



AMERICAN UNIVERSITY OF ARMENIA

Master's Paper

**Improvement of dominant position regulation  
under Armenian Competition Law using EU  
Competition Law best practice**

LL.M. ,2<sup>nd</sup> year student- **Hasmik Tigranyan**

Supervisor – **Adelaida Baghdasaryan**

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## **Introduction**

In market economies like Armenia competition is an elementary cornerstone of the economic system. The competition in markets for goods and services gives incentives to enterprises to produce efficiently and to provide goods and services in quantities and qualities that match the consumers' needs. Competition also promotes innovation and adaptation to changing environments. Armenian competition law is rooted in the Constitution of the Republic of Armenia. Legal acts regulating the field of economic competition protection in the Republic of Armenia are provided within the framework of National Program for PCA (Partnership and Cooperation Agreement between EU and Armenia) implementation where the overview of compliance of the Armenian legislation with the EU criteria has also been mentioned in detail. Besides, the establishment of coherent policies on competition and state aid control are a priority area for Armenia: it is highlighted in the commitments stated in the EU-Armenia in ENP Action Plan. One of the EU requirements for Armenia in the field of economic competition protection is to take effective steps to prevent abuse of dominant position. The aim is to prevent companies with a dominant position in their economic sector from abusing this position and from thus distorting competition in the country. Furthermore, the Armenian Competition Law and practice need substantive improvements. And the examination of EU practice in this field will help to suggest solutions for the gaps in legislation and practice. For the foregoing reasons this paper is devoted to the enforcement issues and gaps in the Armenian Competition Law regarding dominant position, as in order to establish abuse of dominant position first it is necessary to determine whether a firm is dominant or not. There are enforcement issues regarding the procedure established by Article 4 (this article is about relevant market determination, which is necessary to identify the fact of dominant power of economic entities). Besides, Article 6.1 on market power of the Armenian Competition law, several other parts of Article 6 on dominant position are too general and vague, are not enforced because of lack of enforcement mechanisms and methodology. These problems do

not allow Armenian Competition Authority to regulate those markets where economic entities have dominant position due to their market power. For example, in cheese market the high price of cheese affect and may distort competition, and thus consumers' trust may also be abused. This market is a competitive market, however there is a company whose shares in the relevant market are not enough to hold it having dominant position in accordance with the current legislation, but in reality this company is believed to have market power and dictate prices. The same problem exists in some other markets, too. Moreover, the abovementioned articles do not have any provision on effective enforcement. They just mainly mention some terms.

*The aim of the study:* This study makes suggestions how to use EU best practice to fill the gaps and address the enforcement issues regarding Article 4 and Article 6 of the Armenian Competition Law and practice through comparative analysis of the Armenian and EU Competition Laws regarding dominant position. Besides, this will help the approximation process of Armenian competition legislation to EU standards and establishment of coherent policies on competition.

To fulfill the aforementioned goals, the paper will discuss:

- Article 6 on dominant position and Article 4 on relevant market definition of the Law on Protection of Economic Competition of the Republic of Armenia.
- *Procedure on Definition of Commodity Market Boundaries* adopted by the Commission's decision *No 190-N of 23 May 2011*, application in case law.
- Decision No 194-N "On approving the procedure and criteria for defining the monopolistic or dominant position, also market power of an economic entity" (May 23, 2011), application in case law.
- European Commission notice on the definition of the relevant market for the purposes of Community competition law.

- “Communication from the Commission-Guidance on the Commission’s Enforcement Priorities in Applying Article 85 (now Article 102 TFEU) of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings”.<sup>1</sup>
- Relevant case law of European Court of Justice (ECJ) and General Court.

This paper consists of an *introduction*, *three chapters* and a *conclusion*. *Introduction* concerns the purpose of writing on this topic and its relevance and importance, underlines the main issues being considered in the paper. *The first chapter* discusses the Armenian Competition Law analyzing Article 6 on dominant position and Article 4 on definition of relevant market of the Law on Protection of Economic Competition of the Republic of Armenia, decisions No 190-N and No 194-N (that define the procedure for these articles), and relevant cases. *In the second chapter* the paper studies EU Competition Law best practice analyzing “Commission notice on the definition of the relevant market for the purposes of Community competition law”, European Commission Communication about dominant position, relevant case law. *The third chapter* makes comparative analysis, shows similarities and differences to see how to use EU best practice to fill the gaps and enforcement issues in the Armenian Competition Law and practice. EU procedure for determining market power is used in an Armenian cheese market case. *The conclusion* consists of a brief summary and solutions to the issues discussed in the paper.

*Methodology:* For the full and comprehensive assessment of the issues the method of comparative research and case study method are applied. We will analyze Armenian and EU competition regulation regarding dominant position and its application in particular cases to see differences and similarities. Then application of EU criteria for assessing dominance is used in Armenian cheese market case to see whether it will help to solve current problems.

Considering the urgency and importance of the topic and that there is much to learn from experts in the field than from the books, field research method is used. The experts, who practice in the field of Competition law and economics, were interviewed: Arman

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<sup>1</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF>

Manasryan- Assistant to Chair of the State Commission for Protection of Economic Competition of the Republic of Armenia (SCPEC RA), economic expert in the field of Competition Law, candidate to economic sciences (besides the interview and all the useful information, he helped to make economic calculations regarding cheese market); Gnel Alaverdyan- economic expert in competition assessment and analysis department of SCPEC RA.

# Chapter 1

## Dominant position under the Armenian Competition Law

The Armenian Competition Law is rooted in the Constitution of the Republic of Armenia (hereinafter the Constitution). Article 8 of the Constitution provides “Freedom of economic activity and free economic competition is guaranteed by the Republic of Armenia”. Most Armenian competition law provisions are provided for by the Law on Protection of Economic Competition of the Republic of Armenia passed on 6 November 2000. This Act has been amended several times since then, but the most significant change took place on 23 May, 2011. The significance of these amendments is determined by inclusion of provisions that made the law more flexible for regulation of current problems, by making many vague provisions more comprehensive.

Legal acts regulating the field of economic competition protection in the Republic of Armenia are provided within the framework of National Program for PCA (Partnership and Cooperation Agreement between EU and Armenia) implementation where the overview of compliance of the Armenian legislation with the EU criteria has also been provided in detail. The EU requirements for Armenia in the field of economic competition protection are the following<sup>2</sup>:

- ✓ To take effective steps in enforcing competition rules, particularly in preventing anticompetitive agreements, **abuse of dominant position**, in controlling concentrations it is necessary to establish a National Competition Authority.
- ✓ National Competition Authority should be vested necessary powers to investigate and examine anti-competitive practices as well as prevent and eliminate such practices by applying different sanctions.
- ✓ National Courts should have an important role in the protection of competition.

The following are the primary legal bases for competition legislation in Armenia:

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<sup>2</sup>AEPLAC, Assessment of Institutional standing in the fields of competition and state aid, July 2007; <http://competition.am/index.php?menu=170&lng=2>

- ✓ The *Partnership and Co-operation Agreement* (PCA) between Armenia and the Member States of the European Community (EC) that entered into force on 1 July 1999.<sup>3</sup> The PCA provides explicitly for legislative co-operation between the parties also in the field of competition.<sup>4</sup> It envisages approximation of the legislation of Armenia with that of the EC.<sup>5</sup>
- ✓ The *Constitution of the Republic of Armenia*, Article 8 provides that "The state guarantees the free development and equal legal protection of all types of property, freedom of economic activity and free economic competition".<sup>6</sup>
- ✓ The *Civil Code of the Republic of Armenia*, Article 12 that prohibits restriction of competition (also abuse of a dominant position in the market) by the way of exercising civil rights.<sup>7</sup>
- ✓ *The Law on the Protection of Economic Competition*: the main objectives of this Law are the "protection and promotion of economic competition, provision of appropriate environment for fair competition, for the development of entrepreneurship and protection of consumer rights".<sup>8</sup>
- ✓ Other legal acts<sup>9</sup>

The establishment of coherent policies on competition and state aid control is a priority for the Republic of Armenia, which is highlighted in the commitments stated in the EU-Armenia European Neighborhood Policy Action Plan. In view of this the Twinning project was established.

General objective of this Project is to contribute to improvement of the competition environment in Armenia through enhancing the powers and capacities of the State Commission for Protection of Economic Competition of the Republic of Armenia

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<sup>3</sup> Article 6 of the Constitution of Republic of Armenia provides that ratified international treaties comprise an indivisible part of the legal system

<sup>4</sup> PCA, Article 43(2).

<sup>5</sup> PCA, Article 43(1).

<sup>6</sup> RA CONST. Ch. 1, Art. 8

<sup>7</sup> RA Civil Code, Ch.2, Art. 12

<sup>8</sup> The law on Protection of Economic Competition of Republic of Armenia, Chapter 1 (1).

<sup>9</sup> Legal acts adopted by SCPEC RA, RA Criminal Code, Ch. 21, Art. 195



(hereinafter Armenian Competition Authority) in enforcing competition and State aid legislation in Armenia, as well as become a more competent and active partner in the wider European setting. Specific objectives of the Twinning Project are as follows:<sup>10</sup>

- ✓ Harmonizing the Armenian Competition and State aid control legislation with EU standards.
- ✓ Enhancing the administrative capacity of the Commission to properly adopt and enforce decisions.
- ✓ Raising public awareness on Competition and State aid principles.

As it is already mentioned, one of the *EU requirements* for Armenia in the field of economic competition protection is to take effective steps to prevent the abuse of *dominant position*. The aim is to prevent companies with a dominant position in their economic sector from abusing this position and from thus distorting competition in the country. In order to establish abuse of dominant position first it is necessary to **determine the relevant market**, then determine whether a firm is dominant or not. Determination and definition of commodity market (it is the same as relevant market concept) is a tool to identify the boundaries of competition between firms. Besides, it allows establishing the framework to apply competition policy by the Commission. *Article 4* of The Law on Protection of Economic Competition of the Republic of Armenia (hereinafter the Law) provides basic concepts of the **commodity market, product and geographical boundaries of commodity market**, and establishes that the commodity market is defined by the decision of the Commission. Then the *Procedure on Defining the Commodity Market Boundaries*, adopted by Armenian Competition Authority's decision *No 190-N of 23 May 2011*<sup>11</sup> (hereinafter Decision 190-N), provides procedure for defining commodity market boundaries, composition of market participants and volumes. It specifically mentions that commodity market is characterized via **product boundaries of commodity market** and **geographical**

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<sup>10</sup><http://competition.am/index.php?menu=308&lng=2>

<sup>11</sup>[http://competition.am/uploads/resources/vor\\_arm\\_2011\\_05\\_190.pdf](http://competition.am/uploads/resources/vor_arm_2011_05_190.pdf)

