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Global Forum on Competition

HYPOTHETICAL CASES

-- Session VII --

The attached document contains four hypothetical cases submitted FOR DISCUSSION in breakout sessions under session VII of the Global Forum on Competition to be held on 21 and 22 February 2008.

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CONSUMER CHOICE IN MOBILE TELEPHONY**A HYPOTHETICAL CASE**

Type of case	Consumer advocacy
Product	Mobile Telephony
Parties and market shares	Tiko – 50% (incumbent) Wynd – 50% (incumbent) Quick – New entrant

Summary

The Consumer Protection Commission of Genovia received numerous complaints from Quick Mobile concerning a variety of issues. Quick is a mobile service provider that is planning on entering the national market. At the present time, 2 firms provide mobile service within Genovia and each have a market share of approximately 50%. Quick had sought approval from the Communications Commission to implement certain billing practices and to give away free mobile phones in exchange for subscriber contracts lasting 1 year. It also would like the Communications Commission to require number portability and to order two other mobile operators to upgrade their networks to allow Quick's subscribers to send messages to the other networks.

CONSUMER CHOICE IN MOBILE TELEPHONY

1. Background

1. Mobile telephony service in Genovia has undergone a radical change in the last 10 years. Up until 1995 most of the population did not own a mobile telephone and only a relatively small fraction had a fixed line phone. All of this changed in 1997 when two mobile telephony licenses were auctioned off to Wynd and Tiko Mobile. Although each company's initial focus was primarily concentrated in larger cities, the incumbents began expanding into less populated areas during the last 4 years. During this same period, the number of fixed line subscribers grew quite slowly. In fact, the number of mobile subscribers quickly passed fixed line subscribers, and now 80% of all telephone subscribers use a mobile. At the present time, roughly 10% of the population has a mobile phone and this figure is growing by 15% annually. And, while consumers have applauded the spread of mobile telephony, many consumers have complained about high prices. Several newspaper articles have documented that prices in Genovia are higher than in other neighbouring countries. Currently Genovia has a population of 30 million people and has a per capita income of 3,650 USD per year.

2. In 2006, the Genovia Communications Commission auctioned off another block of spectrum. Both incumbents and other firms were allowed to bid for the single nationwide license that would be granted. Bidding was reported to be vigorous, and out of the 7 firms bidding, Quick Mobile emerged as the winner. Quick also provides mobile service in two nearby countries.

3. Quick recently lodged several complaints with the Consumer Protection Commission.

1.1 Complaint I

4. Shortly after obtaining its license to operate, Quick petitioned the Genovia Communications Commission to allow it to establish a particular billing plan. Quick wanted to be able to charge customers based on segments of time lasting 10 seconds. For example, customers would be charged an initial connection fee and then billed based on time blocks lasting 10 seconds. Thus, if a phone call lasted 12 seconds they would be charged the connection fee plus a fee for 2 blocks of time.

5. It is well established that the Genovia Communications Commission does not regulate the price that is charged by any given mobile service provider. However, it does regulate the way in which firms bill their customers. Prior to Quick's application, the Communications Commission had approved plans by Tiko and Wynd to charge customers based on 15 second blocks of time after the first minute.

6. In its order, the Genovia Communications Commission rejected plans by Quick to charge customers based on 10 second increments *after the initiation* of the phone call. However, it did allow Quick to charge customers based on 10 second increments *after the completion of the first minute*. And, as usual, the Communications Commission allowed Quick to determine the tariff that it would charge its customers for initiating the phone call as well as the price it would charge for each block of time. In its order, the Genovia Communications Commission also permitted Tiko and Wynd to charge customers based on 10 second blocks of time after the first minute should they wish to do so. In the Commission's order, it is noted that they seemed to be worried about Tiko and Wynd's arguments that they might cancel plans for making additional investments in their network and expanding their network should the Communications Commission allow billing based on 10 second increments after the initiation of the call. The Communications Commission reasoned that consumers would be harmed if that were to occur.

7. Quick also complains that because the Communications Commission allowed Tiko and Wynd to charge customers based on 10 second blocks of time (even though neither company specifically asked for such permission), it wouldn't reap any benefit from its innovation, potentially. In addition, Quick stated that because 75% of all mobile calls last less than 1 minute, most callers will not benefit from this pricing plan. Quick states that consumers simply won't save a lot of money under the order. Quick complains that it was their idea to have a new tariff plan based on 10 second increments (they have developed proven technology) and as such they would like the new billing plan to apply to them alone. Quick states that both Tiko and Wynd testified before the Genovia Communications Commission that they currently cannot bill in increments less than 15 seconds. Quick states that if it is the case that neither Tiko nor Wynd can bill in this way then the Commission should not have allowed them to charge in that way until they can prove that they can do it.

