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**The role of competition policy and consumer protection in markets
characterised by network effects**

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THE ROLE OF COMPETITION AND CONSUMER POLICY IN THE TELECOMS, ENERGY AND BANKING MARKETS

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Abstract

This paper aims to discuss the interaction between competition policy and consumer policy with specific regard to the telecoms, energy and banking markets. The common feature of these markets, which are now in the process of being fully opened to competition and integrated at European level, is that while on the supply side they are characterised by the existence of capital-intensive infrastructures capable of generating economies of scale and network externalities that magnify the market power of firms, on the demand side they are frequently biased by lack of information transparency and high switching costs which in many cases prevent consumers from achieving optimal market benefits when purchasing products or services.

The oligopolistic and network-based structure of the telecoms, energy and banking industries, which are vital sectors of the global economy, demands for special attention to be paid by regulators to ensure that the competitive process works properly and generates high benefits for consumers. Competition policy and consumer policy in these markets have not always been successfully pursued in Europe and have so far achieved mixed results particularly in countries with a strong public control heritage, such as Italy. The information asymmetry and the barriers to switching which can be found in deregulated markets in several EU member States are the result of policies which proved ineffective in cultivating nascent market competition to the profit of the competitive process and its ultimate beneficiaries, i.e. the consumers.

In the following pages, it will be argued that, for competition and consumer policy to work effectively in such markets, regulators should have a sound understanding of how the competitive process should work in the specific market they are confronted with. Moreover they should carefully evaluate *ex ante* the costs of intervention vis-à-vis the benefits obtained, so as to ensure that exogenous action delivers better

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results than what the market's own forces would achieve in overcoming market failures. Lastly they should ensure best coordination in the application of the regulatory and enforcement tools provided to them by the law.

The paper is structured as follows. Firstly, we look at the supply- and demand-side structure of deregulated markets in general, with particular attention being paid to the process of liberalisation in the telecoms, energy and banking industries. In doing so, we discuss the role played by competition policy and consumer policy in that process. It will be maintained that, while the two policies have complementary goals and each of them can be effectively used to advance the goals also pursued by the other, an uncoordinated approach by public authorities and regulators risks giving rise to conflicts which are detrimental for either consumers or market functioning, depending on whether consumer protection is sacrificed in favour of competition or vice-versa. Therefore the initiatives taken in the context of one policy have to factor-in the possible spill-over effects in the sphere of the other one.

We will try to point out some factors that should be taken into account when planning antitrust or regulatory measures aimed at protecting competition and consumers in these sectors. In particular we will discuss the importance of strong coordination between competition policy and consumer protection policy in "engineering market regulation". Policy efforts must indeed aim, on the offer side, to shape the competitive structure of the market by abating entry barriers and preventing incumbency predation on new entrants, while on the demand side, to improve consumers' market position by increasing information transparency and product comparability. The recent experience of enforcers and regulators in some European countries, and particularly Italy, will be of interest here, as it gives an insight on how consumer and competition policies are tackling competitive failures in the telecoms, energy and retail banking markets.

We conclude that it is not enough to liberalize certain industries in order for competition to replace the previously existing market situation, which in the case of energy, telecoms and banking markets was often characterized by legal monopolies or regulated oligopolies. Rather, overcoming information asymmetries on the demand side and abating restraints to full competition on the offer side (such as existing barriers to entry and other pre-liberalisation privileges) through coordinated and long-term planned actions both at antitrust, regulatory and consumer protection level is pivotal in ensuring that markets are both competitive and deliver maximum benefits to consumers.

Part One – The interaction between competition and consumer policy in deregulated markets

1) Introduction

According to an effective caption by J. Mulholland's and L. Sylvan's contribution to the 2007 OECD Roundtable on Economics for Consumer Policy *"a basic condition for ensuring that markets perform to their potential is that they are structurally sound on the supply side. Competition policy has a strong emphasis on structure as it ensures that there are no unnecessary barriers to entry and that market concentration does not result in economic loss for consumers vis-à-vis producers. Even vigorous supply side competition, however, falls short of delivering economic benefits if market are not well developed on the demand side. On the demand side, active consumers stimulate firms to innovate, improve quality and increase price competition, which in turn lead to productivity improvements and economy-wide benefits, including international competitiveness"*¹.

If we look at how competition works in a number of deregulated markets of today's Europe, we might have the impression that these markets are neither *"structurally sound on the supply side"*, nor *"well developed on the demand side"*. If we focus on the energy, telecoms and banking industries, we notice that in several countries few firms, mostly incumbent ones, dominate the market and somehow manage to dictate the pace and scope of competition, and that consumers are not an active market resource but rather often remain subdued in a position of commercial weakness vis-à-vis their dominant counterparts.

As it will be argued in the next pages, these market failures are the result of inefficiencies, both on the supply and demand side, generated by a mix of bad (or simply excessive) regulation, insufficient and/or inappropriate competition law enforcement and lack of sound initiatives to stimulate consumers activity.

¹ OECD, 2007 *Roundtable on Economics for Consumer Policy*, presentation by J. Mulholland and L. Sylvan; the paper s available at the following link: <http://www.oecd.org/dataoecd/5/38/39015963.pdf>.

2) *Looking at deregulated markets from the supply side: the importance of the network structure in the competitive process*

A common feature of several deregulated markets which is sometimes not exhaustively dwelled upon when analysing the reasons behind the failures of the competitive process is that these markets are network-based, i.e. on the offer side they are characterised by the existence of networks which are necessary for providing the service to final customers. The fundamental role played by the network infrastructure in the competitive process is clear when one thinks of electricity grids, railways, telecom networks or inter-bank payment schemes, i.e. those long-lasting, capital intensive infrastructures that allow operators to supply electricity, transport goods and persons, provide telecommunications services and process inter-bank transactions².

In network markets, undertakings are exposed to high economies of scale, proportional to the incremental use of the network infrastructure. Networks may additionally generate externalities of both positive and negative nature depending primarily on their size. Under a generally accepted economic definition, “*a market exhibits network externalities when the value to a buyer of an extra unit is higher when more units are sold, everything else being equal*”³. Thus, for example, a widely accepted credit card network generates positive externalities to the users of the network because they know that they are likely to have their card accepted by most retailers. Similarly, mobile phone users benefit from widespread diffusion of their network operator because this means they have more chances of paying less for their next phone call. The smaller the scale of the business, the less the network externalities it produces for its users and for the undertaking concerned. While networks generate benefits to undertakings in the form of economies of scale, they can also cause high losses if sales volumes shrink to the point of not covering the high fixed costs of running the network infrastructure itself.

One might then come to the conclusion that monopolies are the most efficient market structure because they maximise network effects for users and generate economies of scale (and sometimes also of scope, like in the case of public utilities providing complementary services like gas, electricity and water) for the monopolist firm, thus

² Other typical examples of network industries are computer software, airlines, water distribution, postal services and broadcasting/media services (such as TV channels and newspapers).

³ N. Economides, “*Competition policy in network industries: an introduction*”, in “*The New Economy and Beyond: Past, Present and Future*”, ed. Dennis Jansen, London 2006.

benefiting the whole of the community. Indeed, this would hold true if monopolies did not experience other types of shortcomings, first and foremost the monopolists' tendency to apply exploitative prices to their wholly bound customers.

Still, network industries have historically been organised as monopolies as a necessity because of the economies of scale generated by the network, so huge that no competition was deemed viable. In return for the privileged market position enjoyed on the market (i.e. no or low level of competition) companies in network industries - such as telecom operators, gas and electricity suppliers and railway or air carriers, just to mention a few examples – were subject to some form of direct or indirect government control, in the form of economic regulation (e.g. price control) and social regulation (e.g. obligations of universal and/or continuous service provision). In the banking and financial systems, the State retained stringent regulatory control over the market players because they jointly controlled and managed key financial assets underpinning the functioning of the economic system of the country. For this reason, and in order to ensure economic stability, many banks were structured as non-profit organisations and stock exchanges were mutualised, while all market players, both public-controlled and private, were - and to a varying extent continue to be - subject to pervasive regulation and public scrutiny, for example on minimum paid capital, available financial reserves and other mandatory business requirements.

