Unclassified **DAF/COMP/WP3/WD(2016)39**

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

02-Nov-2016

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/WP3/WD(2016)39
Unclassified

Working Party No. 3 on Co-operation and Enforcement

GEOGRAPHIC MARKET DEFINITION

-- Note by Hungary --

28-29 November 2016

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

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

Please contact Ms. Despina Pachnou if you have any questions regarding this document [phone number: +33 1 45 24 95 25 -- E-mail address: despina.pachnou@oecd.org].

JT03404245

English - Or. English

-- HUNGARY --

1. This contribution discusses recent Hungarian practice relating to geographic market definition. The focal point of the contribution is two recent Phase II merger cases where geographic market analysis and competitive assessment based on geographic parameters formed a relevant part of the investigation. The contribution also briefly discusses Hungarian experience concerning jurisdictional issues related to geographic market definition.

1. The Hungarian merger regime and the role of geographic market analysis

2. The Gazdasági Versenyhivatal (Hungarian Competition Authority, "GVH") has the option of conducting either a Phase I or a Phase II review of the merger applications filed by the merging parties. Phase II reviews are reserved for cases where potential harm to competition cannot be excluded based on the available data within the timeframe and scope of a Phase I investigation. An official Notice[1] issued jointly by the president of the GVH and the chair of the Competition Council provides specific rules on the differentiation between Phase I and Phase II cases.

3. Since 2009 the assessment of merger effects has been based on the SLC-test (substantial lessening of competition), whereas before this date the dominance-test was in use. While the test applies to both Phase I and Phase II cases, an in-depth analysis of markets and effects is usually performed in Phase II cases.

4. In the Hungarian practice, when applying the SLC-test the main objective of merger control is to identify the competitive pressure the merging parties used to exert on each other, and to assess the countervailing competitive pressure the remaining competitors are capable of exerting in order to prevent a current or future price rise. Within this framework of analysis the competitive closeness of the market players strongly relates to the substitutability of their products. Thus, the assessment of merger effects is strongly connected to the relevant market definition.

5. The Hungarian Competition Act formally establishes the principles of market definition. According to Article 14 of the Competition Act:

1. The relevant market shall be defined by taking into account the goods that are subject to the agreement and the geographical area concerned.
2. In addition to the goods subject to the agreement, any goods that can reasonably be substituted for them in view of their intended use, price, quality and the terms of performance (demand-side substitutability) and the aspects of supply-side substitutability shall be taken into account.
3. Geographical area means the territory outside which

    a. the trading party is unable to purchase goods or is able to purchase them only under considerably less favourable conditions; or

    b. the seller of the goods is unable to sell the goods or is able to sell them only under considerably less favourable conditions.

[1] Notice number 1/2014.

6. However, market definition is not an aim in itself, but is rather a tool assisting competitive effects analysis. The formerly used dominance-test placed much stronger emphasis on market definition, as the creation or the lack of dominance within a specific market needed to be established. When applying the SLC-test the emphasis shifts to the assessment of competitive effects with the result that, the analysis goes beyond the simple conclusions succeeding market definition.

2. The Messer/Air Liquide merger (VJ/92/2015)

7. In May 2016 the GVH unconditionally cleared the Messer/Air Liquide merger. The transaction involved two large suppliers of industrial gases. Based on EC case law product market definition was straightforward and the affected markets included tonnage, bulk and cylinder markets for various types of industrial gases. The parties to the merger had large market shares on the majority of the affected markets within Hungary and therefore the GVH performed a Phase II review of the transaction.

8. Among the most relevant questions was the issue of the relevant geographic dimension, especially for various bulk and cylinder markets. In bulk markets the buyers of the industrial gases are usually large companies with an average demand of 20-100 tons/day and the supplier transports the desired gas via road, in large specialised vehicles. In cylinder markets the demand splits between large buyers with a constant and high demand of gases in cylinders and small buyers of such gases. In general, however, all the buyers of cylinder gases have a much lower demand compared to the bulk (and the tonnage) buyers. The large cylinder buyers usually have the gas cylinders transported via road to their facilities, while the small buyers usually transport the cylinders with their own vehicles from the premises (depots) of the suppliers.

9. For the bulk markets the parties argued that some foreign production capacities are profitable to import and should be included in the assessment of competitive effects. Thus, the parties argued for a broader than national geographic market definition. As evidence they mainly relied on the analysis of existing imports which indeed were high, and they provided an economic analysis of the rational transportation distance.

