantial business: for example, General Foods, Armour, Curtiss Candy Co., and smaller users in the bread industry, cracker industry, and frozen food industry. These customers are unwilling to use more cellophane because of its relatively high price, would use more if the price were reduced, and have increased their use as the price of cellophane has been reduced.

¹⁰⁶ 351 U.S. 400-401.

¹⁰⁷ Donald F. Turner, Antitrust Policy and the Cellophane Case, 70 Harv. L. Rev. 281, at 308-309.

the concept of demand cross-elasticity helps establish whether two products are close substitutes only when both are sold at competitive prices.¹⁰⁸

5.3.4.2 IBM [1975]

In *IBM*¹⁰⁹, Telex has alleged in the complaint that IBM violated the Sherman Act and the Clayton Act in that it had monopolized the manufacture, distribution, sale, and leasing of plug compatible peripheral products which are attached to IBM central processing units. IBM in turn filed a counterclaim against Telex in which the latter is charged with unfair competition, theft of trade secrets, and copyright infringement.¹¹⁰

The district court determined that the relevant product market was limited to peripheral devices plug compatible with IBM central processing units together with particular product submarkets, all of which were plug compatible with an IBM CPU.¹¹¹

This definition was reversed by the Tenth Circuit. Suppliers of peripherals plug compatible with non-IBM systems could in various instances shift to the production of IBM plug compatible peripherals at low cost, and vice versa.¹¹² Record shows that these products, although not fungible, are fully interchangeable and may be interchanged through interface changes with minimal financial outlay, and so cross-elasticity exists within meaning of the *Cellophane* decision. It seems clear that reasonable interchangeability is proven and hence the market should include not only peripheral products plug compatible with IBM CPUs, but all peripheral products, those compatible not only with IBM CPUs but those compatible with non-IBM systems.¹¹³

5.3.4.3 Swedish Match [2000]

In *Swedish Match*¹¹⁴, Swedish Match is a wholly owned subsidiary of the Swedish company Swedish Match AB. It manufactures and sells primarily loose leaf and moist snuff tobacco. In 1999, its loose leaf sales constituted 42% of all loose leaf sales and its moist snuff sales constituted 3% of all moist snuff sales. National is a limited partnership, which primarily manufactures and sells loose leaf chewing tobacco and is the third largest producer of loose leaf chewing tobacco in the United States. In 1999, its sales constituted an 18% share of the loose leaf market.¹¹⁵

¹⁰⁸ Ernest Gellhorn, William E. Kovacic and Stephen Calkins, *Antitrust Law and Economics*, Fifth Edition, THOMSON WEST, 2004, Page 121.

¹⁰⁹ See *Telex Corporation v. IBM*, 510 F.2d 894 (1975).

¹¹⁰ *Ibid.*, at 898.

¹¹¹ *Ibid.*, at 914.

¹¹² *Ibid.*, at 916.

¹¹³ *Ibid.*, at 919.

¹¹⁴ See *FTC v. Swedish Match*, 131 F.Supp.2d 151 (2000).

¹¹⁵ *Ibid.*, at 153-154.

In February 2000, the two companies entered into an asset purchase agreement under which Swedish Match would acquire the loose leaf tobacco brands and certain related assets of National.¹¹⁶

Section 7 of the Clayton Act prohibits a corporation from acquiring “the whole or any part of the assets of another corporation engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” The proper definition of the relevant product market is the first step in this case.

The Commission argues that loose leaf tobacco constitutes a distinct relevant product market, which does not include moist snuff. Under this narrower view of the market, the acquisition in this case would create a combined entity consisting of the first and third largest sellers of loose leaf tobacco that would be twice as large as its nearest competitor and would control 60% of all loose leaf sales. Swedish Match and National rejoin that the relevant market is a broader, smokeless tobacco market, which includes moist snuff as well as loose leaf tobacco. Under their view, the concentration of the smokeless tobacco market and any increase to it caused by this acquisition are minimal. The Court finds the relevant product market in this case to be, as the Commission contends, loose leaf chewing tobacco.¹¹⁷

The Court finds the products to be functionally interchangeable for the purpose of outlining the relevant product market. However, this does not end the analysis. Smokeless tobacco constitutes a broader market in this case, comprised of both loose leaf and moist snuff which at some level compete with one another. But as stated by this Court in *Staples*¹¹⁸, the mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes.¹¹⁹

The Supreme Court in *Brown Shoe*¹²⁰ ruled that within a broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. The Court in that case provided a series of factors or “practical indicia” for determining whether a submarket exists, including industry or public recognition of the submarket as a separate economic entity, the product’s peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes and specialized vendors.