1.2 Complaint II

8. Quick also put forward a plan to the Genovia Communications Commission to give mobile phones away to consumers for free or for a nominal fee if they signed a service contract with Quick for at least one year. These phones are "locked" and cannot operate on other mobile networks. Quick argued that the free phones would have benefited consumers. Tiko and Wynd countered that free phones are simply a way to lock in consumers and that most consumers currently use a mobile phone not tied to a particular carrier. Such phones can be switched to different mobile operators by changing the internal operating card.

9. The Commission did not approve this proposal. The Communications Commission was worried about Quicks opportunity to exploit its locked in subscribers. They also seemed to be persuaded by Tiko and Wynd's arguments that they would cancel plans to make investments in their network and expand their network should this strategy be allowed.

1.3 Complaint III

10. Quick also complained to the Consumer Protection Commission about number portability. Quick stated that consumers are reluctant to switch providers because doing so means that they must get a new mobile number. This means that business consumers, for example, would have to change all of their business cards. Quick would like customers to be able to retain their number should they decide to switch mobile service providers. They argue that this would lower switching costs. In contrast, Tiko and Wynd argued that if number portability was required it would significantly raise overhead costs for mobile providers and therefore impede the expansion of mobile telephony in Genovia.

1.4 Complaint IV

11. Finally, Quick claims that users of its technology cannot send text messages to either Tiko or Wynd as both employ *an older messaging technology*. Quick claims that both Tiko and Wynd could upgrade their infrastructure in a matter of weeks to allow Quick subscribers to be able to send messages to Tiko or Wynd customers. Quick would like the Commission to order Tiko and Wynd to upgrade their technology to allow Quick customers to be able to send messages to Tiko and Wynd subscribers. Quick claims that if they are not allowed to interconnect with Tiko and Wynd that Quick will never be able to grow and achieve a lower operating cost. Achieving lower operating costs would allow Quick to more effectively compete against Tiko and Wynd. Quick admits, however, that it could require its subscribers to use the existing technology rather than Quick's upgraded technology.

2. Recommendations

12. Based on the above information, the Consumer Protection Commission has made the following recommendations to the Communications Commission.

- Allow mobile service providers to structure both the billing segment and rate base as they deem necessary.
- Allow mobile service providers to give away mobile telephones at prices that the providers determine even if it means giving them away for free.
- Permit mobile users to switch their telephone number among providers. And require providers to make investments that would allow for number portability.
- Require Tiko and Wynd to make the necessary investments to modernise their equipment to be able to accept text messages from Quick customers.
- Cap price increases by Tiko and Wynd at the inflation rate for the next five years in order to prevent them from further abusing their strong position in the market.

ISSUES FOR DISCUSSION

1. Consumer Protection versus Competition Policy

- Does the billing regulation in this case appear to impact competition? Are there pro-consumer reasons for fixing billing segments? If it is unclear whether this rule impacts consumers, what additional information would you need to have in order to make that determination?
- Does the policy of prohibiting free “locked” phones or other similar practices consistent with protecting consumers? How does one determine whether certain business practices such as this negatively or positively impact consumers in both the short and long run?
- What, if anything, should be done for Quick concerning the inability of its subscribers to send messages to Tiko and Wynd? Does the fact that both Tiko and Wynd fail to accept messages from Quick seem suspicious?
- What is the difference between ordering Tiko and Wynd to upgrade their networks to be able to accept messages from Quick and an order requiring firms to allow subscribers to switch their phone numbers among mobile providers?

2. Switching Costs and Entry Barriers

- What switching costs in this case were identified? Which ones are most relevant? How do they affect your analysis?
- What things should be defined as entry barriers in this case? Are they related to switching costs?

3. Capping Price Increases

- What potential impact do you see from the Consumer Protection Commission’s recommendation on price caps? Do you think Tiko and Wynd are likely abusing their strong position in the market or do you require additional information? If so, what additional information? If you disfavor price caps but would like to propose another remedy that might likely be beneficial in this situation, what would it be?

