Fair Trading Commission

Commissioners' Decision

Case no. 3685

Grace Kennedy Remittance Services (GKRS) under Section 20 of the Fair Competition Act:

April 30, 2002

PUBLIC VERSION
Confidential information omitted. The omissions are indicated by an endnote or by the symbol [✄]

Fair Trading Commission
52 Grenada Crescent
Kingston 5
Tel: (876) 960 1020 – 4; Fax: (876) 960 0763
Email: ftc@cwjamaica.com
Website: http://www.jftc.com

Executive Summary

1. An investigation was carried out to determine whether Grace Kennedy Remittance Services (GKRS), was engaging in tying in the markets for electronic money transmission and utility bill collections. The investigation was a result of a complaint from Paymaster Jamaica Limited (Paymaster). The allegation brought forward by Paymaster against GKRS falls under Section 20 of the FCA, which prohibits the abuse of dominance. Under Section 20(1), an enterprise would be considered to have abused a dominant position if it impedes the maintenance or development of effective competition in a market. For the purposes of the Act an enterprise holds a dominant position in a market if by itself or together with an interconnected company, it occupies such a position of economic strength as will enable it to operate in the market without effective constraints from its competitors or potential competitors.

2. Subsection 20(1)(f) states that an enterprise abuses a dominant position if it "makes the conclusion of agreements subject to acceptance by other parties of supplementary obligations which by their nature, or according to commercial usage, have no connection with the subject of such agreements". The Commission interprets this to refer to the tying or bundling of goods and services.

3. Section 20 (2), however, provides that an enterprise shall not be treated as abusing a dominant position-

- if it is shown that-
  - its behaviour was exclusively directed to improving the production or distribution of goods and services or to promoting of technical or economic progress, and
  - consumers were allowed a fair share of the resulting benefit;
- by reason only that the enterprise enforces or seeks to enforce any right under or existing by virtue of any copyright, patent, registered design or trademark.

4. In conducting the investigation under Section 20 of the FCA, the allegation against GKRS was assessed according to the following five-step approach:

(a) *Definition of the relevant market*—this is necessary in order to establish the dominance of the supplier and to assess the anti-competitive impact, if any;

(b) *Assessment of dominance*—Both market share and entry barriers are taken into consideration in assessing whether the firm in question is in fact dominant in the market for the tying product.

(c) *Assessment of the existence of a tying arrangement*—Tying refers to the case where the supplier makes the purchase of one product (the "tying" product) conditional on the purchase of a second product (the "tied" product). Tying can be pure or mixed. Pure tying means that the goods cannot be separately purchased at all whereas mixed tying allows for goods to be bought separately although at less favourable terms. If there is no evidence of tying then the investigation is terminated.

(d) *Assessment of abuse of dominance*—if dominance and the tying arrangement are established, the tying practice should be assessed to determine if it is indeed an abuse of dominance. Specifically, in accordance with Section 20(1), it should be determined if the behaviour has led to the impediment of "the maintenance or development of effective competition in a market".

(e) Assessment *of pro-competitive benefits*—If it is found that the behaviour impedes the maintenance or development of effective competition in a market, an assessment in accordance with Section 20(2) shall be carried out, i.e., to determine whether or not the behaviour was exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress and consumers were allowed a fair share of the resulting benefit. If the tying carried out by GKRS is found to be pro-competitive then the company will not be treated as having abused a dominant position.

Relevant market definition

5. The relevant product market defines the product boundaries within which competition meaningfully exists, and includes only those products that are "reasonably interchangeable" by consumers for the same purpose. In this case, the relevant product markets are defined as the market for electronic money transmission and the market for utility bill collections.

6. The geographic market is the "area of effective competition" in which the seller operates and to which the purchaser can practicably turn for supplies. In this case the geographic market was defined to cover the entire island.

Assessment of dominance

Electronic money transmission market

7. The relevant market is defined as the market for electronic money transmission services and includes both wire transfers and cash remittances. Gross inflows through these conduits totaled US$780.5 million. According to the statistics from Bank of Jamaica, cash remittance companies accounted for US$446 million (55.4%) of incoming remittances. In its response to a questionnaire administered by the Staff, GKRS indicated that Western Union accounted for [✂]% of private inflows through cash remittance companies. This meant that GKRS' market share met the guideline threshold for dominance in the relevant market.

Utility bill collection services market

8. The market has been defined as the market for utility bill collections. GKRS' own estimated share of the utility bill collections market is as follows:

- Jamaica Public Service – [✂]%
- Cable and Wireless – [✂]%

– National Water Commission – [✂]%

9. Paymaster on the other hand has placed their total share of the utility bill collection market at [✂]%. These figures are supported by data collected from two utility companies, Cable and Wireless Jamaica Limited (C&WJ) and Jamaica Public Service Company (JPSCo). The data collected from these two companies revealed that more than [✂]% of their customers paid at their commercial offices.

This meant that GKRS is not dominant in the market for utility bill collections.

Assessment of the existence of a tying arrangement

10. It is only after the existence of a tie is shown that it is necessary to determine whether an illegal tying arrangement exists. Where a tying product has not been withheld, there is no tie. There is no tie for any antitrust purpose unless the Respondent improperly imposes conditions that explicitly or practically require buyers to take the second product if they want the first one.

11. Tying is not limited to contractual terms and "forcing" can be accomplished through less formal means such as discriminatory discounting or coercion. A widespread migration of customers, who are also users of the tying product, from suppliers of substitutes for the tied product and towards the supplier of the tied product may also be suggestive of "verbal coercion".

12. The Commission's review of GKRS' Western Union and Bill Express sub-agency agreements did not reveal any contractual terms that suggest the existence of any discriminatory treatment and which would imply a tying arrangement. The commission structures of both agencies were also examined. The examination revealed that all Western Union sub-agents received the same rate of commission. This was also true for the Bill Express sub-agents. Entities that operated both Western Union and Bill Express sub-agencies did not receive higher rates of commission than entities that operated only Western Union or Bill Express.

13. Further, if there were any form of "verbal coercion" taking place one would expect to see a significant decrease in the number of Western Union outlets that also operate Paymaster sub-agencies. There should be a significant shift of Western Union outlets from Paymaster to Bill Express sub-agencies.

14. In July 2001, Paymaster indicated that nine (9) Western Union outlets also operated Paymaster sub-agencies. In November 2001, there were twelve (12) Western Union outlets that also operated Paymaster sub-agencies. The increase in Western Union outlets with Paymaster sub-agencies suggests that there is no form of verbal coercion taking place.

Conclusion

15. The investigation of the relevant markets did not divulge any evidence of tying. Our review of the sub-agencies agreements and commission structures did not reveal any terms that suggest the existence of any discriminatory treatment and which would imply a tying arrangement. The increase in Western Union outlets

with Paymaster sub-agencies is also indicative of the fact that a tying arrangement does not exist.