**boundaries of commodity market.** Then it is stipulated that the determination of product boundaries of commodity market is based on **mutual substitutability of products** (repeating the definition of Article 4 of mutual substitutable products); or probable behaviour of buyers based on the **purpose** of product use, **application, qualitative, technical, price** or other properties; or the **classification of relevant commodity**: Foreign Economic Activity Commodity Nomenclature (FEACN)<sup>12</sup>, Classification of Products by Activities (CPA)<sup>13</sup>, etc.; or other sources such as data given by other state bodies or economic entities, expert reports, inquiries, the results of previous studies, etc. For geographical boundaries of commodity market Decision 190-N repeats particular definition in Article 4. Id. In practice and in its decisions, however, *Armenian Competition Authority* until now has determined and defined commodity product market via mutual substitutability of products using mostly FEACN classification. If we look at the wording of Decision 190-N, we can see that it repeats the wording of Article 4 of the Law. The Decision 190-N is adopted as procedure for the application of Article 4; however it gives definitions similar to Article 4 and lacks comprehensive elaboration methods and enforcement mechanisms. For this very reason this decision is not enforced. All the aforementioned cause difficulties for the *Armenian Competition Authority* in regulating competition in those commodity markets, that are small and cannot be defined using classification methods<sup>14</sup>. For example, in “sour cream market” sour creams with different fat percentages (from 10-30 %) have different prices that mostly depend on the percentage of fats: as high is the percentage of fat, as high the price of the sour cream raises. Thus, sour creams with different percentages are probably not interchangeable; as not only prices are different, but customers of low price sour cream would not probably buy sour cream with high price. However the *Armenian Competition Authority* considers sour cream as one market based on FEACN. The excessive high price in sour cream market

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<sup>12</sup> *Foreign Economic Activity Commodity Nomenclature* is a tariff nomenclature based on Harmonized Commodity Description and Coding System (HS), that is an internationally standardized system of names and numbers for classifying traded products developed and maintained by the World Customs Organization (WCO)

<sup>13</sup> *Classification of Products by Activities* is a statistical classification of products and services, that classifies products by activity in which they are produced

<sup>14</sup> Nearly all the issues and gaps regarding Armenian competition law are also found via my working experience in the field of Armenian Competition law (I am a legal expert in competition assessment and analysis department of SCPEC RA)

with high fat percentage is not regulated for this particular reason. Therefore, in the process of defining the market the application of proper and differentiated approaches, the availability of comprehensive elaboration methods and enforcement mechanisms in Decision 190-N, in my opinion, would not only help to regulate any kind of market, but also avoid later disputes regarding determination of the relevant market.

As it was already mentioned, the next step after determination of relevant market is determination of dominant position. *Article 6 of the Law on Protection of Economic Competition of the Republic of Armenia provides that*<sup>15</sup>:

*1. Within the meaning of this Law, the economic entity shall be deemed as holding a monopolistic position on a commodity market if it has no competitors as a seller or buyer.*

*2. The economic entity shall be deemed as having **dominant position** in a commodity market in following cases, if:*

*1) An economic entity shall be deemed as dominant on a commodity market if as a seller or buyer it does not face any material competition and (or) is able to influence significantly on the general conditions of commodity turnover in the concerned commodity market and (or) to oust another economic entity from the concerned commodity market and (or) or impair its entry to the concerned commodity market; or*

*2) By its sale or purchase volume it has at least 1/3 of share in the concerned market as a seller or buyer; or*

*3) Each of the two economic entities with higher sale or purchase volumes in the commodity market shall be deemed as dominant in the concerned commodity market, if as a seller or buyer their combined share in the market by their sale or buy volumes is equal to at least 1/2 of the market; or*

*4) Each of the three economic entities with higher sale or buy volumes in the commodity market shall be deemed as dominant in the concerned commodity market, if as a seller or*

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<sup>15</sup> Article 6, the Law On Protection of Economic Competition of the Republic of Armenia (amended version)

*buyer their combined share in the market by their sale or buy volumes is equal to at least 2/3 of the market.*

*3. The economic entity (entities) shall be classified as dominant based on any of the grounds stipulated in parts 2, 3 or 4 of this article, taking into account distinguishing features of the concerned commodity market structure in terms of distribution of shares of economic entities operating in this market. Economic entities defined in this part may submit evidences excluding their dominancy in the concerned commodity market.*

*4. The procedures and criteria for classifying an economic entity as dominant or as a monopoly, as well as its market power, shall be defined by the Commission.*

*5. A commercial network shall be deemed as dominant, if it is a group of four or more traders.*

*6. An economic entity shall be deemed as having a monopolistic or dominant position in a commodity market upon decision of the Commission.*

*7. In order to liquidate (terminate the activity) an economic entity having a monopolistic or dominant position, a reference by the Commission, stating that it does not object to the liquidation (termination of activity) of the entity, is mandatory.*

The procedure for the application of *Article 6* is defined in Armenian Competition Authority's decision No. 194-N (hereinafter *Decision 194-N*) "On approving the procedure and criteria for defining the monopolistic or dominant position, also market power of an economic entity" (May 23, 2011)<sup>16</sup>. It lists procedural elements necessary for market share determination mainly giving general definitions. Part 9 on criteria and procedure of the market power of the Appendix of *Decision 194-N* just enumerates several criteria which are too general and vague: part 9.1 mentions just **financial capacities of economic entity**, 9.2- **the degree of concentration** and the of **market share** of an economic entity in the relevant market, which is mainly quantitative criteria, 9.3-**barriers to entry** to a relevant market, without mentioning what are considered as barriers, 9.4- **stability** of relevant market, 9.5-

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<sup>16</sup> [http://competition.am/uploads/resources/vor\\_arm\\_2011\\_05\\_194.pdf](http://competition.am/uploads/resources/vor_arm_2011_05_194.pdf)

**influence** of an economic entity on other connected markets. *Id.* *Part 9* contains *no procedure* for applying the abovementioned criteria and no test to apply for these criteria. This decision has never been used or referenced because of its vagueness.<sup>17</sup>

The definition of dominance is given by *Article 6*. According to *Articles 6.1–6.4*, dominance is defined by market power (the definition of dominant position by market power has not been used in practice, though this criterion has been added to the Law by the recent amendment) or market share and incorporates both single firm dominance (a market share of 1/3 or greater) as well as dominance on the part of the two or three largest firms, depending again on their collective market shares (each of two economic entities will be dominant if between them they command a 50% or greater market share, while each of three firms will be dominant if they capture 2/3 or more of the market in question). In the case of commercial networks, they are considered to be dominant if they are a group of 4 or more traders. The use of market share thresholds to either establish a *prima facie* case or thus shift the burden of proof or to rule out dominance enhances the efficiency of the enforcement of the competition authority and gives entrepreneurs legal certainty. For example, by the *Armenian Competition Authority*'s decision N537-A of November 18, 2011 "On the results of the study of "Bakery Yeast" product market" "LIA-K GROUP" Ltd, "AELQS-GRIG" Ltd and "ELITA" Ltd were recognized as having a dominant position: these three companies' share in the market sales volume altogether is 78.84 % (more than 2/3)). The same "ELITA" Ltd in 2007 by the decision of N71-A was recognized as having a dominant position on "Bakery Yeast" product market (as a seller captures at least one third of the market (50.41%). By another decision (N538-A) of November 18, 2011 the Competition recognized "Arman and Partnyor" Ltd and "Bio Food" Ltd as having dominant position (as a seller they capture more than one third of the market (51.79%)) in "Spread" product market. "Aleqs-Grig" Ltd, "Nor Zovq" Ltd, "SAS Group" Ltd and "Fresh" Ltd were recognized as having dominant position, as they have 4 or more than 4 commercial networks (decision N218-A,

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<sup>17</sup> Manaseryan Arman (Assistant to Chair of SCPEC RA, economic expert, candidate of economic sciences). Personal interview. 20 January, 2012.

June 8, 2011). As the practice of the Commission shows, market power has never been used for defining dominance because of the absence of adequate procedure and enforcement methods. These problems do not allow competition authority to regulate those markets where companies have dominant position due to their market power. For example, in cheese market the high price of cheese affects and may distort competition, abuse trust that consumers have in that product. This market is a competitive market, however there is a company whose shares in the relevant market are not enough to hold it having dominant position, but this company is supposed to have market power and dictate prices.<sup>18</sup> The same problem exists in gas market and in some other markets, too<sup>19</sup>. In the case of collective dominance of three largest firms it is possible, that the third firm, that has the lowest market share (for example, 10-15% market share) among the other two, does not have market power, has little influence on market and is probably not dominant.

Thus, Armenian Competition Authority uses mostly classification methods for relevant market definition. This, however, do not allow regulation of competition in those markets that are too small. For dominant position determination Armenian Competition Authority follows market share thresholds. This approach, however, poses the risk of underemphasizing or overemphasizing market share in certain cases, leading to over enforcement or under enforcement. Therefore, as a rule, competition laws of USA and EU (which have one of the best experience in this filed) do not stipulate irrefutably that a company is dominant when it reaches certain market share thresholds<sup>20</sup>

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<sup>18</sup> Manaseryan Arman (Assistance to Chair of SCPEC RA, economic expert). Personal interview. 17 January, 2012

<sup>19</sup> Alaverdyan Gnel (Economic Expert in analysis and competition assessment department of SCPEC RA). Personal interview. 21 January, 2012

<sup>20</sup> J. David Richardson and Edward M. Graham. *Global Competition Policy*. Peterson Institute, 2007. page 344

## Chapter 2

### Dominant position under the EU Competition Law

Competition is an essential characteristic of market economies like the EU and its Member States. A competitive environment is a prerequisite to a high level of economic welfare, international competitiveness and ultimately high consumer benefits. Competition law and its strict application are needed in order to ensure that destructive tendencies which are inherent to the market economy system will not succeed.

Competition Law in the EU and its Member States explicitly addresses these problems by enforcing:

- ✓ the prohibition of cartels (Art. 101 TFEU<sup>21</sup>)
- ✓ the prohibition of the **abuse of dominant positions** (Art. 102 TFEU)
- ✓ the prohibition of mergers that significantly impede effective competition in the common market or a substantial part of it (EU Merger Regulation).

As it is mentioned above, Competition Law in EU and its Member States also addresses the enforcement of the prohibition of the **abuse of dominant positions**. The aim is to prevent companies with a dominant position in their economic sector from abusing this position and from distorting competition in intra-Community trade. This aim requires preventive intervention to investigate company mergers, since these may create dominant positions.<sup>22</sup>

Art. 102 TFEU prohibits **abuse** by one or more undertakings of a **dominant position** within the internal market or in a substantial part of it in so far as it may affect trade between Member States. The existence or creation of dominance is not prohibited by Article 102 TFEU, but only its abuse. However, for the establishment of abuse of dominant position first

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<sup>21</sup> Treaty on the Functioning of the European Union, 2009.

<sup>22</sup> [European Parliament Fact Sheets: Abuse of a dominant position and investigation of mergers: http://www.europarl.europa.eu/factsheets/3\\_3\\_2\\_en.htm](http://www.europarl.europa.eu/factsheets/3_3_2_en.htm)

it is necessary to determine whether a firm is dominant or not.<sup>23</sup> In order to determine whether an economic entity has dominant position, it “must be viewed in relation to the “relevant product/service market” and “relevant geographic market””.<sup>24</sup> It is, indeed, logical that the Court and the Commission will be able to determine the existence of abuse (that will distort competition) after having defined relevant market. The importance of market definition is recognized by the European Court of Justice (ECJ) itself. In *Hoffmann-La Roche & Co. v Commission* the ECJ did underline, “how necessary it is to define the market concerned in order that the relative strength for the undertakings in such a market might be considered”.<sup>25</sup> The approach of the Commission to market definition is transparent in “COMMISSION NOTICE on the definition of relevant market for the purposes of Community competition law (97/C 372/03)” (hereinafter the Notice), which is a guideline of economic principles how to define market for the purposes of EU Competition Law<sup>26</sup>. It should be noted that the Notice describes a process for defining the relevant market which was not evident in previous decisions of the Commission and judgments of the Court.<sup>27</sup> The Notice<sup>28</sup> characterizes market definition as a tool for identifying and defining boundaries of competition between economic entities and as a framework within which the Commission applies competition policy.<sup>29</sup> The definition of market itself makes it possible to calculate market shares of economic entities that would convey meaningful information regarding market power of these entities for the purposes of assessing dominance. Id. The ECJ and the Commission in the Notice define relevant market in terms of substitutability (it is the same as interchangeability) and they both consider the combination of product aspect (product

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<sup>23</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*, Fourth Edition, Oxford University Press, 2011. P. 284

<sup>24</sup> P.S.R.F. Mathijsen. *A guide to European Union Law as amended by the Treaty of Lisbon*. 10<sup>th</sup> ed. London. Sweet and Maxwell, 2010, page 339

<sup>25</sup> Id at 340

<sup>26</sup> Stephen Weatherill. *Cases and Materials on EU Law*. 9<sup>th</sup> ed. New York. Oxford University Press, 2010, page 529.

