
The Merger of Digicel & Claro is likely to hurt Mobile Phone Customers



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Ladies and Gentlemen, a pleasant good afternoon.

It is an honor to be here and to be speaking with the esteemed members of your club on a topic of your choice - *how the Digicel/Claro agreement is likely to hurt mobile phone customers*. I thank 2nd Vice President Mr. Richard Rowe for providing the Fair Trading Commission (FTC) with this opportunity.

By now we are all aware that the Jamaican mobile market has been reduced from 3 players to 2 players. You may also be aware that the FTC has filed a claim in the Supreme Court seeking a declaration that the agreement between Digicel and Claro is in breach of section 17 of the Fair Competition Act (FCA). That section of the law deals with agreements that have as their purpose, effect or likely effect, the substantial lessening of competition in a market. By this we mean in short, that consumers will be worse off.

The legal framework for the mobile sector

This case is particularly interesting as it involves a matter that implicates both the competition legislation, the Fair Competition Act (FCA) as well as the Telecommunications Act (TA), which is administered by the industry regulator, the Office of Utilities Regulation. While the Telecoms Act expressly recognizes the jurisdiction of the competition authority in a general way, it seems that there is at least one inconsistency in its application, which became apparent with the agreement

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between Digicel and Claro. That is, where the holder of a telecommunications license wishes to transfer its license and operation to an existing operator. The Telecoms Act does not require consideration of the competitive effect of the transfer. It should be noted that while the FCA does not contain provisions which stipulate that a merger review process must be undertaken it does contain provisions to deal with agreements that have the potential to adversely affect competition. The FCA also allows the parties to an agreement to seek authorization from the FTC if there is a concern that the agreement may adversely affect competition.

In essence the FCA addresses commercial agreements whether those agreements are covert as in a cartel arrangement or overt as in a merger.

Historical changes in the mobile market

The telecoms industry is not new to acquisitions. You may recall that Cable & Wireless Jamaica Limited (now t/a LIME) had purchased Telecommunications of Jamaica (TOJ) in the latter part of the 1990's; and before that, TOJ had acquired the Jamaica Telephone Company (JTC). Also, that during the period up to the turn of the century it was the sole provider of telephone services (both landline and mobile). In 2001 Digicel and Oceanic Digital entered the market as mobile service providers. In 2007 Oceanic Digital was acquired by American Movil and operated the Mi-Phone brand until it launched the Claro brand in October 2008. Note that those acquisitions did not change the structure of the market as they involved the replacement of one enterprise by another enterprise. This agreement, however, between Digicel and Claro, differs from the previous ones as it allows for the elimination of Claro, an effective competitor, from the market without a replacement. Further, it allows for the participant with the largest market share, ie Digicel, to acquire a significant competitor.

The competition issue is whether, by acquiring Claro, Digicel will eliminate a rival which would be a binding competitive constraint in the foreseeable future; and therefore exercise market power which would manifest in Digicel raising, maintaining or extending prices above competitive levels for a sustained period of time.

Claro was an effective competitor in the telecoms market

One critical role of the FTC is to protect the competitive environment, that is, to promote the right incentives for enterprises to compete fiercely. Our role is not to protect competitors. It is to protect competition for the benefit of consumers.

Having conducted its investigation into the Digicel/Claro agreement, the FTC has concluded that the effect of the agreement is a substantial lessening of competition in the market for voice and text messaging service. But essentially, what does this mean?

Our investigation reveals that Claro had exerted significant competitive pressure on Digicel; and that all consumers benefitted from the rivalry between the two mobile providers. We estimated that between 2007 and 2011 Digicel's subscribers benefitted to the tune of approximately \$16 Billion. Because of the intensity of the competition in the market Digicel's subscribers benefitted from more talk time for less money. In addition to price competition, we saw technological improvements. In 2008, in just over one year of entry and with the smallest subscriber base, Oceanic Digital introduced 3G technology in Jamaica under the brand name Claro. LIME responded in the technological race, by launching 3G in 2009. Digicel remained at 2G. It has now announced that it will be launching 4G in the near future.

In order to properly illustrate the effect on competition and on consumer welfare, I will speak on some of the highlights of our assessment of the market from before Claro entered, up to the point at which we were advised that they would be acquired by Digicel.

Prior to Claro's entry in 2007 Digicel exercised market power. It is our view that LIME was not a significant competitor, as Digicel's prices were significantly higher than LIME's prices; Digicel enjoyed a larger market share despite having higher rates; and consistently expanded its subscriber base. In contrast, LIME's subscriber base, on average, remained unchanged during the period 2006 to 2009.