16. Given that it is only after the existence of a tie is shown that it is necessary to determine whether an illegal tying arrangement exists, the Commission did not see it fit to continue the investigation any further. No breach of the FCA was therefore found.

Table of Contents

1. Scope of investigation

1.1 The allegation brought forward by Paymaster against GKRS falls under Section 20 of the FCA, which prohibits the abuse of dominance. Under Section 20(1), an enterprise would be considered to have abused a dominant position if it impedes the maintenance or development of effective competition in a market. For the purposes of the Act an enterprise holds a dominant position in a market if by itself or together with an interconnected company, it occupies such a position of economic strength as will enable it to operate in the market without effective constraints from its competitors or potential competitors.

1.2 Subsection 20(1)(f) states that an enterprise abuses a dominant position if it "makes the conclusion of agreements subject to acceptance by other parties of supplementary obligations which by their nature, or according to commercial usage, have no connection with the subject of such agreements". The Commission interprets this to refer to the tying or bundling of goods and services.

1.3 Section 20 (2), however, provides that an enterprise shall not be treated as abusing a dominant position-

- if it is shown that-
  - its behaviour was exclusively directed to improving the production or distribution of goods and services or to promoting of technical or economic progress, and
  - consumers were allowed a fair share of the resulting benefit;
- by reason only that the enterprise enforces or seeks to enforce any right under or existing by virtue of any copyright, patent, registered design or trademark.

2. Methodology for analysis

2.1 In accordance with Section 20 of the FCA, the behaviour, i.e., tying, attributed to GKRS must be examined to determine if it impedes the maintenance or development of effective competition in a market. If it does not, then it is not in contravention of Section 20. If it does, then an analysis must be carried out to determine if the provisions are exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress with consumers being allowed a fair share of the resulting benefit. If the latter condition is fulfilled, then GKRS will not be treated as abusing its dominant position and there will be no breach under Section 20 of the FCA. If, however, the condition is not met, then a breach will be determined.

2.2 In sum, the allegation shall be assessed according to the following five-step approach:

(a) *Definition of the relevant market*—this is necessary in order to establish the dominance of the supplier and to assess the anti-competitive impact, if any;

(b) *Assessment of dominance*—Both market share and entry barriers are taken into consideration in assessing whether the firm in question is in fact dominant in the market for the tying product. In most jurisdictions an enterprise with a market share of at least 50% of the relevant market is generally considered to be dominant.1 The FTC adopts the same percentage in its cases under Section 20 of the FCA.

(c) *Assessment of the existence of a tying arrangement*—Tying refers to the case where the supplier makes the purchase of one product (the "tying" product) conditional on the purchase of a second product (the "tied" product). Tying can be pure or mixed. Pure tying means that the goods cannot be separately purchased at all whereas mixed tying allows for goods to be bought separately although at less favourable terms. There are various ways in which tying may be effected:

- Direct tied sales where goods or services are packaged together as one unit;
- Contractual tying where a contract to retail a good or service is made conditional upon the agreement to retail another good;
- Discounting whereby the discounts applied to one good are made conditional upon the purchase (or sale) of another good. This gives incentives to the retailer/customer to sell/buy the related good in order to obtain the discount, which leads to the same 'tied' outcome. Popular cable networks, for example, have been sold in a package at a discount from the single product price.

[1] The European Court, for example, has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%.[1] The Office of Fair Trading in the UK considers it unlikely that an undertaking will be individually dominant if its market share is below 40% (see OFT (1999), *The Competition Act 1998: The Chapter II Prohibition*, March). The Competition Bureau of Canada applies a guideline threshold of 35% market share in its assessment of dominance (see Competition Bureau (2001), *Enforcement Guidelines on the Abuse of Dominance Provisions,* July).

Suppliers use this to encourage cable systems operators to carry multiple networks and achieve cross promotion among networks in the package.

If there is no evidence of tying then the investigation is terminated.

(d) *Assessment of abuse of dominance*—The antitrust concern with tying is that a firm that is dominant in one market might be able to "leverage" this dominance into another market, exclude rivals in what would have been a competitive market and thus raise prices above the competitive level in this second market. In other words, the enterprise may be using its market power in the *tying good* market to improve anti-competitively its market power in the *tied good* market. As it is dominant in the tying market, it would be able to force an increase its sales in the other market through offering both goods as a "bundle".[2] Consequently, rivals would be excluded from the tied good market and competition reduced, to the detriment of consumers.

If dominance is established, then the practices in question should be assessed to determine if they are an abuse of dominance. Specifically, in accordance with Section 20(1), it should be determined if the behaviour has impeded "the maintenance or development of effective competition in a market".

In the Hoffman-La Roche case, the European Court of Justice defined the abuse of dominance as follows:[3]

> "… The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which … through recourse of methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition".

In the Michelin case, the European Court of Justice stated that:[4]

> "a finding that an undertaking has a dominant position is not in itself a recrimination but simply means that, irrespective of the reasons for which it has the position, the undertaking concerned has a *special responsibility* not to allow its conduct to impair genuine undistorted competition on the Common Market". [emphasis added]

In *Hoffmann-La Roche*, the European Court of Justice found:

> 'An undertaking which is in a dominant position in a market and ties purchasers – even if it does so at their request – by an obligation or promise on their part to obtain all or most of their requirements exclusively from the said undertaking

[2] A recent anti-trust case on tying brought on by the US Department of Justice against Microsoft. Microsoft is dominant in the Intel-compatible PC operating systems market and tied its operating systems with its internet browser. The US DOJ claimed that the tying was anti-competitive and constituted an attempt by Microsoft to gain a monopoly in the market for internet browsers in violation of §2 of the Sherman Act. As the internet browser is offered free to purchasers of the operating systems, for example, consumers face a disincentive to purchase an alternative browser.

[3] Case 85/76 Hoffman-La Roche v Commission [1979] ECR 461.

[4] Case 322/81 NV Nederlandsche Banden Industrie Michelin v Commission [1985] 1 CMLR 282, [1983] ECR 3451.

> abuses its dominant position within the meaning of Article 86 [now Article 82] of the Treaty, whether the obligation in question is stipulated without further qualification or whether it is undertaken in consideration of the grant of a rebate. The same applies if the said undertaking, without tying the purchasers by a formal obligation, applies, either under the terms of agreements concluded with these purchasers or unilaterally, a system of fidelity rebates, that is to say discounts conditional on the customer's obtaining all or most of its requirements - whether the quantity of its purchases be large or small - from the undertaking in a dominant position.
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> Obligations of this kind to obtain supplies exclusively from a particular undertaking, whether or not they are in consideration of rebates or the granting of fidelity rebates intended to give the purchaser an incentive to obtain his supplies exclusively from the undertaking in a dominant position, are incompatible with the objective of undistorted competition within the common market, because - unless there are exceptional circumstances which may make an agreement between undertakings in the context of Article 85 [now Article 81] and in particular of paragraph (3) of that article, permissible - they are not based on an economic transaction, which justifies this burden or benefit but are designed to deprive the purchaser of or restrict his possible choices of sources of supply and to deny other producers access to the market…'

The principles laid out in the *Hoffmann-La Roche* judgement cited above make it clear that it is an abuse for a firm in a dominant position to make anti-competitive bundling agreements. They do not suggest or imply that such behaviour becomes abusive only at the point at which it has actually foreclosed some particular proportion of the market.