<sup>27</sup> Erika Szyszczak and Adam Cygan. *Understanding EU Law*. 2<sup>nd</sup> ed. London. Sweet and Maxwell, 2008, page 226.

<sup>28</sup> This *Notice* itself is not binding, it is soft law instrument, however the practice of European Commission shows that the *Notice* is enforced as hard law.

<sup>29</sup> “COMMISSION NOTICE on the definition of relevant market for the purposes of Community competition law (97/C 372/03)” <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209%2801%29:EN:NOT>



market) and geographical aspect (geographic market) of the relevant market. The Court of Justice (ECJ) has applied the following definitions of relevant market<sup>30</sup>:

*...the definition of relevant market is of essential significance, for the possibilities of competition can only be judged in relation to those characteristics of the products in question by the virtue of which those products are particularly apt to satisfy an inelastic need and are only to a limited extent interchangeable with other products.*<sup>31</sup>

*The concept of relevant market in fact applies that there can be effective competition between the products which form part of it and this presupposes that there is sufficient degree of interchangeability between all the products forming part of the same market insofar as a specific use of such product is concerned.*<sup>32</sup>

*...for the purposes of investigating possible dominant position of an undertaking on a given market, the possibilities of competition must be judged in the context of market comprising the totality of products which, with respect to their characteristics are particularly suitable for satisfying constant needs and are only to a limited extent interchangeable with other products.*<sup>33</sup>

Market definition suggested by the Commission in the Notice is based on the ECJ's above mentioned definitions:

*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.*

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<sup>30</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*. 4th ed. New York .Oxford University Press, 2011, page 62

<sup>31</sup> Case 6/72, *Europemballage Corp and Continental Can Co. Inc. v. Commission* [1973] ECR 215, [1973] CLPR 199, para 32.

<sup>32</sup> Case 85/76, *Hoffman-La Roche & Co AG. v. Commission* [1979] ECR 461, [1979] 3 CLPR 211, para 28

<sup>33</sup> Case 322/81, *Nederlandsche Banden-Industrie Michelin. v. Commission* [1983] ECR 3461, [1985] 1 CLPR 282, para 37.

*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 neighboring areas because the conditions of competition are appreciably different in those area. Id.*

When defining market, the Notice identifies three main competitive constraints which undertakings are subject to: supply **substitutability** (concerned with the ability of product users to switch to substitute product), **demand** substitutability (the ability of similar product producers to produce the product), **potential competition**.<sup>34</sup> Demand substitutability, and, to more limited extent, supply substitutability are relevant for market definition. Potential competition may be relevant during supply substitutability consideration; however it will be more relevant during the determination of dominant position of an undertaking in relevant market. Id. These are the basic principles that the Commission uses in market definition process. The Notice also gives the methods of assessing each of these constraints (see Appendix 2, parts 15-19 for the assessment of demand substitution, parts 20-23 for supply substitution and parts 24 for potential competition). As it is already mentioned the Commission in the Notice mainly concentrates on demand-side substitution (this is also evident from part 13-14 in Appendix 2). *Substitutability* is judged by measuring cross-elasticity of demand.<sup>35</sup> As a primary method of measuring cross-elasticity of demand the Commission relies upon Hypothetical Monopolist Test (HMT) using SSNIP (Small but Significant Non-transitory Increase in Price) test. Id. The test is used by competition authorities around the world (in USA, New Zealand, Canada, Australia...).<sup>36</sup> This test is an economic approach for market definition. SSNIP test applies as follows: 5-10 % (a small %), but non-transitory rise of a product/service (A) price is assumed. Then it is asked whether

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<sup>34</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*. 4th ed. New York .Oxford University Press, 2011, page 293

<sup>35</sup> Bruce Lyons. *Cases in European Competition Policy: the economic analysis*. New York. Cambridge University Press, 2009, page 31

<sup>36</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*. 4th ed. New York .Oxford University Press, 2011, page at 68

this increase in price would cause the customers of product A to buy product B, or to buy product A from another area, to such an extent that the increase in price is unprofitable. A practical example this test is provided in the Notice (Appendix 2, part 18), which helps to understand the test better: "... An issue to examine in soft drink bottlers case would be to decide whether different flavors of soft drinks belong to the same market. In practice, the question to address would be whether consumers of flavor A would switch to other flavors when confronted with a permanent price increase of 5 % to 10 % for flavor A. If a sufficient number of consumers would switch to, say, flavor B, to such an extent that the price increase for flavor A would not be profitable owing to the resulting loss of sales, then the market would comprise at least flavors A and B. The process would have to be extended in addition to other available flavors until a set of products is identified for which a price rise would not induce a sufficient substitution in demand". Id.

Actually, the practical problem is applying SSNIP test.<sup>37</sup> The Commission answers the question "how customers reaction in price increase is going to be judged" in 32-52 parts of the Notice (Appendix 2). It is important to consider the risk of "cellophane fallacy"<sup>38</sup>. This problem arises from the fact that SSNIP test whether current price is already a dominant price arising from the exercise of market power. Part 19 of the Notice speaks about the difficulties with the test, though it does not give the name of "cellophane fallacy"<sup>39</sup>. Along with this test, the Commission also uses other quantitative tests for market delimitation, such as elasticity estimates, price correlation analysis, analysis of price convergence and causality calculations (Appendix 2, part 39).

As it has already been mentioned, the Commission also considers supply-side substitutability for market definition. It takes into account the following situation: would

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<sup>37</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*. 4th ed. New York .Oxford University Press, 2011, page 70

<sup>38</sup> Id at 72

<sup>39</sup> The name "cellophane fallacy" was given after subject-matter in *United States vs. El Du Pont de Nemours* case where the Supreme Court accepted the argument of Du Pont that cellophane does not constitute to a separate market as it closely and directly compete with other packaging materials, though the SSNIP test has considered it as a separate market.

producers of product B enter the market of product A in case of a price increase for A. For this purpose likelihood (risks, costs), timeliness of access is considered (Appendix 2, part 20-23).

During the determination of relevant geographic market the Commission considers analysis of market shares of all market participants in different regions, analysis of shipping costs, views of customers and competitors, analysis of distribution/service system, basic demand characteristics, past evidence of diversion of orders to other areas, regulatory barriers (tariffs, regulation, technical standards, environmental law, access to distribution networks, access to infrastructure, etc.), current geographic pattern of purchases (Appendix 2, parts 44-52).

The temporal market is often ignored and the Notice does not even refer to it. However it is important during the consideration of transport market.<sup>40</sup> In fact, in such market temporal dimension may be an inherent part for product market definition.<sup>41</sup> For example in *European night services v. Commission* (1998) case the General Court annulled the decision of joint venture by the Commission. During the appeal the Commission raised the issue of confining the business transport market to early morning and late evening rather than all around the day. In *ABG Oil* case the Commission looked at the oil market only during the period of the OPEC crisis in the 1970s. *Id.*

The next step after the definition of relevant market is determination of dominant position. In order to find whether the undertaking is dominant, the power which undertaking has on that market must be assessed. There are two ways of assessing market power- “direct” and “indirect”<sup>42</sup>. The “direct” method involves estimation of market power using economic methods- residual demand curve (the demand curve that a single firm faces). However, this

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<sup>40</sup> Toney Storey and Chris Turner. *Unlocking EU Law*. 2<sup>nd</sup> ed. London. Hodder education an Hachette UK Company, 2008, page 418

<sup>41</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*. 4th ed. New York .Oxford University Press, 2011, page 320

<sup>42</sup> *Id* at 61

method requires data that it is often difficult to get. “Indirect” method considers structural approach. It involves assessment of market share (quantitative indicator) and competition structure-market position of the dominant undertaking and its competitors, expansion or entry, countervailing buyer power (qualitative indicator) in conjunction. Id. The “indirect” method is the one that is used by competition authorities around the world (including EU countries).<sup>43</sup>

In EU there is no single act, regulation or directive establishing when an undertaking can be considered holding dominant position. Dominant position is established by well settled case law (ECJ and General Court) and by the *Communication from the Commission-Guidance on the Commission’s Enforcement Priorities in Applying Article 85 (Article 102 TFEU) of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (2009) OJ C 45/2*<sup>44</sup> (hereinafter the Communication).

Dominant position is largely determined by the extent to which undertakings can act independently of their competitors or customers.<sup>45</sup> The concept of dominant position was defined by the Court of Justice as “a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers” (*United Brands Continental BV v. Commission, Hoffmann-La Roche & Co. v Commission*). The Communication continues on this, providing that “...this notion of independence is related to the degree of competitive constraint exerted on the undertaking in question. Dominance entails that these competitive constraints are not sufficiently effective and hence that the undertaking in question enjoys substantial market power over a period of time. This means that the undertaking's decisions are largely insensitive to the actions and reactions of competitors,

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<sup>43</sup> Sanoussi Bilal and Marcelo Ollareaga. “Regionalism, Competition Policy and Abuse of Dominant Position”. Journal of World Trade, 32 (3), June 1998.

<sup>44</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF>

<sup>45</sup> Herbert J. Hovenkamp. “The Legal Periphery of Dominant Firm Conduct”. U Iowa Legal Studies Research Paper No.

07-21. University of Iowa - College of Law, 2010, page 10; [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1014426](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1014426)

customers and, ultimately, consumers. The Commission may consider that effective competitive constraints are absent even if some actual or potential competition remains.<sup>46</sup> In general, a dominant position derives from a combination of several factors which, taken separately, are not necessarily determinative<sup>47</sup>...” Then, the Commission considers in the Communication that an undertaking can generally be regarded as holding dominant position, when the undertaking does not face sufficiently effective competitive constraints and is capable of increasing price<sup>48</sup> profitably above competitive level for a significant of time.

The Communication also provides that the Commission will consider competitive structure of market during the assessment of dominance. Particularly the following factors will be taken into account:

- constraints imposed by the existing supplies from, and the position on the market of, actual competitors (the market position of the dominant undertaking and its competitors),
- constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors (expansion and entry),
- constraints imposed by the bargaining strength of the undertaking’s customers (countervailing buyer power)<sup>49</sup>.

The Communication then discusses each of these factors in detail:

(a) *Market position of the dominant undertaking and its Competitors*

13. Market shares provide a useful first indication for the Commission of the market structure and of the relative importance of the various undertakings active on the market.<sup>50</sup>

However, the Commission will interpret market in the light of the relevant market

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<sup>46</sup> Case 27/76 *United Brands Company and United Brands Continentaal v Commission* [1978] ECR 207, paragraphs 113 to 121; Case T-395/94 *Atlantic Container Line and Others v Commission* [2002] ECR II-875, paragraph 330.