¹¹⁶ *Ibid*, at 154.

¹¹⁷ *Ibid*, at 156-157.

¹¹⁸ See *FTC v. Staples*, 970 F.Supp. 1066 (1997).

¹¹⁹ 131 F.Supp.2d 159.

¹²⁰ See *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

The Court finds that the limited amount of price-based substitution stemming from moist snuff competition and a rising level of dual usage is insufficient evidence of loose leaf price sensitivity. While the Court believes there is some degree of competition between, and overlapping consumer usage of, moist snuff and loose leaf tobacco, the weight of the evidence read in light of *Brown Shoe*'s indicia convinces the Court that loose leaf chewing tobacco constitutes a distinct relevant product market.¹²¹

Finally, the Court concludes that loose leaf chewing tobacco constitutes the relevant product market for the purposes of antitrust analysis.

5.4 Relevant Geographic Market

5.4.1 Geographic Market Definition

Absent price discrimination, the geographic market is defined as a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a “small but significant and nontransitory” increase in price, holding constant the terms of sale for all products produced elsewhere.¹²²

5.4.2 Process of defining the Geographic Market

The process of defining geographic market is the same as defining product market. It begins with the location of one defendant (or each plant of a multiplant firm) and one question is asked: what would happen if a hypothetical monopolist of the relevant product at that point imposed at least a “small but significant and nontransitory” increase in price, but the terms of sale at all other locations remained constant? If the price increase turns out to be unprofitable, then that location will be added, from which production is the next-best substitute for production at the defendant's location. The price increase question is then asked again and the process will continue until a smallest group of locations is identified such that a hypothetical monopolist over that group of locations would profitably impose at least a “small but significant and nontransitory” increase.¹²³

What constitutes a “small but significant and nontransitory” increase in price will be determined in the same way in which it is determined in product market definition. The relevant evidence which should be taken into account is the same as what has been enumerated above, only with respect to geographic locations.

¹²¹ 131 F.Supp.2d 164-165.

¹²² See 1992 US Horizontal Merger Guidelines, Section 1.21.

¹²³ *Ibid.*

5.4.3 Additional Geographic Markets

If a hypothetical monopolist can identify and price differently to targeted buyers in certain areas who would not defeat the targeted price increase by substituting to more distant sellers for the relevant product, and if other buyers likely would not purchase the relevant product and resell to targeted buyers, additional geographic markets consisting of particular locations of buyers will be added.¹²⁴

5.4.4 Case Study

5.4.4.1 *Grinnell* [1966]

In *Grinnell*¹²⁵, Grinnell manufactures plumbing supplies and fire sprinkler systems. It also owned 76% of the stock of ADT, 89% of the stock of AFA, and 100% of the stock of Holmes at that time. Each of the three companies offers a central station service under which hazard-detecting devices installed on the protected premises automatically transmit an electric signal to a central station. The central station is manned 24 hours a day. Upon receipt of a signal, the central station, where appropriate, dispatches guards to the protected premises and notifies the police or fire department direct. The three companies that Grinnell controls have over 87% of the business.¹²⁶ Grinnell was sued by the United States for committing violations of the Sherman Act.

The Court upheld the district court's definition of geographic market — the accredited central station service is national. The activities of an individual station are in a sense local as it serves, ordinarily, only that area which is within a radius of 25 miles. But the business of providing such a service is operated on a national level. The appellant ADT has a national schedule of prices, rates, and terms, though the rates may be varied to meet local conditions. It deals with multistate businesses on the basis of nationwide contracts. The manufacturing business of ADT is interstate.

Mr. Justice Fortas disagreed on the definition of geographic market. In his opinion, the correct geographic market should be local.¹²⁷ As Gellhorn, Kovacic and Calkins pointed out in their book, whether an individual firm operates on a national or local basis does not define a geographic market. They also gave a more familiar example: retail grocery competition exists between local stores and chains as well as among large interstate chains. But competition between sellers and alternative sources of supply for buyers is invariably local.¹²⁸

¹²⁴ Ibid, Section 1.22.