In *BPB Industries and British Gypsum v Commission* case T-65/89 [1993] ECR II-0389, the Court of First Instance (whose judgment was upheld by the European Court of Justice on appeal) stated that where an undertaking held a dominant position "the conclusion of exclusive supply contracts in respect of a substantial proportion of purchases constitutes an unacceptable obstacle to entry to that market…" However, the judgement did not give any indication as to what proportion of purchases was affected, and so what it meant by "substantial", nor did it imply that it intended to narrow the effect of the judgement in *Hoffmann-La Roche.* Indeed it went on to reiterate and clarify the principles laid out in *Hoffmann-La Roche:*

> 'The Court points out, secondly, that, as the Court of Justice has held (in the judgement in Michelin, cited above), the application by a supplier who is in a dominant position, and upon whom as a result the customer is more or less dependent, of any form of loyalty rebate through which the supplier endeavours, by means of financial advantages, to prevent its customers from obtaining supplies from competitors constitutes an abuse within the meaning of Article 86 [now Article 82]'of the Treaty.'

This makes no reference to the proportion of the market covered and, as has been noted, the essence is that a dominant supplier's exclusivity agreements with retailers that prevents them from obtaining supplies from its competitors.

More recently, the European Court of First Instance made the same point in relation to the pricing policies of Irish Sugar (Case T-228/97 *Irish Sugar plc v Commission* [1999] paragraph 114):

> 'With particular reference to the applicant's practices in relation to price fixing, the case-law shows that, in determining whether a pricing policy is abusive, it is necessary to consider all the circumstances, particularly the criteria and rules governing the grant of the discount, and to investigate whether, in providing an advantage not based on any economic service justifying it, the discount tends to remove or restrict the buyer's freedom to choose his sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties or to strengthen the dominant position by distorting competition (Hoffmann-La Roche, paragraph 90; Michelin, paragraph 73). The distortion of competition arises from the fact that the financial advantage granted by the undertaking in a dominant position is not based on any economic consideration justifying it, but tends to prevent the customers of that dominant undertaking from obtaining their supplies from competitors (Michelin, paragraph 71)'

The key issue is the effect that the behaviour of the dominant undertaking tends to have. This follows the established position in European case law that dominant firms have a "special responsibility" on account of the prejudice their activities may cause to competition in general, which is derived from *Michelin v Commission* (Case 322/81) [1983] ECR 3461. It is indisputable that, if a supplier has strong dominance in the form of, say, a market share of around 90%, and strong brand image, any form of anti-competitive agreement between that supplier and on-trade retailers will tend to reduce the small amount of competition existing in the market.

Furthermore, the actual scope of the special responsibility imposed on a dominant undertaking must be considered in the light of the specific circumstances of each case.[5] In Compagnie Maritime Belge v Commission, Advocate General Fennelly stated at point 137 of his opinion:

> "To my mind, Article 86 [now Article 82] cannot be interpreted as permitting monopolists or quasi monopolists to exploit the very significant market power which their superdominance confers so as to preclude the emergence either of a new or additional competitor."

In the same point of his opinion, the Advocate General noted that an undertaking which enjoys a position of overwhelming dominance verging on monopoly has a particularly onerous special obligation not to impair further the structure of the feeble existing competition in the relevant market.

We believe that the above comments are of assistance in assessing the conduct of suppliers that enjoy a position of overwhelming dominance in the relevant market.

[5] Case C-395/96P and C-396/96P *Compagnie Maritime Belge Transports SA v Commission* (paragraph 114) [2000] 4 CMLR 1076-1170

We consider that dominant suppliers have an onerous special responsibility not to engage in conduct which risks furthering the weak structure of competition remaining in the relevant market by precluding the emergence of new or additional competitors. Further, while the fact that a dominant undertaking cannot preclude itself from protecting its own commercial interests if they are attacked, such behaviour is not acceptable under Section 20 of the FCA if its actual purpose is to strengthen this dominant position and abuse it.[6]

The fact that a dominant supplier has entered into bundling arrangements with only some of its customers and that therefore such arrangements do not cover the whole of a relevant market is, in our view, immaterial to the finding that the abuse of a dominant position has an effect on competition. In *Hoffmann-La Roche*, the European Court of Justice said that:

> 'Since the course of conduct under consideration is that of an undertaking occupying a dominant position on a market where for this reason the structure of competition has already been weakened within the field of application of Article 86 [now Article 82] any further weakening of the structure of competition may constitute an abuse of a dominant position.'

In a market where one player is strongly dominant and competition is weak, the development of competition is more fragile and more easily affected by particular actions by the dominant incumbent. In the case of a new entrant, for example, anti-competitive behaviour such as predatory pricing may need only to target the relatively few outlets into which the new entrant is attempting to gain a foothold in order for competition to be eliminated. In such a case, the proportion of the market that is affected by the arrangement in question need not be significant.

(e) *Assessment of pro-competitive benefits*—If it is found that the behaviour impedes the maintenance or development of effective competition in a market, an assessment in accordance with Section 20(2) shall be carried out, i.e., to determine whether or not the behaviour was exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress and consumers were allowed a fair share of the resulting benefit. In particular, vertical restraints may be beneficial when there: (i) is a free-rider problem; (ii) are significant client-specific investments to be made by either supplier or buyer; or (iii) is transfer of substantial know-how. See Appendix A for a detailed discussion of the anti- and pro-competitive effects of vertical restraints.

The most fundamental pro-competitive justifications for tying concern cost factors. Tying can lead to a reduction in transaction costs by reducing search and information costs of finding out who to do business with, the bargaining and decision costs of negotiation, and the policing and enforcement costs of agency. Specifically, tying may lead to cost savings with regard to three factors:

- *Economies of scope*—these advantages refer to cost savings that originate from production or delivering several products in a single entity rather than

[6] Case-310/93P *BPB Industries plc and British Gypsum Limited v Commission* at paragraph 69 – cited above.

separately. Setup costs and supply costs are lowered when there are economies of distribution including administration and billing. Efficiencies can be gained in areas such as marketing, customer operations, and information technology. It is not uncommon for a multi-product firm to undertake joint marketing efforts. It might, for instance, seek to develop a single brand identity for a variety of products so that expenditures on promotion of the brand might enhance the sales of all products.