<sup>47</sup> Case 27/76 *United Brands and United Brands Continentaal v Commission* [1978] ECR 207, paragraphs 65 and 66; Case C-250/92 *Guittrop-Klim e.a. Grovwareforeninger v Dansk Landbrugs Grovvareselskab* [1994] ECR I-5641, paragraph 47; Case T-30/89 *Hilti v Commission* [1991] ECR II-1439, paragraph 90.

<sup>48</sup> In the Communication the expression ‘increase prices’ includes the power to maintain prices above the competitive level and is used as shorthand for the various ways in which the parameters of competition — such as prices, output, innovation, the variety or quality of goods or services — can be influenced to the advantage of the dominant undertaking and to the detriment of consumers.

<sup>49</sup> Communication from the Commission- Guidance on the Commission’s Enforcement Priorities in Applying Article 85 (Article 102 TFEU) of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (2009) OJ C 45/2.

<sup>50</sup> Case 85/76 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, paragraph 39-41; Case C-62/86 *AKZO v Commission* [1991] ECR I-3359, paragraph 60; Case T-30/89 *Hilti v Commission* [1991] ECR II-1439, paragraphs 90, 91 and 92; Case T-340/03 *France Tülicom v Commission* [2007] ECR II-107, paragraph 100.

conditions, and in particular of the dynamics of the market and of the extent to which products are differentiated. The trend or development of market shares over time may also be taken into account in volatile or bidding markets. *Id.*

14. The Commission considers that low market shares are generally a good proxy for the absence of substantial market power. The Commission's experience suggests that dominance is not likely if the undertaking's market share is below 40 % in the relevant market. However, there may be specific cases below that threshold where competitors are not in a position to constrain effectively the conduct of a dominant undertaking, for example where they face serious capacity limitations. Such cases may also deserve attention on the part of the Commission. *Id.*

15. Experience suggests that *the higher the market share and the longer the period of time over which it is held, the more likely it is that it constitutes an important preliminary indication of the existence of a dominant position* and, in certain circumstances, of possible serious effects of abusive conduct, justifying an intervention by the Commission under Article 82.<sup>51</sup> *However, as a general rule, the Commission will not come to a final conclusion as to whether or not a case should be pursued without examining all the factors which may be sufficient to constrain the behavior of the undertaking. Id.*

(b) *Expansion or entry*

16. Competition is a dynamic process and an assessment of the competitive constraints on an undertaking cannot be based solely on the existing market situation. The potential impact of expansion by actual competitors or entry by potential competitors, including the threat of such expansion or entry, is also relevant. An undertaking can be deterred from increasing prices if expansion or entry is likely, timely and sufficient. For the Commission to consider expansion or entry likely it must be sufficiently profitable for the competitor or entrant, taking into account factors such as the barriers to expansion or entry, the likely reactions of

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<sup>51</sup> Joined Cases C-395/96 P and C-396/96 P *Compagnie Maritime Belge Transports, Compagnie Maritime Belge and Dafra-Lines v Commission* [2000] ECR I-1365, paragraph 119; Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969, paragraph 186.

the allegedly dominant undertaking and other competitors, and the risks and costs of failure. For expansion or entry to be considered timely, it must be sufficiently swift to deter or defeat the exercise of substantial market power. For expansion or entry to be considered sufficient, it cannot be simply small-scale entry, for example into some market niche, but must be of such a magnitude as to be able to deter any attempt to increase prices by the putatively dominant undertaking in the barriers, such as tariffs or quotas, or they may take the form of advantages specifically enjoyed by the dominant undertaking, such as economies of scale and scope, relevant market. Id.

17. Barriers to expansion or entry can take various forms. They may be legal privileged access to essential inputs or natural resources, important technologies<sup>52</sup> or an established distribution and sales network.<sup>53</sup> They may also include costs and other impediments, for instance resulting from network effects, faced by customers in switching to a new supplier. The dominant undertaking's own conduct may also create barriers to entry, for example where it has made significant investments which entrants or competitors would have to match<sup>54</sup>, or where it has concluded long-term contracts with its customers that have appreciable foreclosing effects. Persistently high market shares may be indicative of the existence of barriers to entry and expansion. Id.

(c) *Countervailing buyer power*

18. Competitive constraints may be exerted not only by actual or potential competitors but also by customers. Even an undertaking with a high market share may not be able to act to an appreciable extent independently of customers with sufficient bargaining strength.<sup>55</sup> Such countervailing buying power may result from the customers' size or their commercial significance for the dominant undertaking, and their ability to switch quickly to competing suppliers, to promote new entry or to vertically integrate, and to credibly threaten to do so. If

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<sup>52</sup> Case T-30/89 *Hilti v Commission* [1991] ECR II-1439, paragraph 19.

<sup>53</sup> Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, paragraph 48.

<sup>54</sup> Case 27/76 *United Brands v Commission* [1978] ECR 207, paragraph 91.

<sup>55</sup> Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969, paragraphs 97 to 104, in which the Court of First Instance considered whether the alleged lack of independence of the undertaking *vis-a-vis* its customers should be seen as an exceptional circumstance preventing the finding of a dominant position in spite of the fact that the undertaking was responsible for a very large part of the sales recorded on the industrial sugar market in Ireland.



countervailing power is of a sufficient magnitude, it may deter or defeat an attempt by the undertaking to profitably increase prices. Buyer power may not, however, be considered a sufficiently effective constraint if it only ensures that a particular or limited segment of customers is shielded from the market power of the dominant undertaking. Id.

Thus, finding out whether or not an undertaking is in a dominant position requires a complex assessment of a number of elements, including the market position of undertakings operating in a relevant market, barriers to entry and expansion in the market, the countervailing buyer power, the power which undertakings have on that market (market power). The case law provides the following criteria necessary for the estimation of above mentioned three elements<sup>56</sup>:

(a) For *market position of undertakings operating in a relevant market* one or several of these criteria are considered.

Factors: market share, resources.

Criteria: 1. market shares of leading undertakings in relevant market, correlation of shares 2.financial power; 3.deep pockets; 4.cross subsidization; 5.engineering capacities; R&D capacities; 6.access to capital markets.

Factors: Access to Customers/Suppliers/Inputs

- Criteria: 1.secure or integrated access to inputs; 2.access to machines; 3.access to logistics/means of transport; 4.access to sales channels/local distribution network; 4.supply of systems/range of products high reputation/strong brands/advertising/product differentiation; 5.foreclosure strategies; 6.integration/efficiencies (horizontal integration with competitors); 7.cost reduction; 8.vertical story (vertical integration with suppliers/customers).

(b) For *barriers to entry and expansion in the market* one or several of these criteria are considered.

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<sup>56</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*. 4th ed. New York .Oxford University Press, 2011, pp. 327-354

Criteria- 1.access to key inputs; 2.access to technologies; 3.access to customers; 4.spare capacities; 5.timeliness of access; 6.sunk costs/reversibility; 7.market phase.

Factors: Access to Customers/Suppliers/Inputs

- Criteria: 1.secure or integrated access to inputs; 2.access to machines; 3.access to logistics/means of transport; 4.access to sales channels/local distribution network; 4.supply of systems/range of products high reputation/strong brands; 5.foreclosure strategies; 6.integration/efficiencies (horizontal integration with competitors); 7.cost reduction; 8.vertical story (vertical integration with suppliers/customers).

(c) For *countervailing buyer power* one or several of these criteria are considered.

Criteria-1.size of customers; 2.dependence on buyers; 3.size and frequency of sales; 4.market transparency; 5.strategic buyer behavior. Id.

The Court and the Commission also consider other factors indicating dominance, such as the undertaking's own assessment of its position (Tomra Systems v. Commission, where several documents of the company, that were found during the Commission's dawn raid, referred to the company's dominant position)<sup>57</sup>, profits (United Brands case, Michelin case, where the Court considered the ability of companies to absorb temporary losses), overall size and strength and range of products (Portfolio power)( Hoffman-La Roche case, also in Michelin case, where the ECJ considered the advantages that Michelin derived from belonging to group of economic entities that operate in Europe and in the world),<sup>58</sup> intellectual property rights (Hilti AG v Commission case, Tetra Pak I case, Volvo v. Veng)<sup>59</sup>, secondary markets (aftermarkets)- whether a firm has dominance in other markets (Hilti case, etc.)<sup>60</sup>. These cases also provide the way how each of these factors was assessed. Besides, as a general rule, high market shares held over long period of time to be important

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<sup>57</sup>Tomra Systems v. Commission; <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62006TJ0155:EN:NOT>

<sup>58</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*, Fourth Edition, Oxford University Press, 2011, p-p 333-336.

<sup>59</sup> Steven Anderman and Hedvig Schmidt. *EU Competition Law and Intellectual Property Rights*. 2<sup>nd</sup> ed. New York. Oxford University Press, 2011, page 58-64

<sup>60</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*, Fourth Edition, Oxford University Press, 2011, page 306

preliminary indicators of the existence of a dominant position.<sup>61</sup>The case law of the European Courts establishes a presumption of dominance where an undertaking has a market share of 50 per cent or more. However, as a general rule, the Commission will not come to a final conclusion as to whether or not a case should be pursued without examining all the factors which may be sufficient to constrain the behavior of the undertaking.<sup>62</sup> For example, in the case of *British Airways v. Commission* the undertaking was found to have a dominant position having the lowest market share (39.7%). Here the Court looked into the whole circumstances of the case, particularly considering the following factors: 1. market share of British Airways is more than twice more (39.7%) than the cumulative shares of its five main competitors (together these five companies have 17.9% share in the UK market for air travel agency services); 2. travel agents in UK substantially depend on the income that they receive from British Airways in consideration for their air travel agency services; 3. for travel agents, established in UK, British Airways is an obligatory business partner; 4.in comparison to its main five competitors, British Airways offers more frequent flights and a wider choice of routes; 5.due to its economic strength British Airways occupies word rank in terms of international scheduled passenger-kilometers flown, its hub network and the extent of its transport services; 6. British Airways is in a position to reduce or increase number of travel agencies in UK.<sup>63</sup> Importantly, regardless of the form of the behavior in question, its likely effect on competition will depend on the circumstances at hand and will be assessed on a case-by-case basis.

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<sup>61</sup> Chalmers, Davies and Monti. *European Union Law, Cases and Materials*. New York. Cambridge University Press, 2010, page 999

<sup>62</sup> Alison Jones and Brenda Sufrin, *EU Competition Law, texts, cases and materials*, Fourth Edition, Oxford University Press, 2011. P. 329

<sup>63</sup> *British Airways v. Commission* [2003] ECR II-5917; <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61999TJ0219:EN:HTML>

## Chapter 3

### Comparative Analysis of EU Competition Law and Armenian

### Competition Law regarding dominant position: similarities and differences

The Law on Protection of Economic Competition of the Republic of Armenia last was amended on May 23, 2011. The main reasons for amendment were not only to improve competition legislation, but also approximation of this legislation to EU standards.