From the late 1980s onwards also in Europe, well after the US, the state monopoly system was eventually discarded as a model because of the many flaws that come with it, such as the lack of incentives on regulated undertakings to innovate, reduce costs and pursue service quality to the benefit of customers. With the advent of new technological improvements and the globalisation of world economies, competition was brought to these network industries by way of liberalisation of market access and transformation of state-controlled enterprises into private equity companies, sometimes participated by the State as shareholder with special rights (the so-called “golden share” system). This process was accompanied by the creation of sector-specific independent authorities appointed with the task of ensuring that the newly created competitive spaces functioned in a socially responsible way and that certain public interest requirements were continued to be met by the market participants, notwithstanding the abolition of direct State control.

Because of the capital-intensive character of the infrastructural systems and the socio-political relevance for the society, newly liberalised industries remained subject to a degree of regulation, necessary for engineering a level playing field and a

system of “workable competition” between incumbent (ex-monopolist) firms and new market players, while preserving public interests in doing so.

While the EU member States engaged at variable degrees in the process of liberalisation of network industries (with some administrations, such as those in France and Italy, maintaining a tighter grip on these industries in comparison to other countries, such as the UK), competition policy initiatives focused on unbundling networks ownership and ensuring new entrants’ unhindered access to essential infrastructures run by incumbent firms, as well as preventing other forms of (price) discrimination by the latter. Several forms of regulatory control have been employed for ensuring public interest protection, for instance by reviewing compliance with general interest service obligations, or by determining termination tariffs and network capacity allocation.

Still, combining competition principles with public interests in sectors so strategic to the market economy is not an easy task. Paradoxically, the final outcome of the liberalisation process could even be another situation of market dominance by single firms or tight oligopolies; it could be that the return to monopolistic or oligopolistic market structures be the natural evolution of certain markets for which the maintenance of artificial forms of competition might make all stakeholders – including consumers – worse off, as forms of spoon-fed competition might push up prices that the otherwise efficient single firm would be able to apply, thus diminishing the overall welfare.

In other cases, effective rivalry may be blocked because the potential impact of new entry is overestimated. This is the case when regulators “support” third-party market entry which ends up being confined to shallow or niche competition vis-à-vis the incumbents. Here, the point is asking ourselves at which cost that market entry has been fostered, for instance in terms of general obligations imposed on the incumbent and loss of overall market welfare. For instance, a long-term mandatory roaming agreement imposed on the incumbent telecoms provider in favour of a newly established mobile carrier might have the effect of a disincentive to investments to expand and improve the network infrastructure.

It might also be, however, that competition does not successfully spring as a result of the liberalisation process because the powers of the incumbent operators have been seriously underestimated by regulators. Key advantages in favour of incumbents are, for example, the past reputation and an established brand, the existence of long-standing arrangements with clients, a superior market knowledge, the capability of

discriminating prices to customers and the extensive network externalities they might be able to offer to their clients.

Major impediments to effective competition are still existing barriers to entry that come with the historical legacy of these markets. For example, incumbent firms in many countries still fully own non-duplicable network infrastructures. While unfettered access obligations upon the incumbent and in favour of competitors may formally remove the issue of creating a level playing field, they might not be enough to ensure that the dominant firm does not abuse its power in other ways, for instance by leveraging its market power at different levels of the production chain or in neighbouring markets, also thanks to its incumbency advantage. On the other hand, market liberalisation shall not mean that the incumbent should be the sole to bear the high sunk costs of establishing the network, with newcomers behaving as pure “free-riders”. On this regard, the reference to industrial models based on the “replicability” of the incumbent’s structure may end up chilling competition, as it might reduce the incumbent’s efficiencies and work as a disincentive for it to invest in innovation. The issue of replicability is open for debate, for instance, in the case of the “Mobile Virtual Network Operators”, which is discussed in section 5.2 below.

*3) Strengthening the functioning of deregulated markets on the demand side:
the relevance of consumer behaviour*

While in the first few years following the major wave of market liberalisation in Europe (from the late 1970s in the US and UK to the mid/late 90s in most other European countries) policy initiatives were mainly concerned with setting the level playing field on the market in order for competition to spark and break through, in recent years regulators gradually realised that for competition to work well in liberalised markets, attention had to be given not only to protecting the market structure on the supply side, but also to enhancing the position of consumers on the market, so that they also would contribute to stimulate competition between undertakings.

As a consequence of a new way of thinking that identifies in “consumer welfare” one of the key objectives of competition policy⁴, regulators in the EU started looking at

⁴ In the course of the years, with social policy in the EU and in Member States becoming more and more concerned with protecting consumers’ position on the marketplace, competition policy gradually shifted its focus towards a consumer-oriented approach. This change in policy perspective was not unrelated to the need of reconciling arguments on market efficiency with reasons of social policy and public interest, often being regarded by Community courts as goals to be duly weighed when applying the Treaty rules on competition, and in some circumstances even capable of overriding them. As a consequence of

how to pursue the competitive process in deregulated markets not exclusively by disciplining the structure of the market on the supply side but also by increasing the competitive pressure on firms coming from the demand side.

Over the last decade, in Europe the EC Commission and the national antitrust authorities concentrated their efforts to enhance competition in the energy, telecoms and banking sectors by resorting not only to the tool of competition law enforcement (against abusive conducts by dominant incumbents or anti-competitive agreements between firms) but also to other competition policy initiatives (sometimes referred to as “competition advocacy”) such as public consultations, reports to national and EU legislators and sector-specific regulators, and direct involvement in drafting legislative bills. The common goal of these actions is to flexibly employ different tools to tackle the various failures that take place both on the supply and the demand side of the market.

Extensive sector-specific inquiries carried out at EU level (by the European Commission), and at national level (by antitrust and sector-specific authorities) in the recent years – for instance in the energy and banking sectors⁵ – revealed that several deregulated markets are biased by lack of information transparency and high switching costs which in many cases prevent consumers from achieving optimal market benefits when purchasing products or services.

The realisation that in deregulated markets consumers were not receiving a fair share of benefits in terms of better prices and quality of services induced regulators at EU and national level to examine the causes of such failure. Indeed, notwithstanding liberalisation of market entry and the consequential variety of choice of retail suppliers available on the market, consumers often seem not to take

these factors, regulators in Europe started identifying in consumer welfare the final goal of a modern effects-based and economics-grounded competition policy, and eventually elected it as the standard for benchmarking the effectiveness of antitrust law enforcement. As clearly indicated by Neelie Kroes in one of her first public speeches following appointment as Commissioner for Competition, the aim of the Commission in competition policy is “*to protect competition in the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources*”. Speech by Commissioner Kroes held at the European Consumer and Competition Day, London, 15 September 2005.

⁵ Pursuant to Article 17 of Regulation 1/2003 EC, in 2005 and 2006 the European Commission launched competition inquiries, respectively, into the gas and electricity markets and retail banking,. For further information on these enquires please refer to the following links:
<http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html>
http://ec.europa.eu/comm/competition/sectors/financial_services/inquiries/retail.html

advantage of the benefits of switching or, when they do so, sometimes they end up switching to higher-cost suppliers.

Suboptimal purchase choices by consumers in deregulated markets depend on several factors which act as barriers to customer mobility. Examples are high costs charged by firms in order to discourage switching, such as termination penalties (for instance, charges for cancelling mobile network subscriptions or closing bank accounts); other times, the absence of interoperability agreements between different networks may represent a cost which has the effect of hindering customer mobility. Examples here are software incompatibility, lack of portability solutions for mobile phone numbers or non-transferability of banking services when switching bank.

Information, or lack thereof, can also be used by firms as a barrier to customers mobility. In certain markets, consumers fail to identify the essential information they need to elaborate in order to take the most efficient purchase choices; information asymmetry has to do partially with the intrinsic complexity of the products and services on offer, partially with the “manufactured confusion”, as defined by some authors⁶, that is injected by the industry participants in order to reduce customer switching and through this to indirectly limit price competition. For instance, the adoption of different standards or criteria for presenting product features and the way in which information is often made available in a bundle for several different products make direct product comparability hardly possible for consumers. An example here can be offered by telecoms service tariffs or bank account fees, which are sometimes presented as bundled “all-in-one” offers covering several distinct services, with the result that customers might find it hard to understand what they are exactly being charged for, what is included in the fee package they get and what, on the contrary, is payable as an extra⁷.

