



# **Competition (Jersey) Law 2005 Guidelines**

## **7. Market Definition**

<b>Contents</b>		<b>Page</b>
1.	<b>Introduction</b>	3
	Disclaimer	3
2.	<b>Market Definition</b>	4
	The purpose of market definition	4
	The main concept	5
3.	<b>The Product Market</b>	6
	The demand-side	6
	<i>Captive customers and price discrimination</i>	7
	<i>Chains of substitution</i>	7
	The supply-side	8
4.	<b>The Geographical Market</b>	9
	The demand-side	9
	The supply-side	10
	Imports	10
5.	<b>Other Issues</b>	11
	Temporal dimension	11
	Functional dimension	11
	Identifying the competitive price	11
	Previous cases	12

## 1. INTRODUCTION

Under the Competition (Jersey) Law 2005 (the Law), an issue that will arise often is whether an undertaking, or a group of undertakings together, hold or are likely to hold market power. For example, the existence of a dominant position (a particular level of market power) is a pre-condition for a finding of abuse of a dominant position, contrary to Article 16 of the Law. In determining whether market power (including dominance) exists, it is necessary to define the relevant economic market(s). Similarly, market definition is a critical step in determining the potential and actual effect on competition of mergers and acquisitions and other commercial arrangements.

This Guideline provides information on how the JCRA defines markets when investigating cases under the Law. The techniques described in this Guideline are not new. For example, they reflect the practices of the UK's Office of Fair Trading and of the European Commission.

Market definition and the measurement of market shares form only one part of an investigation. An investigation will normally look at other evidence of market power, the potential for new entry and the individual behaviour of undertakings.

The approach described in this guideline is not mechanical; it is a conceptual framework within which evidence can be organised. The JCRA will not follow every step described below in every case. Instead, the JCRA will look at the areas of evidence that are relevant to the case in question – and will often be constrained by the extent to which evidence is available. Market definition is not an end in itself, but rather a step that helps in the process of determining whether undertakings possess, or will possess, market power.

In particular, in some cases it may be clear that under any sensible market definition the undertaking under investigation will not possess any market power. In that case it normally will not be necessary to establish which of the potential market definitions is correct.

### **Disclaimer**

This Guideline is not a substitute for the Law. Anyone with particular questions concerning the application of this Guideline or the Law to specific facts should seek legal advice. Proof that a person has failed to comply with this Guideline is not proof that a person failed to comply with the Law. The JCRA may, however, rely on non-compliance with the Guideline as evidence toward establishing an infringement of the Law. This Guideline remains subject to amendment or revocation by the JCRA.

## 2. MARKET DEFINITION

### The purpose of market definition

The prohibitions in the Law are designed primarily to prevent undertakings from exploiting market power. Market power exists where undertakings can charge higher prices, or supply goods and services of a lower quality, than they would if they faced effective competition.

Market power can exist when an undertaking has a high market share, or when undertakings which together have high market shares do not actively compete with each other.

Some relationships such as price-fixing agreements may be prohibited even if the undertakings involved do not possess market power (see the JCRA Guideline **Anti-Competitive Arrangements**).

Nonetheless, in most cases, an investigation under the Law normally begins with the question whether particular undertakings possess, or will possess market power as a result of a particular transaction or conduct. High market shares, combined with other evidence, may indicate that undertakings possess market power. Where an undertaking has a high market share, there may be a lack of strong competitors, in which case it may be able to raise prices above competitive levels without fear of losing sales. It may also be easier for undertakings to collude. In a small island such as Jersey, a lack of competitors is more likely to be an issue that, therefore, may lead to such results. High market shares do not always convey market power – for example, there may be a strong threat of competition from new entrants. If, however, the relevant market has been defined appropriately, undertakings with very low market shares almost certainly will not possess market power, and an investigation normally can be concluded at an early stage.

Market definition is important because, first, market shares can be calculated only after the boundaries of a market have been defined. Secondly, it is important in the rest of the JCRA's analysis under the Law, because it sets the stage on which competition takes place. For example, when considering the strength of existing competition and the potential for a new entry, it is necessary to identify the relevant market.

Thirdly, market definition is important for establishing whether or not particular undertakings fall within the scope of the prohibitions:

- The Part 2 prohibition applies only to arrangements that have an 'appreciable' effect on competition. This test requires definition of a relevant market and demonstration that the arrangement would have an appreciable effect on competition within that market (see the JCRA Guideline **Anti-Competitive Arrangements**);
- Under Part 3 of the Law, undertakings with very low market shares are unlikely to be dominant, so their behaviour will not be caught by the prohibition (see the JCRA

Guideline **Abuse of a Dominant Position**). Calculation of market shares requires the relevant market to be defined.