Article 4 of the Law provides basic concepts of commodity market, product and geographical boundaries of commodity market:

*“**Commodity market:** sphere of circulation of the concerned commodity or its mutually replaceable commodities in a certain area as approved under the decision of the State Commission for Protection of Economic Competition of the Republic of Armenia (hereinafter the Commission) whose boundaries are determined by the economic abilities of the buyer to acquire the commodity in the respective area and its appropriateness. The commodity market is characterized by product and geographical boundaries, composition of its subjects, and volume;*

***Product boundaries of commodity market:** entirety of the concerned commodity and its mutually replaceable commodities, as defined by the decision of the Commission;*

***Geographical boundaries of commodity market:** specific geographical area (including roads, routes (air, water, land, etc.)), as defined by the decision of the Commission, within which it is economically possible and appropriate for the buyer to acquire the concerned commodity and its mutually substitutable commodities, and such possibility and expedience does not exist beyond the mentioned area. The geographical boundaries of a commodity market may include the entire territory of the Republic of Armenia or a part thereof or the*

*territory of the Republic of Armenia (or a part thereof) and the territory of another state (or a part thereof)...*”

If we compare these definitions with the ones suggested by the Commission in the Notice (see Appendix 2), we will find similarities. Both in Armenia and in EU commodity market is characterized via product boundaries of commodity market and geographical boundaries of commodity market. The differences between the Armenian Competition Law and EU Competition Law are in the procedure and criteria of defining relevant market. As it was mentioned in the first chapter, the procedure for market definition under Armenian Competition Law is provided by the SCPEC RA decision *No 190-N of 23 May 2011 about “Procedure on Definition of Commodity Market Boundaries”*. This decision repeats the definitions stipulated by Article 4, and then mentions several criteria for determination of mutual substitutability. This decision, however, lacks of any kind of procedural provisions regarding market definition. The Armenian Competition Authority in its decisions, however, have determined and defined commodity product market via mutual substitutability of products using mostly FEACN classification (there are only few decisions that are based on other classification). Very often the Armenian Competition Authority faces a problem of not being capable to define the relevant market narrowly in order to be able to regulate the problems that exist in narrower market. As discussed above in Chapter 1, in “sour cream market” sour creams with different fat percentages (from 10-30 %) are probably not interchangeable and constitute different markets. However the Armenian Competition Authority considers sour cream as one market based on FEACN. The reason of such kind of problems is, in my opinion, the practice of being so tied only to the method of defining mutual interchangeability via classification methods. This kind of methods are mostly mechanical approach to a problem, it lacks any analytical approach for market determination. In EU practice, however, the situation is different. The Commission in the Notice not only gives definitions, but also exactly mentions the criteria and procedure for the determination of relevant market. As it has already been mentioned in the second chapter, in

EU the Commission considers three main competitive constraints which undertakings are subject to: supply substitutability, demand substitutability, potential competition for defining relevant market. The notice also provides how each of these constraints is assessed. Thus substitutability is judged by measuring cross-elasticity of demand by SSNIP test, also considering other quantitative tests for market delimitation, such as elasticity estimates, price correlation analysis, analysis of price convergence and causality calculations. Id. For supply-side substitutability the Commission takes into account likelihood (risks, costs), timeliness of access is considered (Appendix 2, part 20-23). Relevant geographic market is defined via analysis of market shares of all market participants in different regions, analysis of shipping costs, views of customers and competitors, analysis of distribution/service system, basic demand characteristics, past evidence of diversion of orders to other areas, regulatory barriers (tariffs, regulation, technical standards, environmental law, access to distribution networks, access to infrastructure, etc.), current geographic pattern of purchases (Appendix 2, parts 44-52). So, the study of EU Competition Law and practice shows that approach to market definition is very much flexible via being analytical and comprehensive. This kind of approach allows European Commission to regulate competition in any kind market- being it big or too small. The abovementioned problem with Armenian “sour cream market”, in my opinion, will be solved using SSNIP test (my assumption about non-interchangeability of sour cream with different fat percentages is possible to approve using this test). Thus, for the Armenian Competition Authority it will be very much useful to consider EU above mentioned criteria and procedure for the definition of those markets are too small but need very much regulation.

As it was already mentioned the next step after market definition is to define whether an economic entity holds dominant position. As it was discussed in Chapter 1, Article 6.2 (1) of the Armenian competition law stipulates the definition of dominant position. This rule conforms to generally accepted European standards: EU court practice defines dominance similarly as a position allowing an enterprise to prevent effective competition by affording it

the power to behave to an appreciable extent independently of its competitors, its buyers or suppliers, and ultimately of consumers.

Article 6.2 (2-4) defines dominance by market share and incorporates both single firm dominance, as well as dominance on the part of the two or three largest firms, depending again on their collective market shares. In the case of commercial networks, a group of 4 or more traders are considered to be dominant. In this point the Armenian rule differs from that of EU. For establishing dominance the Armenian Law considers quantitative (market share) or qualitative (market power) indicators. In EU for determination of dominant position the conjunction of quantitative (market share) or qualitative (market power) indicators is used. Under EU Competition law finding out whether or not an undertaking is in a dominant position requires a complex assessment of a number of elements (Chapter 2 discusses each of these element in details), including the market position of undertakings operating in a relevant market, barriers to entry and expansion in the market, the countervailing buyer power, the power which undertakings have on that market (market power). The Court and the Commission also consider other factors indicating dominance, such as the undertaking's own assessment of its position, profits, overall size and strength and range of products (Portfolio power). Besides, as a general rule, high market shares held over long period of time may be important preliminary indicators of the existence of a dominant position. The case law of the European Courts establishes a presumption of dominance where an undertaking has a market share of 50 per cent or more. However, as a general rule, the Commission will not come to a final conclusion as to whether or not a case should be pursued without examining all the factors which may be sufficient to constrain the behavior of the undertaking. Thus Armenian Competition Law mostly considers market share when defining dominance. However market shares alone do not imply dominance. Market shares may be used, however, as thresholds in the sense that they establish a rebuttable presumption of dominance. Rebuttable presumptions of dominance are compatible with the generally accepted standard according to which a dominant position arises from a situation described

in Article 6.2 (1). Particularly, if an enterprise does not control a market share establishing the rebuttable presumption of dominance, this does not mean that it could not nevertheless be dominant in light of a comprehensive assessment of all relevant circumstances. In cases of buying power, for instance, dominance may be present well below these shares. The establishment of a dominant position requires in any case a comprehensive analysis of all relevant circumstances, such as the development of market shares over time, the relevance of actual or potential competition, the current market structure, the existence and quality of barriers to entry, access to buying or sales markets, buying power, superior financial resources of competitors, existence or absence of competition between oligopolists, the role of technology in the market etc. This analysis can find fierce competition and no dominance, for instance, in a tight oligopoly where all market share presumptions are fulfilled.

Now in the Armenian problematic cheese market<sup>64</sup> example let's see whether applying EU criteria for market power assessment will help to define which undertakings have dominant position, which in its turn will help to stop abuse of dominant position (in cheese market- excessive high price) and abuse of consumers' trust . In Armenian cheese market<sup>65</sup> we have such situation:

1. According to data from State Revenue Committee, 78 economic entities operate in cheese market. Market shares of the economic entities are the following:

Company A <sup>66</sup> -32.4 %

Company B -6.1%

Company C -5.3%

Remaining 75 companies together -55.8% (average market share of each company is 0.7%).

2. Company A has dominant position in nearly all other dairy markets (SCPEC RA have already defined the dominance of Company A in all other dairy markets, except the butter

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<sup>64</sup> All the information about economic entities, different economic calculations in cheese market are given and conducted by Arman Manaseryan during personal interview on 27<sup>th</sup> of January in 2012.

<sup>65</sup> By decision N-322 of December 3, 2010 SCPEC RA have defined cheese market: relevant product market- all kinds of cheese produced by industrial methods, relevant geographical market- Republic of Armenia.

<sup>66</sup>Because of the confidentiality of the information the names of companies are expressed by letters.



market, where the company does not have dominant position). But neither two main competitors of Company A in cheese market, nor the other 75 participants of the market are holding dominant position in any dairy market.

3. Company A has very strong brands in nearly all daily markets (in “matsun market”, in “milk market”, in “ttvaser (sour cream) market”, in “ice-cream market”, in “yogurt market”, etc.). However the competitors of Company A do not have any famous brand.

4. So the broad range of different products and strong brands in dairy market have given Company A high reputation (the information in Company A’s website also confirms its high reputation). All the competitors of Company A do not have reputation, their names aren’t even known to most of the customers.

5. Company A has modern and high technologies that are necessary for daily production (also for cheese production). The other economic entities in cheese market do not have such technologies. They produce cheese in traditional way, many of them in domestic way. These entities are family farmsteads (these are firms that are be characterized with a few scale of supply, usually in the framework of particular community).

6. Company A has access to nearly all the sale channels and republican supermarket networks. Its products are in every market and supermarket. However the other economic entities in the market usually have access only to local (community, village or marz) sale channel.<sup>67</sup>

7. The key product necessary for cheese production is milk. Company A has huge channel of milk procurement. It cooperates with 6000 farmsteads located in 83 communities of the Republic of Armenia and has milk procurement units in 10 marzes (all marzes) of Armenia. The competitors of the company, however, procure milk from the possible family farmsteads and families who have cows in their village/community/marz. Therefore, Company A has a huge access to key inputs for cheese production that its competitors do not have. Id.

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<sup>67</sup> Personal Interview. Arman Manaseryan (Assistant to Chair of SCPEC RA, candidate of economic sciences, economic expert), February 1-5, 2012

8. Company A has access to specially modified vehicles (machines) that transport raw milk to the factory: these vehicles have all the necessary conditions for keeping milk.<sup>68</sup> Its competitors do not have any such kind of machines; they transfer milk in traditional small barrels for keeping milk.<sup>69</sup>

9. Company A has good marketing policy; it advertises its products by different methods. However its competitors do not even advertise their product. Factually, in cheese market two kind of product is famous among the costumers- “cheese of Company A production” and “cheese of others’ production”. Id.

10. In its advertisements, in information provided in its website, in its pages in social networks Company A itself accepts and declare that the company has leading position in the daily market (as it was mentioned , cheese is also included in daily market).Id.

Thus, Company A has 32.8% market share, Company A and B together have 38.9% and Companies A, B and C together comprise 44.2% of cheese market. The Armenian Competition Law provides that a firm is dominant if it has a market share of 1/3 or greater (33.3% and more), two firms are dominants if they together command a 50% or greater market share, while each of three firms will be dominant if they capture 2/3 or more of the market in question (66.6% and more).In present case we should notice that market share of Company A alone, or in conjunction with Company B, or Company A, B, C together do not have enough market share to satisfy the demands of the Law. For this reason the Armenian Competition Authority is not able to hold dominance of Company A. Another obstacle is the non-enforcement of the market power provision and that the Law does not contain a provision which would allow considering market share and market power in conjunction. Now let’s apply EU Competition Law techniques (it is discussed in Chapter Two) for market power in Armenian cheese market case.

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<sup>68</sup> Web site of Company A also confirms this information.

<sup>69</sup> Personal Interview. Arman Manaseryan (Assistant to Chair of SCPEC RA, candidate of economic sciences, economic expert), February 6, 2012

As it has already been discussed in the second chapter, finding out whether or not an undertaking is in a dominant position, EU Competition law provides a complex assessment of a number of elements<sup>70</sup>.