⁶ Ian McAuley, contribution to the “*OECD Roundtable on demand-side economics for consumer policy*”, 20 April 2006.

⁷ In 2006-2007, the ICA carried out a market investigation into retail banking services, with particular regard to current accounts and related products such as payment and cash withdrawal services. The inquiry, which partially mirrored the market study undertaken in the same period by the Commission at EU level, revealed that the market was characterized by scarce price transparency and lack of comparability of the various products offered by banks, as well as high switching costs in terms of current account termination fees. Proceeding no. IC32 “*Indagine conoscitiva riguardante i prezzi alla clientela dei servizi bancari*”, decision no. 16403 of 01/02/2007. More recently, the Office of Fair Trading launched a sector inquiry into the personal current account market in the UK. According to the preliminary findings published in on 16 July 2008, much of banks' revenue from current accounts is derived opaquely, with 81% of their income coming from two sources: insufficient funds charges and net credit interest income. The OFT found that a significant number of customers do not know how much

Similar information imbalances can be experienced by consumers in the utilities industry, i.e. electricity, gas and water. In these markets, firms offer identical goods with almost no possibility of product differentiation; that means that competition is necessarily centred on pricing or services related to pricing, such as billing frequency or bundling of products (i.e. electricity and gas supply). In theory, because the product characteristics are fixed, searching for substitutes should be a rather simple process, being confined to pricing aspects. In reality, price comparison can be not straightforward at all, and frequently consumers happen to get lost in the myriad of different data they get, and fail to extricate from these data the relevant information in order to assess the price value of products. Often this “stickiness” of the market has to do with the behaviour of the incumbent (ex-monopolist) firms, which have scarce incentives to stimulate price transparency, since customers’ switching, at least initially, would probably be a one-way process to the benefit of newly established competitors.

However, save for the pathologic situations where firms collude to limit price competition by “manufacturing confusion” or where this is due to the single dominant firm not providing the necessary market data, information failures are sometimes the result of a mix of firms’ reluctance to provide for free information which is costly for them and consumers’ failure to act rationally, even when rational choices would be within their reach.

There is a growing body of economic evidence that shows that consumer behaviour can be biased by a number of factors which lead them to make decisions which are not in their best interests⁸. For example, consumer adherence to a particular supplier may be explained in terms of information failure, but it can also be explained by the observed behavioural phenomenon of the “endowment effect” (or “*status quo*” effect), that is an established bias in favour of the supplier already being used: even when an alternative supplier is clearly available at a lower price, and switching costs are low, consumers tend to stay with the supplier they have.

they actually pay in bank charges, either before or after they are incurred: over three-quarters do not know the credit interest rate of their current account, and even those that do know, lack the means to calculate the interest they forgo. The complexity and lack of transparency of personal current accounts makes it extremely difficult for individual customers to compare their bank account with other offers. The OFT thus concludes that there is little incentive for consumers to switch - especially as switching is generally believed to be complex and risky.

⁸ See Thaler, R. “*Toward a positive theory of consumer choice*” in Kahneman D., Tversky R. “*Choices, Values and Frames*”, Russell Sage Foundation, 2000, and I. Mc.Auley, quoted above.

Another frequent bias is the “hyperbolic discounting” effect, where individuals prefer to incur higher costs at a later stage and enjoy immediate discounts and benefits, notwithstanding in the long run they are worse off that way. A classic example is that of credit cards which offer advantageous free-interest periods but charge substantial interests once the free-interest period is over. If consumers acted in a rational way, they would fully benefit from the free-interest period by making sure they pay within the deadline so as to avoid being charged high rates for late payments. This is rarely the case, with the bulk of the customers being late payers who are charged exorbitant fees, as shown by the 2006 sector inquiry into store credit cards carried out by the Competition Commission in the UK⁹.

In other cases, consumers may suffer from “choice overload”, when there are too many product alternatives on the marketplace. Such situation acts as a disincentive to consumer choices, especially when products are undifferentiated and the advantages of switching are not immediately evident. The experience of the US residential electricity market is particularly interesting from this point of view. Differently from wholesale buyers, retail consumers in the United States have shown little interest in choosing electricity from a supplier other than the incumbent, notwithstanding widespread consumer information campaigns and *ad hoc* regulation on forced capacity reallocation to entrants and revised rules on minimum default service¹⁰.

While the US retail electricity case brings about the distinct question - discussed below in section 4 - of whether and when consumer policy should be employed to drive competition *en lieu* of the market own forces, it also highlights that consumers may actually prefer the old regime if opening up a market to competition means that, because of higher compliance costs, the resulting prices on the market are not lower than would have ensued under continued regulation.

4) *Coordinating consumer policy and competition policy in deregulated markets*

In deregulated markets, failures in the competitive process happen both on the offer and on the demand side, as we briefly sketched in the previous pages. The question

⁹ *Competition Commission Final report on store cards in the UK market*, published on 07.03.2006, available at: <http://www.competition-commission.org.uk/inquiries/completed/2006/storecard/index.htm>

¹⁰ See Brennan T. “*Consumer preference not to choose: methodological and policy implications*”, published in November 2005 by Resources for the Future, Washington DC. The paper is available online at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=854424.

then is how to devise a policy framework which can successfully coordinate regulation and enforcement to the benefit of the marketplace *and* consumers.

The introduction of a new system of competition law enforcement (the “modernisation package” introduced by EC Regulation 1/2003) which sets forth mechanisms of close cooperation between the EC Commission, national antitrust authorities as well as domestic courts of the Member States in the application of the EC Treaty rules and, more recently, the entry into force of specific legislation in the field of consumer protection (Directive 2005/29/CE on unfair commercial practices) now make it possible for regulators across Europe to embrace far-fetching policies which rely on the competition and consumer protection law tools to pursue consumer welfare, while at the same time ensuring that the markets remain competitive.

To this aim, well coordinated use of available competition and consumer policy instruments is fundamental, and knowing when and how to apply each of the available leverages is pivotal for policy success. Competition policy and consumer policy indeed share common purposes, although they rely on different instruments to achieve them. As a general matter, competition policy aims at protecting, and where appropriate and efficient extending, the range of choices available to consumers by tackling market failures on the offer side. At the same time, consumer policy seeks to protect, and where appropriate enhance, the quality of consumers’ choice, and “*to ensure that consumers can exercise choice effectively and with confidence in the fairness and integrity of the market process*”¹¹.

The interaction between competition policy and consumer policy is evident from several perspectives. On competitive markets, the risk of displacement that bears on firms creates incentives for them to develop and protect a reputation as good quality suppliers and fair commercial counterparties. Thus, ensuring that a market is competitive reduces the burden that would otherwise fall on consumer policy in terms of enforcing product and service standards or tackling unfair trading practices, as market players will strive on their own to meet - and possibly exceed - customer expectations.

Equally, firms that operate in competitive markets aim to attract customers away from their rivals. They will thus have incentives to minimise switching costs as much as possible both by informing consumers of the advantages of switching and in some cases by helping them to financially bear the one-off costs of changing supplier. With

¹¹ See, Muris, T. “*The interface of competition and consumer protection*”, Fordham Corporate Law Institute Annual Conference on International Antitrust Law and Policy, 2002.

firms proactively investing in stimulating customer mobility by reducing switching costs, competition on the market becomes more vigorous and, at the same time, the need for consumer policy initiatives diminishes. Here too, ensuring a competitive market structure may help levying what would otherwise be a consumer policy problem.

On the flip side of the coin, many consumer policy interventions are beneficial to market competition. For instance, policies that ensure the non-misleading nature of advertising and product descriptions, or the fairness and proportionality of contractual obligations bearing on non-professional counterparties will both make consumer choice more efficient and force firms to compete on the merits. Similarly, standards that facilitate comparability of products and services not only help customer to understand the real value of their purchases (and thus when switching is profitable), but also compel firms to concentrate competition on what is perceived by customers as the essential features of the product or service being traded.

While competition policy and consumer policy usually reinforce one another, it is not however uncommon for them to clash, for instance when consumer policy is employed in ways that inevitably affect competition, or where market competition is pursued in one sector with insufficient regard to consequential issues for final consumers.