10. The parties used the analysis of the rational transportation distance to assess which domestic and foreign capacities could offset a hypothetical 50% reduction in the target company’s (Air Liquide) production. Based on their own production and transportation costs, the production cost estimates for the neighbouring countries and their own revenues the parties determined the current rational transportation distance. Then the parties calculated the change in the rational transportation distance in case of a 5% and a 10% price rise, essentially performing a SSNIP-test. In the final step they assessed the relevant capacities within the relevant rational transportation distance boundaries and calculated the spare capacities needed to offset a 50% reduction in the target company’s production level.

11. The GVH acknowledged the general approach of the economic analysis on the rational transportation distance and decided to perform the same analysis with higher quality data. The case handlers collected production cost, transportation cost and revenue data from the parties’ main competitors and recalibrated the rational transportation distance boundaries. The investigation then reassessed the spare capacities needed to offset not only a 50% reduction in the target company’s production level but a complete shutdown as well.

12. The GVH complemented the above analysis with qualitative responses from the main buyers. The data collected from the buyers helped determine their expected behaviour in case of a hypothetical 10% price rise, the level of price rise which would force them to switch suppliers and their take on the competitiveness of foreign market players. The parties’ main competitors also provided their views on competition from abroad.

13. When assessing competitive effects in various bulk markets the GVH took into account the results of the economic analysis on rational transportation distance and the existing imports to Hungary and the qualitative data collected from buyers and competitors. All of these placed a strong emphasis on assessing the competitive pressure coming from outside of Hungary. The combined results confirmed the parties' argument that certain foreign production capacities provide relevant competitive pressure. Together with other evidence collected during the investigation, such as closeness of competition between parties (tender-analysis), buyer power and the presence of maverick competitors, the results related to the geographic dimension formed part of a set of arguments that enabled the GVH to clear the merger with respect to all the affected bulk markets.

14. Regarding the cylinder markets the main question was if narrower local geographic markets could be established. The smaller buyers estimated that the transportation costs made it rational to transport the cylinders within a maximum distance of 30 km.

15. The investigation took account of all the depots of the relevant market players within Hungary and drew isochrones of various distances around each one of them using mapping software. The results showed that at least three relevant market players covered the whole territory of Hungary with their depots and no potential local market was detected where the merging parties were the only competitors.

16. Taking into account the above facts, complemented with the evidence that the market players used a single pricelist for the whole territory of Hungary, the GVH established that the geographic market for cylinder gases was at least national in scope. The GVH was then able to exclude any concerns of potentially harmful effects due to almost non-existing switching costs, relevant buyer power, the presence of at least three market players with a country-wide depot network and the presence of imports in certain markets and certain geographic areas.

17. In the end the GVH did not establish clear-cut boundaries for geographic markets in any of the affected markets as it was able to exclude harmful competitive effects while properly taking into consideration the geographic dimensions of market competition.

3. The Fastrock/Ipress merger (VJ/39/2016)

18. In another recent merger case the GVH cleared the transaction through which the Germany based EDS Group acquired Ipress, a Hungarian printing company present predominantly in the market for magazines. A Phase II investigation was necessary as EDS Group was already present in Hungary with Zrínyi Nyomda, a company specialising in printing advertisement leaflets, and both Zrínyi Nyomda and Ipress were large market players in their own segments, while also providing services in each other's product markets.

19. Both product market and geographic market definition proved to be a challenge in this case. On the product side the GVH had to assess – among other factors – the technological substitutability of supply and the impact of declining demand for printing services, especially in case of daily newspapers. In the end the GVH analysed separate product markets for advertisement leaflets and magazines.

20. On the geographic side the parties argued for a wider-than-national geographic market definition on both relevant product markets. To support their argument the parties submitted a detailed transportation cost analysis. The parties used their own turnover and transportation cost data, and calculated the transportation cost/product price ration for various transportation distances and shipment sizes of 3, 8 and 24 tons. They finally determined the rational transportation distances in case of a 5% and a 10% price rise, and assessed the relevant production capacities within these boundaries.

21. The GVH largely agreed with the general approach of the parties, but decided to perform a new analysis with more complete data. The GVH collected revenue and transportation cost data from the main market players and refined the calculations submitted by the parties. Also, the GVH collected data not only on the domestic and potential foreign competitors' total capacities, but also on their spare capacities, and used these to re-evaluate the parties' conclusions on domestic and foreign competitive pressure.

22. To complement the findings of the transportation cost analysis the GVH used other analytical tools as well. One such tool was the Elzinga-Hogarty test whereby the case team used export-import data to calculate the ratio of imports to domestically sold quantities and the ratio of exports to domestically produced quantities. The analysis was based on production and export-import data of the relevant market players.

