

## **A great leap forward for definition of the relevant market**

On July 7 2009, the Anti-monopoly Commission of the State Council published the long-awaited final Guidelines on the Definition of Relevant Market (国务院反垄断委员会关于相关市场界定的指南). These are the first guidelines adopted by the Anti-monopoly Commission according to the PRC Anti-monopoly Law (AML). Compared with the first draft of the Guidelines circulated by the Ministry of Commerce (Mofcom) for public comments on January 5 2009, the finalised Guidelines have the same structure but contain some amendments, such as providing more details for the application of the Hypothetical Monopolist Test. Basically, the Guidelines will provide more certainty to companies in complying with the AML, such as carrying out mergers and acquisitions, or implementing pricing policies and arranging distribution networks which may affect the Chinese market.

### **Role and relevance of market definition**

As explicitly advocated in the Guidelines, the definition of the relevant market is the “starting point” in any proceeding and is an important step in the actual enforcement of the AML. In the Coca-Cola/Huiyuan Juice case, a Mofcom spokesman stated that, in order to prove the market dominance of Coca-Cola, the first step was to define the relevant market. Meanwhile, under the draft Regulation on Prohibition of Abuse of Dominant Market Position released by the State Administration of Industry and Commerce (SAIC) in April, it has stressed that the determination and presumption of the market dominance should be carried out on the basis of market definition. Hence, following international antitrust practice, the process of market definition serves as prerequisite to the analyses of any anti-competitive behaviour and thus market definition is a means to an end, not an end in itself.

As the Guidelines point out, market definition is relevant to the three pillars of the AML: monopoly agreement, abuse of market dominant position and the concentration of undertakings which has or likely has the effect of excluding or restricting competition. In the Mitsubishi Rayon/Lucite merger case, the Mofcom explicitly defined the product market as MMA, SpMAs, PMMA pellets and PMMA board, and defined the geographic market as China. In a later abuse of market dominance case against Baidu, the leading search engine player in China, market definition was also involved as the precondition to establishing the violation of the AML. Market definition therefore has practical significance in cases of monopoly agreement, abuse of market dominance and merger control.



## **Meaning and classification of market definition**

Generally, the concept of a relevant market has specific meaning under the AML which is quite different from the traditional use of the word “market” in a commercial context. Under the Guidelines, a relevant market is defined as the product scope and geographic scope within which undertakings compete for particular products and services (hereinafter collectively referred to as the product) during a particular period.

The Guidelines provide that when defining a relevant market, it is usually necessary to define the relevant product market and the relevant geographic market, as is the case in many other jurisdictions. Meanwhile, it is sometimes necessary to take into account the third dimension: the times or period during which supply and demand on that market occur (the temporal market), and in some circumstances involving technology licensing and assignment, the technology market should be defined with consideration to the elements of IP rights and innovation.

## **Methodology for defining the relevant market**

The Guidelines explicitly stress that there is no single method for defining the relevant market. The basic method for defining the relevant market is the substitution analysis both from the demand-side, and from the supply-side where the case requires. Where the market scope is not clear or is not easy to define, the Hypothetical Monopolist Test, known as the SSNIP (small but significant and non-transitory increase in price) test, may be applied. This test has long been a routine part of US and EU antitrust practice in defining the relevant market.

### **Substitution analysis**

Similar to international antitrust practice, the Guidelines set out that the scope of a relevant market is mainly determined by the degree of substitutability of the product or the geographic area. Under the Guidelines, definition of the relevant market should be mainly analysed from demand-side substitution, and supply-side substitution should be also considered where the supply substitution has competition constraints on the behaviours of undertakings similar to those of demand substitution. In the Coca-Cola/Huiyuan case, the Mofcom spokesman stressed that in the review process Mofcom had adopted the method of demand substitutability and supply substitutability to define the relevant product market. Adhering to the economic analysis, Mofcom, based on the evidence from collection and market investigation, held that the



carbonated soft drinks market and fruit juice beverage market are separate product markets and the relevant product market applicable in that transaction was the latter market.

The Guidelines list numerous elements to be considered when defining the relevant market from demand-side substitution and supply-side substitution. For instance, in terms of defining the product market from the demand-side, the Guidelines set out the following factors to be taken into account: the evidence of switching or considering switching to other products by purchasers, the general characteristics and usage of the product, price differentials, distribution channels, etc. In relation to the analyses from the supply side substitution, factors should include without limitation the evidence of reaction by other undertakings against the change of the product price, the undertaking's production process and craft, difficulties regarding production switch, the time required for the production switch, the extra investments and risk, etc.

To define the geographic market both from the demand-side substitution and from the supply-side substitution, a similar method will be adopted. The factors provided in the Guidelines include without limitation the transportation cost and feature, sales networks, cross-border trade barrier, the instantaneity and feasibility of supplying relevant products by other undertakings from other areas, etc.

### **Hypothetical Monopolist Test (SSNIP test)**

#### **General operation**

The application of the SSNIP test is described in Article Four of the Guidelines. When using the SSNIP test to define a relevant product market, it should be examined whether a hypothetical monopolist would be able to keep price increase of its product on a small basis – generally 5% to 10% – continuously (usually one year) provided that other conditions pertaining to the sales of other products remain unchanged. Where the price increase leads to customers switching to other close substitutable products, which would thereby deprive the hypothetical monopolist of its profit, the enforcement authorities will expand the relevant product to include these substitutable products and go with the foregoing examination. This operation will be repeated to include more products until the substitutability becomes less and less, and the hypothetical monopolist would profit by increasing prices. The relevant product market can be found as the final group of products.



In terms of defining the relevant geographic market, a similar method may be applied by the enforcement authorities.

### **Limitations**

In order to avoid the so-called Cellophane Fallacy (named after a US Supreme Court decision concerning the dominant supplier of cellophane, Du Pont, which raised prices to such a level that consumers were prepared to substitute other materials; the Court found that cellophane was therefore part of a wider flexible packaging market, although it appears that the other materials would not have been regarded as substitutes had the price of cellophane been competitive), the Guidelines expressly stipulate that the benchmark price in the operation of the SSNIP test should be the current market price derived from the full competition. In cases of abuse of market dominance, collusion behaviours and concentration involving existing collusion, where the current price deviates from the competitive price, adjustment should be made to such current price and thus using the more competitive price.

### **A significant and encouraging step**

In line with international antitrust practice, the publication of the Guidelines is highly significant as it marks the adoption by China of the first systematic and conceptual approach to market definition, including encouraging the use of economic analysis and economic data. The Guidelines are an essentially welcome addition to complement the current abstract AML as they provide great clarity regarding the analytical framework for market definition. This benefits companies, practitioners, and indeed the competent enforcement authorities. However, as in other mature jurisdictions, it might be predicted that market definition will be a complex process and is a rather tough job for undertakings to handle in China. It would be advisable for undertakings to keep a close eye on the future enforcement of the Guidelines, thus complying with the AML in an appropriate manner.



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