

Unclassified

DAF/COMP/WD(2016)7

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

06-Jun-2016

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON FIDELITY REBATES

-- Note by Spain --

15-17 June 2016

This document reproduces a written contribution from Spain submitted for Item 6 of the 125th meeting of the OECD Competition Committee on 15-17 June 2016.

*More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/fidelity-rebates.htm>*

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JT03397449

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SPAIN

1. Introduction

1. Spain's Commission on Markets and Competition (CNMC) wishes to contribute to the discussion on Fidelity Rebates to be held at the forthcoming OECD Competition Committee's meeting on 15-17 June 2016 by way of describing the approach it has followed in a recent decision entailing rebates that were deemed anticompetitive (case S/0422/12 CONTRATOS DE PERMANENCIA).¹

2. More specifically, the case at hand dealt with the commitment periods included in the most widely subscribed contract among Small and Medium-sized enterprises (SMEs) customers of Telefónica Móviles de España (TELEFÓNICA), the main mobile operator in Spain.

3. Under the commitment period of this contract, SMEs subscribed TELEFÓNICA's mobile communication services for a period of 12, 18 or 24 months in exchange of discounts on list prices. This commitment period was extended automatically for the same length of time if the customer did not give warning to TELEFÓNICA at least one month before its end. If the customer failed to comply with this commitment period, it had to pay a financial penalty equal to the sum of price discounts enjoyed from the beginning of the contract (or its renewal) to the date of its termination. Thus, the penalty increased in time, and therefore, higher the closer the SME was to the end of its contract.

4. The CNMC found that such commitments resulted in a restriction of competition because they disproportionately limited SME's ability to switch to competing operators. Furthermore, the CNMC also indicated that such practices substantially increased the subscriber acquisition costs of competitors and effectively excluded some of them from the SME segment, including mobile virtual network operators (MVNOs).

5. Though the decision did not strictly address fidelity rebates, in essence what the CNMC reviewed was the granting of price discounts to SME conditional on subscribing TELEFÓNICA's services for a given period of time, subject to penalties that increased with time in case of failure to comply with this period commitment. Taking into account that SME customers tend to source their mobile communication needs from a single provider, the situation described easily fits with the concept of fidelity rebate retained by the OECD Competition Commission for this discussion.

6. In what follows, we will briefly sketch the main points of this decision that in our view may be more useful for the discussion on fidelity rebates to be carried out in the forthcoming OECD Competition Committee's meeting. First, we will survey why the CNMC took the view that the suspected clauses fell under article 101 of the Treaty on the Functioning of the European Union (TFEU) and its analogous article under Spanish law, given that TELEFÓNICA had no dominant position in the market for mobile communication services in Spain when these commitments were in place. Secondly, we will provide some background on how the CNMC reached the conclusion that the above-mentioned period commitments were anticompetitive and thus illegal under Spanish and EU

¹ The full text of this decision is available at <http://cnmc.es/desktopmodules/buscadorexpedientes/mostrarfichero.aspx?dueno=1&codigoMetadato=521540> Unfortunately, there is no public information in English about this case at the CNMC webpage.

Competition law, with an emphasis on the effect analysis conducted. Lastly, we will summarize the main efficiencies put forward by TELEFÓNICA to justify the conditions attached to the price discounts and why the CNMC found them without merit.

2. Application of Article 101(1) of the TFEU

7. Thought the suspected commitment only affected SME customers, the CNMC stuck to a wider relevant market (the provision of mobile telecommunications services to end customers in Spain), following precedents in this area, given the supply-side substitutability found in these services (e.g., between households and business customers).

8. According to this relevant market definition, the market was highly concentrated, with the three main operators (TELEFÓNICA, Vodafone España, S.A. –VODAFONE- and Orange Espagne, S.A. –ORANGE-) accounting for 81% of the residential segment and 98.7% of the business segment in the year 2013.