¹²⁵ See *United States v. Grinnell Corp.*, 384 U.S. 563 (1966).

¹²⁶ Ibid, at 566-567.

¹²⁷ Ibid, at 589.

¹²⁸ Ernest Gellhorn, William E. Kovacic and Stephen Calkins, *Antitrust Law and Economics*, Fifth Edition, THOMSON WEST, 2004, Page 127.

5.4.4.2 *Rebel Oil* [1995]

In *Rebel Oil*¹²⁹, self-serve gasoline retailers Rebel Oil Company (hereafter “Rebel”) and Auto Flite Oil Company brought antitrust action against competitor Atlantic Richfield Company (hereafter “ARCO”), alleging predatory pricing of gasoline in Las Vegas by competitor in violation of Sherman Act and Clayton Act.¹³⁰

Retailers in Las Vegas sell gasoline through two types of service. Some gasoline is sold only on a self-serve, cash-only basis. Motorists purchasing this product must pump their own gasoline and must pay cash. Other gasoline is sold on a full-serve basis. In full serve, a service station attendant pumps the gasoline for the consumer and may perform other minor services. The motorist also has the option of paying either with cash or a credit card. The consumer pays a premium for these services, which means that the price for full-serve gasoline is generally higher than the price for self-serve gasoline.¹³¹

According to Rebel’s expert affidavits, when the alleged predation ended in 1989, ARCO had captured 54 percent of the market for self-serve, cash-only gasoline.¹³² ARCO argued that the two products, self-serve, cash-only gasoline and full-serve gasoline were correlated in price, indicating that the products are substitutes for each other and thus should be included in the relevant market.¹³³

In this case, the two parties and the US courts all considered the geographic market as Las Vegas directly. None of them referred to defining the geographic market. We may make an analysis here. What would happen if a hypothetical monopolist of gasoline in Las Vegas imposed at least a “small but significant and nontransitory” increase in price? Will the customers go to other cities to purchase gasoline? Will the suppliers in other cities come to Las Vegas to supply it? Firstly, the customers cannot drive to the neighboring areas every time the car is running out of gas. The transportation expense is relatively too high and it is time consuming. According to the characters of gasoline, it cannot be stored at home in a large volume because it can easily causes fire, which means a customer will not purchase a big volume at a time from other cities and keep it in their garages. Secondly, the supplier in other cities will not come to supply the Las Vegas market because they have to face significant sunk costs to set up a new gas station and this takes time. There is neither demand- nor supply-side substitutes. Such a hypothetical monopolist in Las Vegas would profitably impose at least a “small but significant and nontransitory” increase, so the relevant geographic market can be defined as one city, Las Vegas.

¹²⁹ See *Rebel Oil Company, Inc. v. Atlantic Richfield Company*, 51 F.3d 1421 (1995).

¹³⁰ *Ibid*, at 1421.

¹³¹ *Ibid*, at 1430.

¹³² *Ibid*, at 1431-1432.

¹³³ *Ibid*, at 1435.

5.4.4.3 Kodak [1995]

A relevant geographic market may be defined as national, several states, one state or even a city. Sometimes it is also defined as world-wide.

In *Kodak*¹³⁴, the photographic film manufacturer Eastman Kodak brought motion to terminate consent decrees entered due to alleged antitrust violations. With respect to the 1921 Decree, the district court defined the relevant geographic market as world-wide. Finding that Kodak only has a 36-percent share of the highly competitive world-wide market, the district court concluded that Kodak does not possess market power over film.¹³⁵ The government contends that this determination is clearly erroneous and that the relevant geographic market in this case should be limited to the United States.