The risk of the two policies clashing against each other is actual in deregulated markets. Opening a previously highly regulated market to competition may raise unexpected issues of consumer protection, where the liberalisation is not accompanied by sound consumer welfare-enhancing measures. In formerly monopolistic markets (energy, telecoms, postal service, transports), or in markets otherwise characterised by strong incumbency positions (such as banking and financial services), when the market is suddenly opened up to competition the incentives of the players to compete may change in ways that are not necessarily advantageous to consumers. As mentioned above in section 3, incumbent firms may try to lock customers in by resorting to a number of artificial barriers, such as long-term contracts or termination penalties; or, knowing that they are going to lose market share anyway, they might be more willing to exploit their market position to the detriment of consumers, for example by charging them higher prices. While these conducts clearly qualify as illicit practices when they stem from dominant companies (art. 82 of the EC Treaty) or when they are the result of an anticompetitive agreement among market participants (art. 81 of the EC Treaty), outside these pathologic

situations little can be done from a competition law standpoint to protect consumers vis-à-vis commercial counterparts.

In the same way, consumer protection policies, however well intentioned they may be, can have adverse consequences for competition, with the ultimate outcome being contrary to the goals that both consumer and competition policy should seek. Classic cases include prohibitions on comparative advertising, mandatory product standards that exclude low-cost market entrants, and posted prices requirements that artificially increase transparency and facilitate collusion.

In all markets and particularly in deregulated markets, potential clashes between competition policy and consumer policy should be prevented by ensuring that the two policies share the mid- to long-term goals for the development of the market and that enforcement, as well as regulatory, activities are closely coordinated. Particularly, competition law enforcement should take place where market failures that result in suboptimal benefits for consumers are detected, and should be limited to the extent necessary to eliminate these failures, so that market competition may healthily develop as a consequence.

The ultimate risk here is, quite clearly, that regulators and enforcers go beyond what is necessary and proportionate to establish a competitive market structure and embrace consumers' interests to the point that these are elected as general market interests¹² or that, on the contrary, they excessively focus on pursuing optimal market conditions for competition, while in doing so they lose touch with the everyday interests of final consumers to better quality, safer, and cheaper products.

Rather, successful policymaking also depends on the understanding that policy initiatives that would work well for other types of markets might be ineffective in deregulated industries.

For instance, in certain types of markets consumers act as an important constraint to firms behaviour in the sense that their purchase choices influence the market strategy of firms and motivate them to compete with each other. In markets for undifferentiated goods (such as flour, steel beams or petrol, for instance) where products are homogeneous and readily comparable and consumers' choices are primarily based on price and to a much lesser extent on product features, consumers

¹² As effectively pointed out by JB Baker, "*Competition Policy as a Political Bargain*", in *Antitrust Law Journal*, 2005, vol. 73 p. 483, policymakers should take into account that competition policy arises out of the interaction and coordination between two large interest groups (consumers and producers) and is eventually the result of political bargaining between these groups.

usually enjoy a high degree of price information, since price is the main driver behind their purchase choices.

In differentiated goods markets consumers are usually provided with enough information on price and product quality to allow them to choose what is best for their personal need and expenditure profile. In general, this is the case also for the so called “experience goods” markets, i.e. those markets where consumers gain knowledge of the product/service after they purchase it (for instance, cars). In fact, in experience good markets the initial information gap is eventually overcome by consumers once they try the product out and gain their own opinion on it; thus, the *ex-post* knowledge of consumers usually act as an incentive for undertakings to keep a high level of information in order to differentiate their products and benefit from returning customers.

In all these markets, the already existing price transparency and the pro-active role of consumers on the marketplace usually facilitate competition agencies the detection of exogenous alterations of the market likely to affect consumers welfare, such as for instance anticompetitive agreements on price-fixing or violations of health and safety regulations.

Conversely, when dealing with deregulated markets, policymakers and enforcers need to take into account that consumers experience a weak bargaining position vis-à-vis undertakings which derives from the monopolistic heritage of the marketplace. Consumers mobility is discouraged by high switching costs and bureaucratic hurdles, let alone lack of information transparency.

Although many supply-side interventions in deregulated markets have benefited both competition in its infancy and consumers, for consumer welfare to reach further gains more attention will be required in the future to addressing the dynamics of consumer behaviour on the demand side. On this regard, regulators should be fully aware that consumer behaviour is complex and often based on habits, social norms and decision-making shortcomings.

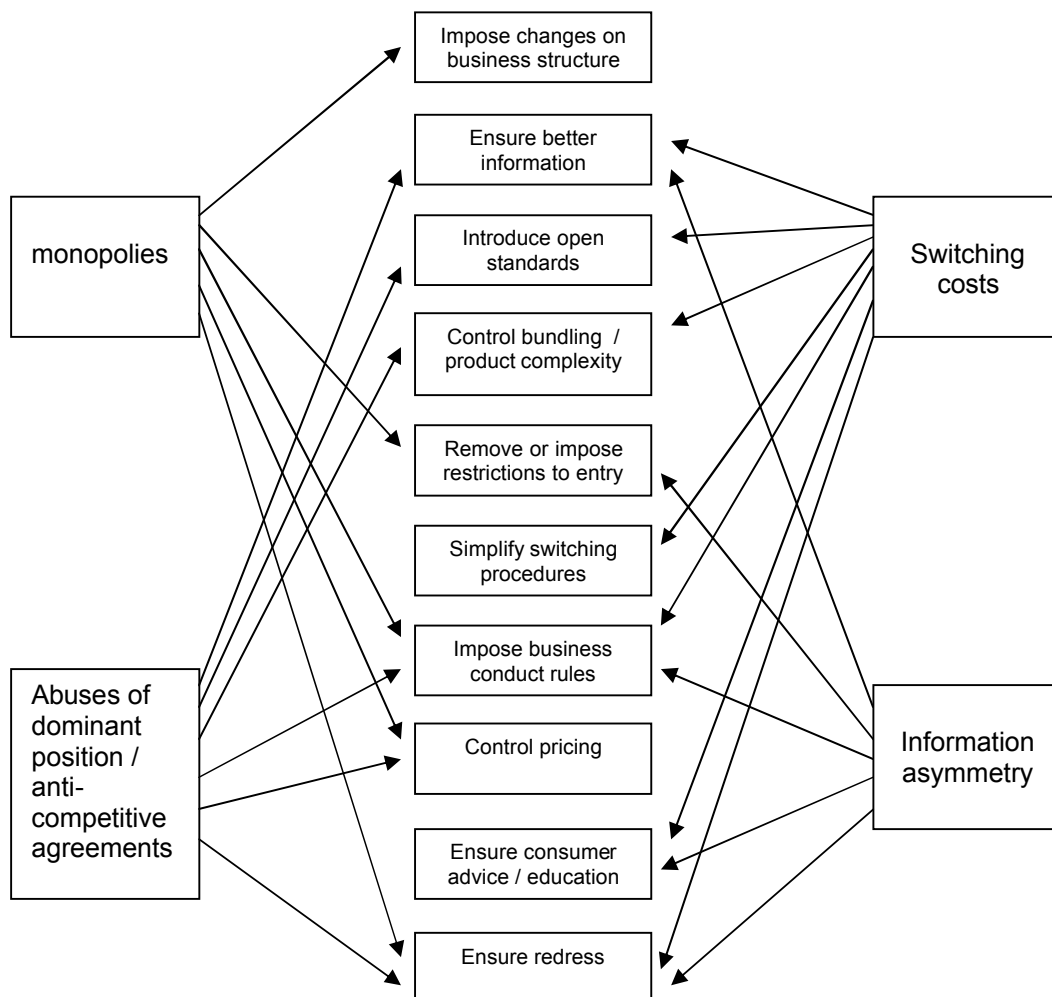
On the offer side, regulators and enforcers should focus on the competitive structure of the industry so to ensure that the legacy market power of incumbents does not run counter the establishment of market competition by hindering market access, for example through discrimination in the access to the essential infrastructures; in doing so, specific attention should be attributed to the peculiar structure of these markets and the importance of network externalities for overall welfare. Here, care should be

taken in ensuring that a fair share of the positive externalities generated by the network are passed on to consumers in the form of lower prices and better products.

On the demand side, consumer protection should specifically address the existing barriers to customer mobility and the information shortcomings, and promote the adoption of industry standards on comparability, adequacy and, where necessary, simplification of the data available to consumers.

