EUROPEAN ECONOMIC AREA

EFTA SURVEILLANCE AUTHORITY

DECISION OF THE EFTA SURVEILLANCE AUTHORITY

No 46/98/COL

of 4 March 1998

on the issuing of two notices in the field of competition on the definition of the relevant market for the purpose of competition law within the European Economic Area (EEA), and on agreements of minor importance which do not fall under Article 53(1) of the EEA Agreement

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area (1), in particular Article 55,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice (2), in particular Article 5(2)(b) and Article 25(1),

Having consulted the European Commission,

Whereas the European Commission has adopted a notice on the definition of the relevant market for the purpose of Community competition law (3) and a notice on agreements of minor importance which do not fall under Article 85(1) of the Treaty establishing the European Community (4);

Whereas these notices are of relevance also for the European Economic Area;

Whereas it is necessary to provide guidance for undertakings by indicating the principles and rules which will guide the EFTA Surveillance Authority when applying the concept of relevant product and geographic market and in assessing whether an agreement has an appreciable effect on trade and competition in relation to Articles 53 to 60 of the EEA Agreement;

Whereas a uniform application of the EEA competition rules is to be ensured throughout the European Economic Area;

Whereas according to point II under the heading ‘General’ at the end of Annex XIV to the EEA Agreement, the Surveillance Authority is to adopt, after consultation with the EC Commission, acts corresponding to those adopted by the EC Commission in order to maintain equal conditions of competition,

(1) Hereinafter referred to as the EEA Agreement.
(2) Hereinafter referred to as the Surveillance and Court Agreement.
HAS ADOPTED THIS DECISION:

1. The following notices which are annexed to this Decision as Annexes I and II:
   — notice of the EFTA Surveillance Authority on the definition of the relevant market for the
     purpose of competition law within the European Economic Area (EEA),
   — notice of the EFTA Surveillance Authority on agreements of minor importance which do not
     fall under Article 53(1) of the EEA Agreement,
   shall be issued.

2. This decision and the attached notices shall be authentic in the English language and shall
   be published in the EEA section of and the EEA supplement to the Official Journal of the
   European Communities.

Done at Brussels, 4 March 1998.

For the EFTA Surveillance Authority

President

Knut ALMESTAD
ANNEX I

NOTICE OF THE EFTA SURVEILLANCE AUTHORITY ON THE DEFINITION OF RELEVANT MARKET FOR THE PURPOSE OF COMPETITION LAW WITHIN THE EUROPEAN ECONOMIC AREA (EEA)

A. The present notice is issued pursuant to the rules of the Agreement on the European Economic Area (EEA Agreement) and the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice (Surveillance and Court Agreement).

B. The European Commission has issued a notice on the definition of the relevant market for the purpose of Community competition law (1). This non-binding act contains principles and rules which the European Commission follows in the field of competition.

C. The EFTA Surveillance Authority considers the abovementioned act to be EEA relevant. In order to maintain equal conditions of competition and to ensure a uniform application of the EEA competition rules throughout the European Economic Area, the EFTA Surveillance Authority adopts the present notice exercising the power conferred upon it by Article 52(b) of the Surveillance and Court Agreement. It intends to follow the principles and rules laid down in this notice when applying the relevant EEA competition rules to a particular case.

I. INTRODUCTION

1. The purpose of this notice is to provide guidance as to how the EFTA Surveillance Authority applies the concept of relevant product and geographic market in its ongoing enforcement of the competition rules of the EEA Agreement, in particular the application of the provisions of Chapter II of Protocol 4 to the Surveillance and Court Agreement (2) and of point 1 of Annex XIV to the EEA Agreement together with Chapter XIII of Protocol 4 to the Surveillance and Court Agreement (3), and their equivalents in other sectoral applications such as transport, and coal and steel (4).

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 EFTA Surveillance Authority. The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved (5) 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' behaviour 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 53 of the EEA Agreement.

3. It follows from the above, that the concept of 'relevant market' is different from other concepts 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 geographic dimensions often has a decisive influence on the assessment of a competition case. By rendering public the procedures the EFTA Surveillance Authority follows when considering market definition and by indicating the criteria and evidence on which it relies to reach a decision, the EFTA Surveillance Authority 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 advisors being able to anticipate better the possibility that the EFTA Surveillance Authority 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 Authority considers relevant for the purposes of market definition.