RESIDENTIAL WATER HEATERS**A HYPOTHETICAL CASE**

Type of case	Abuse of Dominance
Product	Residential Hot Water Heaters
Parties and market shares	
<i>New installations</i>	Hot Waters – 65% (target firm) Numerous other small firms – 35% (collectively)
<i>Installed base</i>	Hot Waters – 85% (target firm) Numerous other small firms – 15% (collectively)

Summary

Hot Waters, the leader in rental and service of residential water heaters in Lakeland Province, is accused by competitors of altering its contractual terms with its existing customers to hinder competitors' entry and expansion. The changes at issue include provisions that increase exit penalties on its rental contracts, and provisions that allow Hot Waters to automatically adjust the sales price for its used water heaters to match competitors' prices. Hot Waters instituted these contractual changes, along with a rental price increase, soon after purchasing its water heater assets from the regulated local gas distribution monopoly, GasTransit. When owned by GasTransit, these assets were included in their rate base and subject to a regulated rate of return.

RESIDENTIAL WATER HEATERS

1. Background

1.1 *Product at Issue*

1. This case concerns gas-powered water heaters sold for residential use. These water heaters typically have a capacity in the range of 160 to 300 litres, and have an average usable life of about 15 years. Consumers usually purchase a series of related services for their water heater, including installation, servicing, and disconnection of the water heater at the end of its useful life. These services can in theory either be purchased separately or together with the water heater. Installation fees can range from 15-35% of the price.

2. This case focuses on water heaters and related services in a particular area, known as Lakeland province. The importance of this geographic dimension will be discussed in more detail below.

1.2 *Industry Structure*

3. Within the Lakeland area there are approximately 1.4 million installed residential water heaters. Approximately 128,000 of these were newly installed in 2005, the most recent year for which data are available. The annual market for sales and installations in Lakeland is approximately 90 million dollars.

4. The supply of water heaters and related services is carried out through a variety of arrangements between vendors and Lakeland households:

- Rental programs combining supply of a water heater and 24-hour servicing.
- Lease-to-own arrangements, where a rental arrangement can be converted into a purchase after a time.
- The sale of installed water heaters directly to customers.
- Separate sale of water heaters and installation services.

5. A company called **Hot Waters** installs and rents natural gas water heaters to households within Lakeland. Hot Waters does not manufacture its own water heaters. Instead, it buys them from manufacturers and then rents them to consumers in a package with installation and repair services. From 2004 to 2005, Hot Waters had a market share in excess of 65% of all new water heater installations within Lakeland and about 80% of all replacement water heater installations. About 85% of existing water heaters in Lakeland were installed by Hot Waters and are serviced under its water heater rental program.

6. The large market share of Hot Waters is related to the history of the distribution of gas in Lakeland. Hot Waters is a wholly owned subsidiary of GasCommerce, which is also the parent company of GasTransit, Inc. GasTransit is the regulated monopoly natural gas distribution company in Lakeland. The water heater rental and service business now operated by Hot Waters was initially developed under regulatory oversight by GasTransit. It was developed in part to expand the use of natural gas in Lakeland. Gas Transit would offer to its natural gas customers the option of renting a gas water heater from them, at a low price, and most would accept. The rental program assets were included in the GasTransit rate base and subject to a regulated rate of return.

7. Five years ago, this business was sold to Hot Waters, removing it from further regulatory oversight, and giving Hot Waters a large installed base of gas-powered water heaters under rental contract in Lakeland. Hot Waters has participated in the water heater rental and service business outside of Lakeland, but in these areas it has been a relatively small new entrant rather than a dominant incumbent and has been less successful.

1.3 Competitive Landscape

8. As has been mentioned, Hot Waters does not manufacture its own water heaters. The two companies that manufacture them in Lakeland are Well-built Water Heaters and Clear Water Heaters. Neither Well-built nor Clear are involved directly in the supply and service of water heaters for residential customers.

9. A number of firms compete with Hot Waters on sales, installation, rental, and repair of water heaters. These include numerous small independent HVAC (heating, ventilation and air conditioning) companies that offer sales, rental agreements and installation. In addition, large multiproduct retailers (firms which sell a variety of products and services) sell residential water heaters and generally offer installation and service through contractors. Two large independent gas suppliers also sell or rent residential water heaters and supply installation themselves.

10. Equipment and facility costs to enter the market for sales and service of water heaters are low and involve a limited sunk cost component. For example, large retailers such as could easily switch their space from displaying water heaters to displaying alternative products. Similarly, small HVAC and other contractors have very little in the way of specific investments that are put towards water heaters and could not be used elsewhere.

2. Market Definition

11. The Competition Authority defined a product market of “supply to non-commercial customers of gas-powered water heaters and related services including installation, disconnection, and repair.” They defined the geographic market as the Lakeland area.