- *Economies of information and transacting*—these refer to cost advantages for producers when they are searching for trading partners and when several services are sold in one selling effort. Since tying means selling several products together, such economies are achieved when a customer that is already located, i.e. existing customer, is sold many services simultaneously. For firms in the customer relationship business, for example, the up front cost of winning a customer is so great that the challenge is to sell as many products as possible to the same customer, i.e., to tie. Where economies of distribution are present, there may be benefits to selling multiple products to the same customer. It follows that the greater the cost savings from tying, the larger the potential gains to both producer and consumer. Economies of information and transaction refer therefore to selling activities that can be reduced by tying.
- *Economies of time*—this is a related cost concept to the economies of information and transacting. It refers to long term cost savings in the acquisition of customers. It is more economical to retain existing customers instead of having to look for new customers. This assumes that the cost of serving an existing customer does not increase proportionally through time. If tying can be used in order to lengthen the relationship with a customer it will reduce the need of resources to be put on acquiring new customers.

The three situations mentioned above make clear that under certain conditions tying is likely to help realize efficiencies and the development of new markets and that this may offset possible negative effects.

3. Defining the relevant market

3.1 The first step in any antitrust investigation is to define the relevant market. This is important as it determines the market shares of relevant players that, in turn, heavily influence the assessment of market power and dominance. As emphasized by the European Commission:

> "market definition is a tool whose purpose is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market … is to identify those competitors of the undertakings involved that are capable of constraining their behaviour and of preventing them from behaving independently of any effective competitive pressure. It is from this perspective, that market shares may provide meaningful information for the purposes of assessing dominance ..."[7]

3.2 This relevant market will have two dimensions - the relevant goods (i.e., the product market); and the geographic extent of the market (the geographic market). Both are discussed below. This is followed by an assessment of the relevant markets.

The product market

3.3 The relevant product market defines the product boundaries within which competition meaningfully exists, and includes only those products that are "reasonably interchangeable" by consumers for the same purpose. The US Supreme Court has explained what it means to be "reasonably interchangeable:"

> "For every product, substitutes exist. But a relevant market cannot meaningfully encompass that infinite range. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose 'cross-elasticities of demand' are small." [8]

3.4 The boundaries of the market are, therefore, determined by taking the products relevant to the investigation and looking at the closest substitute products, those products which consumers would switch to if prices of the relevant products rose. These substitute products are included in the market if substitution by consumers and suppliers would prevent prices of the products relevant to the investigation from rising above competitive levels. The alternative products do not need to be perfect substitutes, but alternatives that would fill a similar role to the goods in question, and to which consumers would switch in the event of a price increase. Essentially any similar goods that would prevent price-setting above competitive levels should be included in the definition of the relevant product market.

3.5 In addition to this substitution by customers (so-called "demand substitution"), prices can also be constrained by the potential behavior of suppliers producing

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[7] Notice on the Definition of Relevant Market for the Purposes of Community Competition Law [1998] 4 C.M.L.R. 177; [1997] O.J. C372/5 (E.C. Commission) (97/C 372/03), Para. 2.

[8] Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 612

other products ("supply substitution"). Businesses that are not currently supplying a particular product might switch some of their existing facilities to supplying that product (or close substitutes) if prices rose significantly. There can also be importation of close substitutes.

An example of supply substitution may be found in the paper industry. Although low quality paper is often not considered to be a substitute for high quality paper, from a consumer's point of view, the different grades of paper are almost perfect substitutes from the producer's point of view. This is because the production methods are identical across all grades of paper where only the input (pulp) has to be changed in order to change the output from low to high quality paper. In this example, even though there is no demand substitutability, a rise in the price of high quality paper is likely to see paper manufacturers switching from low quality paper towards producing more high quality material. In other words, a similar product should be included in the same relevant market as the product in question as long as either demand or supply substitution applies.

3.6 One common way of defining the market is to apply the conceptual framework of a hypothetical monopolist. This framework assumes an undertaking that was the only supplier of the products (or group of products) to be at the center of the investigation and asks the question if it could maximize its profits by consistently charging higher prices than it would if it faced competition.[9]

Based on the concept of the hypothetical monopolist, a test that is commonly applied is the so-called "SSNIP test", where SSNIP stands for "small but significant non-transitory increase in price" which is normally interpreted as a 5 – 10% price increase.[10] Further, as a rule of thumb, the Office of Fair Trading (OFT) in the UK interprets "non-transitory" to mean more than one year. In other words, if substitution took longer than one year, the products would not be included in the same market.

The question posed is, can the hypothetical monopolist effect an SSNIP? If consumers will switch to substitutes such that the hypothetical monopolist *cannot* effect an SSNIP, then these substitutes will be added to the market definition. The test is repeated and wider circles of substitutes added to the market definition until the hypothetical monopolist can effect an SSNIP. This implies that there is limited substitutability between goods included in the market definition and those excluded. At this point, the boundaries of the relevant market are drawn. Both demand and supply substitution are taken into account when applying this test.

[9] The SSNIP concept is applied by the EU Competition Commission, the Office of Fair Trading in the UK as well as the Department of Justice and the Federal Trade Commission in the US.

[10] Competition agencies that apply the SSNIP test include the OFT in the UK (see OFT (1999), *The Competition Act 1998: Market Definition*); the Department of Justice and the Federal Trade Commission in the US (see DOJ and FTC (1992, amended 1997) *Horizontal Merger Guidelines*); The Canadian Competition Bureau (see Competition Bureau (1997), *Merger Enforcement Guidelines*); and the European Commission (see European Commission (1997), *Notice on the Definition of Relevant Market for the Purposes of Competition Law*).

The geographic market

3.7 The geographic market is the "area of effective competition" in which the seller operates and to which the purchaser can practicably turn for supplies. Therefore, the geographic market will sometimes be the area supplied by the parties to the conduct concerned. However, consideration should also be given to whether customers could easily obtain similar products from suppliers in other areas on reasonable terms. If so, those other areas may form part of the geographic market.

3.8 The geographic market is determined by transport cost and overlap of sub-sections of supply region. Relatively high transport costs can segregate markets and would sometimes explain why trade between two regions is economically infeasible (at least at current prices)[11]. In other words, high transport costs between two regions would tend to place them in two separate markets.

3.9 Nonetheless a "chain substitution" can cause otherwise separate markets to be the same geographic market if there is an appreciable number of consumers at the margin. For example, if A, B and C are groups of consumers in contiguous regions 1, 2 and 3, transportation cost could cause consumers in region 1 not to operate/purchase in region 3. In other words, consumers in region 1 may not be willing to travel to region 3 for a particular product. If, however, there were an appreciable overlap of consumers between regions 1 and 2, then a hypothetical monopolist in region 2 who raised prices may lose a significant proportion of his marginal consumers (in the area of overlap) to suppliers in region 1. The hypothetical monopolist would therefore be constrained by prices in region 1. This would put regions 1 and 2 in the same geographic market. By the same argument, if there is an appreciable overlap of consumers between regions 2 and 3, these regions would be in the same relevant market. By the "chain substitution" effect, this implies that prices in region 3 indirectly influence those in region 1. Consequently, regions 1, 2 and 3 would be in the same geographic market.