6. The EFTA Surveillance Authority’s interpretation of the notion of ‘relevant market’ is without prejudice to the interpretation which may be given by the EFTA Court, the Court of Justice or the Court of First Instance of the European Communities.

II. DEFINITION OF RELEVANT MARKET

Definition of relevant product and relevant geographic market

7. Certain Acts relating to Articles 53 and 54 of the EEA Agreement, in particular the provisions in section 6 of Form A/B
with respect to Chapter II of Protocol 4 to the Surveillance and Court Agreement (1), as well as the provisions in section 6 of Form CO with respect to point 1 of Annex XIV to the EEA Agreement and Chapter XIII of Protocol 4 to the Surveillance and Court Agreement (2) 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 homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.’

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 EFTA Surveillance Authority interprets the definitions at paragraphs 7 and 8 (which reflect the jurisprudence of the Court of Justice and the Court of First Instance of the European Communities as well as its own decision-making practice) according to the orientations defined in this notice.

10. The concept of relevant market is closely related to the objectives pursued under EEA competition policy. For example, under the EEA 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 territory covered by the EEA Agreement. Under the EEA 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 would account for a large share of the supply in any given market, provided that other factors analysed in the assessment (such as entry barriers, capacity of reaction of customers, etc.) point in the same direction.

11. The same approach is followed by the EFTA Surveillance Authority in its application of Article 54 of the EEA Agreement to firms that enjoy a single or collective dominant position. Under Chapter II of Protocol 4 to the Surveillance and Court Agreement (4) the EFTA Surveillance Authority has the power to investigate and bring to an 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 53 of the EEA Agreement, in particular, in determining whether an appreciable restriction of competition exists or in establishing if the condition under Article 53(3)(b) for an exemption from the application of Article 53(1) is met.

12. The criteria to define the relevant market are applied generally for the analysis of certain behaviours 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 analysing 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 EFTA Surveillance Authority is examining a change in the structure of supply, such as a concentration or a cooperative joint venture, or issues relating to certain past behaviour.

Basic principles for market definition

Competitive constraints

13. Firms are subject to three main sources of 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, both in terms of products/services and 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 determining this 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 to define markets.
16. Conceptually, this approach implies 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 5 to 10% range) 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 would be included in the relevant market. This would be done until the set of products and geographic 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 stating 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 under 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 flavours of soft drinks belong to the same market. In practice, the question to address would be whether consumers of flavour A switched to other flavours when confronted with a permanent price increase of 5 to 10% for flavour A. If a sufficient number of consumers switched to say, flavour B, to such an extent that the price increase for flavour A was not profitable due to the resulting loss of sales, then the market would comprise at least flavours A and B. The process would have to be extended in addition to other available flavours 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 might not be the case where the prevailing price has been determined in the absence of sufficient competition. In particular for 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 (1) 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 therefore able to compete for orders of the various qualities, in particular if orders are passed with sufficient lead time to allow for modifying production plans. Under such circumstances, the EFTA Surveillance Authority would not define a separate market for each quality of paper and its respective usage. 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 entails 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 of where supply side substitution is not likely to lead the EFTA Surveillance Authority to enlarge the definition of the market may be found in the area of consumer products, for instance with respect to 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

(1) That is, the period which does not imply a significant adjustment of existing tangible and intangible assets (see paragraph 23).
III. EVIDENCE RELIED UPON 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 determined, 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 EFTA Surveillance Authority 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 Authority does not follow a rigid hierarchy of different sources of information or types of evidence.

26. The process of defining relevant markets may be summarised as follows: on the basis of the preliminary information available or information submitted by the undertakings involved, the EFTA Surveillance Authority 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.

Geographical dimension

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.