12. On geographic market, the Competition Authority found that supply of water heaters and services to individual households is inherently local in nature, reflecting the travel time and costs to deliver water heaters to customers’ locations and install them on-site. For this reason, suppliers require access to local storage and installers operate within limited geographic areas. As Lakeland is a large province measuring 450 km by 300 km with several large cities, the competition authority came to the conclusion that the Lakeland area was the appropriate geographic market. The competition authority also cited another relevant factor: the fact that Lakeland was exactly the transmission area of GasTransit, the regulated natural gas distribution company that formerly owned the Hot Waters assets.

3. The Practices of Concern

13. This case was initiated after several competitors voiced concerns to the Competition Authority regarding certain features of Hot Water’s rental contracts, pertaining both to existing customers and to new customers. Competitors argued that these contracts served as a barrier to entry for them. In particular, they pointed to a recent change in Hot Waters’ standard terms and conditions for customers to exit its rental program, and an option Hot Waters provided to its customers to buy-out their installed rental water heaters at a price adjusted to take into account the price that competitors offered for comparable equipment.

3.1 *Exit Charges and Conditions*

14. Hot Waters rental contract mandates that *only Hot Waters* can disconnect and return its water heaters before a competitor's water heater can be installed. Customers are required to pay Hot Waters 75 dollars to disconnect and pick up a functioning water heater, until it is 15 years old or deemed irreparable, at which point the charges are waived. In addition, customers of Hot Waters are required to pay an "installation recovery charge" when they want to terminate their rental agreement and their water heater is less than 10 years old. The charge starts at 100 dollars and declines by 10 dollars per year.

15. Cumulatively, these charges can amount to up to 35% of the price of a new water heater. In addition, as a result of these policies, customers effectively must organise two service calls if they wish to install a competitor's water heater. First, Hot Waters must disconnect and remove their water heater and, second, a competitor must install their new water heater. In addition to the inconvenience to dealing with two separate parties, there is also the potential cost of being without a water heater while the two sides of the transaction are coordinated. This increases the cost for customers to switch to a competitor.

16. The disconnection restriction, the pick-up charge and the installation cost recovery charge were all implemented by Hot Waters just following the transfer of the rental water heater business from GasTransit. A couple of months after that, Hot Waters increased the average monthly rental rate for water heaters by 18.2%

3.2 *The Buy-Out and Price Match Plans*

17. Under Hot Waters' "buy-out plan," customers have the option of leaving the water heater rental program by buying their rental water heaters. The buy-out price is based on the current retail price of a comparable Hot Waters water heater and discounted to take into account the age of the customer's heater. This offer is combined with a price-match guarantee, which allows the buy-out price to be adjusted to account for lower competitor advertised prices for similar water heaters.

18. Although the buy-out and price match plans create mechanisms by which customers can opt out of the Hot Waters rental program, competitors complain that they create barriers to entry. The combination of the two allows Hot Waters to adjust its buy out price and automatically meet competitors' effective prices, which can discourage customers from buying competitors' water heaters.

4. Competition Tribunal's Decision

19. The Competition Tribunal ultimately concluded that both the disconnection charges and the buy-out/price-match plans represented an anti-competitive abuse of a dominant position, leading to a substantial lessening or prevention of competition in the Lakeland market. It ordered the following:

- Competitors would no longer be prevented from disconnecting and returning Hot Waters rental water heaters themselves or via third parties.
- The period during which rental arrangement exit charges applied would be reduced from 10 to 5 years, having the immediate effect of eliminating exit charges for 35% of Hot Waters' existing rental customers.
- All customers would be given a clear "buy-out price" option reflecting the water heater's price at the time of installation and the length of the installation.

- While subject to exit charges, Hot Waters rental customers would be protected against rental rate increases greater than the rate of inflation.

ISSUES FOR DISCUSSION

1. **Market Definition**

- The competition authority in this case considered defining a market of services for “Hot Waters water heaters” – in other words, aftermarket services for Hot Waters’ water heaters only. Would such a market definition have made a difference in the final analysis? Do you think it is more correct than the actual market definition they settled on? Less so?
- Should the competition authority have considered separating the market into a “renters” market for water heaters and a “buyers” market? What are some arguments for each position?

2. **Contractual Terms/Price Rise**

- Are there pro-competitive, that is efficiency-based, explanations for Hot Waters’ contractual terms? If so, what are they, and do you think they have any validity?
- Of the two types of contractual terms at issue: exit charges and buy-out clauses with price-matching guarantees, which do you think are more potentially anti-competitive? Should the case have been brought if only one of the two sets of terms existed?
- Is the price rise an abuse of dominance in itself? If not, is it one in conjunction with the contractual terms?