The Second Circuit upheld the district court's definition of relevant geographic market based on the following analysis. Kodak is the only domestic film manufacturer. Of its four competitors, all of which sell film in the United States, Fuji manufactures film in Japan and in the Netherlands, Konica manufactures film in Japan, Agfa manufactures film in Germany, and 3M manufactures film in Italy. Since Kodak has two-thirds of the United States film market, a full one-third of all film used in the United States comes from abroad. Additionally, foreign manufacturers could quickly increase the supply of film for US consumption if Kodak attempted to restrict output and raise prices. Moreover, the flow of imported film has been continuous and systematic through the entire United States, and there is no evidence in the record of transportation costs or tariffs that put imported film at a significant cost disadvantage. The foregoing provides an ample basis for the district court's finding that foreign film producers act as a check on Kodak's ability to raise domestic prices. Film purchasers are, for the most part, price sensitive and will shift among Fuji, Kodak, and private label film on the basis of changes in price. While many consumers state a preference for the familiar Kodak brand name, the empirical evidence of what consumers actually do indicates that consumers find non-Kodak film to be an acceptable substitute.¹³⁶

The government, however, contends that, by relying on the significant cross-elasticity of demand between Kodak film and other brands, the district court fell victim to the Cellophane fallacy. It contends that, because Kodak already is pricing its products at monopolistic levels in the United States, consumers' willingness to switch to other brands of film when the price of Kodak film rises actually demonstrates that Kodak possesses market power in the United States.¹³⁷

¹³⁴ See *United States v. Eastman Kodak*, 63 F.3d 95 (1995).

¹³⁵ *Ibid.*, at 99-100.

¹³⁶ *Ibid.*, at 104-105.

¹³⁷ *Ibid.*, at 105.

The Second Circuit does not agree. The economic error allegedly committed by the Court in *Cellophane* was in failing to recognize that a high cross-elasticity of demand may, in some cases, be the product of monopoly power rather than a belief on the part of consumers that the products are good substitutes for one another. In the *Cellophane* case, the high cross-elasticity between cellophane and wax paper simply may have been a function of the high price that du Pont demanded for cellophane. This case, however, does not involve a comparison of two highly-differentiated products like cellophane and wax paper. The film produced by Kodak's competitors is of comparable quality to Kodak's film and is an excellent substitute. Moreover, the government's contention assumes that Kodak film is priced well above competitive levels, and the Court does not believe that the small but declining price premium that Kodak obtains for its film bears out this assumption.¹³⁸ Thus, the district court did not fall victim to the Cellophane fallacy.

5.5 Supply Side Considerations

In the Guidelines, supply substitution factors, such as possible production responses, are considered in Sections 1.3 and 3 in the identification of firms that participate in the relevant market and the analysis of entry. This thesis is going to discuss the former situation only, that is to say, uncommitted entrants.

5.5.1 Uncommitted Entrants

Uncommitted entrants are firms that are not currently producing or selling the relevant product in the relevant area as participating in the relevant market. These supply responses must be likely to occur within one year and without the expenditure of significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" price increase. The Agency will identify those firms if their inclusion would more accurately reflect probable supply responses.¹³⁹

These supply responses may give rise to new production of products in the relevant product market or new sources of supply in the relevant geographic market. Uncommitted supply responses may occur in several different ways: by the switching or extension of existing assets to production or sale in the

¹³⁸ Ibid.

¹³⁹ See 1992 US Horizontal Merger Guidelines, Section 1.32. In the Guidelines, sunk costs are defined as the acquisition costs of tangible and intangible assets that cannot be recovered through the redeployment of these assets outside the relevant market, i.e., costs uniquely incurred to supply the relevant product and geographic market. Examples of sunk costs may include market-specific investments in production facilities, technologies, marketing (including product acceptance), research and development, regulatory approvals, and testing. A significant sunk cost is one which would not be recouped within one year of the commencement of the supply response, assuming a "small but significant and nontransitory" price increase in the relevant market.

relevant market; or by the construction or acquisition of assets that enable production or sale in the relevant market.¹⁴⁰

5.5.2 Case Study — *Rebel Oil* [1995]

In *Rebel Oil*¹⁴¹, Rebel relied on “demand elasticity” — that is, whether a price rise in self-serve, cash-only gasoline would cause self-serve consumers to shift their demand to full-serve gasoline. A price differential between two products may reflect a low cross-elasticity of demand, if the higher priced product offers additional service for which consumers are willing to pay a premium.¹⁴²

However, the Ninth Circuit stated defining a market on the basis of demand considerations alone is erroneous. Supply elasticity measures the responsiveness of producers to price increases. If producers of product X can readily shift their production facilities to produce product Y, then the sales of both should be included in the relevant market. Rebel fails to account for the fact that sellers of full-serve gasoline can easily convert their full-serve pumps, at virtually no cost, into self-serve, cash-only pumps, expanding output and thus constraining any attempt by ARCO to charge supracompetitive prices for self-serve gasoline.¹⁴³

The ease by which marketers can convert their full-serve facilities to increase their output of self-serve gasoline requires that full-serve sales be part of the relevant market. It is immaterial that consumers do not regard the products as substitutes, that a price differential exists, or that the prices are not closely correlated.¹⁴⁴

¹⁴⁰ Ibid.