9. TELEFÓNICA, the market leader, held a market share of 30.5% of the residential segment and 49.9% of the business segment in 2013 (in fact, the leadership of TELEFÓNICA had been more stable in the business segment than in the residential one). However, the CNMC could not conclude that TELEFÓNICA had a dominant position in the market and thus the suspected practices could not give rise to an abuse of a dominant position under Spanish and EU Competition law.

10. However, given that the affected customers were businesses, the CNMC deemed that the suspected clauses amounted to vertical restraints between non-competing firms that fell under article 101 of the TFEU and its analogous article under Spanish law.

11. The logic behind this legal approach starts from the fact that businesses incorporate mobile communication services as an input in their activity in order to be able to conduct business.

12. The letter of the EU regulations covering vertical restraints further supported the legal approach followed by the CNMC since

- the concept of vertical agreement under article 1(1)(a) of the Commission Regulation 330/2010 of 20 April 2010 on the [application of Article 101\(3\) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices](#) (the Block Exemption Regulation) encompasses parties at a different level of the production chain. In this same vein, paragraphs 2 and 25(b) of the Commission's [Guidelines on Vertical Restraints](#) clearly state that vertical agreements with final consumers operating as an undertaking are covered by the Block Exemption Regulation.
- the concept of production chain is not limited to the use of intermediate goods, but also includes services as an input, as supported by paragraph 25(d) of the Commission's [Guidelines on Vertical Restraints](#); and
- according to this same paragraph of the Commission's Guidelines on Vertical Restraints, the relative weight of the good or service under the vertical agreement is not a relevant factor to take into account for excluding the application of these guidelines.

13. Moreover, in the present case, article 101(1) of the TFEU applied to vertical agreements under review because they did not qualify for the exemption provided by article 2 of the Block Exemption Regulation. More specifically, TELEFÓNICA's market share in the relevant market was higher than 30%, thus exceeding the threshold established by article 3 of the Block Exemption Regulation that prevents the exemption provided by article 2 from being applicable.

14. Though VODAFONE, and to a lesser extent ORANGE, had in place commitment periods similar to those of TELEFÓNICA under review, the CNMC did not investigate them at the time, given that VODAFONE and ORANGE qualified for the exemption provided by article 2 of the Block Exemption Regulation.

3. Restriction by object and by effect

15. Before summarizing the effect analysis conducted by the CNMC in its decision, it may be useful to highlight some market facts concerning the suspected price discounts, as detailed in the text of the decision:

- price discounts linked to commitment periods were hardly found in the residential segment and those in place were not tacitly extended;
- in the business segment, these discounts were almost exclusively found among SME customers of TELEFÓNICA (there was a minor presence among freelance workers);
- contracts with these price discounts accounted for 74% of revenues in the SME segment for TELEFÓNICA in the year 2012; and
- contracts with these price discounts were linked to the mobile phone lines with the highest unit revenues among SME customers.

16. The CNMC reached the conclusion that the price discounts and the conditions attached to them were a restriction of competition by object and that their potential anticompetitive effects were highly likely and substantial.

17. First, the CNMC considered that the clauses related to the commitment period and the penalties for failing to comply with this commitment were aimed, from an objective point of view, at making harder for competitors to attract TELEFÓNICA's SME customers, while not bringing any significant benefit to the SME customer.

18. In particular, the CNMC singled out the following features of these contracts as showing their anticompetitive object:

- the penalty formula.

The CNMC had no hesitation in concluding that the formula was *per se* a restriction of competition, given that its goal was to prevent customer switching and thus led to market foreclosure for TELEFÓNICA's competitors. In this regard, it should be borne in mind that the customer is more prone to switching the closer he/she is to the expiry of the commitment period.

The CNMC highlighted the penalty's lack of economic logic (the penalty being the highest just before the end of the contract) because it did not take into account the time period already fulfilled when the customer decided to quit the contract (and the revenue this partial period fulfillment had entailed for TELEFÓNICA). In particular, the increasing nature of the penalty in time ruled out any justification related to the need of recouping any marketing expense or initial investment from TELEFÓNICA.

