Competition Authority

Competition Act 2002

Decision of the Competition Authority
No. E/02/002

The Increase in the Wholesale Price of Electronic Top-Up by Vodafone Ireland Limited

25 October 2002
(Case: COM/118/02)

SUMMARY

The Competition Authority has decided that the unilateral reduction in margins paid to retailers resulting from an increase in the wholesale price on €10 and €15 denominations of Etop-up by Vodafone Ireland Limited effective 9 September 2002 does not breach competition law. The Authority, having analysed the conduct of Vodafone, is satisfied that it would not constitute an abuse nor damage consumer welfare if Vodafone were in a dominant position in the relevant market. Having so decided, the Authority did not find it necessary to express a view on whether or not Vodafone was in fact in a dominant position.

The Competition Authority's investigation was prompted by 30 complaints that Vodafone Ireland Limited was abusing its alleged dominant position by reducing retailer margins.

The Competition Authority considers that the relevant market is the market for mobile telephony services in the State. According to figures produced by the Office of the Director of Telecommunications Regulation, Vodafone Ireland Limited accounted for 57% of this market in 2002.

Insufficient evidence was presented to show that Vodafone Ireland Limited retailer margin levels were excessively low or that the predicted reduction in retailer profits from top-up products would lead to a decline in competition. Retailers can unilaterally charge a fee for the provision of top-up services. There are a number of alternative easily substitutable sources from which consumers can purchase top-up. The Competition Authority is therefore of the view that Vodafone Ireland Limited's actions in increasing the wholesale price of Etop-up would not ultimately cause consumer harm.

1. THE ISSUES

The complaint

1.1 The Competition Authority ("the Authority") received 30 complaints in relation to a reduction in retailers' margins on electronic mobile phone top-up ("Etop-up") during the period August-September 2002; four from retailers' associations and another twenty-six from individual retailers.

1.2 These complaints concerned the decision by Vodafone Ireland Limited ("Vodafone") to increase the wholesale price charged to electronic terminal service providers Alphyra Ireland Limited ("Alphyra"), An Post, and Eason Electronic Limited ("Eason Electronic") of Vodafone (087) Etop-up effective from 9 September 2002 on €10 and €15 denominations with consequent margin reduction for retailers from 10% to 6.5%. The complainants claimed that the reduction in Etop-up margins would lead to a reduction in retailers' profits to the extent that the overall number of retailers in the State would fall, resulting in a lessening of competition in the grocery trade.

1.3 Etop-up is distributed to retailers through terminals installed in retail stores. These terminals are supplied by three service providers in the State: Alphyra, An Post, and Eason Electronic. From 9 September 2002, electronic terminal suppliers receive a wholesale margin of […]% in the case of €10 and €15 denominations (as opposed to […]% prior to that date, from which retailers received 10%). Wholesale margins for €20, €25 and €40 denominations remain at […]% for the terminal suppliers. Subsequent to Vodafone announcing its decision to reduce the margins paid to them, all three terminal service providers announced their decisions, on 27th, 28th, and 26th August respectively, to pass on this reduction to their retailer customers, thereby reducing retailers' margins from 10% to 6.5% on €10 and €15 Etop-up denominations – while leaving the commission on sales of Etop-up of €20, €25 and €40 unchanged at 10%. The diagram below gives a brief outline of the payments involved. The complainants estimated that sales of €10 and €15 denomination Etop-up account for around 94-95% of total Etop-up sales.

Where does the money go?	Recommended Retail Price*		
	€10	€15	€20
Retailer	€0.65	€0.975	€2.00
Wholesaler	€[X] of total €[Y]	€[X] of total €[Y]	€[X] of total €[Y]
Vodafone	€[less than 9.35]	€[less than 14.025]	€[less than 18.00]

*As of 9th September 2002

1.4 The complainants argued that the relevant *geographic market* is the State and the *relevant product market* was 087 pre-paid mobile phone top-up.