28. The EFTA Surveillance Authority’s approach to geographic market definition might be summarised as follows: it will take a preliminary view of the scope of the geographic market on the basis of broad indications regarding the distribution of market shares of the parties and their competitors, as well as a preliminary analysis of pricing and price differences at national and EEA levels. This initial view is used basically as a working hypothesis to focus the Authority’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 homogenous 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, etc.) 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 authorisations, packaging regulations, etc. In short, the EFTA Surveillance Authority will identify possible regulations, etc. In short, the EFTA Surveillance Authority 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 flow 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 flow 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 European Economic Area

32. Finally, the EFTA Surveillance Authority also takes into account the continuing process of market integration in the EEA when defining geographic markets. Within the scope of the EEA Agreement (1), the measures adopted and implemented to remove barriers to trade and further integrate the EEA markets cannot be ignored when assessing the effects on competition of, for example 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.

(1) It should be noted that the EEA Agreement is limited in scope compared to the EC Treaty. For instance, the absence of a customs union and limited application to certain products may affect the scope of market integration between the EFTA States and between the EFTA States and the Community.
The process of gathering evidence

33. When a precise market definition is deemed necessary, the EFTA Surveillance Authority 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 Authority might also contact the relevant professional associations, and companies active in upstream markets, so as to be able to define, insofar 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 from the undertakings involved.

34. Where appropriate, the EFTA Surveillance Authority 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 on the boundaries of the relevant market. They will also include requests to provide the factual information the Authority deems necessary to reach a conclusion on the extent of the relevant market. The Authority 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 to understand better issues relating to the definition of the relevant market. Where appropriate, it might also carry out visits or inspections to the premises of the parties, their customers and/or their competitors, in order to understand better how products are manufactured and sold.

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

Evidence to define markets — product dimension

36. An analysis of the product characteristics and its intended use allows the EFTA Surveillance Authority, as a first step, to limit the field of investigation of possible substitutes. However, product characteristics and intended use are insufficient to conclude whether two products are demand substitutes. Functional interchangeability or similarity in characteristics may not provide in themselves 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 EFTA Surveillance Authority considers relevant to assess whether two products are demand substitutes can be categorised as follows:

38. Evidence of substitution in the recent past

In certain cases, it is possible to analyse 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 (1) 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 EFTA Surveillance Authority will take 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 EFTA Surveillance Authority may contact 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 to reach 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 5 to 10 %) are taken into account when they are sufficiently backed by factual evidence.

41. Consumer preferences

In cases of consumer goods, it might be difficult for the EFTA Surveillance Authority 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 Authority'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

(1) Own price elasticity of demand for product X is at measure of the responsiveness of demand for X to a percentage change in its own price. Cross-price elasticity between products X and Y is the responsiveness of demand for product X to a percentage change in the price of product Y.
Parties and their competitors will be 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 Chapter II of Protocol 4 to the Surveillance and Court Agreement (1) will usually be scrutinised with utmost care. Unlike pre-existing studies, they have not been prepared in the normal course of business for the adoption of business decisions.

(1) See footnote 2 of this Decision.

42. Barriers and costs associated with switching demand to potential substitutes

There are a number of barriers and costs that might prevent the EFTA Surveillance Authority 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 authority may be 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 to define markets — geographic dimension

44. The type of evidence the EFTA Surveillance Authority considers relevant to reach a conclusion as to the geographic market can be categorised 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 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 EFTA Surveillance Authority 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 to reach 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 EEA on similar terms, or they procure their supplies through effective tendering procedures in which companies from anywhere in the EEA submit bids, the geographic market will usually be considered to be EEA-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 cross-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 geographical 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 EFTA Surveillance Authority will then define a geographic market that could range from a local dimension to a global one.

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 on 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.

IV. CALCULATION OF MARKET SHARES

53. The definition of the relevant market in both its product and geographic dimensions allows the identification of 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 EFTA Surveillance Authority 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 reflect better 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 54 of the EEA Agreement. 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 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 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 on extreme ends of the chains would have to be of the same magnitude as well.
ANNEX II

NOTICE OF THE EFTA SURVEILLANCE AUTHORITY ON AGREEMENTS OF MINOR IMPORTANCE WHICH DO NOT FALL UNDER ARTICLE 53(1) OF THE EEA AGREEMENT