The relevant product market for money transmission services

3.10 Money transmission services enable customers to send money to various locations around the world. The major share of the Jamaican money transmission market involves international transfers as opposed to intra-island transfers. To this effect, the analysis will concentrate on international money transfers. This makes it a unique market in that the persons paying for the service are usually not domiciled in Jamaica.

3.11 There are three forms of international money transmission services currently available in Jamaica. They are as follows:

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[11] See Bishop, S. and Walker, M (1999), *The Economics of EC Competition Law*, Sweet and Maxwell: London

- *Wire transfers*─This service is provided by financial institutions. The transaction involves a sender, sending institution, a receiving institution and a receiver. A sender requests the sending institution to make a designated amount available to a claimant at the receiving bank. The sending institution then "wires" the receiving institution informing it of the particulars of the transaction and that the funds have been lodged to its account. Funds are paid out to the claimant when the receiving institution receives the "wire". Funds may be disbursed in the sender's currency as well as the receiver's currency.

- *Cash remittances*[12]─This service is provided by companies that are specifically set up to provide money transfer services. In Jamaica these companies include: Western Union, Xtran, Money Gram, Quik Cash, and Rapid Remittance. A cash remittance transaction involves a sender, a sending location, a receiver, receiving location and a service authorization center. A sender at a sending location requests that a designated amount be made available to a claimant at a receiving location. The transaction is authorized and conducted by telephone instructions to collect and disburse funds in separate locations. There is no direct transfer of funds (no wire transfer) between the receiving and sending locations. The Authorization Center acts as a clearing house for the transactions by verifying the particulars of the transaction from the sending location and then authorizing the receiving party to disburse a designated amount of money to a designated receiver, in the receiver's local currency.

- *Postal service*─A "postal transfer" involves a sender, a sending post office, a receiving post office and a receiver. The sender has the choice of sending funds via registered or unregistered mail. The sender mails a letter containing the funds and the receiver picks up the letter when it reaches the receiving post office. Funds received will be in the sender's currency.

3.12 In their responses to questionnaires administered by the Staff both Paymaster and GKRS indicated that, in addition to other cash remittance companies, they consider banks and building societies as competitors in the money transmission market. The question therefore is, should the relevant product market be defined to include only cash remittance services or should it include the other forms of money transfer discussed above. As discussed below, this depends on the demand and supply substitutability between the different types of transfers.

Demand substitution

3.13 Demand substitutability can be inferred by looking at the characteristics of each type of transfer, in particular, the risk levels involved with, and the speed of, each type of transfer as well as the accessibility of their respective outlets. Each factor will be discussed in the following.

Risk Levels

[12] The term cash remittance is used to describe the service provided by companies such as Western Union, Money Gram, Xtran, etc.

3.14 The different types of transfers may have different risk levels. The probability that funds sent will reach the receiver may differ. In addition, the ability of the sender to reclaim his or her funds, should the receiver not get the funds sent, may vary depending on the type of transfer used.

3.15 The risk level associated with wire transfers and cash remittances will be similar, as there will be a low probability that the funds will not be received. On the other hand, the postal transfers will have a higher probability of all or some of the funds not arriving. In terms of the ability to reclaim missing funds the user of wire transfer, cash remittances and registered mail will all be able to reclaim his or her funds. Unregistered postal transfer does not provide any official avenues for reclaiming lost funds.

Speed of transfer

3.16 Cash remittance is the fastest way to transfer funds. Most cash remittances can be collected on the same day they are dispatched. Wire transfers have a one-day lag while postal transfers can take days to reach the recipient.

Accessibility of the different types of outlets

3.17 The accessibility of the different types of money transfer outlets to both the sender and receiver of funds will have an impact on their substitutability. Although the sender is the one bearing the cost of the transfer he or is likely to factor in the ability of the receiver to access the funds.

3.18 All three types of money transfers are available throughout the island of Jamaica. In nearly all the towns across the country there is a branch of each of the major commercial banks. Cash remittance companies are also quite prevalent across the island and most districts have a post office.

Demand substitutability: A summary

3.19 The comparison of cash remittances to other types of money transfers in respect of the various factors discussed above is summarized in Table 1.

Table 1: A comparison of the characteristics of different money transfers mechanisms

Feature	Cash remittances	Wire transfers	Postal transfers
Risk Level	Low	Low	High
Accessibility	Good	Good	Good
Speed	Fast	Fast	Slow

3.20 Taking into account the factors discussed above, it appears that wire transfers are likely to be a close substitute to cash remittances from the consumers' point of view. The slowness of the postal system as well as the risk involved in sending money via the mail places postal transfers in a different product market from wire transfers and remittances. Therefore, from a demand perspective, the relevant market for cash remittances would include wire transfers.

4.3.2 Supply substitution

3.21 The Bank of Jamaica supervises entry into the Jamaican banking system. On the other hand, there is no specific legislation governing entry into the cash remittance business. Entry into this business requires finding the financial resources to build a local network and finding an international remittance "partner".

The geographic market

3.22 Money transfer services are offered throughout Jamaica and appear to operate under similar conditions. The geographic market should therefore be defined to cover the entire island.

Summary

3.23 In sum, the market relevant to this investigation is defined to include the range of electronic money transfer services, both wire transfers and cash remittances, offered throughout Jamaica.

The relevant product market for bill collection services

3.24 Bill Express and Paymaster both offer services that enable a customer to pay in person for utilities and other bills at one of their centers. Our research has revealed that the total sum collected on behalf of non-utility companies is negligible when compared with that collected for utility companies. The analysis will therefore concentrate on services for utility bill collections.

3.25 Consumers have other utility bill payment options. For example, they may also pay all their utility bills at branches of commercial banks and building societies. In addition, apart from the case of Digicel, customers can make payments at commercial offices of the utility companies. The question therefore is, should the relevant market be defined as including Paymaster and Bill Express or as also including the banks and the commercial offices of the utility companies on whose behalf Paymaster and Bill Express collect?

Demand substitution

3.26 Demand substitutability in this case has to be examined from the points of view of both the persons paying the bills and the companies whose bills are being paid. Both views are discussed in this section.

Substitutability of the payment options from bill payer's point of view

3.27 In data received from Jamaica Public Service Company (JPS), for the financial year ending March 31^{st}, 2001 only [✂] % of its customers used Paymaster and Bill Express to pay their bills. In the case of Cable and Wireless for the year ending August 31^{st}, 2001 only [✂]% of their customers used Paymaster and Bill Express to pay their bills. These figures imply that most utility bill payers find the banks and/or commercial offices of the utility companies an acceptable substitute for either Paymaster or Bill Express.

Substitutability of the payment options from the utility companies' point of view

3.28 The efficient operations of utility companies depend on their ability to collect from their customers and, over the years, they have sought to provide several payment options. Before the advent of multi-bill collection agencies such as Paymaster and Bill Express the utility companies had authorized banks to collect on their behalf and these banks are still being used as "bill collectors".