The parties[1]

1.5 The main complainant in this instance was the Retail Grocery, Dairy and Allied Trades' Association ("RGDATA"). RGDATA is a representative body for the Independent Retail Grocery Sector in Ireland. The organisation includes over 4,000 grocers in the State. Its main aim and objective is to provide support for independent family grocers while encouraging and developing a high standard of retailing, equal to best European practice and competitor standards.

1.6 The next complainant, the Irish Retail Newsagents Association ("IRNA") is an organization representing news retailers in Ireland. Its 1,287 members own more than 1,500 outlets in Ireland. The IRNA takes on a number of roles in order to represent the needs of its members throughout Ireland. One of the most important is to act as a

[1] The information with respect to each of the parties named is taken from their websites.

legislative and industrial relations watchdog, informing members of any changes that are of relevance to them.

1.7 A further complainant, the National Federation of Retail Newsagents ("NFRN") represents over 22,000 newsagents in the United Kingdom and Ireland. Its members are for the most part small local shops everywhere from isolated rural communities to the largest cities.

1.8 For reasons of confidentiality the identities of the remaining complainants, including the fourth representative body, are not stated.

1.9 The principal activities of Vodafone are as a mobile phone operator with a customer base of over 1.7 million people and a total of 1,500 employees. The company was established in 1984, and operated Ireland's first mobile phone service as part of the former state telecommunications company - Telecom Eireann. Operating under the separate brand - Eircell - it enjoyed huge expansion in the late 1990's as penetration in the mobile telephony market grew considerably in Ireland. In May 2001, Eircell was acquired by Vodafone. The company is now part of a Pan-European mobile phone network.

2. ASSESSMENT

Introduction

2.1. Allegations that an undertaking (or a group of undertakings) has abused its dominant position are covered by Section 5 of the Competition Act 2002 ("the Act"), which reads as follows:

> (1) Any abuse by one or more undertakings of a dominant position in trade for any goods or services in the State or in any part of the State is prohibited.
>
> (2) Without prejudice to the generality of subsection (1), such abuse may, in particular, consist in-

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions,

(b) limiting production, markets or technical development to the prejudice of consumers,

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage,

(d) making the conclusion of contracts subject to the acceptance by other parties of supplementary obligations which by their nature or according to commercial usage have no connection with the subject of such contracts.

An undertaking is defined in the Act as "a person being an individual, a body corporate or an unincorporated body of persons engaged for gain in the production, supply or distribution of goods or the provision of a service."

2.2. In order to establish that there is a breach of Section 5 of the Act, the Authority must demonstrate that the undertaking in question:

- holds a dominant position in a relevant market; and,
- has abused that dominant position.

The creation or existence of a dominant position does not breach the Act; rather it is the *abuse* of that position that constitutes the breach.

2.3. Section 5 is based on Article 82 of the Treaty establishing the European Community. In applying Section 5 the Authority has regard not only to its interpretation by Irish courts, but also to that of Article 82 by the European Commission ("Commission"), the Court of First Instance ("CFI") and the European Court of Justice ("ECJ").

The relevant market

2.4. There are at least two possible markets that are relevant to an analysis of the effects of this behaviour: the market for provision of mobile telephony services and a related or sub-market for the sale of pre-paid mobile phone vouchers, i.e., top-up. It could be argued that the market for mobile telephony services may be further subdivided according to the method of payment – between pre-paid and bill paid services. It is not necessary however for the purposes of the analysis of this complaint.

2.5. ***Mobile Phone Top-Up:*** The complaints in question concern the sale of Etop-up for the Vodafone (087) network. There are a number of alternative distribution methods in the market for ***supply of top-up*** through which Vodafone[2] prepaid mobile phone customers can purchase phone top-up.

(1) Mobile top-up – Vodafone customers can phone the customer service line and pay by credit card;

(2) Text top-up – customers who have registered with Vodafone and received a PIN number can then send a text specifying an amount to be debited to their credit card.

