ANTI-COMPETITIVE BEHAVIORS THROUGH CONSUMER SWITCHING CONSTRAINTS IMPOSED BY MOBILE TELECOMMUNICATIONS FIRMS IN THE PHILIPPINES[*]

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ABSTRACT

This Note, adding to the development of legal and economic authors on switching costs, postulates that the collectively dominant incumbent mobile telecommunication service providers—Globe and Smart—in imposing lock-in periods and mobile number (un)portability are abusing their dominant position. The substantial and strategic creation or increase by a dominant firm of switching costs, which are the monetary and non-monetary costs consumers incur in switching from one provider to another, constitutes abuse under Section 15 of the Philippine Competition Act.

I. INTRODUCTION

The Philippine mobile telecommunications market is one of the country's most highly concentrated sectors, what with only two major players in the field, namely Globe Telecom ("Globe") and Philippine Long Distance Telephone's ("PLDT") Smart Communications, Inc. ("Smart").[1] Yet in spite of these two companies having charge over almost one hundred percent of the market, the concentration in the industry has still managed to increase over the last decade through a series of mergers and acquisitions.[2] Recently, the question as to whether or not this virtual duopoly adequately serves the market or if it is actually detrimental to consumer welfare has

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[*] *Cite as* Gian Angelo E. Chua, *Anti-Competitive Behaviors through Consumer Switching Constraints Imposed by Mobile Telecommunications Firms in the Philippines*, 91 PHIL. L.J. 536, (page cited) (2018).

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[1] Epictetus Patalinghug, Wilfred Manuela, Jr., Regina Manzano-Lizares & Jason Patalinghug, *Assessment of the Structure, Conduct, and Performance of the Philippine Telecommunications Industry*, Jan. 31, 2017, at 19, *available at* https://ssrn.com/abstract=2912238.

[2] *Id.*

been in the spotlight.[3] This is especially so considering that various comparison studies have consistently shown the Philippines ranking low in terms of average page load time for mobiles and average cellular mobile data speed, to name a few.[4] Over the years, there have been, and still are, attempts to introduce a third player in the market, but these attempts have yet to come into fruition.

With only Globe and Smart having significant influence in the telecommunications industry, coupled with the high barriers set to prevent the introduction of new competitors, these incumbents have attained a status that ultimately enables them to engage in strategic non-cooperative actions, i.e. "schemes."[5] This research examines one of these schemes—"consumer lock-in"—where, through clever marketing and operational strategies, these incumbents effectively capture consumers despite offering subpar services. Particularly, this research examines the legality of two policies used by the incumbents to achieve consumer lock-in: (a) *contractual lock-in* and (b) *mobile number (un)portability*. This research concludes that Globe and Smart, by imposing these policies, are substantially and strategically increasing the "switching costs" of consumers. Being collectively dominant, Globe and Smart are, in effect, violating Section 15 of Republic Act No. 10667 or the Philippine Competition Act ("PCA"), which prohibits abuse of dominant position.

This Note is divided into four parts: Part I frames the problem and the suggested solution by giving a brief background of the PCA, its provision on abuse of dominance, and its similarities with the competition laws in the United States (US) and in the European Union (EU). Part II presents a general overview of switching costs, namely its definition, types, categories, and effects on price and competition. Part III examines how the concept of switching costs relates to antitrust enforcement, and presents concrete examples thereof through illustrative US and EU jurisprudence. This part also identifies salient provisions in the PCA and its Implementing Rules ("Rules") which show that the PCA explicitly considers switching costs in the framework of analysis for enforcing its prohibition on abuse of dominance. Lastly, Part IV studies the invalidity of contractual lock-in and mobile number (un)portability by applying Section 15 of the PCA vis-à-vis switching costs.

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[3] Miguel Camus, *Keeping a Promise to End Telco Duopoly*, PHIL. DAILY INQ., Jan. 29, 2018, *available at* http://business.inquirer.net/244941/keeping-promise-end-telco-duopoly.

[4] Patalinghug et al., *supra* note 1, at 48.

[5] *Id.* at 29.

II. ANTITRUST ENFORCEMENT AS A SOLUTION

A. The Problem: Contractual Lock-In and Mobile Number (Un)portability

Because a consumer has virtually only the services of Globe or Smart to choose from, one might expect that, at the very least, consumers would be free to switch from one service provider to another. This, however, is not the case. Instead, Globe and Smart have utilized the lack of competition by locking subscribers in through varying schemes that have been a common source of frustration for many of their consumers. Even if subscribers are grossly unsatisfied with the services delivered by their chosen provider, they would inevitably find themselves unable to terminate their contract with said provider because of either, any, or all of their prevalent schemes, which include contractual lock-in and mobile number (un)portability, among others.