An effective policy framework for enhancing competition and consumers' benefits in deregulated markets depends on a well-coordinated balance of initiatives on the supply and on the demand side, as successfully captured by the following table published on the OECD's report on the 2007 roundtable on Economics for Consumer Policy:

A supply-demand policy framework



Part Two - Enforcing competition law to the benefit of consumers in the telecoms, energy and banking markets in Europe: selected cases

5) Introduction

In many European countries (and Italy amongst them), the process towards a full-fledged competitive process in the telecoms and energy markets requires competition authorities to take action against conducts by incumbent suppliers that aim at leveraging their dominant position to the detriment of new market entrants. On the regulatory side, the abolition of artificial barriers such as excessively long-term purchase agreements, refusals to supply and to grant access to the network are preliminary steps which are necessary to create the conditions both for competitors to enter the market at competitive conditions, and for consumers to be able to switch, if it is profitable to them.

In the banking sector, incumbent players in domestic markets have been striving to react to the new business threats coming from the globalisation of the financial services, the changes in the banking business model (driven by the widespread growth of the internet banking) and the establishment of foreign banks at domestic retail level, all phenomena which are significantly impacting the dynamics of market competition in retail banking. In several cases, the reaction of the incumbents has been in the sense of resisting, if not obstructing, these market changes in order to preserve the pre-existing *status quo* on the market. The ongoing creation of a Single European Payments Area (SEPA) and the entry into force of new legislation, the Payment Services Directive (PSD) which opens the payments market to some non-banking institutions, provide an important contribution to abolishing entry barriers to key retail banking services and making financial markets more contestable.

In the following, we briefly discuss some selected topics arising out of recent antitrust law enforcement and regulatory interventions in the telecoms, energy and banking industries, which offer interesting views of the multi-faceted challenges European regulators are confronted with as they attempt to shape the competitive process of these network-based markets.

5.1. Telecommunications - can Mobile Virtual Network Operators (MVNOs) be a competitive constraint on incumbent players and do they actually increase customers choice?

In the last few years, the mobile telecoms industry has witnessed the appearance on the market of Mobile Virtual Network Operators (MVNOs) to compete on the mobile segment alongside existing network-operating carriers. MVNOs are companies that buy network capacity from mobile network operators (MNOs) in order to offer their own branded mobile subscriptions on the market. In substance, MVNOs “replicate” the business structure of the underlying MNO by relying on the vertically-integrated MNOs for network access and provision of termination and network services. The business strategy that drives MVNOs market entry is often aimed at differentiating their offer from those of MNOs by targeting unserved or under-served market segments (such as, for instance, “no-frills” mobile users, or linguistic/ethnic minorities) that might not be fully reached by MNOs, and by adding value to the resale of mobile services in the form of brand appeal, distribution channels, and other special features.

While MVNOs have been existing in the USA and in some European countries (such as Denmark) since the early 2000s, they have only recently appeared on the Italian market, and not without a painstaking process. In 2005, the Italian Competition Authority (ICA) launched an Article 82 EC Treaty investigation against TIM (Telecom Italia Mobile), Vodafone and Wind Italia, the three GSM network carriers operating in Italy, for having allegedly foreclosed access to their mobile networks to a number of competitors in the fixed line telecoms business which intended to establish themselves as MVNOs¹³.

According to the ICA’s final decision, which was delivered in August 2007, TIM and Wind had abused their dominant position by applying discriminatory mobile termination charges for calls originating from potential MVNOs and directed to users within their own network. The ICA found that the mobile termination fees applied by Wind and TIM to business customers buying a bundle of fixed line services, including mobile termination, was lower than the price it charged to those among its business customers (that happened to be at the same time potential MVNO competitors) which were interested exclusively in having access to the mobile termination services. While discounts in case of bundled offers are widespread business practice normally

¹³ Decision No. 14045 of 23/02/2005, case A357, *Tele2 / TIM-Vodafone-Wind*, in ICA Bulletin no. 8/2005.

justifiable under general economic principles on grounds of the cost savings they generate, the ICA found that the mobile termination service to business customers buying TIM's and Wind's bundle was offered at a price well below its cost. The loss in profit sustained vis-à-vis bundled offers was more than compensated by the high return margins enjoyed by the investigated undertakings by offering mobile termination as a individual service to potentially competing customers. According to the ICA, the discriminatory behaviour was made possible by the dominant position that the existing mobile network operators enjoy vis-à-vis termination of calls on their own mobile networks, their vertically integrated structure and their ability to leverage market power at different level of the service chain – i.e. where most needed to fend off potential competition.

The case at hand is particularly interesting also because the ICA decided to sanction only two out of the three companies against which it originally started the investigation – i.e. TIM and Wind – while it accepted commitments pursuant to art. 9 of Regulation 1/2003 from the remaining one (Vodafone) which accordingly was not fined¹⁴.

During the investigation Vodafone had Indeed informed the ICA that it had entered into an agreement with British Telecom (BT) according to which BT was granted access to Vodafone mobile termination service, thus being able to provide BT's own mobile services. Vodafone's commitment was considered by the ICA to be sufficient to remove the anticompetitive effects of the abuse of dominant position by Vodafone and was also deemed capable of increasing the overall competitiveness of the mobile telecoms market.

For the purpose of our analysis, the relevant question arising out of this case concerns the basic conditions that a commitment should satisfy in order to credibly, promptly, effectively and permanently contribute to modify the competitive scenario of oligopolistic markets where, like in the case of mobile telecoms, the competitive outcome is strongly influenced by, and dependent upon, the effects generated by the commercial strategies adopted by each market player on its own network. The risk here is that the commitment may not be sufficient, alone, to positively impact on the

¹⁴ Pursuant to art. 9 of regulation 1/2003, any undertaking involved in an art. 81 or art. 82 EC Treaty investigation may submit to the Commission (or the national authorities which are competent to apply the Treaty rules) behavioral and/or structural commitments aimed at eliminating the anticompetitive effects caused by its conduct. If the antitrust authority deems the proposed remedies capable of positively overcome the anticompetitive effects, it declares them binding on the concerned undertaking and closes the art. 81-82 investigation without ascertaining the actual existence of the infringement.

market interactions between the mobile telecoms operators, specially considering that the market equilibrium might act on them as an incentive to maximise existing positive network externalities and scale economies also, if necessary, by limiting the scope of competition.

From this point of view, in order to be capable of removing the effects of the abuse and generate pro-competitive spill-over effects on the whole market, commitments like those offered by Vodafone should comply with a two-fold test: i) on the one hand, they should guarantee access to a competitor which is efficient enough to generate a credible and commercially autonomous competition on the retail market; ii) on the other hand, they should be capable of causing a structural departure from the pre-existing market equilibrium to the extent that market incumbents have an incentive to counteract the new competitive threat, rather than annul it by persisting in their collusive behaviour. Indeed, if the presence of a MVNO on one of the existing players' network was a real threat for the other MNOs, they too would soon be incentivised to allow MVNOs on their own network in order to meet competition and thus internalizing, at least partially, the negative network effects generated by the presence of the "maverick" MVNO of the competitor.

In the case of Vodafone, the commitment offered to and accepted by the ICA appears somehow inadequate to modify the structure of the market on a lasting basis and in such way as would be required in order to positively impact on the competitive structure of an oligopolistic, highly regulated market such as the mobile telecoms market. Indeed Vodafone committed to enter into a bilateral agreement with a selected commercial partner and not, as it could have been expected, to offer network access to any third party matching some pre-defined objective efficiency criteria. Thus, such solution brings about doubts as to the likelihood that the selected counterpart may actually represent a competitive threat for Vodafone, let alone a "maverick" player on the market. Rather, the choice of a potentially weak counterpart might leave some suspicions of possible vertical coordination (for instance in the form of resale price maintenance) between Vodafone and its MVNO, a situation which would end up strengthening the risks of horizontal coordination between the existing network mobile operators.

Since the closing of the ICA's investigation in 2007, a number of new MVNOs have sprung onto the market or are expected to be launched soon; the existing MVNOs include those by Poste Italiane, some major multiple chains (Auchan, Coop, Conad and Carrefour), and existing competitors in the fixed line market (BT, and recently Tiscali).