¹⁴¹ The summary of facts, see Section 5.4.4.2.

¹⁴² 51 F.3d 1436.

¹⁴³ Ibid.

¹⁴⁴ Ibid.

6 Comparision of EC and the US Notions and Proposals to the Establishment of Notion of Relevant Market in China

The US is the pioneer of anti-trust law. Europe has learned a lot from the US within this field. After many years of interaction between the two legal systems, the notions of relevant market seem to be quite similar to some extent, but there are still fine differences in many important aspects. In this section, the thesis is going to compare several important aspects between the EC and the US perspectives and make respective proposals to the Chinese legislation.

6.1 Definition of the Relevant Market

Relevant market is defined in a static way in EC while it is defined in a dynamic way in the US. We may take the definition of relevant product market as an example.

In EC, relevant product market is defined as follows:

A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.

In the US, relevant product market is defined as follows:

Absent price discrimination, the product market is defined as a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price.

In the Chinese Draft Anti-monopoly Law, relevant product market is defined as follows:

Relevant product market is defined as a certain market made up of a group of products which are regarded as substitutable due to the products' characteristics, their prices and their intended use.

We may see here, the EC definition mainly bases on interchangeability and substitutability while the US definition bases on SSNIP test. It is clear the Chinese definition is a copy of the EC one. In the author's opinion, it is

better to follow the EC definition because it is clearer and easier to understand. Relevant market is a whole new concept for the Chinese legal workers and the Chinese are more used to a static definition, so the legislators have done it in a suitable way.

6.2 Form

In EC, the notion of relevant market is provided in a Commission's notice for applying Article 81 and 82 EC and Merger Regulation. In the US, it is provided in the Horizontal Merger Guidelines but also for applying the Sherman Act and the Clayton Act.

In China, there are several forms available. The notion of relevant market can be provided in the Draft Anti-monopoly Law, in a regulation or in a notice or Judicial Interpretation¹⁴⁵ of the Supreme Court. Because the methods used for defining market will be updated from time to time, the notion sometimes needs revising. For that reason, it is not wise to integrate it into the Anti-monopoly Law because revision of a primary legislation will be effort- and time-consuming.

We may see EC and the US both provide the notion in a secondary legislation, to some degree, for that reason. In the author's opinion, the EC way is even better to provide it in a totally independent form. The author's proposed form of the notion is to provide it in a regulation or in a notice or Judicial Interpretation of the Supreme Court.

6.3 Process of Defining the Relevant Market

The EC provision on process of defining relevant market is more specified than the US counterpart. It provides several steps that the Commission will take to define the market while the US Guidelines provide the process generally. We may take the process of defining the relevant product market as an example.

The US Guidelines provide that the process begins with each product produced or sold by each defendant and then the SSNIP test is carried out. If the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the product, as the next-best substitute for the defendant's product, is added to the product group. The test is then carried out again for a hypothetical monopolist controlling the expanded product group. This process will continue until a group of products is identified such

¹⁴⁵ Judicial Interpretation of the Supreme Court is a source of legislation in China. Several years after the adoption of a certain law, the Supreme Court will issue a Judicial Interpretation of that law in order to clarify some important aspects in the application of that law if it considers it necessary.

that a hypothetical monopolist over that group of products would profitably impose at least a “small but significant and nontransitory” increase.

Actually the Commission Notice also provides the general process of SSNIP test but in another section, the Principles for Market Definition. The Chinese legislation may follow the EC way by providing the general process of SSNIP test in the Principles section and the more specified process in the Process section.