3. **Competition Policy versus Consumer Protection**

- Would this case have better been handled under consumer protection laws as a case of unreasonable contract terms, or handled as it was as an abuse of a dominant position under the antitrust laws? What facts of the case point in one direction or the other?
- Does it matter, from either a competition or a consumer protection standpoint, whether the contractual terms were imposed after customers had already signed the contracts? Would the contractual terms be acceptable if they had only been applied to new contracts?

4. **Competition and Competitors**

- Competitors to Hot Waters do exist and are apparently plentiful. In fact, based on the market share figures, they seem to be gaining share on Hot Waters relative to their share of the installed base. Should we therefore be sceptical of their complaints?
- If competitors had not complained, should the competition authority still have brought the case?

5. **Prior Regulation**

- What role does the fact that Hot Waters is an affiliate of the local regulated natural gas distribution monopoly play in the analysis? If the water heater assets had been sold to a completely independent company before the case had been brought, would the case have been similarly argued? Would Hot Waters selling off the assets to a company completely unaffiliated with the gas monopoly be a possible remedy for the violations?

6. Switching Costs and Entry Barriers

- What types of switching costs are most relevant for the analysis?
- What factors should be defined as entry barriers in this case? Are they related to the existence of switching costs?

MOBILE TELEPHONY MERGER**A HYPOTHETICAL CASE**

Type of case	Merger
Product	Mobile Telephony
Parties and market shares	NT – 50% (target firm) Cellphonica - 15% (acquirer) Megaphone – 35%

Summary

Cellphonica, the third mobile operator in Coastland, proposed the acquisition of the leading mobile operator in the country. The merged entity would have 70% of the relevant market for mobile phone services in Coastland. The competition authority found that the barriers to entry into the market and the switching costs were such that the proposed merger would substantially lessen competition in the market place and consequently would likely lead to a rise in prices to the final consumer. As a result the Authority sought to have the Tribunal block the merger, which it ultimately did.

MOBILE TELEPHONY MERGER

1. Background

1. This case concerned the proposed acquisition of the mobile telephony business of National Telecom by Cellphonica within the country of Coastland. Cellphonica only offers mobile services within Coastland. National Telecom (NT) by contrast is the historic incumbent operator. Other than NT and Cellphonica, Megaphone also provides mobile services within Coastland and is also a major mobile service provider in a large number of other countries. In sum, these three companies currently service the mobile market within Coastland which is currently valued at 3 billion Coastland dollars.

2. Each of the three companies has the capability to offer not only retail services but wholesale services as well. In addition to their retail offerings each company can sell access to its network should another company wish to contract for it. The companies that contract for these services are known as MVNOs, which stands for Mobile Virtual Network Operators. Within Coastland, no company to this date has ever sold access to its network although there have been several interested companies. The presence of MVNOs is relatively common in other countries.

3. Coastland is a country of about 5 million people. Companies that wish to offer mobile services within Coastland must obtain a license to operate. Once granted the license allows firms to provide mobile services within the entire country, as it gives them access to national spectrum, without which no company can offer these services. Currently Megaphone, Cellphonica and NT provide mobile services and support services within the entire country. Moreover although mobile telephony can be broken into various types of services (2G, slow 3G - sometimes called 2.5G, and 3G), all three companies offer all types of services throughout Coastland.

4. Coastland has one of the highest penetration rates of mobile telephony in the world. Currently the penetration rate is over 100% among individuals who are at least 18 years old. This would mean that any firm that entered most likely would have to gain sales not by helping to grow the entire market but by competing for existing users.

2. Market Definition

5. Although there are different types of mobile telephony, the Competition Authority in this matter saw no reason to analyse whether 2G and 3G were separate markets for instance as the firms in those markets were the same as were their share approximately.

6. The Competition Authority considered whether a distinction should be drawn between business customers and private individuals. According to the firms in the market, mobile operators design their tariff structure on the basis of high, moderate or low usage subscribers rather than along business or personal usage. That Authority found that customers can choose from a wide range of tariff packages and if prices for business tariffs were to rise well above the competitive level, corporate customers could, if necessary, switch to residential customer tariffs. The same would apply, conversely, to residential customers. Therefore the Authority found that it was not appropriate to subdivide the retail market for mobile telecommunication services into narrower markets.

