

## **Summary**

According to the Federal Law of 26 July 2006 N 135-FZ "On Protection of Competition", defining a product market is impossible without determining its geographical boundaries. This is done as a step of competition analysis in accordance with the Procedure of Analysing State of Competition on Commodity Markets. This step includes **three stages**: the preliminary determination of geographic borders, the identification of conditions (economic, technical, etc.) that limit the economic possibility of acquiring the good, and final determination of geographic boundaries. Based on the markets definition, they can be referred to as **federal, interregional, regional and local markets**.

There are **several methods** that can be used by the FAS Russia for defining product markets' geographic boundaries. The authority's classic choice between them is the "**hypothetical monopolist test**". While undertaking it, the FAS Russia asks customers at which sellers and in which quantity they would prefer to buy the good if its price increased for longer than 1 year by 5-10% on the pre-defined geographic market, while the price outside this market remained the same. The geographic borders of the commodity market in question are then extended so as to include the territories where customers would continue to buy the product in question even after this increase in price. At the same time, opportunities of deliveries are taken into consideration: if due to acquisition of the good delivered from another area customers suffer significant additional costs that exceed, as a rule, 10 percent of the weighted arithmetic mean of prices for the good available to customers located within that area, then it is considered as a separate market.

It is worth adding that in the **sphere of natural monopolies** for defining geographic markets a special procedure is used.

The same is true for cases involving companies operating on the **markets of information and communication technologies (ICT)**. The procedure in such cases takes into account many aspects related to the specificity of goods' circulation on markets.

For instance, given the zero cost of replication, reproduction and transportation of the ICT goods and the global nature of production and consumption, the geographic boundaries may initially be defined as global, however while talking about certain product markets it is necessary to take into account the particularities related to goods' consumption (i.e., consumer protection issues) that may affect the customers'

behaviour. The FAS Russia had such an experience while considering cases on the markets of online sales.

Moreover, it is necessary to take into account the circulation of goods on the markets that are intrinsically related with the functioning of the ICT markets: the majority of the ICT goods (such as software) do not present an independent consumer value without the appropriate hardware. This was taken into account while considering the case on the Google's abuse of dominance.

To conclude, the FAS Russia has accumulated experience in definition of geographic markets, including in the sphere of digital economy, and it should be emphasized that the authority supports the idea of **international cooperation** and exchange of antitrust enforcement experience in this complex but crucial field.

## **1. Law provisions regarding geographic market definition**

According to the Federal Law of 26 July 2006 N 135-FZ "On Protection of Competition" (hereinafter - the Law on Protection of Competition), defining a product market for the competition analysis is impossible without determining geographical boundaries in accordance with the "Procedure of Analysing State of Competition on Commodity Markets" of April 28, 2010 elaborated by the Federal Antimonopoly Service (the FAS Russia) on the basis of the Law on Protection of Competition, and examined by an expert group comprising representatives of the business.

The procedure for determining geographical borders of a commodity market (the territorial boundaries where purchasers acquire or have an economic, technical or other opportunity to buy goods and do not have such an opportunity outside these boundaries) includes:

- Preliminary determination of geographic borders of a commodity market;
- Identification of conditions of a good's circulation that limit the economic possibility of acquiring the good by purchaser(s);
- Definition of territories included into the geographic boundaries of the relevant commodity market.

Commodity market may cover the territory of the Russian Federation or to go beyond it (federal market), cover the territory of several Russian Federation's subjects (interregional market), not go beyond the boundaries of the Russian Federation's subject (regional market), not extend beyond the boundaries of the municipal entity (local market).

Definition of geographical boundaries in Russia is carried out on the basis of information:

- a) on the region where an economic entity undertakes its activities;
- b) on product's pricing, or on differences in prices for this product on the territory of the Russian Federation;
- c) on trade flows' structure.

While identifying the conditions of the good's circulation that limit economic, technical or other opportunities of the commodity's acquisition by purchasers the FAS Russia takes into account:

- the good's transportations requirements;
- organisational and transport schemes of purchase of goods;
- possibilities of the good's transfer to the buyer (or vice versa);
- availability, accessibility and interchangeability of vehicles for transferring the product in question (or the purchaser of the product in question);
- costs associated with the search and acquisition of the product as well as transportation costs;
- particularities of the territory inside the preliminarily defined geographic boundaries (including climatic and socio-economic characteristics, presence of zones with regulated or partially regulated pricing);
- regional characteristics of the demand for the product in question (including consumer preferences);
- business conditions, rules and customs.

If due to acquisition of a good delivered from some areas, a customer suffers significant costs that exceed, as a rule, 10 percent of weighted arithmetic mean of prices for the good available to customers within preliminarily determined geographical boundaries of the commodity market, then these areas shall be considered as another commodity markets.

Definition of product markets' geographical boundaries is carried out based on the following methods:

- "hypothetical monopolist test" (as described below);
- establishing areas of actual sales (customers' location), areas of economic agents engaged in the sale on the relevant commodity market;
- combination of the methods listed above or any other method that will allow to identify clearly the good's sellers and to establish the geographical location of sales areas where sellers compete with each other in the sale of the given good.

The choice of research methods must be justified in the analytical report. In case the "hypothetical monopolist test" is used, a justification is not required. The choice of research methods depends on such factors as time and information available for the research.

As a result of the "hypothetical monopolist test" the FAS Russia obtains customers' opinion on geographic boundaries of the commodity market. For this, consumers answer the question: "At which sellers (outside the pre-defined geographic market) and in which quantity customers will prefer to buy the good if its price (within the pre-defined geographic market) increases for longer than 1 year by 5-10%, and the price outside this market remains the same?".