1. The EFTA Surveillance Authority considers it important to facilitate cooperation between undertakings where such cooperation is economically desirable without presenting difficulties from the point of view of competition policy. To this end, it published the "Notice concerning agreements, decisions and concerted practices in the field of cooperation between enterprises" (1) listing a number of agreements which by their nature cannot be regarded as being in restraint of competition. Furthermore, in the "Notice concerning its assessment of certain subcontracting agreements" (2), the EFTA Surveillance Authority considered that that type of contract, which offers all undertakings opportunities for development, does not automatically fall within the scope of Article 53(1) of the EEA Agreement. The "Notice concerning the assessment of cooperative joint ventures pursuant to Article 53 of the EEA Agreement" (3) describes in detail the conditions under which the agreements in question do not fall under the prohibition of restrictive agreements. By issuing this notice, the EFTA Surveillance Authority is taking a further step towards defining the scope of Article 53(1) in order to facilitate cooperation between undertakings.

2. Article 53(1) EEA prohibits agreements which may affect trade between the Contracting Parties to the EEA Agreement and which have as their object or effect the prevention, restriction or distortion of competition within the territory covered by the EEA Agreement. The Court of Justice of the European Communities has clarified that the corresponding Article 85(1) of the Treaty establishing the European Community is not applicable where the impact of the agreement on intra-Community trade or on competition is not appreciable. Agreements which are not capable of significantly affecting trade between the Contracting Parties are not caught by Article 53. They should therefore be examined on the basis, and within the framework, of national legislation alone. This is also the case for agreements whose actual or potential effect remains limited to the territory of only one Contracting Party or of one or more third countries. Likewise, agreements which do not have as their object or their effect an appreciable restriction of competition are not caught by the prohibition contained in Article 53(1).

3. In this notice the EFTA Surveillance Authority, by setting quantitative criteria and by explaining their application, has given a sufficiently concrete meaning to the term "appreciable" for undertakings to be able to judge for themselves whether their agreements do not fall within the prohibition under Article 53(1) EEA by virtue of their minor importance. The quantitative definition of appreciability, however, serves only as a guideline: in individual cases even agreements between undertakings which exceed the threshold set out below may still have only a negligible effect on trade between the Contracting Parties or on competition within the area covered by the EEA Agreement, and are therefore not caught by Article 53(1). This notice does not contain an exhaustive description of restrictions which fall outside Article 53(1). It is generally recognised that even agreements which are not of minor importance can escape the prohibition on agreements, on account of their exclusively favourable impact on competition.

4. The benchmarks provided by the EFTA Surveillance Authority in this notice should eliminate the need to have the legal status of agreements covered by it established through individual EFTA Surveillance Authority decisions; notification for this purpose will no longer be necessary for such agreements. However, if it is doubtful whether, in an individual case, an

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agreement is likely to affect trade between the Contracting Parties to the EEA Agreement or to restrict competition to any significant extent, undertakings are free to apply for negative clearance or to notify the agreement pursuant to Chapter II (4), Chapter VI (4), Chapter IX (4) and Chapter XI (4) of Protocol 4 to the Surveillance and Court Agreement.

5. In cases covered by this notice, and subject to points 11 and 20, the EFTA Surveillance Authority will not institute any proceedings either upon application or on its own initiative. Where undertakings have failed to notify an agreement falling within the scope of Article 53(1) because they assumed in good faith that the agreement was covered by this notice, the EFTA Surveillance Authority will not consider imposing fines.

6. This notice is likewise applicable to decisions by associations of undertakings and to concerted practices.

7. This notice is without prejudice to any interpretation that may be given by other competent authorities and in particular by the national courts, the EFTA Court, the Court of Justice or the Court of First Instance of the European Communities.

8. This notice is without prejudice to the application of national competition laws.

II

9. The EFTA Surveillance Authority holds the view that agreements between undertakings engaged in the production or distribution of goods or in the provision of services do not fall under the prohibition in Article 53(1) if the aggregate market shares held by all of the participating undertakings do not exceed, on any of the relevant markets:

(a) the 5 % threshold, where the agreement is made between undertakings operating at the same level of production or of marketing ("horizontal" agreement);

(b) the 10 % threshold, where the agreement is made between undertakings operating at different economic levels ("vertical" agreement).