7. Given the market characteristics and the fact that both Cellphonica and NT only operate in Coastland, the relevant geographic market was found to be the territory of Coastland.

3. Market Shares and Market Evolution

Table 1. Market Share Evolution: 1997-2006

	1997	2002	2006
NT	60%	50%	50%
Megaphone	40%	30%	35%
Cellphonica	0%	20%	15%

8. As shown in Table 1 above, in 1997, before Cellphonica entered the market, NT was still the leader with 60% market share, followed by Megaphone with 40%.

9. When Cellphonica entered the market in 1998 it caused a major disruption and was aggressive in gaining market share (up to 20%) by pricing low. It gained its market share equally from NT and Megaphone. One estimate by Coastland Economic Consulting found that as a result of Cellphonica's entry, competitors costs went down by more than 25%. Prices also fell sharply since Cellphonica entered the market.

10. The Consumer Protection Agency of Coastland complained that, if the merger were to go ahead, prices would return to pre-1998 values. This agency also made the point that, in the Coastland mobile market, consumers already had to contend with misleading and confusing contracts, tariffs that could not be easily compared between operators and long-term contracts they could not get out of. They argued in their submission that these problems would become more acute if the merger were allowed through.

11. On the other hand, the Competition Authority found that prices for mobile service had started to fall since 1997, a year before Cellphonica entered. Moreover, the price decline that occurred between 1997 and 2002 was about the same in Coastland as it was in other countries.

12. After Cellphonica had obtained about 20% market share, in 2002, its pricing practices seemed to become less aggressive and it became more of a follower than a leader. Since 2002, Cellphonica has lost some market share, mainly to Megaphone: market shares for NT, Cellphonica and Megaphone were now 50%, 15%, and 35%. Megaphone has become the leading force in the market, the most aggressive and innovative player in recent years. Due to its international scope, investment in new technologies and partnerships, Megaphone has been gaining some market share.

4. Switching costs

13. Mobile operators typically charge less for in-network (in-net) phone calls than for between network (off-net) phone calls. That is, when a user calls someone who subscribes to the same mobile operator then that user pays a lower price than if that same person subscribed to a different operator. Market studies show that when consumers are choosing a mobile operator an important factor to consider is the operator to whom most of their contacts belong to. This means that the biggest operator has a clear advantage over the smaller ones since the value of the service provided grows exponentially with the size of its network. These are called network effects and they are closely linked to the on-net/off-net price differential. The Competition Authority found that these network effects lead to inertia on the part of consumers to switch to other plans.

14. Another important switching cost concerns number portability. That is, when a customer switches operators they must give up their phone number and get a new one. In that event, customers must

then get a new phone number from their new mobile service provider and inform all contacts of that new number. Consumers frequently cite this factor as a significant deterrent to switching.

15. Other switching costs include hand-set locking (not being able to insert the chip of any operator into the phone of a customer and then using that network), long-term contracts relating to hand-set subsidisation, and loyalty programs.

16. The Competition Authority found the annual churn rates – that is, the percentage of costumers that change provider every year - were around 10%. Although this is a relatively high rate, for international standards, this means that the average subscriber leaves the network after 10 years.

5. Barriers to Entry

17. The following barriers to entry into the mobile market were identified by the Competition Authority:

- All useable spectrum has been sold and is currently held by the 3 operators. Not all of the spectrum is currently being used by them in their business;
- High sunk costs of setting up networks;
- Network effects from the on-net/off-net pricing differential;
- Switching costs;
- High penetration rate.

18. It is important to note that, if the merger were authorised:

- The merger entity would be forced, for regulatory reasons, to give back its spectrum, thus freeing up enough spectrum for another operator to provide mobile telephony services in Coastland to be auctioned off in 12 months.
- The merger entity committed to allow entry of MVNOs into the market, upon completion of the merger.

6. Competition Assessment

19. As the merger would combine 2 of 3 companies in the mobile telephony market and because the combined firms market share would approach 70%, and given the existence of switching costs and barriers to entry, the Competition Authority ultimately found that the merger would substantially lessen competition in the market place and consequently would likely lead to a rise in prices to the final consumer. As a result the Authority sought to have the Tribunal block the merger, which it ultimately did.

ISSUES FOR DISCUSSION

1. **Market definition**

- The authority defined the relevant market as the market for mobile phone services in Coastland. Do you think this was a contentious issue in this case?
- What do you think were the main points of the authority's analysis that lead to this conclusion? Do you agree with them?