Responses are then summarised, and with the use of this information the FAS Russia determines whether the following two conditions are met:

- as a result of the price's increase purchasers will buy the product in question in other areas (or in appropriate cases from sellers located in other areas);
- the sales volume will decline within the predefined geographic market, which will make such an increase unprofitable for the sellers of this pre-defined geographic market.

If these conditions are fulfilled, the geographic borders of the commodity market are expanded so as to include the territories where customers will continue to buy the product in question even after this increase in price.

This procedure (questioning, summarising responses, expanding geographic boundaries of the commodity market) is repeated as long as the area is identified, within which at least one of the following conditions is met:

- a hypothetical increase in price for a good circulating within this territory does not lead to a situation where purchasers will acquire the product in question in other areas (or from sellers located in other areas);
- a hypothetical increase in the price for a good circulating within this territory does not cause the loss of benefit for sellers selling the good at an increased price.

If the geographic boundaries of the product market are defined using the "hypothetical monopolist test", other methods of determining the geographic market may not be used.

In the sphere of services provided by natural monopolies, geographic markets are determined while taking into account the peculiarities set by the Russian legislation concerning relevant markets, including on the basis of one or more of the following criteria:

- administrative-territorial criterion (territory of the Russian Federation, of its federal district, of its economic area, of its region, other (district, city, town etc.);
- organisational criterion (area of activity of a natural monopoly entity or territory of activity of its branch);
- technological criteria (presence and location of technological infrastructure, including access to the infrastructure and to its use).

The Law on Protection of Competition envisages the possibility of review of FAS Russia's decisions in case of changes of geographical boundaries of a market - on the authority's own initiative or at the request of a person involved in the case.

An expert group consisting of business representatives in Russia at the discussion on the "Procedure of Analyzing State of Competition on Commodity Markets" noted that in most cases penalties for violating the Russian antitrust legislation depend to a crucial degree on how the product and geographic boundaries of markets are defined.<sup>1</sup>

## **2. Defining geographic markets in the sphere of information technologies**

The need for discussion of this topic is related to economies' digitalisation, the basic processes in which take place with the use of information and communication technologies (ICT).

The main factor which determines revolutionary processes in the digital economy is a change of the system of products' circulation and a consequential change in approaches to production management. In the digital economy, the main resource (instead of stocks of goods) becomes information and its streams are renewed on a constant and free basis; shopping areas and operating activities are moving to the Internet and become more and more global; commercial transaction costs are significantly reduced and can amount to zero.

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<sup>1</sup> <http://economy.gov.ru/minec/activity/sections/ria/result/201404211>

Changes in goods' circulation related to the introduction of ICT change the existing markets and create new ones, where useful value is created due to collection, processing and provision of information, including telemetry data. This concerns the markets of wholesale and retail trade, insurance, transportation, tourist services and many others.

The ICT markets have a number of characteristics that determine the behavior of their actors and are essential for the implementation of the antimonopoly control:

- these markets' main products are software, data, content, which are characterized by immateriality, zero cost of their replication and transportation to any part of the world.
- these markets' global character, which is explained not only by a zero-cost transportation but also by their products' features such as universality or capacity to be adapted to national markets with low time and financial costs.

The FAS Russia is not experiencing extreme difficulties in defining geographical borders when it comes to the ICT markets, but a more complicated procedure is used for such cases. This procedure takes into account many aspects related to the specificity of goods' circulation on these markets.

First, it is necessary to take into account the circulation of goods on the markets that are intrinsically related with the functioning of the ICT markets: the majority of the ICT goods (such as software) do not present an independent consumer value without the appropriate hardware: while considering the Google case, this relationship was studied on the markets of software for mobile devices, and on the markets of mobile devices themselves. Here it is worth mentioning that each country may have its own peculiarities on hardware markets (required certification, etc.), which must be taken into account in the course of analysing.

Second, some types of software (namely application software) can not function without the basic software, i.e. operating systems. In such cases, when determining the geographic boundaries of the market of application software, the functioning of operation systems markets is taken into account. The latter, in their turn, are intrinsically connected to the hardware.

Based on the established procedure, the geographic boundaries are defined depending on availability of opportunities to acquire a good in question within a certain geographic territory or on practicability of such acquisitions outside this territory.

Given the zero cost of replication, reproduction and transportation of the ICT goods and the global nature of production and consumption, the geographic boundaries may initially be defined as global, however while talking about certain product markets it is necessary to take into account the particularities related to goods' consumption.

As examples here can be cited the following product markets:

A) the market of applications for mobile devices working on the Android operation system (its study was carried out during the FAS Russia's antitrust investigation against Google). A specific feature of the goods (i.e. app store) determining its functionality was the interface language, which allowed concluding on the national character of the product market boundaries. At the same time, the geographic boundaries of this product market were defined as global.

B) online markets of trade of computer equipment and accessories, because disadvantages were revealed concerning the acquisition of such goods outside the Russian Federation due to a significant complexity of consumer protection if goods are purchased in a store registered in a foreign jurisdiction, as well as due to duration of delivery and the need for customs clearance / declaration and payment of customs duties.

It is worth noting here that differences between "bricks and mortar" and online companies are established by the FAS Russia basing on the same approach related to difficulties in the sphere of consumer protection.

While conducting research on the state of competition on information markets and determining whether borders of the market in question are of national or wider scope, this issue is decided on based on the information on the circulation of goods and requirements imposed on it in the Russian Federation, as well as on Russian consumers' opinions.

As the procedure for directing information requests on behalf of the FAS Russia is the same in all cases, regardless of the nature of the information requested, the

authority may face typical difficulties in obtaining information from persons outside the Russian Federation.

It should be emphasized that the FAS Russia supports the idea of international cooperation and exchange of antitrust enforcement experience in this complex but crucial sphere of digital economy.