3.29 Should GKRS succeed in forcing Paymaster out of business could it then pressure the utility companies into increasing the commission the companies pay to GKRS? This is highly unlikely. Currently, Cable and Wireless' commercial offices account for the major share ([✂]%) of its "billed" revenue collections. In the case of JPS [✂]% of its operating revenue for the financial year April 2000-March 2001 was collected by banks. In fact, Paymaster and Bill Express together collected less than [✂]% of the two utility companies' billed revenue.

Demand substitutability: A summary

3.30 Taking into account the factors discussed above, it appears that from the utility companies and the bill payer's point of view, banks and/or commercial offices of the utility companies are likely to be close substitutes for the multi-bill collection agencies. The figures show that multi-bill collection agencies do not account for the collection of the major portion of the utility companies' "billed" revenue. The figures also show that the majority of utility bill payers do not patronize these multi-bill collection agencies. Therefore, from a demand perspective, the relevant market would include the full range of utility bill collection services.

Supply substitution

3.31 There are no legal restrictions which would prevent an existing utility company from opening additional commercial offices. Further, there is no specific legislation governing entry into the multi-bill collection business. Entry into this business requires finding the financial resources to build a local network and negotiating agreements to collect on the utility companies' behalf.

The geographic market

3.32 Since utility bill collection services are offered throughout Jamaica and appear to operate under similar conditions, the geographic market should be defined to cover the entire island.

Summary

3.33 In sum, the other market relevant to this investigation is defined to include the range of utility bill collection services offered throughout Jamaica.

4. Assessment of dominance

4.1 Dominance is usually determined by consideration of market share of the enterprise and barriers to entry into the relevant market. Both are discussed in the following.

4.2 *Market shares*—a market share of between 40 – 50% is commonly used by competition authorities as a guideline threshold for dominance. The European Court, for example, has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%.[13] The Office of Fair Trading in the UK considers it unlikely that an undertaking will be individually dominant if its market share is below 40%.[14]

4.3 *Barriers to entry*—the ability of an undertaking to dominate a market is constrained to the extent that new entrants may easily enter the market. Put differently, a firm is said to dominate a market if it is able to act independently of competitive pressures, allowing it to charge higher prices profitably. If, however, barriers to entry are low, any action by the firm to increase prices – and therefore profitability – would attract new entrants who would put competitive pressures onto the undertaking, forcing it to reduce prices again. In this case, the firm would not be considered to be dominant. On the other hand, if barriers to entry are high, entry is unlikely even if the market is highly profitable. In this case, the firm will be able to sustain high prices and profitability and can therefore be said to be dominant. High barriers to entry could exist for various reasons including licensing and regulatory requirements for entry (including patent rights) and high sunk costs.[15] Factors that would constitute barriers to entry would differ according to the case and circumstance.

4.4 In sum, a firm can be considered to be dominant if it has a market share of more than 40% and there are high barriers to entry.

[13] see Case C62/86, *AKZO Chemie BV v Commission* [1993] 5 CMLR 215

[14] OFT (1999), *The Competition Act 1998: The Chapter II Prohibition*, March. These are, however, guideline thresholds that are not set in stone. Dominance could be established even below the 40% threshold if other relevant factors, such as weak position of competitors in that market provided strong evidence of dominance, For example, if the largest player in the market has 30% market share and many other small firms, none possessing more than 3% of the market, sharing the remainder of the market. In this scenario, 30% market share could be sufficient to meet the dominance test. Consider another scenario in which a market is equally shared between two players, each accounting for 50% of the market. In this case, collusive behavior aside, neither of them can be said to be truly dominant, as neither is likely to be able to act independently of the other. Actions of one player are likely to be met by equally forceful reactions from the competitor who himself commands a similar degree of market power. In this case, a competition authority may see it appropriate to raise the dominance threshold level to between 70 – 80% market share.

[15] Sunk costs refer to the investments that have to be made to enable production of a good or service. These costs are incurred even before a single unit of good or service is produced. An example of sunk costs can be found in telecommunications where the cable network has to be put in place – at a high cost – before any voice or data transmission can be made.

GKRS' share of the electronic money transmission market

4.5 According to the statistics from Bank of Jamaica gross inflows to the private sector reached US$806.5 million in the year 2000.[16] The cash remittance companies accounted for the largest share of inflows and acted as a conduit for US$446 million (55.4%) of incoming remittances. Financial institutions accounted for US$334.5 million (41.5%) and US$26 million (3.1%) came through other sources (e.g postal system). (See Table 2)

Table 2: Gross inflows to private sector for 2000

Conduit	Amount (US$M)
Remittance Companies	446.0
Financial Institutions	334.5
Electronic transfers: total	***780.5***
Other	26.0
Total gross inflows to private sector	**806.5**

4.6 The relevant market is defined as the market for electronic money transmission services and includes both wire transfers and cash remittances. Gross inflows through these conduits totaled US$780.5 million. In its response to a questionnaire administered by the Staff, GKRS indicated that Western Union accounted for [✄]% of private inflows through cash remittance companies. This therefore means that GKRS accounts for US$[✄] million of private inflows and [✄]% of the relevant market.

4.7 GKRS is therefore dominant in the market for electronic money transmission services.

GKRS' share of the utility bill collection services market

4.8 The market has been defined as the market for utility bill collection services. GKRS' own estimated share of the utility bill collections market is as follows:

- Jamaica Public Service – [✄]%
- Cable and Wireless – [✄]%
- National Water Commission – [✄]%

4.9 Paymaster on the other hand has placed their total share of the utility bill collection market at [✄]%. These figures are supported by data collected from two utility companies, Cable and Wireless Jamaica Limited (C&WJ) and Jamaica Public Service Company (JPS). The data collected from these two companies

[16] See Bank of Jamaica Annual Report 2000 (Table 32).

revealed that the majority of their customers ([✂]%) paid at their commercial offices.

4.10 GKRS is therefore not dominant in the market for utility bill collections as its share of the market is less than [✂]%.

5. Is there evidence of tying?

5.1 In *Jefferson Parish Hospital Dist. vs Hyde*, (1984), the US Supreme Court ruled that:

> "The essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms. When such "forcing" is present, competition on the merits in the market for the tied item is restrained."

It is only after the existence of a tie is shown that it is necessary to determine whether an illegal tying arrangement exists. Where a tying product has not been withheld, there is no tie. There is no tie for any antitrust purpose unless the Respondent improperly imposes conditions that explicitly or practically require buyers to take the second product if they want the first one.[17]

5.2 Tying is not limited to contractual terms and "forcing" can be accomplished through less formal means such as discriminatory discounting or coercion. In *Amerinet Inc. vs Xerox Corp.,* (1992) the US 8th Circuit Court observed that in cases where there are no explicit contractual tying arrangement, an illegal tie may still be shown if the supplier's policy renders the purchasing of both products together "the only viable economic option". A widespread migration of customers, who are also users of the tying product, from suppliers of substitutes for the tied product and towards the supplier of the tied product may also be suggestive of "verbal coercion".