- The JCRA has the authority under Part 4 of the Law to review proposed mergers and prohibit those that would substantially lessen competition in Jersey or any part thereof (see JCRA Guideline **Mergers and Acquisitions**). Defining the markets relevant to a merger or acquisition is the first step in the process of assessing whether a merger or acquisition may have the effect of substantially lessening competition.

High market shares are not themselves prohibited, and do not necessarily indicate a competition problem. The main purpose in measuring market shares is to establish at an early stage those cases where it is clear that no market power is present and that no further action by the JCRA is necessary.

It should be noted that although undertakings will have their own methods of defining markets and calculating market shares, these methods may not necessarily coincide with the economic approach to market definition under the Law, as set out in this Guideline.

## **The main concept**

For competition law purposes, a market is defined to include those suppliers among whom there is close competition. The internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, would be able to impose a small yet significant and non-transitory increase in price assuming all other terms of sale remain constant (this is known as the ‘SSNIP test’). The JCRA generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for one year.

The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who could produce, or who could easily switch to producing, those goods or services. The JCRA starts from the same position, trying to identify products which are substitutes for each other, so that competing undertakings can be identified.

The boundaries of the market, however, are not always obvious. Does a manufacturer of colas compete in the market for cola-flavoured drinks, the market for carbonated or ‘fizzy’ drinks, the market for soft drinks, the market for non-alcoholic beverages, or some other collection of products? Clearly, its market share could vary significantly depending on which definition was used. Market shares cannot be measured until that question has been resolved. The question involves identifying the products which are the closest substitutes for the product at the centre of the investigation. If an undertaking supplying the products set prices above competitive levels, would its consumers still buy its products, or would they switch to substitutes? In particular, would so many switch to substitutes that it would be unprofitable to raise prices above competitive levels?

A market definition normally will contain two dimensions; a product and a geographic area.<sup>1</sup> For example, when looking at a complaint regarding ice cream cabinets in Ireland the European Commission defined the relevant market as the retail supply of impulse ice cream in Ireland. The product market was impulse ice cream (ice creams bought from convenience outlets on the spur of the moment rather than from a supermarket) and the geographic market was Ireland (rather than say, the UK). The market definition analysis has to be applied separately to determine both the product and the geographic area.

The issue in market definition is usually to determine products to which consumers might switch. However, substitution by suppliers can also take place. If prices rise, undertakings that currently do not supply the product might be able to start supplying it at short notice. This will prevent undertakings charging monopoly prices, so any supply-side substitutes should also be included in the market.

### **3. THE PRODUCT MARKET**

The relevant product market is defined primarily using the SSNIP test, described above. This test can examine both the likely reaction of purchasers (i.e., demand-side) and other suppliers (i.e., supply-side) to a SSNIP.

#### **The demand-side**

The process starts by looking at a relatively narrow potential definition. This normally would be the products that two parties to an agreement both produce or the product which is the subject of a complaint. The JCRA will ask what would happen if a hypothetical monopolist of that product imposed a SSNIP, but the terms of sale of all other products remained constant? If significant numbers of customers would switch to other products (known as demand-side substitution) so that the hypothetical monopolist would not find it profitable to impose such a price increase, the market definition should be widened to include those substitutes. This process will continue until a group of products over which a hypothetical monopolist could impose a SSNIP profitably is identified. The JCRA generally will consider the relevant product market to be the smallest group of products that satisfies this test.

For example, if two manufacturers of cornflakes increased the price of their products, would consumers switch from cornflakes to other types of breakfast cereal? If they would, a market definition of ‘cornflakes’ would clearly be too narrow. It is not necessary for all customers, or even the majority, to switch. The important factor is whether the number of customers likely to switch is large enough to prevent a ‘hypothetical monopolist’ profitably raising its price.

---

<sup>1</sup> Throughout this Guideline, the term product includes services and property rights

An issue is the time over which customers may switch to substitutes. As a rule of thumb, if substitution took longer than one year, the products would not be included in the same market. However, the answer will vary from case to case. For example, substitution that was possible within one year might not be included if customers would have to incur significant switching costs.

The JCRA considers evidence on substitution from a number of different sources. The information used will vary from case to case, but the following areas are likely to be important.