- the automatic renewal of the commitment period and the minimum period of notice for avoiding this automatic renewal, raised rivals' costs by obliging TELEFÓNICA's competitors to pay the customer's penalty if they wanted to attract its customers.

Moreover, the advance notice customers had to give TELEFÓNICA for leaving the contract, allowed TELEFÓNICA to react to competitors' offers.

- the lack of transparency in the marketing of these contracts, which entailed another barrier to entry and expansion because it made more difficult for TELEFÓNICA's customers the comparison of their contract with competitors' deals.

This lack of transparency stemmed from the fact that SME customers who had signed this period commitment were not able to access their contract in TELEFÓNICA's website. If they wanted to know the exact price discount they were enjoying or the penalty they would have to pay in case of early termination of the contract, they had to contact TELEFÓNICA by phone.

19. Secondly, the CNMC considered that the potential anticompetitive effects of the conditions attached to the price discounts were highly likely and substantial, given (i) the market situation, which confirmed TELEFÓNICA's market power, and (ii) the prevalence of the contracts containing the suspected practices (as argued at the start of this section). Thus, the CNMC concluded that the suspected clauses led artificially to higher barriers to entry and expansion in the relevant market without any objective justification. As already mentioned, the cost of attracting TELEFÓNICA's SME customers for competitors was substantially increased by these clauses, giving ample time to TELEFÓNICA to react to competitors' offers once the SME customer had given TELEFÓNICA advance notice of his/her wish to leave the contract.

20. The CNMC further took into account that the number of mobile lines in the business segment had barely experienced any change in the period under investigation (as opposed to what had happened in the residential segment) and roughly 99% of those lines were provided by three operators (TELEFÓNICA accounting for half of them in terms of revenues). In this market context, the suspected clauses meant that a high share of SME customers were 'out of the market' because of the commitment period, foreclosing competition in this segment, and artificially reducing the alternatives open to SME customers.

21. According to the CNMC, this helped to explain why MVNOs had made such an insignificant dent in the SME segment, despite the fact that they had significantly reinvigorated competition in the residential segment and the higher unit revenue of a SME customer in comparison with a household.

22. Finally, using data provided by TELEFÓNICA, the CNMC reached the conclusion that the period commitments in every relevant segment of the demand were associated with less customer churn (that is, they increased customer loyalty). However, TELEFÓNICA's failure to provide the CNMC more data prevented the CNMC from conducting a more thorough of the practical effects of the suspected clauses in the market.

4. Analysis of efficiency claims

23. TELEFÓNICA argued in the proceedings, with the help of a commissioned third-party report, that the suspected clauses had a clear business rationale and gave rise to efficiencies. Moreover, any restriction of competition they could cause was inherent to the efficiencies they produced, allowing lower prices for a substantial part of the demand and streamlining business processes. Thus, TELEFÓNICA claimed that the criteria contained in article 101(3) of the TFEU were fulfilled and article 101(1) of the TFEU was not applicable in the present case.

24. The CNMC disagreed with the claim that the conditions attached to the commitment period (penalty formula, automatic renewal, short window of opportunity for leaving the contract, lack of transparency) were essential for granting the price discounts, for the following reasons:

- market trends showed a price drop in mobile communication telecommunications services and a lesser prevalence of period commitments in the residential segment;
- the penalty formula's inner workings, as explained in the previous section,
- the automatic renewal and the short window of opportunity for the consumer leaving the contract significantly limited the possibilities of consumer switching and in practice tended to extend the effective length of the period commitments;
- the theoretical goals pursued by TELEFÓNICA for granting the price discounts (achieving a minimum level of revenues or network usage) could be achieved by less restrictive means like a flat rate or requiring a minimum consumption per month, since these alternatives did not limit consumer switching.