The appearance on the market of these MVNOs – many of which rely on the mobile networks of TIM and Wind, the two companies sanctioned by the ICA in the 2007 proceeding – has so far not brought the expected beneficial impact for final consumers. Indeed, the fees offered by MVNO seem to largely replicate those applied by traditional network operators. The impression is that many MVNOs substantially act as resellers of existing mobile network operators' services, thus adding little to the product offerings available to consumers on the market. The limited effect on price competition following the market entry of MVNOs might be due to insufficient market maturity or scarce consumer information; still, the risk that the MVNO phenomenon might turn into a big anticlimax is real. One might indeed wonder whether the presence of several virtual players substantially replicating the same product offers (and, probably the costs, plus additional margins) of established operators might even have the effect of facilitating market collusion between the incumbent network operators.

Still, MVNOs might prove successful where they can differentiate their offers from those of the incumbent mobile operators, for example by leveraging commercial expertise they have in other markets and come up with innovative integrated services that pure telecoms providers cannot match. Of interest here is the case of Poste Italiane, Italy's national postal service, which has built a successful banking business over the last few years and has now begun selling mobile services as a MVNO. With a retail network of 14.000 branches throughout the Country, Poste has both the large distribution reach and the banking capability to offer mobile services - like bill payments, money transfers or prepaid credit card top-ups – that until now have been unavailable to consumers. Poste's banking-on-mobile offer could indeed be a successful example of network combination capable of generating substantial positive externalities for consumers of mobile and banking services, while at the same time acting as an effective "maverick" competitor for both banks and telecoms operators in their respective markets.

5.2 Energy - the issue of market foreclosure in the gas and electricity market

The European Union embarked upon a course of energy market liberalisation more than ten years ago, adopting the first liberalisation package – the so-called first electricity directive – in December 1996, followed by the first gas directive in 1998¹⁵.

¹⁵ The on-going liberalisation process of the electricity and gas market is due to take place in three main phases. As far as the electricity market is concerned, the process started in 1996 with the adoption of the Directive 96/92/EC, successively repealed by Directive 2003/54/EC. With respect to the gas

The aim of the first liberalisation directives was to move from a system of vertically integrated companies often with legal supply monopolies to a system that distinguished between areas where competition was possible and areas of natural monopoly to which other non-incumbent undertakings would have access at reasonable costs.

The goal of the liberalisation process was, and still is, to spur competition, increase efficiency and bring Europe's energy prices to competitive levels. Regulatory initiatives in the EU electricity and gas sectors throughout the late 1990s and the first half of the 2000s focused on key issues such as the separation of network operators and other key infrastructures from energy producers and suppliers, non-discriminatory access for third parties to essential facilities, gradual removal of exclusive supply rights, and the establishment of independent regulators with effective powers. Eleven years and several other directives later, in September 2007, the Commission presented the European Council with its new package of legislative proposals for the energy market which aims, as stressed by Competition Commissioner Neelie Kroes, at "*the effective separation of supply and production activities from network operations*" (emphasis added), a statement which underlines the long way energy markets still have to go in the infrastructure unbundling process¹⁶.

It cannot be argued, indeed, that the European energy sector has remained behind other deregulated industries in terms of level of competitiveness and market contestability, primarily because of the vertically integrated structure of incumbent suppliers and the persistent risk of foreclosure for new market entrants at various level of the industry chain.

sector, the liberalization process started in 1998, with the adoption of Directive 98/30/EC, successively repealed in 2003 by European Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC. Finally, in 2007 the Commission has adopted a comprehensive energy package which contains also two legislative proposals aimed at completing the liberalization process in the energy sector, namely the Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003, and the Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003. For further details please refer to the following link to the EC Commission website: http://ec.europa.eu/energy/electricity/legislation/legislation_en.htm.

¹⁶ See Ms. Kroes' intervention at the 2007 Fordham Law Institute Conference, "*Improving competition in European energy markets through effective unbundling*", in the *Annual proceedings of the Fordham Corporate Law Institute 2007*, vol. 34, p. 247.

As confirmed by the comprehensive sector inquiry conducted by the Commission in 2005¹⁷, despite liberalisation, Europe's energy markets remain largely national and dominated by traditional suppliers and, as a result, the benefits of a well-functioning, competitive and integrated single market delivering increased choice and lower prices for consumers, have not been achieved yet.

Alongside regulation, competition law enforcement has been largely employed as a tool to address foreclosure problems at the various upstream and downstream levels of the gas and electricity supply chains in the newly liberalised market context.

Enforcement actions by both the Commission and national authorities have targeted conducts by dominant players seeking to deny access to gas and electricity supplies to their competitors at upstream (import) and downstream (distribution) level, for instance by hoarding capacity in controlled transit pipes, as in the *RWE* and *E.ON* cases currently being investigated by the Commission¹⁸, or by failing to expand

¹⁷ *DG Competition report on energy sector inquiry* (SEC(2006)1724, 10 January 2007), available at: <http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html>. In a nutshell, the Commission Sector Inquiry found that European energy markets are highly concentrated and lack liquidity, there is absence of cross-border competition and unbundling of network and supply activities is insufficient.

¹⁸ On 31 May 2008 the Commission communicated that it had received some structural remedies, which are currently being market-tested, proposed by German energy incumbent distributor, RWE, to settle ongoing investigation against RWE in the gas sector in Germany. The Commission had launched an investigation against RWE in order to ascertain whether RWE had used the control over its transmission network in the west of Germany to foreclose supply markets and thus to abuse its dominant position in the markets for the transport and supply of gas in that region. RWE undertook to divest its gas transmission system network in the west of Germany to an independent operator. Case COMP/39.402 - *RWE GAS*, see Commission press release at the following address: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/355&format=HTML&aged=0&language=EN&guiLanguage=en>. As regards E.ON, the Commission has been investigating two cases concerning E.ON's alleged behaviour on respectively the German wholesale electricity market and the German balancing electricity markets (balancing energy is last-minute energy necessary to maintain the frequency of the current in the grid). E.ON proposed commitments pursuant to art. 9 of Regulation 1/2003, offering to divest generation capacity in Germany from different types of technology and fuels, i.e. run-off-river, lignite, hard coal, gas, pump storage and nuclear, to remedy the Commission's concerns on the wholesale electricity market. In addition, E.ON proposed to divest its transmission system business consisting of its Extra-High-Voltage (380/220 kV) line network and the system operations currently run by E.ON Netz to meet the Commission's concerns on the electricity balancing markets. Case COMP/39.388, see Commission press release at the following address: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/132&format=HTML&aged=0&language=EN&guiLanguage=en>

networks in response to market demand, as in the 2006 *ENI / TTPC* case before the Italian Competition Authority¹⁹.

At distribution level, antitrust authorities have also tackled abusive conducts aimed at foreclosing competition by tying contestable customers (such as large industrial clients and local resellers, for instance utilities companies) through the conclusion of excessively long-term contracts, which in some cases also impose minimum purchase requirements.

In particular, recent antitrust investigations by the Commission concerned long-term distribution contracts imposed on industrial customers for gas and electricity supply in Belgium respectively by *Distrigaz* (the case was closed with commitments pursuant to art. 9 of Reg. 1/2003 in October 2007)²⁰, and *Electrabel* and *GDF* (both companies are currently being investigated by the Commission, which started proceedings in July 2007)²¹. In Germany, in 2005 the Federal Cartels Office carried out proceedings against *E.ON Ruhrgas* and other local distributors concerning the contractual arrangements that these undertakings were imposing long term gas supply agreements to industrial consumers, thus preventing any possibility for them to switch suppliers²².

In all these cases, the long-term duration of supply agreements has been analysed in connection with the possible risks of rigidity and market foreclosure that excessively durable supply agreements with customers may bring about on markets characterised by the presence of dominant (incumbent) players capable of exerting considerable market power both at the upstream and downstream levels. Accordingly, depending on the level of vertical integration within the concerned market and the flexibility ensured to counterparts in the supply contracts in terms of volumes and prices, competition authorities have taken action on incumbent companies in order to reduce their long-term contracts to a maximum duration deemed compatible with antitrust law, which has been generally identified in 4-5

¹⁹ Decision no. 15174 of 15/02/2006, case A358, *ENI-Trans Tunisian Pipeline*, in ICA Bulletin no. 5/2006. See also decision of 29/11/2006 by the Tribunale Amministrativo Regionale (TAR) of Lazio, on appeal no. 3582/2006 which upheld the ICA decision.