(3) Online/Web top-up – customers who have registered with Vodafone and received a PIN number can top-up at Vodafone's website by debiting a credit or debit card;

(4) ATM top-up – available from AIB and Bank of Ireland ATMs;

(5) Go-Cards – i.e., physical top-up cards which can be purchased from various retail outlets; and

(6) Etop-up – electronic code top-up purchased from various retail outlets.

(7) Alternatively, customers could switch to post-paid/billed service subject to credit checks and application procedures being conducted. (There are some costs associated with availing of such an upgrade, e.g., personal administrative costs, or purchase of a new SIM card might be necessary.)

(8) Customers could also choose to switch to another mobile telephone network.

[2] This analysis would be equally relevant to an examination of O2 and Meteor top-up distribution methods.

2.6. There is a huge degree of interchangeability possible between these methods. There are no switching costs associated with users substituting between the different distribution methods (5) & (6). There is however a requirement that a user have access to a credit or debit card and register those details with Vodafone for methods (1)-(3), and access to a bank account using an ATM card for method (4). The breakdown in sales between methods (1) to (6) at December 2002 was estimated by Vodafone as follows:

Credit Card/ Debit Card/ On-Line	[less than 1]%.
ATM	[less than 10]%
Go Cards	[more than 10]%
Etop-up	[more than75]%

2.7. As noted in paragraph 1.2 above, there were three Etop-up terminal providers operating in Ireland in September 2002: An Post, Alphyra, and Eason Electronic. These machines can issue top-up for 085 (Meteor), 086 (02) and 087 (Vodafone) numbers as the retailer wishes. All three operators install the top-up machine at the retailer's premises free of charge. However, there are some overhead costs associated with the installation of an Etop-up facility. These include:

- The cost of the telephone line. An Post insist that the top-up facility has a dedicated phone line, while Alphyra and Eason's allow the phone line to be shared. However, An Post will waive the cost of line rental for retailers that sell in excess of €[…] a month.

- Some complainants also claimed that it takes longer to supply customers with Etop-up than handing over the physical top-up card. This is identified by retailers as a cost directly associated with the provision of Etop-up.

2.8. ***Mobile telephony services*****:** There are three mobile phone service providers: Vodafone, O2 Ireland Limited ("O2") and Meteor Mobile Communications Limited ("Meteor"). According to the Office of the Director of Telecommunications Regulation ("ODTR") September 2002 Quarterly Survey, market shares were as follows:

Vodafone - 57%, unchanged since June review

0_2 – 39%, a decrease of 1% since June review

Meteor - 4%, an increase of 1% since June review

2.9. All three mobile operators offer a suite of advance pay, i.e., pre-paid, and pay as you go, i.e., bill paid, options. They compete through the levels of call charges and quality and range of services offered to customers. There are few barriers to inter-brand substitutability. Any barriers that exist relate to the administrative switching costs that would be incurred by customers in moving from one network to another which would include *inter alia*; registering with another operator, amending details for automated payment (e.g., through telephone and on-line banking), notifying individuals of amended contacts details.

2.10. Due to the high degree of substitutability between the different methods of top-up distribution identified in paragraph 2.5 above, and the relatively low barriers to switching from pre-paid to post-paid mobile phone contracts within and between 085, 086, and 087 networks, the Authority concludes that pre-paid mobile telephony does not constitute a separate market for the purpose of its analysis of this matter. The relevant market in this case is therefore considered to be the wider market for mobile telephony services.

Dominance

2.11. In *United Brands*, the ECJ formulated the following test for dominance:

> …The dominant position thus referred to by Article [82] relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.[3]

In assessing dominance the Authority takes into account if and to what extent an undertaking encounters constraints on its ability to behave independently. Those

[3] Case 27/76, *United Brands v Commission* [1978] ECR 207; [1978] 1 CMLR 429.

constraints might, for example, be entry barriers that make it difficult for potential competitors to compete effectively.