23. Another important element in assessing geographic components of competition was qualitative information obtained from both domestic and foreign competitors, and from the relevant buyers. Domestic competitors had to assess the competitive pressure they face from abroad, while foreign competitors had to analyse their existing or potential supply of Hungarian buyers, including the hypothetical cases of a 5% and a 10% increase in price. On the demand side the GVH analysed the role foreign companies had in past tenders, how relevant their offers were to buyers, and how buyers would respond in case of a 5% and a 10% price rise.

24. Finally, the GVH engaged in on-site inspections at the premises of Zrínyi Nyomda and Ipress during which the case team was able to witness in person the production of foreign language advertisement leaflets and magazines. The list of relevant countries included all neighbouring countries, but also countries from other geographic regions, for example certain Nordic countries.

25. In its decision the GVH left open the question of geographic market definition due to the fact that it was able to exclude any harm to competition within Hungary while fully taking into consideration existing and potential competitive pressure arising from a potentially broader geographic market. In doing so the GVH emphasised that the calculated market shares overestimated the parties' true market power due to the unquantifiable but relevant market power of certain foreign competitors, and it emphasised the importance of large spare capacities both domestically and abroad, especially in the neighbouring countries and in the proximity of the border.

26. The GVH did, however, provide a list of factors which it considered to point toward a broader-than-national geographic market. The list included (i) the findings of the transportation cost analysis as performed by the case team based on the parties' original analysis; (ii) the buyers' existing practice of dealing with foreign suppliers; (iii) the evidence of actual printing to abroad as witnessed during the on-site inspections; (iv) the qualitative assessments made by domestic and foreign competitors; and (v) the spare capacities of the relevant competitors.

4. Jurisdictional issues – the Norm/Lukoil merger (VJ/72/2014)

27. In 2014 the GVH assessed a merger between Norm and the Lukoil Group whereby Norm acquired the Hungarian and the Slovak petrol stations previously owned by the Lukoil Group through Lukoil Magyarország Kft. (Lukoil HU) and Lukoil Slovakia s.r.o (Lukoil SK) respectively. The parties to the merger notified both the GVH and the Slovak competition authority about the merger.

28. In their Hungarian notification documents the parties asked the GVH to approve the whole transaction, meaning Norm's acquisition of Lukoil HU and Lukoil SK. However, during the investigation the GVH established that Lukoil SK was only present in the Slovak retail market for refined petroleum products through its petrol station network, and the company had no sales to or revenue from Hungary.

29. As the geographic market for the services provided by Lukoil SK was clearly not broader than the national territory of Slovakia, in its decision the GVH established that Lukoil SK was not capable of realising sales to Hungary, while its entry into the Hungarian market was unlikely due to the market presence of Lukoil HU with the same services. For these reasons the GVH decided to assess competitive effects in Hungary only in relation to Lukoil HU and its Hungarian petrol stations.

5. Final remarks

30. The Hungarian Competition Act provides basic and general guidelines on geographic market definition, thereby recognising it as a relevant concept in competition law enforcement. In the practice of the GVH the concept of geographic markets predominantly presents itself within the framework of merger control.

31. The Hungarian merger regime used to be based on the dominance test where geographic market definition had a well-defined role in helping to determine whether a dominant market position existed or not. Since 2009, however, the GVH has been applying the SLC-test and in doing so the focus has shifted from defining the geographic markets to assessing geographic aspects of competition and their role in offsetting the potentially harmful effects of mergers.

32. Recently the GVH performed two thorough Phase II merger investigations where the geographic dimensions of competition played a relevant role. In both cases the parties submitted detailed economic analyses based on transportation costs, rational transportation distances and relevant capacities to argue for a broader-than-national geographic market. Again in both cases the GVH decided to fine tune the parties' calculations by using more accurate and more complete data, and to complement the results with other analyses, including assessments of export-import data, past tenders and market practices, the behaviour of competitors and buyers, probable market reactions to various levels of price increase, etc.

33. By combining the results of various analyses aimed at assessing the geographical dimensions of competition with other results of competitive effects analysis the GVH was able to come to a satisfactory decision in both cases without having to define exact geographic markets. This shows that in practice issues usually related to geographic market definition can successfully and effectively be incorporated into the assessment of competitive effects.

34. Recent Hungarian case law also suggests that geographic market definition can have an impact on jurisdictional issues such as the scope of a national competition authority's investigation into competitive effects in case of mergers affecting multiple markets in multiple geographic regions.