²⁰ Case Comp B-1/37966 *Distrigaz*, decision of 11 October 2007, available at the following link: <http://ec.europa.eu/comm/competition/antitrust/cases/decisions/37966/en.pdf>.

²¹ Cases COMP/39.387 - *Long term electricity contracts in Belgium*

²² Bundeskartellamt, case B8 -113/03, *E.ON Ruhrgas*, decision of 13/01/2006. available at: <http://www.bundeskartellamt.de/wDeutsch/download/pdf/Kartell/Kartell06/B8-113-03.pdf>.

years. This was the case, for instance, with the *E.On Ruhrgas* decision in Germany and, more recently, with the Commission decision in respect to Distrigaz contracts.

With specific regard to the Italian gas market, in 2004 the ICA carried out a sector inquiry which highlighted that at that time ENI still maintained its dominant position at all levels of the gas supply chain²³. Indeed, the IAA noted that there was no flexibility in the offer of gas, since this almost entirely depended on the transport infrastructures controlled by ENI and was largely limited by ENI's long-term "take or pay" contracts, i.e. a form of contractual arrangements which imposes on the buyer to pay a pre-determined amount to the gas supplier irrespective of the actual supply of the agreed gas quantities. With reference to the allocation by ENI to third parties of quota of new transport or regasification capacity, the IAA stressed that long-term "take or pay" contracts reduce the new market entrants' incentive to compete, thus stressing the need for "*more flexible forms of supply leading to short-term access to the market, without the rigidities linked to excessively long take-or-pay agreements*".

In this as well as in other cases concerning ENI²⁴, the ICA appeared to be concerned that, given the dominant position of ENI on the Italian market, the existence of long-term supply contracts between ENI and its clients would *de facto* impede, together with a number of other factors, the liberalisation of the sector. Conversely, it is noteworthy that long term supply gas agreements have been favourably assessed when stipulated by new market entrants, since this would guarantee for a significant period of time the new entrant's competitive position in the wholesale gas supply market autonomously from ENI, thus enhancing competition in the Italian market for gas distribution²⁵.

In conclusion, the risk which has been pointed out by the both EC Commission and national competition authorities throughout their investigations and sector inquiries in the energy sector concerns the possibility that the excessively long duration of the agreements between clients and dominant players, coupled in many cases with the

²³ *Sector Inquiry in the electric energy and natural gas sectors*, no. IC22, published on 09/02/2005, decision no. 14031.

²⁴ See Decision n. 11421, 21 November 2002, Case n. A329, *Blugas/Snam*; Decision n. 15174, 15 february 2006, Case n. A358, *Eni/Trans Tunisian Pipeline*; Decision n. 16530, 6 march 2007, Case n. A371, *Gestione ed utilizzo della capacità di rigassificazione*, respectively in ICA Bulletin no. 47/2002, 5/2006 and 8/2007 .

²⁵ In its 2004 decision concerning a joint venture between Edison, Qatar Mobil and ExxonMobil, the ICA favourably assessed the fact that Edison engaged in a particularly long-term (25 years) "take or pay" supply agreement with Qatar and ExxonMobil. Decision no. 13036 of 25/03/2004, *Qatar Petroleum-Exxonmobil Italiana Gas- Edison Ing/Terminale GNL*, in ICA Bulletin no. 13/2004.

imposition of minimum quantitative requirements or “take or pay” clauses, may end up foreclosing market entry to new competitors, thus severely limiting the chance for contestable industrial customers to switch to more convenient suppliers and to indirectly pass on to final consumers (small undertakings and private individuals, for which direct competition is still largely limited) part of the economic benefits of the first wave of the energy markets liberalisation.

5.3 Retail Banking - the payment services market between voluntary self-regulation, legislative interventions and antitrust enforcement

Usually we refer to “liberalisation” as the process of opening up to market competition certain sectors which had previously been reserved to public monopolies, such as traditionally the utilities, telecoms and public transport services. Still, from a broader perspective, “liberalisation” is also less technically used to refer to the process of shaping the competitive structure of existing markets which fail to deliver certain social results to the benefit of the collectivity²⁶.

If we look at the evolution of the European banking industry from this broader point of view, we can hardly debate that the whole sector is undergoing a significant liberalisation process, specially for what concerns the retail banking business. In particular the integration of the domestic payment systems into a Single European Payments Area (SEPA) is probably the most far-fetched ongoing initiative, as it directly affects the everyday life of million of European citizens.

The SEPA project is indeed the final milestone of a long process embedded within the monetary policy of the European Union, which finds its roots in earlier EC legislation on cross-border credit transfers that paved the way for the consolidation of common rules on cross-border payments eventually achieved with SEPA (EC regulation no. 1103/97, EC directive 97/5/EC and more recently EC regulation 2560/2001 preventing banks from charging their customers with higher fees for cross-border transfers in comparison to domestic transfers).

SEPA substantially consists of a process of standardisation of inter-banking payment procedures which relies on voluntary rules developed by the European banking industry in close cooperation with the European Commission, the European Central Bank and the central banks and the public administration bodies of the SEPA

²⁶ See the interesting contribution by S. Cassese in *Regolazione e Concorrenza* by G.Tesaro and M.D’Alberti, Bologna 2000, p. 14.

member States²⁷. With the roll-out of SEPA in February 2008, it has become possible for consumers to benefit not only from faster and cheaper payments throughout the SEPA region, but also from new services which the fragmentation of the national banking systems had so far prevented. For instance, current account holders from a SEPA member State may activate direct debits (for example, for utility bills) in another SEPA State or pay with their domestic debit card throughout the SEPA zone.

By abolishing entry barriers in the payments market, where so far incumbent domestic banks had retained strong market power thanks to historical links with local customers, the SEPA standardization process will contribute to make the EU retail banking market more contestable and competitive, as banks will eventually be able to reach a wider-than-national customer base and thus rival with local incumbents for attracting current account holders and their payment flows.

Still, being SEPA a self-regulatory standardisation exercise adopted by the banking industry, the risk exists that its implementation might lead to undesired collusive outcomes. Because of this risk, the regulatory surveillance over SEPA cannot but comprise an attentive antitrust assessment particularly in respect to those instances where inter-banking cooperation is necessary to the functioning of the system, as is the case with multilateral interchange fees. SEPA has indeed a direct impact on inter-banking pricing mechanisms, as it comes with a multilaterally agreed interchange scheme applicable to any banks within SEPA. Indirectly, SEPA affects the prices consumers pay for sending and receiving payments, given that this final pricing is largely based on the underlying interchange fee agreed by the banking system.

The issue of the anticompetitive impact of multilateral interchange fees is indeed an old one which has been profusely debated by courts and academics on both sides of the Atlantic²⁸. At European level, the Commission and the national antitrust authorities of many member States (including Italy) have investigated it with

²⁷ For additional information and further details on the functioning of SEPA see the following link to the EC Commission website: http://ec.europa.eu/internal_market/payments/sepa/index_en.htm.

²⁸ Antitrust litigation relating to credit card networks in the US dates back to the 1980s and early 1990s with some key rulings by district courts in cases such as *Nabanco* (1986) *MountainWest* (1993) and *U.S. v. Visa* (1996), where the competitive effects of interchange fees were first examined in connection with the rules underpinning the functioning of the Visa and Mastercard networks. For an overview of these cases as well as follow-on litigation by interested third parties such as Wal-mart, Discover and American Express (the latter proceeding having been settled only in 2007), see “*The Persistence of Antitrust Controversy and Litigation in Credit Card Networks*” by K.C. Wildfang and R.W. Marth, in *Antitrust Law Journal* vol. 73, issue 3 2006, p. 675.

approaches not always compatible with each other, resulting in “alternate outcomes” for consumers and industry stakeholders²⁹.

Initially considered to be a necessary tool for the competitiveness of payment networks provided that they are not excessively burdensome and are cost-oriented³⁰, following the Commission’s far-fetched decision in the 2007 *Mastercard* case interchange fees in Europe now need to satisfy a particularly high standard of (economic) proof in order to be justifiable under EC competition rules (and precisely art. 81(3) of the EC Treaty)³¹.