2.12. Based on data provided in the complaint the market share of Vodafone in the mobile telephony market would appear to be approximately 57%. However, in his judgment in Meridian v. Eircell[4] on the 5th April 2001, O'Higgins J. held that Eircell, which enjoyed a 60% share of the market, was not dominant in the context required by competition law. In so holding, the Court relied upon the definition of dominance as the ability of an undertaking to act independently of its suppliers, competitors and ultimately its customers. The Court found that the pattern of development and competition in the market in the period 1997-1999, which had seen Eircell's share of the market fall from 100% to 60%, and the absence of any barriers to expansion in the market, meant that Eircell could not act independently of its suppliers, competitors and consumers and therefore could not be considered to hold a dominant position within the meaning of the Competition Acts 1991-1996.

2.13. The most significant implication of this judgment for the Competition Authority is that in order to succeed in any action concerning abuse of dominance by one or more firms in the mobile telecommunications market, the Authority will have to be able to demonstrate that the market has changed in the intervening period.

2.14. RGDATA argued that the mobile telephony market had failed to develop in the manner anticipated by the Court since the Meridian case was decided. They claimed that a case could now be made that Vodafone was in fact dominant. In support of its position RGDATA argued that the Court had taken a long term view of the mobile telephony market pointing to the planned development of 3G services and the potential for new entry into the market (i.e., Meteor).

2.15. RGDATA argued that the increased competition in the market that was forecast by the Court had not been realised due *inter alia*, to the delayed introduction of 3G technology and Meteor's experience in entering the market. RGDATA characterized the

[4] Meridian Communications Ltd. v. Eircell Ltd. [2002] 1 IR 17.

Court decision as temporal, "a product of certain time, based on trends that did not continue" concluding that Vodafone enjoyed a position of dominance in 2002.

2.16. The Authority does not take any view with respect to whether or not Vodafone could now be considered dominant. Even if the Authority were to accept the correctness of RGDATA's argument, and come to the view that Vodafone were dominant (which the Authority did not in this instance) the question remains to whether or not the action of Vodafone constituted an abuse of such alleged dominance.

Abuse

2.17. **<u>Excessively low margins.</u>** It could be argued that Vodafone is using its power as the authorizer of 087 top-up to dictate excessively low margins to retailers. Arguably, this could amount to a breach of Section 5(2)(a) in that it "directly or indirectly imposed unfair purchase or selling prices or other unfair trading conditions." There would appear to have been no successful European Union (EU) cases in this regard – i.e. excessively low prices.[5] In the one unsuccessful case concerning the price paid by French TV channels for broadcasting films, the ECJ found, "that the complainant had to show that the price was low in relation to each individual film, and that it could not rely on average or undifferentiated figures."[6]

2.18. According to the responses received from complainants, sales of Vodafone Etop-up account for 10-20% of annual turnover (where location is an important factor in determining the exact level). The complainants claimed that a reduction in margins on sales of Etop-up would result in an equivalent reduction in turnover from Etop-up and a consequent fall in profit margins.

2.19. The complainants alleged that the margins that are being offered by Vodafone's intermediary terminal service providers were insufficient to cover the contingent costs involved in providing the product. These costs include the additional time it takes to process an Etop-up request, the fact that the terminal must be connected to a phone line

[5] R Whish, 2001, *Competition Law*. 4th Edition. London: Butterworths. Pp. 638-639.
[6] R. Whish, 2001, supra note 5, pp. 638-639.

and requests are processed by 'dialing up' to a service provider. In this way the complainants claimed that Vodafone had reduced their margins to an excessively low level.

2.20. If we ignore for a moment the question of whether or not margins of 65 cent and 97.5 cent for processing €10 and €15 Etop-ups respectively constitute 'fair' returns,[7] it must be borne in mind that reference to a reduction in revenues on sales of Etop-up do not automatically result in a reduction in profit levels. These reductions in margins may be offset by an increase in the volume of sales of Etop-up.