The author would like to point out one practical thing here. In the Commission Notice, it is provided that it is often the case that the inclusion of one different product would be enough to remove any competition concerns and thus, in such situations it is not necessary to consider whether the market includes additional products, or to reach a definitive conclusion on the precise product market.¹⁴⁶ In the US Guidelines, it is provided that generally the relevant product market is considered to be the smallest group of products that satisfies this test. The two different wordings have the same meaning. This provision is very practical and should be adopted in the Chinese legislation.

6.4 Evidence for Defining the Relevant Market

The EC Commission Notice provides a concrete evidence list for defining the relevant market while the US Merger Guidelines provide an abstract list. We may take the evidence for defining the relevant product market as an example.

The Commission Notice provides several types of evidence to define the relevant product market: (1) evidence of substitution in the recent past; (2) quantitative tests; (3) views of customers and competitors; (4) consumer preferences; (5) barriers and costs associated with switching demand to potential substitutes; and (6) different categories of customers and price discrimination.

The US Merger Guidelines provide that all relevant evidence should be taken into account, including, but not limited to, the following: (1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables; (2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables; (3) the influence of downstream competition faced by buyers in their output markets; and (4) the timing and costs of switching products.

¹⁴⁶ See Commission Notice on the definition of the relevant market, Paragraphs 26-27.

However, the US Supreme Court created *Brown Shoe's* indicia to help determine a submarket. In practice, these criteria can be used to define a relevant product market as well. As Don T. Hibner Jr. and Suzanne B. Drennon pointed out in their article¹⁴⁷, particular attention should be paid to the following factors: (1) lack of reasonable interchangeability of use between the product and its substitutes; (2) industry or public recognition of the market as a separate economic entity; (3) the product's peculiar characteristics and uses; (4) unique production facilities; (5) distinct customers; (6) distinct prices; (7) product sensitivity to price changes; and (8) the need for, or importance of, specialized vendors. We can find a concrete evidence list in the US case laws.

In both EC and the US, courts can apply former judgments in a current case and may create new rules to amend written laws or to revise prior case laws. In China, prior cases are just for legal research and a court will never apply a prior case to support its judgment or create new rules in a case. The Chinese courts cannot use case laws to amend written laws, which require the evidence list provided in the legislation as concrete as possible. The legislators may analyze and filter the types of evidence provided in EC Commission Notice and the US case laws, modify the criteria, make them more suitable for the Chinese economy, and then transplant them into the Chinese legislation.

6.5 The Range of Price Increase in SSNIP Test

The SSNIP test is the most widely used test for defining relevant market. It is no doubt that China will adopt this test as well. There is one technical question here: how small the small price increase should be?

The small price increase range provided in EC Commission Notice is 5% to 10%. In the US, the 1982 Merger Guidelines provide that the Department will hypothesize a price increase of five percent.¹⁴⁸ This was criticized a lot. The 1992 Merger Guidelines provide that the Agency, in most contexts, will use a price increase of five percent lasting for the foreseeable future. However, what constitutes a "small but significant and nontransitory" increase in price will depend on the nature of the industry, and the Agency at times may use a price increase that is larger or smaller than five percent.¹⁴⁹ This means the US will apply the price increase in a more flexible way.

As reasoned before, the notion of relevant market is a whole new concept in China and the Chinese judges are inexperienced in this field. "Flexible"

¹⁴⁷ Don T. Hibner Jr. and Suzanne B. Drennon, What Lawyers Should Know about Markets: the Good the Bad and the Ugly, 50-APR Fed. Law. 38, at 40.

¹⁴⁸ See US Department of Justice, 1982 Merger Guidelines, Section II A, <http://www.usdoj.gov/atr/hmerger/11248.htm>.

¹⁴⁹ See 1992 US Horizontal Merger Guidelines, Section 1.11.

sometimes may mean “unfeasible”. The US courts have been dealing with this notion for many decades, so they will manage to apply different ranges of price increase to different industries especially on a case law basis. But for the inexperienced Chinese courts, it is better to follow the EC model. The small price increase of the SSNIP test in Chinese notion should be 5% to 10%.

6.6 Time Factor of Supply-side Substitutability

The Commission Notice provides that supply-side substitutability may also be taken into account. In that case suppliers have to be able to switch production to the relevant products and market them in a short term. That is such a period that does not entail a significant adjustment of existing tangible and intangible assets. The US Merger Guidelines provide that the supply responses of the “uncommitted entrants” must be likely to occur within one year, in response to a “small but significant and nontransitory” price increase.