Within SEPA, the complexity of the picture is increased by the fact that in some SEPA countries domestic payment networks operate without a multilateral interchange fee³². This finding makes it harder for payment schemes to argue that their multilateral interchange fees are essential for the functioning of their inter-banking system. Accordingly, any payment network which aims to provide services under the new SEPA regime will then have to demonstrate on empiric grounds that its interchange fee is necessary to the proper functioning of the system and economically sound. Little room seem to be left for arguments purporting the importance of interchange fees as a balancing instrument for the overall positive externalities of the payment network. Although in some cases these arguments may still be valid, they need to be corroborated by strong economical evidence.

While antitrust enforcement would be the correct tool to ensure that no collusive conducts may find roots within the standardisation process, self-regulatory initiatives such as SEPA may not be able alone to spur competition in the payment services market. This is why the EC legislator has introduced a Payment Services Directive

²⁹ In the last few years, antitrust investigations on interchange fees at national level have been carried out with respect to domestic debit card networks in Italy (case I661, “*Accordi Interbancari ABI-Cogeban*”, decision 16709/2007 in ICA’s Bulletin no. 14/2007,) and Spain (Decision of 13 April 2005 by the Competition Tribunal in case *Euro6000/Servired/Sistema4B*). Mastercard’s domestic debit card schemes have been investigated in the UK (OFT’s 2005 investigation into Mastercard’s domestic debit card interchange fees) and Poland (decision of OCCP of 7 January 2007 on Mastercard domestic interchange fee), where the Mastercard multilateral interchange fee was declared illegal by the Polish Antitrust Authority and subsequently abolished by Mastercard. Ongoing antitrust investigations on Mastercard’s domestic multilateral interchange fees are currently taking place in Hungary and the UK.

³⁰ See case COMP/29.373, *Visa International*, in OJ L 318 of 22 November 2002, p. 17-36.

³¹ Case COMP/34.579 *Mastercard / Europay*, decision of 19 December 2007, not yet published in the Official Journal. The decision is available at the following link: http://ec.europa.eu/comm/competition/antitrust/cases/index/by_nr_69.html#34_579.

³² This is the case of the debit card networks in Denmark, the Netherlands, Finland, Norway and Luxembourg.

(PSD) with the specific goal of opening up the payment market to competition on the wake of the industry-conceived SEPA project.

The inspiring idea behind the PSD is that an integrated European market for payment services requires a “level playing field”, that is, homogeneous conditions for the exercise of the business activity under the “*same activity, same risk, same requirements*” principle. To this aim, the Directive dictates new general requirements and creates a single European authorization for setting up and operating a payments service throughout the EU; moreover, it provides that other subjects (identified as “payment institutions”) beside banks and financial institutions can now offer the service under the same conditions, i.e. upon obtaining authorization in a Member State.

The broadening of the payment service offer introduced by the PSD is a substantial departure from past EU and national regulatory policies which were oriented to the preservation of the integrity and financial stability of the payments systems by limiting the business to banks and some other financial institutions; in fact, it does not establish a parallel, “quasi-banking” payment system but rather gives the possibility of entry into the payments market to non-banking operators which for strategic reasons (such as availability of large sums of cash, direct client contact, control over telecoms networks etc.) might find it profitable to provide such service to their clients.

Major multiples chains, money transfer agencies, internet companies and telecoms operators are likely to exploit this opportunity and start offering payment services at their retail premises, via web or via mobile, thus generating direct and indirect positive network externalities to the benefit of their existing clients. From this point of view, the PSD cannot but be hailed as a successful piece of regulation, as it abolish a significant legal barrier impeding commercial enterprise that can directly maximise consumers benefits in several ways.

However, as with many good things, there is “the flipside of the coin” to be reckoned with.

Firstly, the entry of non-banking entities poses some threats to the stability of the whole banking system, particularly for what concerns financial guarantees. For this purpose, the PSD imposes on non-banking entities to set up a specific entity responsible for the payment services business under a separate accounting regime. This might not be enough, however, to spell out the risk of spill-over effects for the whole payments system in case of bankruptcy or winding up of the non-banking payments provider.

Secondly, in a fully interoperable payments system, non-banking entities should have access to the banking network in order to interact with the other market operators and process payments. Because the existing banking networks are often used to process payments as well as other inter-banking operations (for instance, clearing and settlement of financial transactions), risks exist that the non-banking entity poses a threat in terms of network security and thus be not allowed access by incumbent network proprietors. Antitrust scrutiny should be employed here to ensure that access refusal is not discriminatory and thus abusive pursuant to art. 82 of the EC Treaty.

However successful SEPA and PSD will be in delivering a more competitive retail banking market, little benefit will be spared to consumers if they bear substantial switching costs which *de facto* impede their mobility. On this regard, regulators and antitrust authorities have taken action both at EU level and domestically to break down the obstacles that tie customers to their banks, thus reducing the incentives to avail themselves of other payment service providers. In Italy, the Bersani Decree of 2006 abolished the fees charged by banks for closing current accounts and the following Bersani Decree “*Bis*” introduced new rules on mortgage transferability³³. While all these initiatives have been very popular and cannot but be assessed positively as they increase the offer available to consumers and foster customer mobility, attention should be paid to ensure that these forms of price regulation do not impinge upon the natural equilibrium of the market by preventing banks to recover the actual costs which they bear, for instance, in providing mortgage transfer or account cancellation services. Indeed, the risk is that these costs will simply be transferred to other financial services not covered by specific regulatory limitations, to the detriment of other (or perhaps the very same) consumers.

6) *Conclusive remarks*

Several recent initiatives by Europe’s antitrust authorities and regulators in the banking, energy and telecoms markets - some of which have been briefly discussed in the present paper - seem to indicate that more and more efforts are now being directed at ensuring that policy interventions be aimed at shaping the competitive

³³ The so-called Bersani Decree of 4 July 2006 (D.L. 223/2006 transposed into law with Act no. 246 of 4 August 2006) was followed by a second Bersani Decree in January 2007 (D.L. 7/2007, transposed into law with Act no. 40 of 2 April 2007).

process of deregulated markets while ensuring, at the same time, that competition actually delivers concrete benefits to final consumers.

Still, pursuing consumer welfare in industries characterised by historical (monopolistic or oligopolistic) public heritage and where competition responds to peculiar mechanisms dictated by scale, infrastructure ownership and direct/indirect network effects, is not an easy task. Successful competition and consumer policy in these deregulated markets depends, first and foremost, on a sound understanding by regulators of how the competitive process works in these markets. Specific attention should be paid also to the specific (and often complex) features of the products and services and the peculiar interaction between supply and demand, with particular care being paid to the factors affecting consumer behaviour (such as information asymmetries and/or actual or perceived switching costs) and the possible ways to enhance/improve it.

Competition advocacy initiatives such as sector inquiries – a tool which is increasingly being employed by competition authorities both at EU and national level, as seen above with respect to banking and energy – provide a good starting point not only in detecting possible malfunctions of the market on the offer side, but also in spotting suboptimal consumer behaviours on the demand side. Any detected shortcomings on the demand side should prompt further attention to the causes that are at the basis of the failures by market forces to maximise consumer welfare to the full possible extent. In a developed policy scenario, competition law enforcement should serve competition and consumer policy by intervening where market failures are attributable to the illicit conducts of the market participants, and should be directed by clear, homogeneous and long-term policy guidelines setting realistic and consumer-oriented goals whose final objective should be to increase the overall competitiveness of the market. Competition advocacy should be employed to address those market failures that are not attributable to anticompetitive practices by market participants, but are nonetheless detrimental to consumer welfare.

As far as regulation is concerned, legislative interventions should be based on an *ex-ante* assessment of the benefits of the regulation vis-à-vis the expected achievements that would be generated by the market's own forces, for example through self-regulatory initiatives promoted by industry stakeholders. Rather than obstructing this kind of voluntary initiatives, regulators should endorse and guide them so as to ensure that they deliver the expected results in terms of both improvement of the market competitiveness and consumers' benefits. A good example, which perhaps could be replicated for other deregulated markets, is offered

by the ongoing liberalisation process in the payments industry where SEPA and PSD, two initiatives that stem from different sources (industry and EC legislator), successfully complement each other under the umbrella of a common policy framework which embraces the enhancement of both market competition and consumer welfare.