On the other hand Claro was considered a significant competitor to Digicel as it served to constrain Digicel's behavior and stimulated technological innovation in the market and most importantly, direct benefits to consumers. Digicel's promotions and value offers increased significantly after

Claro's entry. Consumers enjoyed many new initiatives, exciting promotions and support programmes, on an individual level as well as on a social development level, from all three players. For example, free nights, free weekends, bonus credit, cheaper handsets, bundled package deals; and increased support to social programmes and sponsorships for sports and communities. Competition was further stimulated when Claro adopted 3G technology, and differentiated their services from that of Digicel's lower quality 2G wireless voice services. This time period is unprecedented in the history of telecoms in Jamaica, in terms of value offers to consumers.

All these value offers resulted in Digicel's transaction price declining sharply over the period 2007 to 2010. Its price on average was reduced by almost 50%. In fact, Mr. Mark Linehan of Digicel, on a radio talk show this morning (January 17, 2012), said that Digicel's effective rate has been \$3.50 to \$4.00 per minute. We have found that talk time increased by 39% while consumer expenditure decreased by 2%. In effect, consumers were getting more for less.

The agreement limits competition and harms consumers

Now in 2012 with Digicel taking control of an effective competitor what is to expect in the market in the future? We have concluded that compared to a future without the elimination of a competitor, there will be higher prices, whether through rate increases or through reduced promotional offers to subscribers; there will be fewer product choices; and there will be slower rates of technological innovation and adoption. Digicel has announced that it will be introducing 4G in the coming months. Could Digicel have acquired 4G without acquiring its competitor?

We believe that in the future, absent any competitive pressure, changes in innovation will be quite limited. Just over ten years ago we all witnessed the technological advancement of the telecoms industry when it was liberalized and when competition was introduced. Consumers were the beneficiaries.

There were 2 main players then. There are 2 players now. But we have a different environment today than we had in 2001. Back then, the market was not mature, it was significantly smaller, with many persons without any phone service. Today the market is saturated. Everybody who wants a phone has one. With the changed environment, though, it is likely that not everybody who now has a phone or two will be able to afford the same level of data usage or talk-time.

Our investigation reveals that LIME was not able to constrain Digicel in the past and is unlikely to constrain Digicel in the future. Given that Digicel already has the largest market share with a significant subscriber base it is able to act independently of LIME and 'shield' itself from competition; in particular because its revenue comes mainly from the service it provides to its subscribers on its own network. It should be noted that Digicel's subscribers pay as low as \$4.00 per minute to call another Digicel subscriber while its rate to call LIME's subscribers was recently reduced from a high of \$17.70 to a low of \$13.80 per minute.

The agreement will also result in the elimination of the reciprocal calling rate of \$5 per minute between Claro and LIME thereby increasing the price that LIME's subscribers will have to pay to make calls to former Claro subscribers who are now on the Digicel network. The effect of this is a reduction in consumer welfare.

There is also the issue of whether a new player could enter the market and provide any competitive pressure. This we believe is unlikely given the limited availability of spectrum, issues surrounding the construction of cell towers and the sharing of cell towers, and Digicel's pricing strategy.

This is what we refer to as a substantial lessening of competition in the market as Digicel will be removing its significant competitor from the market as well as the likely or actual barring of entry of a new participant.

We hear the argument that with or without the agreement, Claro would have exited the market; and therefore that the effect would have been the same. To that we say, had Claro surrendered its licence and spectrum, the entry conditions would be more favourable for a new entrant than with Claro leaving by way of the agreement.

While we note the need for regulatory intervention, our own experiences as consumers has told us that we all prefer when prices are determined by competitive forces rather than by a regulator. We see this in electricity.

Conclusion

For the reasons and points made, the FTC concluded in its investigation that competition in the voice and text messaging services market in Jamaica is likely to be adversely affected as a result of the Digicel/Claro agreement; and therefore mobile phone consumers will be worse off.

Our suggestions to protect the environment include the mandatory sharing of cell towers; reciprocal interconnection rates among players; that Claro's customers be released from any contractual obligations to Claro, thereby allowing them to choose their preferred provider; and mechanisms to ensure that technological advancements are introduced into the market within a reasonable time frame.

Our consumers are in a tough situation. \$16 Billion in benefits over 4 years is a lot to 'lose'. More and more we are looking for better value everyday, for our hard earned dollar. We at the FTC are trying to facilitate the economic environment by ensuring a competitive climate which encourages market players to find ways to provide new products and services to consumers at the lowest possible price.

There is a law in place that serves to protect the competitive environment and we have chosen to use it. We have filed a claim in the Supreme Court – to seek a declaration that the agreement is in breach of the Fair Competition Act (FCA). If the declaration is granted, it would deem the agreement to be unenforceable, which could mean that Digicel would have no authority to assume Claro's operations in the manner in which it did.

Thank you.