5.3 The Commission's review of GKRS' Western Union and Bill Express sub-agency agreements did not reveal any contractual terms that suggest the existence of any discriminatory treatment that would imply a tying arrangement. The commission structures of both agencies were also examined. The examination revealed that all Western Union sub-agents received the same rate of commission. This was also true for the Bill Express sub-agents. Entities that operated both Western Union and Bill Express sub-agencies did not receive higher rates of commission than entities that operated only Western Union or Bill Express.

5.4 Further, if there were any form of "verbal coercion" taking place one would expect to see a significant decrease in the number of Western Union outlets that also operate Paymaster sub-agencies. There should be a significant shift of Western Union outlets from Paymaster to Bill Express sub-agencies.

In July 2001, Paymaster indicated that nine (9) Western Union outlets also operated Paymaster sub-agencies. In November 2001, there were twelve (12) Western Union outlets that also operated Paymaster sub-agencies. The increase in Western Union outlets with Paymaster sub-agencies suggests that there is no form of verbal coercion taking place.

[17] See Phillip E. Areeda et al., Antitrust Law: An Analysis of Antitrust Principles and their Application (1996)

6. Conclusions and recommendations

6.1 The investigation of the relevant markets did not divulge any evidence of tying. Our review of the sub-agencies agreements and commission structures did not reveal any terms that suggest the existence of any discriminatory treatment and which would imply a tying arrangement. The increase in Western Union outlets with Paymaster sub-agencies is also indicative of the fact that a tying arrangement does not exist.

6.2 Given that it is only after the existence of a tie is shown that it is necessary to determine whether an illegal tying arrangement exists the Commission did not see it fit to continue the investigation. No breach of the FCA was therefore found.

A. Vertical restraints and competition policy

A.1 Vertical restraints are provisions made between undertakings operating at different levels in the economic process in relation to any particular agreement that restricts the commercial freedom of one or more parties. The agreement might, for example, be between a manufacturer and a retailer, a manufacturer and a wholesaler, a wholesaler and a retailer, a retailer and a customer, or even between two wholesalers which, for the purposes of the agreement, operate at different stages in the supply chain. In this document, reference is made to agreements between a supplier and a retailer, but the same principles apply to agreements between any two parties which, for the purposes of the agreement, operate at different stages in the supply chain.

A.2 Vertical agreements impose many conditions and restraints upon both parties. Most of these would be considered to be common and acceptable contractual arrangements. Indeed, clear contractual arrangements are necessary for facilitating the smooth functioning of businesses and, by virtue of this, vertical restraints often allow firms to improve the efficiencies of their operations either through creating transaction cost efficiencies.

A.3 While they are generally beneficial, however, some vertical restraints may restrict competition. The types of restraints that may restrict competition, include, but are not limited to, the following:

- *Resale price maintenance*—this occurs when the supplier specifies the resale price of the product. Commonly, the supplier will specify only a minimum or a maximum price.
- *Selective distribution*—is when a manufacturer supplies only a limited number of retailers who are restricted in their ability to re-sell products.
- *Exclusive distribution*—is a particular form of selective distribution where the supplier supplies only one distributor in a particular territory or allows only one distributor to supply a particular class of customer, businesses or consumers for example.
- *Exclusive dealing*—whereby a supplier agrees to supply goods to a retailer on the condition that the retailer does not sell goods from competing suppliers;
- *Tie-in sales* and *bundling*—refers to the case where the supplier makes the purchase of one product (the "tying" product) conditional on the purchase of a second product (the "tied" product).
- *Full-line forcing*—is an extreme form of tie-in sale where the distributor must stock the full range of the supplier's product range.
- *Quantity forcing*--occurs when the supplier is required to purchase a minimum quantity of a certain product.
- *Fidelity discounts*—is where the distributor receives discounts based on the percentage of its sales, which come from the supplier.

A.4 An assessment of the effects of a vertical restraint needs to take account of both its potential anti-competitive effects and any countervailing benefits it produces. The task at hand is, therefore, to determine whether a particular vertical restraint is anti- or pro-competitive. In order to do so, it is useful to understand the conditions under which a vertical restraint is anti-competitive, compared to conditions under which it would be pro-competitive. The following discusses both the potential anti-competitive and pro-competitive effects of vertical restraints. Much of the discussion is relevant to a wide range of vertical restraints (see above beyond the specific elements under investigation.

Anti-competitive effects of vertical restraints

A.5 The negative effects on the market that may result from vertical restraints and which competition law aims at preventing are the following:

- Foreclosure of other suppliers or other buyers by raising barriers to entry;
- Reduction in inter-brand competition between the companies operating in a market, including facilitation of collusion amongst suppliers or buyers; by collusion is meant both explicit collusion and tacit collusion (conscious parallel behaviour);
- Reduction of intra-brand competition between distributors of the same brand.

The anti-competitive effects depend on various factors including the market share of the supplier(s) involved in the restraint, the proportion of the market covered by the restraint, the specific nature of the market and the exact nature of the restraint.

A.6 For most vertical restraints, competition concerns can arise only if there is insufficient inter-brand competition, i.e., if there exists a certain degree of market power at the level of the supplier, of the buyer or both. Conceptually, market power is the power to raise price above the competitive level and, at least in the short term, to obtain supranormal profits. Where there are many firms competing in an unconcentrated market, it can be assumed that non-hardcore vertical restraints will not have appreciable negative effects. The European Commission, for example, considers that market as unconcentrated when the Hirschman-Herfindahl Index (HHI) index, i.e., the sum of the squares of the individual market shares of all companies in the relevant market, is below 1,000.[18]

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[18] See Commission Notice: Guidelines on Vertical Restraints (2000/C 291/01), Official Journal of the European Communities.

Market concentration reveals the extent to which market power is vested in a few firms. One expedient way to measure concentration is the Hirschman-Herfindahl Index (HHI). The HHI is:

$$HHI \equiv \Sigma_i \partial_i^2\text{; Where } \partial_i \text{ represents market share of firm i}$$

The HHI uses the squared sums of the market shares of each firm in the industry as a "weight" in assessing the degree of market concentration. The premise behind this "weight" is that if firms in the relevant market have equal market power the HHI equals 1/N and that the more skewed the index is from 1/N the more concentrated is the market. To put the numbers into perspective, a market where two players each has 50% of the market would have an HHI of 5000. A market where the six players each has 13% market share would have an HHI of 1014.

A.7 There are, however, some restraints that are considered to be anti-competitive regardless of the market power of the player. The restraints that would fall into this category are typically price restraints, for example, resale price maintenance. Since resale price maintenance directly restricts price competition, it is considered to significantly lessen competition regardless of the market shares of the undertaking.

