Guernsey Competition Law
GCRA Guideline 7 - Market Definition

Issued June 2021

What this Guideline is about

This Guideline is one in a series of publications designed to inform businesses and consumers about how we, the Guernsey Competition and Regulatory Authority (GCRA), apply competition laws in Guernsey.

The purpose of this Guideline is to explain to consumers, businesses and their advisers the provisions in Guernsey competition law in respect of anti-competitive agreements. Specifically, this Guideline has been prepared to explain Part II of *The Competition (Guernsey) Ordinance, 2012* (the **2012 Ordinance**).

This Guideline should not be relied on as a substitute for the law itself. If you have any doubts about your position under the law, you should seek legal advice.

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1 Introduction

Why is competition important?

Open and vigorous competition is good for consumers because it can result in lower prices, new products of a better quality and more choice. It is also good for fair-dealing businesses, which flourish when markets are competitive.

Competition law in Guernsey

In Guernsey, the 2012 Ordinance prohibits anti-competitive behaviour, including anti-competitive agreements between businesses and the abuse of a dominant position in a market. It also requires certain mergers and acquisitions to be notified to the GCRA for approval.

What powers does the GCRA have?

The GCRA has a wide range of powers to investigate businesses suspected of breaching the law. We can order that offending agreements or conduct be stopped and levy financial penalties on businesses and individuals for the breach.

What types of organisation are considered a 'business'?

Throughout this Guideline, we refer to a 'business'. This term (also referred to as an 'undertaking' in Guernsey competition law) means any entity engaged in economic activity, irrespective of its legal status, including companies, partners, cooperatives, States' departments and individuals operating as sole traders.

A Note on European Union (EU) Competition Law

Guernsey competition law is modelled on the competition provisions in the Treaty on the Functioning of the EU (**TFEU**). Section 54 of the 2012 Ordinance provides that the GCRA and the Royal Court may take into account the principles laid down by, and any relevant decisions of, the European courts in respect of corresponding questions arising under EU competition law[1].

Relevant sources of EU competition law include judgments of the European Court of Justice or General Court, decisions taken and guidance published by the European Commission, and interpretations of EU competition law by courts and competition authorities in the EU Member States. Section 54, however, does not prevent us from departing from EU precedents where this is appropriate in light of the particular circumstances of Guernsey.

[1] The provisions of section 54 were amended with effect from 23 February 2021 by the European Union (Competition) (Brexit) (Guernsey) Regulations, 2021, regulation 1, which replaced the word "must" with the word "may".

2 Market Definition

A common issue when considering matters in relation to competition law is whether a business, or a group of businesses together, hold or are likely to hold market power. The 2012 Ordinance prohibits businesses from abusing a dominant position (a particular level of market power). In order to determine whether an infringement of the law has occurred, it must first be determined whether business or businesses are dominant in a specific market. To do this, the GCRA must define the relevant market in which the dominance is suspected to arise.

The concept of market definition is also relevant to assessments of whether or not an agreement has as its object or effect the restriction of competition. Such assessments are based on a number of factors including the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which the agreement is or will be applied and the actual conduct and behaviour of the parties on the market. Identification of the market can therefore be relevant to such analyses. Similarly, market definition is a critical step in determining the potential and actual effect on competition of mergers and acquisitions and other commercial arrangements in all identified relevant markets.

The techniques used to define relevant markets are described in this Guideline. They reflect well established practices and precedents applied internationally, including those of the UK's competition authorities and the European Commission.

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

The approach described in this Guideline is not mechanical; it is a conceptual framework within which evidence can be organised. We will not follow every step described below in every case. Instead, we will look at the areas of evidence that are relevant to the case in question – and will often be constrained by the extent to which evidence is available. As noted earlier, market definition is not an end in itself, but rather a step that helps either in the process of determining whether businesses possess, or will possess market power in the relevant market, or inform any assessment of the behaviour that is in question.

3 The Purpose of Market Definition

The prohibitions in the 2012 Ordinance are designed primarily to protect competition in the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Market power exists where businesses can charge higher prices, or supply goods and services of a lower quality, than they would if they faced effective competition.