2. **Market shares**

- Do you think the size of the market shares of the parties was an important factor in the authority reaching their decision?
- What were the factors they concerned themselves the most regarding the analysis of market shares?
- Do you agree with their analysis on this issue?

3. **Switching costs**

- How important do you think were the issues of switching costs in the analysis of the authority regarding the proposed merger?
- What do you consider were the most important points of this analysis?
- Do you agree with this analysis? And their conclusions?

4. **Barriers to entry**

- Do you think the issues of barriers to entry were very important for the analysis of the competitive implications of the proposed merger?
- Can you identify the more important aspects of this analysis, on the basis of the authority's report?
- Do you agree with this analysis? And their conclusions?

5. **Impact of merger on prices**

- Some parties were very concerned with the impact that the proposed merger could have on prices. The authority seemed to have concluded they were right. Do you think they were correct in their decision? In what facts were they basing their analysis on?
- The Consumer Protection Agency of Coastland, in particular, had the impression that the disappearance of a firm from the market would return the market structure and prices to pre-1998 levels, thus substantially harming the consumers. Do you agree with this analysis?

6. Consumer protection issues

- The Consumer Protection Agency of Coastland also made the point that the proposed merger would aggravate the problems that consumers have to contend with, namely: misleading and confusing contracts, tariffs that could not be easily compared between operators and long-term contracts they could not get out of. Do you think that, taking the point of the final consumer, the merger could have been allowed through if some consumer protection regulation on these issues had existed?

7. Impact of entry in the market

- There was quite a lot of focus on the impact of entry and exit in prices and general competitiveness of the market. Specifically, it was felt that the reduction of players in the market would lead to significant price rises. Do you think the issue of potential entrants and MVNOs was properly addressed in this analysis? What do you think should have been done regarding this issue?

BANK LOANS
A HYPOTHETICAL CASE

Type of case	Abuse of dominance
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Product	Housing loans / Personal loans
Parties and market shares	BestBank - 50% (market of housing loans) - 12% (market of personal loans)

Summary

BestBank is a full service bank and has a market share of 50% and 12% in housing loans and personal loans respectively. Recently it unilaterally changed important payment terms for both personal and housing loans within existing contracts. As a result of these changes, early settlement charges for existing personal loans increased from approximately 20 Euros to 140 Euros. For existing housing loans, BestBank increased the early repayment rate from zero percent of the outstanding loan amount to 3 percent. In its review, the Competition Authority found that consumers were locked into their loan and BestBank was not constrained by market forces. The Authority found that BestBank had abused its dominant position and accordingly ordered several corrective measures.

BANK LOANS

1. Background

1. This case concerns personal and housing loans by BestBank. BestBank is a large, full service bank operating within the country of Highland. In August 2005, BestBank unilaterally changed important terms for both personal and housing loans within its **existing contracts**. The existing contracts between BestBank and its customers permitted BestBank to make such changes.

2. As a result of these changes, early settlement charges (early repayment penalties) for existing personal loans increased from approximately 20 Euros to 140 Euros. For existing housing loans, BestBank increased the early repayment rate from zero percent of the outstanding loan amount to 3 percent. In addition, BestBank also modified the fee it charged customers for administering their housing loan. Prior to the change, BestBank had capped that fee at 36 Euros. Now, however, BestBank set annual administration fees at 2% of the outstanding loan balance and these fees were not capped in absolute terms.

3. BestBank stated that it modified its fees because there had been a significant increase in demand for early loan termination because interest rates for both personal and housing loans had dropped considerably. BestBank claimed that its initial estimate of the rate at which consumers would repay their loans was incorrect and cited 'unforeseeable costs' of early repayment as the reason for fee increases. In effect, BestBank claimed that the price increases were cost justified.

4. Although all of the modifications meant significant changes to the original contracts, the resulting prices were not necessarily the highest on the market. At the time the modifications took place, competitors charged between 60 and 200 Euros for the early repayment of a personal loan and between 2 and 4 percent for housing loans.

5. Based on the following analyses, the Competition Authority of Highland found that BestBank had abused its dominant position and accordingly ordered corrective measures.

2. Market Definition

2.1 *Relevant product market*

6. The Competition Authority defined two relevant product markets. The first market concerned personal loans for an undetermined use. The second market concerned loans for the purpose of purchasing a house.

2.2 *Relevant geographical market*

7. The Competition Authority determined that the relevant geographic market was the entire country of Highland. BestBank has more than 400 branches and almost 1900 cash machines throughout Highland.