Let's discuss market shares of leading undertakings in cheese market, correlation of shares. As it is already mentioned above, market share of Company A is 32.8 %, Company B- 6.1% Company C- 5.3%, remaining 75 companies together- 55.8% (average market share of each company is 0.7%). So, Company A has more than 5 times more market share, than its main Competitor Company B; more than 6 time more market share, than Company C and nearly 3 time more than cumulative shares of its main competitors B and C. Such great difference in market share makes Company A stronger enough and is a strong evidence of market power. The situation is similar to British Airways case discussed in the Second Chapter, where the market share of British Airways is more than twice more (39.7%) than the cumulative shares of its five main competitors (together these five companies have 17.9% share in the UK market for air travel agency services). In the latter case European Commission considered this as an evidence of dominance though 40% market share was required for dominance. Now let's consider the facts in cheese market (provided in this chapter) and see whether Company A has other advantages that would make it dominant considering EU criteria: Company A has (a) dominant position in all other daily markets (aftermarkets), except butter market; (b) strong brands; (c) broad range of different products and high reputation; (d) access to modern high technologies; (e) access to nearly all the sale channels and republican supermarket networks; (f) access to key inputs (milk); (g) access to specially modified vehicles (machines); (h) good marketing policy, advertisement; (i) own assessment of its dominance. All these advantages of Company A are considered by EU Competition law as necessary and strong elements for market power. Thus if Armenian Competition Law would incorporate EU criteria for market power in procedure for enforcement of market power provision in the Law, the Armenian Competition Authority

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<sup>70</sup> See the criteria and all the other elements in Chapter 2 at pp 25-27

would be able to hold Company A having dominant position and stop abusive conduct of Company A.

This example of application EU criteria for cheese market shows that the Armenian Law should harmonize EU measures of establishment of dominance, as EU measures provide a comprehensive analysis and consider all the relevant circumstances of the case.

## Conclusion

With this paper I tried to present how EU Competition Law best experience can be useful for the enforcement of dominant position regulation under the Armenian Competition Law.

As it was mentioned above competition is a basic and vital characteristic of an economic system in market economies like Armenia and EU Member States.

It was discussed in this paper that in order to establish abuse of dominant position first it is necessary to define relevant market, then to determine whether a firm is dominant or not.

As it was shown, the Armenian Competition Law and EU Competition Law give similar definition of relevant market. However the differences between are in the procedure and criteria of defining relevant market. Article 4 of the Armenian Competition law, which is about the definition of relevant market, is supposed to be enforced by the Commission's (SCPEC RA) decision *No 190-N of 23 May 2011 about "Procedure on Definition of Commodity Market Boundaries"*. However, as we have noticed, this decision is not totally enforced (as the Commission uses only classification method) and has gaps: it repeats the definitions stipulated by Article 4, and then mentions several criteria for determination of mutual substitutability. This decision lacks of any kind of procedural provisions regarding market definition. And because of these issues the Armenian Competition Authority is not able to regulate competition in all the markets. In EU practice, however, the Commission in the Notice not only gives definitions, but also exactly mentions the criteria and procedure for the determination of relevant market: it not only mention competitive constraints that is considered for market definition, but also provides tests and other economic methods how each of these constraints is assessed. In the third chapter, we have seen that the tests and criteria that are used in EU Competition Law can help to solve problems regarding market definition under the Armenian Competition Law.

As soon as the relevant market is defined, the next step is to find whether a firm is dominant or not. As it was mentioned above both the Armenian and EU Competition Laws give similar definition for dominant position. However the mechanism and criteria for

determination of dominant position are a bit different. Finding out whether or not an undertaking is in a dominant position in EU a complex assessment of a number of elements, including the market position of undertakings operating in a relevant market, barriers to entry and expansion in the market, the countervailing buyer power. The Court and the Commission also consider other factors indicating dominance, such as the undertaking's own assessment of its position, profits, overall size and strength and range of products. Besides, as a general rule, high market shares held over long period of time may be important preliminary indicators of the existence of a dominant position (if market share is 50% or more). However, the Commission will not come to a final conclusion as to whether or not a case should be pursued without examining all the factors which may be sufficient to constrain the behavior of the undertaking. Armenian competition law, however, considers only market share when defining dominance. Market shares alone, in any case, do not imply dominance. Market shares may be used, however, as thresholds in the sense that they establish a rebuttable presumption of dominance. The establishment of a dominant position requires in any case a comprehensive analysis of all relevant circumstances such as the development of market shares over time, the relevance of actual or potential competition, the current market structure, the existence and quality of barriers to entry, access to buying or sales markets, buying power, superior financial resources of competitors, existence or absence of competition between oligopolists, the role of technology in the market etc. This analysis can find fierce competition and no dominance, for instance, in a tight oligopoly where all market share presumptions are fulfilled. This analysis can find fierce competition and no dominance, for instance, in a tight oligopoly where all market share presumptions are fulfilled. In the third chapter in Armenian cheese market example we have seen that EU Competition Law criteria for defining market power and thus holding dominance will work for Armenian markets.

The following changes are suggested to improve Armenian competition law and practice regarding dominant position:

- ✓ Amend No 190-N of 23 May 2011 about “*Procedure on Definition of Commodity Market Boundaries*” incorporating all the criteria, tests and economic methods that European Commission has mentioned in the Notice and keeping existing criteria.
- ✓ Amend Article 6 of the Law on Protection of Economic Competition of the Republic of Armenia adding provision that the Commission will define dominant position considering market share and market power in conjunction.
- ✓ Make amendments in Article 6.2; particularly add a provision for a complex assessment of a number of elements, including the market position of undertakings operating in a relevant market, barriers to entry and expansion in the market, the countervailing buyer power, the power which undertakings have on that market.
- ✓ Amend Article 6.4; particularly conduct detailed analysis of market position of commercial networks, their influence on relevant market operation and particularly on prices of products in relevant market.
- ✓ For the effective implementation of Article 6.2 (1) of the Law on Protection of Economic Competition of the Republic of Armenia amend Part 9 of Appendix of Decision No. 194-N “On approving the procedure and criteria for defining the monopolistic or dominant position, also market power of an economic entity” (May 23, 2011) and make criteria necessary for market power determination more clear and complete. Particularly make amendments in the following subparts of Part 9:
  - (a) Change the wording of Part 9.1 “ financial resources of an economic entity” with the wording “market position of undertakings operating in a relevant market one or several of these criteria are considered: market shares of leading undertakings in relevant market, correlation of shares; financial

power; deep pockets; cross subsidization; engineering capacities; R&D capacities; access to capital markets; secure or integrated access to inputs; access to machines; access to logistics/means of transport; access to sales channels/local distribution network; supply of systems/range of products high reputation/strong brands/advertising/ product differentiation; foreclosure strategies; integration/efficiencies (horizontal integration with competitors); cost reduction; vertical story (vertical integration with suppliers/customers).

(b) Amend the text of Part 9.3 with adding/or rewording criteria related to entry barriers in the following way: “barriers to entry to relevant market are considered one or more of the following criteria: access to key inputs; access to technologies; access to customers; spare capacities; timeliness of access; sunk costs/reversibility; market phase; secure or integrated access to inputs; access to machines; access to logistics/means of transport; access to sales channels/local distribution network; supply of systems/range of products high reputation/strong brands; foreclosure strategies; integration/efficiencies (horizontal integration with competitors); cost reduction; vertical story (vertical integration with suppliers/customers)”.

(c) Amend Part 9 and add the following subpart: “Countervailing buyer power and one or several of these criteria is considered: size of customers; dependence on buyers; size and frequency of sales; market transparency; strategic buyer behavior”.

(d) Make amendments in Part 9 and add the following subpart: “For determining market power the following criteria are considered



in conjunction with one of the above mentioned criteria: undertaking's own assessment of its position; profits; overall size and strength and range of products (Portfolio power; intellectual property rights”.

Thus, the Armenian Law should harmonize EU measures of establishment of dominance, as these measures provide a comprehensive analysis and consider all the relevant circumstances of the case. These steps will help Armenia both to improve its competition law and practice and successfully realize its obligation before EU.

I would like also to mention that pursuant to the Article 27.1 of the Law on Legal Acts of the Republic of Armenia any change or amendment in a legal act, regarding approximation to EU legal acts, is subject to examination of legal acts. After entering into force any amendment is subject to regulatory impact assessment which will assess advantages and disadvantages and will let to improve them.<sup>71</sup>

In EU the European Commission assesses the potential economic, social and environmental consequences of any new initiatives it proposes. Impact assessment is a set of logical steps that prepares evidence for political decision-makers on the advantages and disadvantages of possible policy options by assessing their potential impact.<sup>72</sup>

My long-lasting experience in the Armenian Competition Law field and knowledge about the issues in the Law and practice provide me a solid ground to believe that the above mentioned amendment to the Law on Protection of Economic Competition of the Republic of Armenia will successfully pass examination of the legal acts and then regulatory impact assessment.

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<sup>71</sup> RA Law on Legal Acts, <http://www.parliament.am/legislation.php?sel=show&ID=3446&lang=arm>

<sup>72</sup> [http://ec.europa.eu/governance/impact/index\\_en.htm](http://ec.europa.eu/governance/impact/index_en.htm)

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- COMMISSION NOTICE on the definition of relevant market for the purposes of Community competition law (97/C 372/03); <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209%2801%29:EN:NOT>
- <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF>
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# **APPENDIX 1**

## **Law on Protection of Economic Competition of the Republic of Armenia**

### **Article 4**

***Mutually substitutable commodities:*** commodities which can be compared by the purpose of their use, application, qualitative, technical, price or other properties so that the buyer replaces or is ready to replace them with one another;

***Commodity market:*** sphere of circulation of the concerned commodity or its mutually replaceable commodities in a certain area as approved under the decision of the State Commission for Protection of Economic Competition of the Republic of Armenia (hereinafter the Commission) whose boundaries are determined by the economic abilities of the buyer to acquire the commodity in the respective area and its appropriateness. The commodity market is characterized by product and geographical boundaries, composition of its subjects, and volume;

***Product boundaries of commodity market:*** entirety of the concerned commodity and its mutually replaceable commodities, as defined by the decision of the Commission;

***Geographical boundaries of commodity market:*** specific geographical area (including roads, routes (air, water, land, etc.)), as defined by the decision of the Commission, within which it is economically possible and appropriate for the buyer to acquire the concerned commodity and its mutually substitutable commodities, and such possibility and expedience does not exist beyond the mentioned area. The geographical boundaries of a commodity market may include the entire territory of the Republic of Armenia or a part thereof or the territory of the Republic of Armenia (or a part thereof) and the territory of another state (or a part thereof);

**Subjects of a commodity market:** seller (realizer, supplier, disposing party, provider, executor) and acquirer (buyer, recipient, accepting party, consumer) of the concerned commodity or its mutually replaceable commodities

**Volume of commodity market:** total volume of sale or acquisition of the concerned commodity or its mutually replaceable commodities within the boundaries of the commodity market expressed in-kind and (or) monetary value;

**Realization:** sale, supply, disposal, provision, execution;

**Acquisition:** purchase, receipt, acceptance;

## **APPENDIX 2**

### **COMMISSION NOTICE on the definition of relevant market for the purposes of Community competition law (97/C 372/03)**

#### **I. INTRODUCTION**

1. The purpose of this notice is to provide guidance as to how the Commission applies the concept of relevant product and geographic market in its ongoing enforcement of Community competition law, in particular the application of Council Regulation No 17 and (EEC) No 4064/89, their equivalents in other sectoral applications such as transport, coal and steel, and agriculture, and the relevant provisions of the EEA Agreement (1). Throughout this notice, references to Articles 85 and 86 of the Treaty and to merger control are to be understood as referring to the equivalent provisions in the EEA Agreement and the ECSC Treaty.