When are vertical restraints pro-competitive?

A.8 It is important to recognize that vertical restraints can also have positive effects by, in particular, promoting non-price competition and improved quality of services. When a company has no market power, the only way that it can increase its profits is by using its manufacturing or distribution processes optimally. In a number of situations, vertical restraints may be helpful in this respect since the usual arm's length dealings between supplier and buyer, determining only price and quantity of a certain transaction, can lead to a sub-optimal level of investments and sales. To be considered pro-competitive, however, conditions must be such that there are higher levels of investment and sales (output) with the imposition of the restraints than without. The following describes some reasons that may justify the application of certain vertical restraints:

(a) *To 'solve a "free-rider" problem'*—one distributor may free-ride on the promotion efforts of another distributor. This type of problem is most common at the wholesale and retail level. Exclusive distribution or similar restrictions may be helpful in avoiding such free-riding. Free riding can also occur between suppliers, for instance where one invests in promotion at the buyer's premises, in general at the retail level, that may also attract customers for its competitors. Non-compete type restraints can help to overcome this situation of free-riding.

For there to be a problem, there needs to be a real free-rider issue. Free-riding between buyers can occur only on pre-sales services and not on after-sales services. The product will usually need to be relatively new or technically complex as the customer may otherwise very well know what he or she wants, based on past purchases. And the product must be of a reasonably high value as it is otherwise not attractive for a customer to go to one shop for information and to another to buy. Lastly, it must not be practical for the supplier to impose on all buyers, by contract, effective service requirements concerning pre-sales services.

Free-riding between suppliers is also restricted to specific situations, namely in cases where the promotion takes place at the buyer's premises and is generic, not brand specific.

(b) *To 'open up or enter new markets'*—where a manufacturer wants to enter a new geographic market, for instance by exporting to another country for the first time this may involve special 'first time investments' by the distributor to establish the brand in the market. In order to persuade a local distributor to make these investments it may be necessary to provide territorial protection to the distributor so that he can recoup these investments by temporarily charging a higher price. Distributors based in other markets should then be restrained for a limited period from selling in the new market. This is a special case of the free-rider problem described under point (a).

(c) *The 'certification free-rider issue'*—in some sectors, certain retailers have a reputation for stocking only 'quality' products. In such a case, selling through these retailers may be vital for the introduction of a new product. If the manufacturer cannot initially limit his sales to the premium stores, he runs the risk of being de-listed and the product introduction may fail. This means that there may be a good reason for allowing for a limited duration, a restriction such as exclusive distribution or selective distribution. It must be enough to guarantee introduction of the new product but not so long as to hinder large-scale dissemination. Such benefits are more likely with 'experience' goods or complex goods that represent a relatively large purchase for the final consumer.

(d) *The so-called 'hold-up problem'*—sometimes there are client-specific investments to be made by either the supplier or the buyer, such as in special equipment or training. For instance, a component manufacturer that has to build new machines and tools in order to satisfy a particular requirement of one of his customers. The investor may not commit the necessary investments before particular supply arrangements are fixed.

As in the other free-riding examples, however, there are a number of conditions that have to be met before the risk of under-investment is real or significant. Firstly, the investment must be relationship-specific. An investment made by the supplier is considered to be relationship-specific when, after termination of the contract, it cannot be used by the supplier to supply other customers and can be sold only at a significant loss. An investment made by the buyer is considered to be relationship-specific when, after termination of the contract, it cannot be used by the buyer to purchase and /or use products supplied by other suppliers and can only be sold at a significant loss. An investment is thus relationship-specific because for instance it can only be used to produce a brand-specific component or to store a particular brand and thus cannot be used profitably to produce or resell alternatives. Secondly, it must be a long-term investment that is not recouped in the short run. And thirdly, the investment must be asymmetric; i.e. one party to the contract invests more than the other party. When these conditions are met, there is usually a good reason to have vertical restraints for the duration it takes to depreciate the investment. The appropriate vertical restraint will be of the non-compete type or quantity-forcing type when the investment is made by the supplier and of the exclusive distribution, exclusive customer-allocation or exclusive supply type when the investment is made by the buyer.

(e) *Transfer of knowledge*—this refers to the 'specific hold-up problem that may arise in the case of transfer of substantial know-how'. The know-how, once provided, cannot be taken back and the provider of the know-how might not want it to be used for or by his competitors. In so far as the know-how was not readily available to the buyer, was substantial and indispensable for the operation of the agreement, such a transfer may justify a non-compete type of restriction.

(f) *'Economies of scale in distribution'*—in order to have scale economies exploited and thereby see a lower retail price for his product, the manufacturer may want to concentrate the resale of his products on a limited number of distributors. For this he could use exclusive distribution, quantity forcing in the form of a minimum purchasing requirement, selective distribution containing such a requirement or exclusive purchasing.

(g) *'Capital market imperfections'*—the usual providers of capital (banks, equity markets) may provide capital sub-optimally when they have imperfect information on the quality of the borrower or there is an inadequate basis on which to secure the loan. The buyer or supplier may have better information and be able, through an exclusive relationship, to obtain extra security for his investment. Where the supplier provides the loan to the buyer this may lead to non-compete or quantity forcing on the buyer. Where the buyer provides the loan to the supplier this may be the reason for having exclusive supply or quantity forcing on the supplier.

(h) *'Uniformity and quality standardization'*—a vertical restraint may help to increase sales by creating a brand image and thereby increasing the attractiveness of a product to the final consumer by imposing a certain measure of uniformity and quality standardization on the distributors. This can for instance be found in selective distribution and franchising.

A.9 The eight situations mentioned above make clear that under certain conditions vertical agreements are likely to help realize efficiencies and enhance the development of new markets and that this may offset possible negative effects. The case is in general strongest for vertical restraints of a limited duration, which help the introduction of new complex products or protect relationship-specific investments. A vertical restraint is sometimes necessary for as long as the supplier sells his product to the buyer (see in particular the situations described in points (a), (e), (f), and (h).

A.10 Finally, in circumstances where a vertical restraint is implemented due to its pro-competitive benefits, efforts must be made to ensure that the following two conditions hold:

(a) The restraint is not more limiting than it should be—in this regard, it should be noted that there is a large measure of substitutability between the different vertical restraints. This means that the same inefficiency problem can be solved by different vertical restraints. For instance, economies of scale in distribution may possibly be achieved by using exclusive distribution, selective distribution, quantity forcing or exclusive purchasing. This is important as the negative effects on competition may differ between the various vertical restraints. This plays a role when indispensability of the restraint is discussed.

(b) The "switching costs" of resellers to move between suppliers is not unduly high—that is, it is not excessively difficult for resellers to switch to a different supplier. To this end, contracts with anti-competitive vertical restraints must not be for long duration and, in general, there should be no post-non-compete obligations imposed on resellers. The only exceptions would be when there are trade secrets or customer goodwill in the business.