3. Market shares

8. The market structure in the country's banking sector is very asymmetric.

- BestBank is the largest bank in Highland based on a variety of measures: it is the largest bank in Highland based on household savings deposits, household loans, corporate deposits and corporate loans.
- It has a share of 25% based on total assets, while six other banks have asset market shares of approximately 10 percent. Finally, 7 other banks have a market share of approximately 1 percent each.
- BestBank's market share was approximately 50% of the bankcard market by the end of 2006, since bankcards issued by it exceeded 4 million.

9. Moreover, BestBank is the best-known bank in the country, since 60% of the consumers have some client relationship with it, while the second largest bank has a market share of only 18% based on that measure.

10. The Competition Authority determined that in recent years both the personal and housing loan market had grown rapidly. For example, the stock of housing loans at the end of 2006 was 2.5 times larger than in 2004, while the same multiplier was 5 for personal loans.

11. The current national market share of BestBank for personal loans and housing loans was 12% and 50% respectively at the time the investigation began.

4. Right for unilateral modification of loan contracts

12. General terms within BestBank's contracts enable them to make changes to payment terms when it so desires. National law recognises the right of BestBank to make such changes. However, Highland's national laws permit customers to exit the contract without penalty within 15 days after any contract modification at the prior terms. Highland's laws only require banks to notify customers by publishing a notice within its branch offices. Because many customers do not often visit a branch office but instead use cash machines, they could easily remain unaware of any modifications until after the 15 day window has closed.

5. Switching costs

13. Within a loan context, switching costs are costs that customers must bear when switching from the provider of their housing or personal loan to another one. These costs can be divided into three categories:

- costs associated with the termination of the existing banking relationship;
- search costs, and
- costs incurred when entering into a new banking relationship.

14. For example, when switching a housing loan to a new provider, customers must pay for property value estimates, pay upfront fees to the new loan originator as well as the termination fees to the existing loan holder.

15. The Competition Authority estimated that the costs of switching amount to 6-8% of the present value of a loan. Because this number is so high, customers will be reluctant to switch to a new loan when a bank changes terms that adversely affect its customers. Indeed, econometric evidence compiled by the Competition Authority showed that there was a statistically significant decrease in the rate of customers seeking early termination of both housing and personal loans when BestBank changed its rates. These estimates enabled the Competition Authority to determine that a number of consumers had become “locked into their loan” and as a result BestBank was not constrained by market forces.

6. Conclusion

16. The Competition Authority did not find that that BestBank could act independently of its competitors in pricing loans to *new* customers. However, it was independent with respect to those customers who had already taken out a housing or personal loan from BestBank. Reasons for this finding include limited information transparency, low financial literacy among Highland’s citizens, and high switching costs. Based on this analysis, the competition authority found that BestBank had abused its dominant position through exploitative price increases.

17. As a result, the Competition Authority recommended to the Tribunal that BestBank be required to notify all customers via mail if possible and to provide 30 days (rather than 15 days) for consumers to decide whether to accept the new terms or seek a new loan contract. The Authority also recommended that BestBank compensate all consumers who switched to a new loan product (after the price increases). The amount of the compensation was based on the difference between the price they had to pay and the price in place prior to the change. The Competition Authority also recommended that BestBank be required to allow all customers to opt out of their loan at the rates before the change. All of these recommendations focused on both personal and housing loans.

ISSUES FOR DISCUSSION

1. Consumer Protection versus Competition Policy

- Does the fact that certain groups of customers are not very sophisticated with respect to financial instruments impact your analysis of this case? If so, does it affect your assessment of the competition issues or consumer protection issues? Are there special obligations for large companies in these situations?
- Should consumer protection and competition policy be focused on the average customer or particular groups of customers? What are the policy implications of your answer to the above question?
- Would the arguments the Competition Authority used against BestBank also apply to other banks in the market? Should other banks face similar restrictions? Why or why not?
- Is this a competition case, a consumer protection case, neither or both? How does one tell the difference?
- Do you agree with the final conclusion reached by the Competition Authority saying that BestBank had abused its dominant position and its price increases were exploitative?

2. Market Definition

- Was the market defined correctly in this case? What should be the basis for calculating market share in this case (deposits, the number of loans, the value of the loans, or something else)? Was the market share assigned correctly?
- Can you define an antitrust market for a single product sold by one firm? When would this be relevant?

3. Switching Costs

- What switching costs are especially relevant to your analysis of this case, if any? Do cases involving high switching costs warrant special attention by competition authorities? What do you do differently in cases involving high switching costs, if anything?