In the case of a mixed horizontal/vertical agreement or where it is difficult to classify the agreement as either horizontal or vertical, the 5 % threshold is applicable.

10. The EFTA Surveillance Authority also holds the view that the said agreements do not fall under the prohibition of Article 53(1) if the market shares given at paragraph 9 are exceeded by no more than one tenth during two successive financial years.

11. With regard to:

(a) horizontal agreements which have as their object:

— to fix prices or to limit production or sales,
or
— to share markets or sources of supply;

(b) vertical agreements which have as their object:

— to fix resale prices,

or

— to confer territorial protection on the participating undertakings or third undertakings;

the applicability of Article 53(1) cannot be ruled out even where the aggregate market shares held by all of the participating undertakings remain below the thresholds mentioned in paragraphs 9 and 10.

The EFTA Surveillance Authority considers, however, that in the first instance it is for the authorities and courts of the Contracting Parties to take action on any agreements envisaged above in (a) and (b). Accordingly, it will only intervene in such cases when it considers that the interests protected by the EEA Agreement so demand, and in particular if the agreements impair the proper functioning of the internal market as extended to the EFTA States by the Agreement.

12. For the purposes of this notice, "participating undertakings" are:

(a) undertakings being parties to the agreement;

(b) undertakings in which a party to the agreement, directly or indirectly,

— owns more than half of the capital or business assets, or
— has the power to exercise more than half of the voting rights, or
— has the power to appoint more than half of the members of the supervisory board, board of management or bodies legally representing the undertakings, or
— has the right to manage the undertaking’s business;

(c) undertakings which directly or indirectly have over a party to the agreement the rights or powers listed in (b);

(d) undertakings over which an undertaking referred to in (c) has, directly or indirectly, the rights or powers listed in (b). Undertakings over which several undertakings as referred to in (a) to (d) jointly have, directly or indirectly, the rights or powers set out in (b) shall also be considered to be participating undertakings.

13. In order to calculate the market share, it is necessary to determine the relevant market; for this, the relevant product market and the relevant geographic market must be defined.

14. The relevant product market comprises any products or services which are regarded as interchangeable or substitutable by the consumer, by reason of their characteristics, prices and intended use.

15. The relevant geographic market comprises the area in which the participating undertakings are involved in the supply of relevant products or services, in which the conditions of competition are sufficiently homogeneous, and which can be distinguished from neighbouring geographic areas because, in particular, conditions of competition are appreciably different in those areas.

16. When applying paragraphs 14 and 15, reference should be had to the notice on the definition of the relevant market under EEA competition law (7).

(7) Not yet published in the Official Journal.
17. In case of doubt as to the delimitation of the relevant geographic market, undertakings may take the view that the agreement has no appreciable effect on trade between the Contracting Parties to the EEA Agreement or on competition when the market share thresholds indicated in paragraphs 9 and 10 are not exceeded in any State within the territory covered by the EEA Agreement. This view, however, does not preclude the application of national competition law to the agreements in question.

18. Chapter II of this notice shall not apply where in a relevant market competition is restricted by the cumulative effects of parallel networks of similar agreements established by several manufacturers or dealers.

III

19. Agreements between small and medium-sized undertakings, as defined in the EFTA Surveillance Authority Decision No 112/96/COL of 11 September 1996 (*) are rarely capable of significantly affecting trade between the Contracting Parties to the EEA Agreement and competition within the EEA. Consequently, as a general rule, they are not caught by the prohibition in Article 53(1). In cases where such agreements exceptionally meet the conditions for the application of that provision, they will not be of sufficient EEA interest to justify any intervention. This is why the EFTA Surveillance Authority will not institute any proceedings, either upon request or on its own initiative, to apply the provisions of Article 53(1) to such agreements, even if the thresholds set out in paragraphs 9 and 10 above are exceeded.

20. The EFTA Surveillance Authority nevertheless reserves the right to intervene in such agreements:

(a) where they significantly impede competition in a substantial part of the relevant market;

(b) where, in the relevant market, competition is restricted by the cumulative effect of parallel networks of similar agreements made between several producers or dealers.