2.21. Vodafone argued that "the recent margin cut is more than compensated for by the significant increases in top-up sales volume in the last few years. In the financial year ended April 2002, sales grew by 60%. Sales growth is expected to continue. Retailer's cash margin even after reduction, shows real growth over the past two years."

2.22. Furthermore, in his response to questions raised by the Authority in a request for information made on foot of his complaint, one independent retailer stated:

> "My sales figures show top-ups having increased by 47% from 1st January 2002 to 30th September 2002 against the exact same period last year, while confectionary is down 7.3% some other departments showing a decrease of 2%. Overall sales figures increased by just 6%. This increase is mainly from mobile phones top-ups. These figures show that my profit margins would be well down taking all the aforementioned factors into account and my ability to stay in business, [..] would be severely damaged if Vodafone in the first place were allowed and continued to dictate and dominate the market place."

It would not be reasonable to conclude, on the basis that it is impossible to assume that sales of top-ups would remain static into the future, that retailers' profit levels on top-up would fall as a result of the reduction in margins. Further, even if one were to concede that the drop in retailers' profit margins on other items over the period could be linked to the switch from top-up cards to Etop-up service in 2001 as a result of impulse purchases falling, the same logic would apply.[8]

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[7] Information in the Authority's possession suggests that margins paid to retailers in the UK market in 2002 were much lower than in Ireland, to the order of 2-4.5%.

[8] The Authority dealt with complaints in 2001 concerning Vodafone's decision to increase the wholesale price of Go-Cards, thereby reducing retailers' margins from 12% to 10% in August 2000 and from 10% to 6% in October 2001. On that occasion the Authority concluded that Vodafone's decision to increase the

2.23. Retailers argued that given the demographic breakdown of Vodafone pre-paid customers there was unlikely to be a big shift from the lower, €10 and €15 denominations to purchases of €20 and higher. As stated at paragraph 1.3 above, the complainants estimated that sales of lower denomination, €10 and €15, Etop-up account for approximately 95% of overall sales of Vodafone top-up. They further estimated that of these as much as 90% of consumers purchasing €10 and €15 top-up credit are in the 12-25 age bracket. The complainants argued that those consumers would not be in a position to substitute toward higher denominations of top-up on the basis that they are likely to be income constrained. Vodafone also provided figures with respect to the demographic breakdown of registered pre-paid customers. These figures estimate that [less than 25]% of pre-paid customers are under 18 years of age, with a further [less than 25]% in the 19-24 years age bracket. There is therefore some support for an expectation that the movement to higher denominations of top-up would not be significant.[9]

2.24. The Authority takes the view that there is no evidence to suggest that the margins offered to retailers are excessively low within the context of competition law.

2.25. **Reduction in competition.** The complainants argued that there would be less competition as the effect of the reduction in 087 margins would affect retailers' turnover and profits to such an extent that it would lead to a decline in the number of retailers. However, a decline in the number of outlets does not necessarily lead to a decline in competition. In one recent Irish decision the Court commented, "Even if, contrary to the foregoing, the wholesalers were reduced from five to four, it does not follow that there would be a reduction in the intensity of competition at the wholesaler level."[10]

2.26. No estimate of the effect on retailers' profits or the likely decline in retailer numbers was provided. The complainants predictions of a fall in profits are based on the level of growth observed in Etop-up over the preceding 12 month period with no analysis

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wholesale price of top-up cards did not constitute an abuse within the meaning of the Competition Act, on the basis that it could be objectively justified on the basis that Vodafone had implemented the change to encourage the use of a more cost-effective distribution mechanism namely, Etop-up distribution.

[9] Nor does it seem that this is the desired outcome of their strategy. From Vodafone's perspective, if customers switch to higher denominations then there would be no reduction in their cost base as margins have only been reduced on €10 and €15 vouchers.