2. Market definition is a tool to identify and define the boundaries of competition between firms. It serves to establish the framework within which competition policy is applied by the Commission. The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved (2) 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' behavior and of preventing them from behaving independently of effective competitive pressure. It is from this perspective that the market definition makes it possible inter alia to calculate market shares that would convey meaningful information regarding market power for the purposes of assessing dominance or for the purposes of applying Article 85.

3. It follows from point 2 that the concept of 'relevant market` is different from other definitions of market often used in other contexts. For instance, companies often use the term 'market` to refer to the area where it sells its products or to refer broadly to the industry or sector where it belongs.

4. The definition of the relevant market in both its product and its geographic dimensions often has a decisive influence on the assessment of a competition case. By rendering public the procedures which the Commission follows when considering market definition and by indicating the criteria and evidence on which it relies to reach a decision, the Commission expects to increase the transparency of its policy and decision-making in the area of competition policy.

5. Increased transparency will also result in companies and their advisers being able to better anticipate the possibility that the Commission may raise competition concerns in an individual case. Companies could, therefore, take such a possibility into account in their own internal decision-making when contemplating, for instance, acquisitions, the creation of joint ventures, or the establishment of certain agreements. It is also intended that companies should be in a better position to understand what sort of information the Commission considers relevant for the purposes of market definition.

6. The Commission's interpretation of 'relevant market` is without prejudice to the interpretation which may be given by the Court of Justice or the Court of First Instance of the European Communities.

## II. DEFINITION OF RELEVANT MARKET

### Definition of relevant product market and relevant geographic market

7. The Regulations based on Article 85 and 86 of the Treaty, in particular in section 6 of Form A/B with respect to Regulation No 17, as well as in section 6 of Form CO with respect to Regulation (EEC) No 4064/89 on the control of concentrations having a Community dimension have laid down the following definitions, 'Relevant product markets` are 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`.

8. 'Relevant geographic markets` are 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`.

9. The relevant market within which to assess a given competition issue is therefore established by the combination of the product and geographic markets. The Commission interprets the definitions in paragraphs 7 and 8 (which reflect the case-law of the Court of Justice and the Court of First Instance as well as its own decision-making practice) according to the orientations defined in this notice.

### Concept of relevant market and objectives of Community competition policy

10. The concept of relevant market is closely related to the objectives pursued under Community competition policy. For example, under the Community's merger control, the objective in controlling structural changes in the supply of a product/service is to prevent the creation or reinforcement of a dominant position as a result of which effective competition would be significantly impeded in a substantial part of the common market. Under the Community's competition rules, a dominant position is such that a firm or group of firms would be in a position to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers (3). Such a position would usually arise when a firm or group of firms accounted for a large share of the supply in any given market, provided that other factors analyzed in the assessment (such as entry barriers, customers' capacity to react, etc.) point in the same direction.

11. The same approach is followed by the Commission in its application of Article 86 of the Treaty to firms that enjoy a single or collective dominant position. Within the meaning of Regulation No 17, the Commission has the power to investigate and to end abuses of such a dominant position, which must also be defined by reference to the relevant market. Markets may also need to be defined in the application of Article 85 of the Treaty, in particular, in determining whether an appreciable restriction of competition exists or in establishing if the condition pursuant to Article 85 (3) (b) for an exemption from the application of Article 85 (1) is met.

12. The criteria for defining the relevant market are applied generally for the analysis of certain types of behaviour in the market and for the analysis of structural changes in the supply of products. This methodology, though, might lead to different results depending on the nature of the competition issue being examined. For instance, the scope of the geographic market might be different when analyzing a concentration, where the analysis is essentially prospective, from an analysis of past behaviour. The different time horizon considered in each case might lead to the result that different geographic markets are defined for the same



products depending on whether the Commission is examining a change in the structure of supply, such as a concentration or a cooperative joint venture, or examining issues relating to certain past behavior.

#### Basic principles for market definition

#### Competitive constraints

13. Firms are subject to three main sources or competitive constraints: demand substitutability, supply substitutability and potential competition. From an economic point of view, for the definition of the relevant market, 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. Basically, the exercise of market definition consists in identifying the effective alternative sources of supply for the customers of the undertakings involved, in terms both of products/services and of geographic location of suppliers.

14. The competitive constraints arising from supply side substitutability other than those described in paragraphs 20 to 23 and from potential competition are in general less immediate and in any case require an analysis of additional factors. As a result such constraints are taken into account at the assessment stage of competition analysis.

#### Demand substitution

15. The assessment of demand substitution entails a determination of the range of products which are viewed as substitutes by the consumer. One way of making this determination can be viewed as a speculative experiment, postulating a hypothetical small, lasting change in relative prices and evaluating the likely reactions of customers to that increase. The exercise

of market definition focuses on prices for operational and practical purposes, and more precisely on demand substitution arising from small, permanent changes in relative prices. This concept can provide clear indications as to the evidence that is relevant in defining markets.

16. Conceptually, this approach means that, starting from the type of products that the undertakings involved sell and the area in which they sell them, additional products and areas will be included in, or excluded from, the market definition depending on whether competition from these other products and areas affect or restrain sufficiently the pricing of the parties' products in the short term.

17. The question to be answered is whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in the range 5 % to 10 %) but permanent relative price increase in the products and areas being considered. 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. The equivalent analysis is applicable in cases concerning the concentration of buying power, where the starting point would then be the supplier and the price test serves to identify the alternative distribution channels or outlets for the supplier's products. In the application of these principles, careful account should be taken of certain particular situations as described within paragraphs 56 and 58.

18. A practical example of this test can be provided by its application to a merger of, for instance, soft-drink bottlers. An issue to examine in such a case would be to decide whether different flavors of soft drinks belong to the same market. In practice, the question to address would be whether consumers of flavor A would switch to other flavors when confronted with a permanent price increase of 5 % to 10 % for flavor A. If a sufficient number of

consumers would switch to, say, flavor B, to such an extent that the price increase for flavor A would not be profitable owing to the resulting loss of sales, then the market would comprise at least flavors A and B. The process would have to be extended in addition to other available flavors until a set of products is identified for which a price rise would not induce a sufficient substitution in demand.

19. Generally, and in particular for the analysis of merger cases, 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. In particular for the investigation of abuses of dominant positions, the fact that the prevailing price might already have been substantially increased will be taken into account.

#### Supply substitution

20. Supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy. This means that suppliers are able to switch production to the relevant products and market them in the short term (4) without incurring significant additional costs or risks in response to small and permanent changes in relative prices. When these conditions are met, the additional production that is put on the market will have a disciplinary effect on the competitive behaviour of the companies involved. Such an impact in terms of effectiveness and immediacy is equivalent to the demand substitution effect.

21. These situations typically arise when companies market a wide range of qualities or grades of one product; even if, for a given final customer or group of consumers, the different qualities are not substitutable, the different qualities will be grouped into one product market, provided that most of the suppliers are able to offer and sell the various qualities immediately and without the significant increases in costs described above. In such cases, the relevant product market will encompass all products that are substitutable in

demand and supply, and the current sales of those products will be aggregated so as to give the total value or volume of the market. The same reasoning may lead to group different geographic areas.

22. A practical example of the approach to supply-side substitutability when defining product markets is to be found in the case of paper. Paper is usually supplied in a range of different qualities, from standard writing paper to high quality papers to be used, for instance, to publish art books. From a demand point of view, different qualities of paper cannot be used for any given use, i.e. an art book or a high quality publication 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, in particular if orders are placed with sufficient lead time to allow for modification of production plans. 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.

23. 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. Examples where supply-side substitution did not induce the Commission to enlarge the market are offered in the area of consumer products, in particular for branded beverages. Although bottling plants may in principle bottle different beverages, there are costs and lead times involved (in terms of advertising, product testing and distribution) before the products can actually be sold. In these cases, the effects of supply-side substitutability and other forms of potential competition would then be examined at a later stage.

Potential competition

24. The third source of competitive constraint, potential competition, is not taken into account when defining markets, since the conditions under which potential competition will actually represent an effective competitive constraint depend on the analysis of specific factors and circumstances related to the conditions of entry. If required, this analysis is only carried out at a subsequent stage, in general once the position of the companies involved in the relevant market has already been ascertained, and when such position gives rise to concerns from a competition point of view.

### III. EVIDENCE RELIED ON TO DEFINE RELEVANT MARKETS

The process of defining the relevant market in practice

Product dimension

25. There is a range of evidence permitting an assessment of the extent to which substitution would take place. In individual cases, certain types of evidence will be determinant, depending very much on the characteristics and specificity of the industry and products or services that are being examined. The same type of evidence may be of no importance in other cases. In most cases, a decision will have to be based on the consideration of a number of criteria and different items of evidence. The Commission follows an open approach to empirical evidence, aimed at making an effective use of all available information which may be relevant in individual cases. The Commission does not follow a rigid hierarchy of different sources of information or types of evidence.

26. The process of defining relevant markets may be summarized as follows: 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 within which, for instance, a concentration or a restriction of competition has to be assessed. In general, and for all practical purposes when handling individual cases, the question will usually be to decide on a few alternative possible relevant markets. For

instance, with respect to the product market, 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.

27. 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. If under the conceivable alternative market definitions the operation in question does not raise competition concerns, the question of market definition will be left open, reducing thereby the burden on companies to supply information.

#### Geographic dimension

28. The Commission's approach to geographic market definition might be summarized as follows: it will take a preliminary view of the scope of the geographic market on the basis of broad indications as to the distribution of market shares between the parties and their competitors, as well as a preliminary analysis of pricing and price differences at national and Community or EEA level. This initial view is used basically as a working hypothesis to focus the Commission's enquiries for the purposes of arriving at a precise geographic market definition.

29. The reasons behind any particular configuration of prices and market shares need to be explored. Companies might enjoy high market shares in their domestic markets just because of the weight of the past, and conversely, a homogeneous presence of companies throughout the EEA might be consistent with national or regional geographic markets. The initial working hypothesis will therefore 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 again whether the customers of the parties would switch their orders to companies located elsewhere in the short term and at a negligible cost.

30. 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. This analysis will include an examination of requirements for a local presence in order to sell in that area the conditions of access to distribution channels, costs associated with setting up a distribution network, and the presence or absence of regulatory barriers arising from public procurement, price regulations, quotas and tariffs limiting trade or production, technical standards, monopolies, freedom of establishment, requirements for administrative authorizations, packaging regulations, etc. In short, 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.

31. The actual pattern and evolution of trade flows offers useful supplementary indications as to the economic importance of each demand or supply factor mentioned above, and the extent to which they may or may not constitute actual barriers creating different geographic markets. The analysis of trade flows will generally address the question of transport costs and the extent to which these may hinder trade between different areas, having regard to plant location, costs of production and relative price levels.

#### Market integration in the Community

32. Finally, the Commission also takes into account the continuing process of market integration, in particular in the Community, when defining geographic markets, especially in the area of concentrations and structural joint ventures. The measures adopted and implemented in the internal market programme to remove barriers to trade and further

integrate the Community markets cannot be ignored when assessing the effects on competition of a concentration or a structural joint venture. A situation where national markets have been artificially isolated from each other because of the existence of legislative barriers that have now been removed will generally lead to a cautious assessment of past evidence regarding prices, market shares or trade patterns. A process of market integration that would, in the short term, lead to wider geographic markets may therefore be taken into consideration when defining the geographic market for the purposes of assessing concentrations and joint ventures.