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

Some relationships such as price-fixing agreements may be prohibited even if the businesses involved do not possess market power. For more information see GCRA Guideline 2 - Anti-Competitive Arrangements.

Nonetheless, in most cases, an investigation under the competition laws normally begins with the question of whether particular businesses possess market power or will acquire market power as a result of a particular transaction or conduct. High market shares, combined with other evidence, may indicate that businesses possess market power. Where a business has a high market share, there may be a lack of strong competitors, in which case it may be able to raise prices above competitive levels without fear of losing sales. It may also be easier for businesses to collude. In small jurisdictions such as Guernsey, a lack of competitors is more likely to be a factor under consideration.

High market shares do not always imply market power, for example, there may be a strong threat of competition from new entrants. If, however, the relevant market has been defined appropriately, businesses with very low market shares almost certainly will not possess market power, and an investigation can normally be concluded at an early stage.

Market definition provides a framework for competition analysis and is important for a number of reasons.

First, market shares can be calculated only after the boundaries of a market have been defined.

Second, it is important for the rest of our analysis under the 2012 Ordinance, because it sets the stage on which competition takes place. For example, when considering the strength of existing competition and the potential for a new entry, it is necessary to identify the relevant market.

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

- When considering whether agreements have an effect on competition, the relevant market in which competition is affected must be defined: see GCRA Guideline 2 - Anti-Competitive Arrangements**;**
- The 2012 Ordinance assumes that businesses with very low market shares are unlikely to be dominant, so their behaviour will not be caught by the prohibition: see GCRA Guideline 5 - Abuse of a Dominant Position. Calculation of market shares requires the relevant market to be defined.
- The GCRA reviews certain proposed mergers and acquisitions, and must prohibit those that would substantially lessen competition: see GCRA Guideline 6A - Mergers and Acquisitions – substantive assessment. Defining the markets relevant to a merger or acquisition is the first step in the process of assessing whether a merger or acquisition may have the effect of substantially lessening competition.

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

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

It should be noted that businesses will often have their own methods of defining markets and calculating market shares. For example, businesses will often refer to the geographic area in which they provide their goods or services as their “market”. However, these methods may not necessarily coincide with the economic approach to market definition under the laws, as set out in this Guideline.

4 The Main Concept

Markets are defined to include all those suppliers, and those buyers, between whom there is close competition. The focus is on those goods or services that are close substitutes in the eyes of buyers, and on those suppliers who produce, or could easily switch to produce, those goods or services. The purpose of market definition is to identify in a systematic way the competitive constraints that the business(es) face(s). The objective of defining a market is to identify those actual competitors of the businesses involved that are capable of constraining those businesses' behaviour and preventing them from behaving independently of effective competitive pressure.

In general terms, competition authorities will commence their assessment by considering the freedom a business has in the provision of its goods or services without an effective corrective response from consumers or its competitors. This informs the range of goods or services that might be close substitutes in the eyes of buyers, and those suppliers who could produce, or who could easily switch to producing, those goods or services.

The boundaries of the market, however, are not always obvious. For example, the question of whether an internet search engine business is a monopoly depends on what product market it falls within. It might be the case that only three search engine companies compete in the market. However, if it is more appropriate to consider these businesses as advertising companies, rather than search engine companies, search advertising might be a market with a larger number of competitors in a particular region such as the UK, while UK online advertising may be an even larger market. Global advertising is a further enlargement of the relevant market. It is apparent that depending on the relevant market, the position of a market player can vary significantly.

A market definition normally will contain two dimensions; a product and a geographic area.[2] For example, when looking at a complaint regarding ice cream cabinets in Ireland, the European Commission defined the relevant market as the retail supply of impulse ice cream (ice creams bought from convenience outlets on the spur of the moment rather than from a supermarket) in Ireland. The product market was impulse ice cream and the geographic market was Ireland (rather than say, the area around Dublin, or Ireland and the UK, or the entire EU). The market definition analysis has to be applied separately to determine both the product and geographic scope of the relevant market.

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

2 Throughout this Guideline, the term “product” includes services and property rights

5 The Product Market

The relevant product market is defined primarily by reference to the likely response of consumers and competitors. An examination of both the likely reaction of purchasers, ie, demand-side, and other suppliers, ie, supply-side, is typically undertaken.