- Customers and competitors may be interviewed. In particular, customers can be asked directly how they would react to a hypothetical price rise, but because of the hypothetical nature of the question, answers may need to be treated with a degree of caution.
- A significant factor in determining whether substitution takes place is whether customers would incur costs in substituting products. High switching costs relative to the value of the product will make substitution less likely.
- Various patterns in price changes can provide good evidence, when combined with other data. Two products showing the same pattern of price changes, for reasons not connected to costs, could be strong evidence that they were close substitutes. Price divergence over time, without significant levels of substitution, provides evidence that the two products may be in separate markets. However, if the absence of substitution could be explained by a divergence in both price and quality, the products still could be in the same market.
- Evidence on price elasticities may also be examined. Price elasticity is the rate at which demand for a product changes when its price (or the price of substitutes) goes up or down.

### *Captive customers and price discrimination*

In many cases some customers will be able to switch between product A and B while others cannot, and are therefore captive. The market may still be wider than product A if there is a significant number of customers who could substitute to product B. The important question is whether substitution by the non-captive customers will prevent a monopolist charging prices above competitive levels.

### *Chains of substitution*

Two products do not have to be direct substitutes to be included in the same market; there may be a chain of substitution between them. A large luxury car is unlikely to be a direct substitute for a small hatchback, for example. If the price of one manufacturer's hatchback rose, customers would be more likely to switch to a different small hatchback

rather than to a large luxury model. The hatchback and the luxury car are not likely to be direct substitutes for most customers. If the price of small hatchbacks rose, however, customers might hypothetically switch to slightly larger cars (a medium-sized hatchback, for example), since the price differential would narrow. These cars might then be included in the same market. Similarly, if the price of medium-sized hatchbacks rose, customers might either switch to small hatchbacks or to slightly larger cars. If this were the case, there might then be a chain of substitution linking cars of different sizes.

The JCRA will sometimes look at chains of substitution when defining markets. This will be done very carefully to ensure that there are no breaks in the chain that would suggest that separate markets exist. In the example above, the JCRA might decide that a chain of substitution existed between small and medium sized cars, but that large cars formed a separate market.

## **The supply-side**

Substitution can also take place on the supply-side. Close substitute products on the supply-side are those between which suppliers can shift production easily and in the short-run, using largely unchanged production facilities and with little or no additional investment, when given the incentive to do so by a SSNIP. For example, producers of paper may be able quickly to switch their production from low grades of paper to much higher grades of paper if the machines and inputs are very similar.

The test for supply-side substitution follows the same SSNIP approach as on the demand-side. That is, would other suppliers be 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 a SSNIP? If other producers can respond to make the attempted price increase unprofitable, they should be included in the relevant product market. An example that may apply in Jersey is, if the price of tomatoes were to rise by a SSNIP, would a potato producer be willing and able to switch to tomato production? If yes, and the switch could take place within a reasonable time, tomatoes and potatoes may fall within the same product market.

Analysing supply-side substitution raises similar issues to the analysis of barriers to entry (discussed further in the JCRA Guideline **Mergers and Acquisitions**). In both cases the question is whether undertakings would start supplying a particular product if the price rose. The distinction is timing: supply-side substitution occurs when undertakings start supplying the market in the short run (for example, within one year), whereas new entry into the market occurs over a longer time scale. Since the issue is identifying opportunities for short-run substitution, undertakings normally would not be included if they had to make a significant investment in a new production facility or other fixed assets.

Other factors the JCRA considers in supply-side substitutability include:

- the technical feasibility of switching production, and the associated costs;

- the marketing effort and expense involved in establishing a credible and profitable position as a supplier to the market;
- the degree (if any) to which investments are involved; and
- the degree to which any supply-side substitution has occurred in the past.

Even if substitutions were technically possible, there may be other barriers. It may be necessary to advertise products or incur other marketing costs. For example, if two consumer products are produced using similar technology, and substitution is technically feasible, an undertaking switching between them might still need to spend time establishing a brand in a new product area, in which case substitution could not occur in the short run. There might also be other barriers to distribution, for example if supply chains were foreclosed to new suppliers.

#### **4. THE GEOGRAPHICAL MARKET**

The geographical market is the area over which substitution takes place. Geographical markets are defined using the same process as that used to define the product market. Some issues, especially from a Jersey perspective, which are particularly relevant to geographic market definition are:

- demand-side issues;
- supply-side issues; and
- imports.

##### **The demand-side**

As with the product market, the objective is to identify substitutes that are so close they would prevent a hypothetical monopolist in one area from charging a SSNIP without losing business. The process starts by looking at a relatively narrow area, which normally would be the area supplied by the parties to an agreement or the subject of a complaint. The question is: what would purchasers do in response to a SSNIP imposed in that area? If enough purchasers would switch to products sold in other areas, to an extent that would make the SSNIP unprofitable, these areas should be included in the relevant geographic market. This process will continue until a group of locations is identified over which a hypothetical monopolist profitably could impose a SSNIP.