The process of gathering evidence

33. When a precise market definition is deemed necessary, the Commission will often contact the main customers and the main companies in the industry to enquire into their views about the boundaries of product and geographic markets and to obtain the necessary factual evidence to reach a conclusion. The Commission might also contact the relevant professional associations, and companies active in upstream markets, so as to be able to define, in so far as necessary, separate product and geographic markets, for different levels of production or distribution of the products/services in question. It might also request additional information to the undertakings involved.

34. Where appropriate, the Commission will address written requests for information to the market players mentioned above. These requests will usually include questions relating to the perceptions of companies about reactions to hypothetical price increases and their views of the boundaries of the relevant market. They will also ask for provision of the factual information the Commission deems necessary to reach a conclusion on the extent of the relevant market. The Commission might also discuss with marketing directors or other officers of those companies to gain a better understanding on how negotiations between suppliers and customers take place and better understand issues relating to the definition of the relevant market. Where appropriate, they might also carry out visits or inspections to the



premises of the parties, their customers and/or their competitors, in order to better understand how products are manufactured and sold.

35. The type of evidence relevant to reach a conclusion as to the product market can be categorized as follows:

Evidence to define markets - product dimension

36. An analysis of the product characteristics and its intended use allows the Commission, as a first step, to limit the field of investigation of possible substitutes. However, 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. For example, there may be different competitive constraints in the original equipment market for car components and in spare parts, thereby leading to a separate delineation of two relevant markets. Conversely, differences in product characteristics are not in themselves sufficient to exclude demand substitutability, since this will depend to a large extent on how customers value different characteristics.

37. The type of evidence the Commission considers relevant to assess whether two products are demand substitutes can be categorized as follows:

38. Evidence of substitution in the recent past. In certain cases, it is possible to analyze evidence relating to recent past events or shocks in the market that offer actual examples of substitution between two products. When available, this sort of information will normally be fundamental for market definition. If there have been changes in relative prices in the past (all else being equal), the reactions in terms of quantities demanded will be determinant in establishing substitutability. Launches of new products in the past can also offer useful

information, when it is possible to precisely analyse which products have lost sales to the new product.

39. There are a number of quantitative tests that have specifically been designed for the purpose of delineating markets. These tests consist of various econometric and statistical approaches estimates of elasticities and cross-price elasticities (5) for the demand of a product, tests based on similarity of price movements over time, the analysis of causality between price series and similarity of price levels and/or their convergence. The Commission takes into account the available quantitative evidence capable of withstanding rigorous scrutiny for the purposes of establishing patterns of substitution in the past.

40. Views of customers and competitors. The Commission often contacts the main customers and competitors of the companies involved in its enquiries, to gather their views on the boundaries of the product market as well as most of the factual information it requires reaching a conclusion on the scope of the market. Reasoned answers of customers and competitors as to what would happen if relative prices for the candidate products were to increase in the candidate geographic area by a small amount (for instance of 5 % to 10 %) are taken into account when they are sufficiently backed by factual evidence.

41. Consumer preferences. In the case of consumer goods, it may be difficult for the Commission to gather the direct views of end consumers about substitute products. Marketing studies that companies have commissioned in the past and that are used by companies in their own decision-making as to pricing of their products and/or marketing actions may provide useful information for the Commission's delineation of the relevant market. Consumer surveys on usage patterns and attitudes, data from consumer's purchasing patterns, the views expressed by retailers and more generally, market research studies submitted by the parties and their competitors are taken into account to establish whether an economically significant proportion of consumers consider two products as substitutable, also taking into account the importance of brands for the products in question. The

methodology followed in consumer surveys carried out ad hoc by the undertakings involved or their competitors for the purposes of a merger procedure or a procedure pursuant to Regulation No 17 will usually be scrutinized with utmost care. Unlike pre-existing studies, they have not been prepared in the normal course of business for the adoption of business decisions.

42. Barriers and costs associated with switching demand to potential substitutes. There are a number of barriers and costs that might prevent the Commission from considering two prima facie demand substitutes as belonging to one single product market. It is not possible to provide an exhaustive list of all the possible barriers to substitution and of switching costs. These barriers or obstacles might have a wide range of origins, and in its decisions, the Commission has been confronted with regulatory barriers or other forms of State intervention, constraints arising in downstream markets, need to incur specific capital investment or loss in current output in order to switch to alternative inputs, the location of customers, specific investment in production process, learning and human capital investment, retooling costs or other investments, uncertainty about quality and reputation of unknown suppliers, and others.

43. Different categories of customers and price discrimination. The extent of the product market might be narrowed in the presence of distinct groups of customers. A distinct group of customers for the relevant product may constitute a narrower, distinct market when such a group could be subject to price discrimination. This will usually be the case when two conditions are met: (a) it is possible to identify clearly which group an individual customer belongs to at the moment of selling the relevant products to him, and (b) trade among customers or arbitrage by third parties should not be feasible.

Evidence for defining markets - geographic dimension

44. The type of evidence the Commission considers relevant to reach a conclusion as to the geographic market can be categorized as follows:
45. Past evidence of diversion of orders to other areas. In certain cases, evidence on changes in prices between different areas and consequent reactions by customers might be available. Generally, the same quantitative tests used for product market definition might as well be used in geographic market definition, bearing in mind that international comparisons of prices might be more complex due to a number of factors such as exchange rate movements, taxation and product differentiation.
46. Basic demand characteristics. The nature of demand for the relevant product may in itself determine the scope of the geographical market. Factors such as national preferences or preferences for national brands, language, culture and life style, and the need for a local presence have a strong potential to limit the geographic scope of competition.
47. Views of customers and competitors. Where appropriate, the Commission will contact the main customers and competitors of the parties in its enquiries, to gather their views on the boundaries of the geographic market as well as most of the factual information it requires reaching a conclusion on the scope of the market when they are sufficiently backed by factual evidence.
48. Current geographic pattern of purchases. An examination of the customers' current geographic pattern of purchases provides useful evidence as to the possible scope of the geographic market. When customers purchase from companies located anywhere in the Community or the EEA on similar terms, or they procure their supplies through effective tendering procedures in which companies from anywhere in the Community or the EEA submit bids, usually the geographic market will be considered to be Community-wide.
49. Trade flows/pattern of shipments. When the number of customers is so large that it is not possible to obtain through them a clear picture of geographic purchasing patterns,

information on trade flows might be used alternatively, provided that the trade statistics are available with a sufficient degree of detail for the relevant products. Trade flows, and above all, the rationale behind trade flows provide useful insights and information for the purpose of establishing the scope of the geographic market but are not in themselves conclusive.

50. Barriers and switching costs associated to divert orders to companies located in other areas. The absence of trans-border purchases or trade flows, for instance, does not necessarily mean that the market is at most national in scope. Still, barriers isolating the national market have to be identified before it is concluded that the relevant geographic market in such a case is national. Perhaps the clearest obstacle for a customer to divert its orders to other areas is the impact of transport costs and transport restrictions arising from legislation or from the nature of the relevant products. The impact of transport costs will usually limit the scope of the geographic market for bulky, low-value products, bearing in mind that a transport disadvantage might also be compensated by a comparative advantage in other costs (labour costs or raw materials). Access to distribution in a given area, regulatory barriers still existing in certain sectors, quotas and custom tariffs might also constitute barriers isolating a geographic area from the competitive pressure of companies located outside that area. Significant switching costs in procuring supplies from companies located in other countries constitute additional sources of such barriers.

51. On the basis of the evidence gathered, the Commission will then define a geographic market that could range from a local dimension to a global one, and there are examples of both local and global markets in past decisions of the Commission.

52. The paragraphs above describe the different factors which might be relevant to define markets. This does not imply that in each individual case it will be necessary to obtain evidence and assess each of these factors. Often in practice the evidence provided by a subset of these factors will be sufficient to reach a conclusion, as shown in the past decisional practice of the Commission.

#### IV. CALCULATION OF MARKET SHARE

53. The definition of the relevant market in both its product and geographic dimensions allows the identification the suppliers and the customers/consumers active on that market. On that basis, a total market size and market shares for each supplier can be calculated on the basis of their sales of the relevant products in the relevant area. In practice, the total market size and market shares are often available from market sources, i.e. companies' estimates, studies commissioned from industry consultants and/or trade associations. When this is not the case, or when available estimates are not reliable, the Commission will usually ask each supplier in the relevant market to provide its own sales in order to calculate total market size and market shares.

54. If sales are usually the reference to calculate market shares, there are nevertheless other indications that, depending on the specific products or industry in question, can offer useful information such as, in particular, capacity, the number of players in bidding markets, units of fleet as in aerospace, or the reserves held in the case of sectors such as mining.

55. As a rule of thumb, both volume sales and value sales provide useful information. In cases of differentiated products, sales in value and their associated market share will usually be considered to better reflect the relative position and strength of each supplier.

#### V. ADDITIONAL CONSIDERATIONS

56. There are certain areas where the application of the principles above has to be undertaken with care. This is the case when considering primary and secondary markets, in particular, when the behaviour of undertakings at a point in time has to be analysed pursuant to Article 86. The method of defining markets in these cases is the same, i.e. assessing the responses of customers based on their purchasing decisions to relative price changes, but taking into account as well, constraints on substitution imposed by conditions in the connected markets. A narrow definition of market for secondary products, for instance, spare parts, may result

when compatibility with the primary product is important. Problems of finding compatible secondary products together with the existence of high prices and a long lifetime of the primary products may render relative price increases of secondary products profitable. A different market definition may result if significant substitution between secondary products is possible or if the characteristics of the primary products make quick and direct consumer responses to relative price increases of the secondary products feasible.

57. In certain cases, the existence of chains of substitution might lead to the definition of a relevant market where products or areas at the extreme of the market are not directly substitutable. An example might be provided by the geographic dimension of a product with significant transport costs. In such cases, deliveries from a given plant are limited to a certain area around each plant by the impact of transport costs. In principle, such an area could constitute the relevant geographic market. However, if the distribution of plants is such that there are considerable overlaps between the areas around different plants, it is possible that the pricing of those products will be constrained by a chain substitution effect, and lead to the definition of a broader geographic market. The same reasoning may apply if product B is a demand substitute for products A and C. Even if products A and C are not direct demand substitutes, they might be found to be in the same relevant product market since their respective pricing might be constrained by substitution to B.

58. From a practical perspective, the concept of chains of substitution has to be corroborated by actual evidence, for instance related to price interdependence at the extremes of the chains of substitution, in order to lead to an extension of the relevant market in an individual case. Price levels at the extremes of the chains would have to be of the same magnitude as well.

(1) The focus of assessment in State aid cases is the aid recipient and the industry/sector concerned rather than identification of competitive constraints faced by the aid recipient. When consideration of market power and therefore of the relevant market are raised in any

particular case, elements of the approach outlined here might serve as a basis for the assessment of State aid cases.

(2) For the purposes of this notice, the undertakings involved will be, in the case of a concentration, the parties to the concentration; in investigations within the meaning of Article 86 of the Treaty, the undertaking being investigated or the complainants; for investigations within the meaning of Article 85, the parties to the Agreement.

(3) Definition given by the Court of Justice in its judgment of 13 February 1979 in Case 85/76, Hoffmann-La Roche [1979] ECR 461, and confirmed in subsequent judgments.

(4) That is such a period that does not entail a significant adjustment of existing tangible and intangible assets (see paragraph 23).

(5) Own-price elasticity of demand for product X is a measure of the responsiveness of demand for X to percentage change in its own price. Cross-price elasticity between products X and Y is the responsiveness of demand for product X to percentage change in the price of product Y.