[10] See *Chanelle Veterinary Ltd v Pfizer (Ireland) Ltd*. [1998] 1 ILRM, 161.

of whether this level of growth could be sustained going forward. Furthermore, it would appear that the number of retailers has been declining in recent years despite considerable economic growth due perhaps to changes in population demographics or consumer tastes and preferences.

2.27. There is no reason that retailers cannot set – separately, and without co-ordination with actual or potential competitors – transaction charges for the service that they provide for the public. Indeed, a number of retailers chose to impose a handling charge on consumers for sales of €10 and €15 Etop-up denominations in response to Vodafone's action.[11] Vodafone reacted to this move by investing in an advertising campaign, the purpose of which was to identify those locations where consumers could purchase top-up at face value. Some larger retailers also reacted to this move by offering top-up at discounted rates. Thus, it is not clear that the anticipated decline will take place.

2.28. While the reduction in margins may affect the welfare of retailers, it is not clear that there is a corresponding damage to the consumer or the competitive process. For the exercise of any power that Vodafone might have to be harmful, this requires that it must be correlated with either increased cost or a reduction in choices for consumers. However, the strategy that Vodafone adopted has a neutral effect on prices to the consumer. While retailers are free to independently determine whether and at what level they will place a handling charge on sales of Etop-up to consumers as noted above, there are a number of alternative methods through which consumers can purchase this product, listed at paragraph 2.5 above.

2.29. Thus, even if it were the case that the result of Vodafone's action were to increase the cost of purchasing Etop-up from retailers there are a number of alternative, perfectly substitutable, channels through which mobile phone users can purchase top-up. Therefore, the effect of such a move would be to increase competition between the different distribution channels, in other words increased intrabrand competition. Further, if the effect were to drive retailers to discourage consumers from supporting Vodafone

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[11] See Authority Press Release "Competition Authority welcomes move by Irish Retail Newsagents Association on electronic mobile phone top-up charges" of 1st October 2002 for further details on this issue.

sales and switch to alternative mobile operators, then this would constitute a pro-interbrand competitive effect.

2.30. If Vodafone is allowed to adjust its cost base to promote more cost effective methods of top-up distribution this would allow the company either to pass on some of these cost savings to customers and/or to invest more resources in improving the quality and range of services provided. It is difficult to see where any harm to consumers could arise as a result of the change in pricing practices, and if the move is successful it could in fact promote overall benefits to consumers.

2.31. In the Authority notification decision *Murphy Brewery Irl Ltd/Clada Soft Drinks Ltd* [12] the Authority stated that "[i]t considers that undertakings are entitled to decide how their products shall be distributed to their customers." This was cited with approval by Kearns J. in *Ballina Mineral Water Company v Heineken Ireland*.[13] In the Authority's opinion, Vodafone is entitled so to act, even if the result were that retailers ceased to supply top-up

2.32. Given therefore that in the opinion of the Authority the conduct of Vodafone would not, if it were in a dominant position, constitute an abuse of such dominance, the Authority does not consider it necessary to make any finding on whether or not Vodafone is so dominant.

3. DECISION

3.1. On the basis of the facts and for the reasons set out above, the Authority has decided that in its view the increase in the wholesale price, and resultant reduction in retails margins, on €10 and €15 denomination Etop-up by Vodafone effective 9 September 2002 does not breach Section 5 of the Competition Act 2002. [14]

[12] Decision No. 362, 13 October 1994.
[13] Unreported, High Court, (Kearns J.) 31st May 2002
[14] The Authority made the decision on 25th October 2002. Under Section 30(1)(g) of the Competition Act 2002 the Authority is given the function 'to carry on such activities as it considers necessary so as to inform the public about issues concerning competition.' Publishing reasoned decisions of the Authority is part of that function.

3.2. This decision of the Authority does not affect the rights of private parties to take an action under the Act.

For the Competition Authority

Dr Paul K Gorecki
Member and Director Monopolies Division
10 June 2003