Chains of substitution can also be an important factor in geographic markets, particularly retail markets. Consumers in any one location might not be willing to travel more than a certain distance to purchase a particular product, but there may be a chain of substitution creating a much larger geographic market. In principle this could create a market covering the whole of Jersey but it would depend on whether there were areas where the

chain broke. Chains of substitution often break down in rural areas. If an undertaking with a monopoly in several neighbouring areas could raise prices across those areas, the total area might form a separate market.

The evidence used to define geographic markets on the demand-side will usually be similar to the information used to define the product market, but the value of a product is often an important factor in defining geographic markets. The higher the value, the more likely customers are to travel further in search of cheaper supplies.

## **The supply-side**

As with the supply-side analysis in product market definition, substitution should be possible in the short run (for example within one year). Supply-side substitution may not be possible within one year if undertakings need to spend significant sums on advertising or marketing, or if distributions channels are foreclosed.

Again the evidence will usually mirror the information gathered on product market definition, but the level of transport cost relative to the price of a product can be an important issue. In Jersey, on-island transport expense is unlikely to create any significant price difference, but for products that enter from off-island the ferry and air costs incurred may well affect product price.

## **Imports**

Significant imports of a particular product may indicate that the market is international, although it is not always the case. Imports may come only from subsidiaries of domestic suppliers, for example, or there may be quotas which limit the volume of imports.

When imported products, including products bought on the internet, are close substitutes for domestic products, the overseas suppliers are part of the relevant market. In such circumstances, the JCRA may define markets broader than Jersey if overseas suppliers or importers exercise competitive constraint on the participants in the domestic market. In such cases the JCRA may define a supra-national market.

Conversely a lack of imports does not necessarily mean that the market cannot be supra-national. The potential for imports may still be an important source of substitution should prices rise.

## **5. OTHER ISSUES**

### **Temporal dimension**

A third potential dimension to market definition is time. Examples of possible separate temporal markets include:

- peak and off-peak services in transport services or utilities such as electricity supply; and
- seasonal variations, such as summer versus winter months in industries such as tourism.

Temporal dimensions may be considered when:-

- it is not possible for customers to substitute between time periods. Customers might not view peak and off-peak travel tickets as substitutes, for example, or they might not be able to store fruit from one season to another; and
- suppliers' capacity varies between time periods. In Jersey, potato and fresh fruit supplies vary according to the season.

To some extent, temporal markets are simply an extension of the product dimension: a product could, for example, be defined as the supply of bus services at a certain time of day.

### **Functional dimension**

The production, distribution and sale of a product typically occur through a series of functional levels, e.g. manufacturing, wholesale and retail levels. It is often useful to identify the relevant functional level in describing a market as the conduct or merger being considered may affect one level but not others.

Generally, the JCRA will identify separate relevant markets at each functional level affected by the conduct or merger being considered and assess the impact on each.

### **Identifying the competitive price**

A remaining difficulty is how best to identify the competitive price. When assessing a new agreement, the JCRA might assume that the current price was competitive: even if it was not at the competitive level in practice, it might be appropriate to use it as the benchmark price. The agreement could have an appreciable effect on competition if it would allow undertakings to raise prices further above competitive levels than they could at present.

When assessing an undertaking's position, consideration may be given to whether the current price is above competitive levels – a dominant undertaking already could have raised prices above competitive levels to its profit-maximising level. In that situation, it will be constrained from raising prices further by substitution from its closest substitutes, or the possibility that customers may stop buying its products – even a monopolist would find it unprofitable to raise prices above current levels, due to substitution from other products. If prices already exceeded the competitive level, however, it would clearly be wrong to include those products in the relevant market and argue that they prevented the undertaking from exercising market power. A judgment may have to be made on whether or not the current price is likely to be already significantly above competitive levels.

## **Previous cases**

In many cases, a market may have already been investigated and defined by the JCRA or by another competition authority. The JCRA may take note of market definitions taken under European competition law; however, departure may be justified by circumstances specific to Jersey<sup>2</sup>. Sometimes earlier definitions can provide a useful short-cut, but competitive conditions may change over time, changing the market definition.

---

<sup>2</sup> See the JCRA's Guideline **Anti-Competitive Arrangements** for a fuller discussion of the relevance of European precedents under the Law.