The Demand-side

The process starts by looking at a relatively narrow potential definition. This normally would be the product that two parties to an agreement both produce or the product which is the subject of a complaint. The GCRA will ask what would happen if a hypothetical monopolist of that product attempted to exploit its position, typically by considering what would happen if prices rose to some material and permanent level, but the terms of sale of all other products remained constant. If significant numbers of customers are realistically likely to switch to other products (known as demand-side substitution) so that the hypothetical monopolist would not find it profitable to impose such a price increase, the market definition should be widened to include those substitutes.

This process will continue until a group of products over which a hypothetical monopolist could impose a material and permanent rise in prices without a substantive response from consumers or competitors is identified. We will generally consider the relevant product market to be the smallest group of products that satisfies this test.

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

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

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

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

Chains of substitution

Two products do not have to be direct substitutes to be included in the same market; there may be a chain of substitution between them. A large luxury car is unlikely to be a direct substitute for a small hatchback, for example. If the price of one manufacturer's hatchback rose, customers would be more likely to switch to a different small hatchback rather than to a large luxury model. The hatchback and the luxury car are not likely to be direct substitutes for most customers. If the price of small hatchbacks rose, however, customers might hypothetically switch to slightly larger cars (a medium-sized hatchback, for example), since the price differential would narrow. These cars might then be included in the same market. Similarly, if the price of medium-sized hatchbacks rose, customers might either switch to small hatchbacks or to slightly larger cars. If this were the case, there might then be a chain of substitution linking cars of different sizes.

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

The Supply-side

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

The test for supply-side substitution follows the same approach as on the demand-side. That is, would other suppliers be able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to such behaviour by a business? If other producers can respond to make the attempted price increase unprofitable, they should be included in the relevant product market.

Analysing supply-side substitution raises similar issues to the analysis of barriers to entry. For more information see GCRA Guideline 6A - Mergers and Acquisitions – substantive assessment. In both cases the question is whether businesses would start supplying a particular product if the price rose. The distinction is timing: supply-side substitution occurs when businesses start supplying the market in the short run (for example, within one year), whereas new entry into the market occurs over a longer time scale. Since the issue is identifying opportunities for short term substitution, businesses normally would not be included if they would have to make a significant investment in a new production facility or other fixed assets.

Other factors we consider in supply-side substitutability include:

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

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

6 The Geographic Market

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

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

The Demand-side

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

Chains of substitution can also be an important factor in geographic markets, particularly retail markets. Consumers in any one location might not be willing to travel more than a certain distance to purchase a particular product, but there may be a chain of substitution creating a much larger geographic market. In principle this could create a market covering the whole jurisdiction, for example, the whole of Guernsey, but it would depend on whether there were areas where the chain broke. Chains of substitution often break down in rural areas. If a business with a monopoly in several neighbouring areas could raise prices across those areas, the total area might form a separate market.

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

The Supply-side

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

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

Imports

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

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

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

7 Temporal dimension

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

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

Temporal dimensions may be considered when:-

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

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

8 Functional Dimension

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

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

9 Customer Dimension

The GCRA may also examine the extent of, and potential for, suppliers to discriminate between customers within identified relevant markets. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, we will consider whether it would be appropriate to define additional markets based on particular uses for a good or service, particular groups or buyers, or buyers in particular geographic areas that are captive to those products and in the face of a price increase are unable to switch. For example, some customers may be captive to a particular supplier by virtue of the costs associated with switching to an alternative source of supply.

10 Identifying the Competitive Price

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

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

11 Previous cases

In many cases, a market may have already been investigated and defined by the GCRA or another competition authority. We may take note of market definitions adopted in European competition law cases, but these are not precedents and may be departed from. Sometimes earlier definitions can provide useful short cuts, but competitive conditions may change over time, changing the market definition. Market definition will always depend on the prevailing facts.

12 How can I find out more?

Please contact us if you have a question about competition law in Guernsey, or if you suspect that a business is breaching the law and wish to complain or discuss your concerns.

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Publications

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