The EC provision leaves the courts more discretion. Different industries should be assessed in different ways. However, the same reasoning in Section 6.5 is used here again. For the Chinese legislation, it is better to have this “short term” fixed, so the proposal to China is to follow the US provision, one year for this short term.

6.7 Cellophane Fallacy

The Cellophane fallacy was first found in the *Cellophane* case in 1956. The concept of demand cross-elasticity helps establish whether two products are close substitutes only when both are sold at competitive prices. This may not be the case where the prevailing price has been determined in the absence of sufficient competition. The Commission Notice mentions this situation without using the US term “Cellophane fallacy”. As far as the author is concerned, the EC Commission and courts have never met this situation yet while in the US, this fallacy has been discussed a lot.¹⁵⁰ The Chinese legislation should also adopt provisions on this fallacy, not using the US term.

¹⁵⁰ For example, in *Kodak* (1995).

7 Conclusion

Now we come back to the Chinese merger case *SEB SA/SUPOR*. SUPOR argued that the relevant product market should be the market of cookware instead of pressure cooker because people can use a pressure cooker, a pan or a pot to cook food. The other undertakings in the cookware industry argued that SUPOR was intended to broaden the relevant product market in order to avoid the prior notification. The Ministry of Commerce gave no reasoning on the market definition. The author guess the Ministry was trying to avoid market definition since there is no rule for it to rely on. The author would like to make an academic analysis here.

Firstly, we should see if pressure cookers and other cookware, such as pans and pots, are functionally interchangeable for the purpose of outlining the relevant product market. A pressure cooker can be well sealed. When the food is being stewed, the air pressure inside the cooker will rise greatly and thus decrease the boiling point of the water. In such way, it takes a shorter time to stew food with a pressure cooker. People can also use a stew pot to cook the same food but that takes a much longer time. A pressure cooker and another kind of cooker might be considered as partially functionally interchangeable.

The SSNIP test needs to be carried out at this stage. Suppose SUPOR is the hypothetical monopolist of the relevant product, the pressure cooker. What would happen if SUPOR imposed at least a “small but significant and nontransitory” increase, 5% to 10% in price? Will the customers shift to purchase other kinds of cookers? Are the manufacturers in the cookware industry not currently producing pressure cookers likely to change their production line to supply the product?

From the demand-side, if the customers would shift to purchase stew cookers, which makes price increase unprofitable due to the loss in sales, the stew cooker is added to the product group as the next-best substitute for the pressure cooker. The price increase question is then asked again for the hypothetical monopolist controlling the expanded product group. This process will continue until a group of products is identified such that the hypothetical monopolist SUPOR over that group of products would profitably impose at least a “small but significant and nontransitory” increase and then the group of products will be defined as the relevant product market. If the customers will not shift to other kinds of products in response to the price increase, the pressure cooker market will be defined as the relevant product market.

From the supply-side, if the manufacturers in the cookware industry not currently producing pressure cookers are likely to change their production line to supply the product without the expenditure of significant sunk costs and within one year, they would join in to compete with SUPOR in response

to a price increase, which would render a loss of sales and make SUPOR's initial price rise unprofitable.

When we say the relevant product market is cookware market, shall we introduce the US submarket concept to continue the analysis? As the US Supreme Court rules, within a broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. Shall we go on to analyze whether a submarket of the pressure cooker exists? This question is also before the Chinese legislators.

The definition of geographic market is also crucial. China is a big country with regional customer preference and administrative barriers. Transportation web is underdeveloped in certain regions. When defining the geographic market in this case, shall we also include countryside where people may not use pressure cookers, or Guangdong Province where people prefer to stew food for a very long time?

These questions have no answers until the notion of relevant market is established in China. Without a definition of the relevant market, it is impossible to determine market share or assess market power. The absence of the notion of relevant market will make the implementation of Anti-monopoly Law extremely difficult and might cause divergence of the decisions of anti-monopoly authority as well as the judgments given by different courts.

After the adoption of Anti-monopoly Law, the establishment of market definition will be the initial and most crucial step to set up a series of systematic anti-monopoly rules. It is on the way!

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