Contractual lock-in involves an agreement between the subscriber and the provider whereby the subscriber agrees to the imposition by the provider of lock-in periods, which range from six months to as long as two years. Globe's SIM-only ThePLAN PLUS and ThePLATINUM Plan, for example, impose a lock-in period of six months.[6] Meanwhile, Smart's GigaX Plan[7] and All-In Plan[8] impose a 24-month lock-in period, as does Globe's ThePLAN PLUS and ThePLATINUM Plan variants inclusive of a device.[9] Under whatever plan the subscriber opts for, he is not at liberty to cut his service during its term without the imposition of a pre-termination fee (or early termination fee) that can cost as much as six monthly payments in total or even more.[10]

Another reason consumers are prevented from switching providers is the incompatibility of their mobile numbers with those of other providers. This is in direct opposition to the concept of Mobile Number Portability

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[6] *Id.*

[7] GigaX Plan, *available at* https://smart.com.ph/Postpaid/plans/gigax (last accessed Dec. 14, 2018).

[8] All-in Plan, *available at* https://smart.com.ph/Postpaid/plans/all-in-plan (last accessed Dec. 14, 2018).

[9] Globe Postpaid Plans, *available at* https://shop.globe.com.ph/postpaid-plans (last accessed Dec. 14, 2018).

[10] Rigoberto Tiglao, *Smart and Globe's Schemes to Maintain Their Duopoly and Prevent a Free Market*, MANILA TIMES, July 8, 2016, *available at* http://www.manilatimes.net/smart-and-globes-schemes-to-maintain-their-duopoly-and-prevent-a-free-market/272404.

("MNP"), which allows subscribers to switch from one service provider to another without the inconvenience of having to change mobile numbers.[11] MNP has been adopted through legislation by many countries around the world including Singapore, Hong Kong, South Korea, Taiwan, and Vietnam.[12] Although there have been several attempts in previous years by the National Telecommunications Commission to prescribe MNP within the Philippines, Globe and Smart, to the detriment of their consumers, have always opposed such attempts.[13] For convenience, the absence of MNP will be called *Mobile Number (Un)portability*.

B. The Solution: Antitrust Enforcement

Although the above problems are resolvable via legislation, a more efficient approach would be the enforcement of antitrust provisions under the relatively new PCA. As will be discussed in the latter parts of this Note, the imposition of contractual lock-in and mobile number (un)portability in the context of "switching costs" results in an abuse of dominance by Globe and Smart that is violative of the PCA.

C. A Brief Background of Antitrust Law in the Philippines

Republic Act No. 10667, otherwise known as the Philippine Competition Act, is the primary law for promoting and protecting fair market competition in the Philippines. Before its signing into law on July 21, 2015 and its effectivity on August 8, 2015,[14] Philippine competition policy was scattered among the Constitution and about thirty different laws or regulations such as the Revised Penal Code, the Consumer Act, and other sector-specific regulations, most of which are both outdated and rarely enforced.[15] For about two decades prior to the enactment of the PCA, there were many attempts to pass a comprehensive competition bill, all of which

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[11] Mengze Shi, Jeongwen Chiang & Byong-Duk Rhee, *Price Competition with Reduced Consumer Switching Costs: The Case of "Wireless Number Portability" in the Cellular Phone Industry*, 52 MANAGEMENT SCIENCE 27 (2006).

[12] Lorna Pataho-Kapunan, *Mobile Number Portability,* BUSINESS MIRROR*,* Apr. 29, 2018, *available at* https://businessmirror.com.ph/mobile-number-portability.

[13] Pierre Tito Galla, *Mobile Number Portability – What It Means For PH*, NEWSBYTES, Feb. 26, 2018, *available at* http://newsbytes.ph/2018/02/26/opinion-mobile-number-portability-what-it-means-for-ph.

[14] Phil. Competition Comm'n, *The Philippine Competition Act: A Primer*, PHILIPPINE COMPETITION COMMISSION WEBSITE, *available at* http://phcc.gov.ph/philippine-competition-act-primer (last accessed Dec. 14, 2018).

[15] Erlinda M. Medalla, *Understanding the New Philippine Competition Act*, Phil. Inst. for Dev. Stud. Discussion Paper Series No. 2017-4 (2017), at 2.

failed to prosper.[16] Considering this, the eventual passing of the PCA was a long-awaited and much needed reform, especially in light of the rapid developments in technology and global trade that have not only created new business models, but have also intensified international production sharing and interlinked supply chains.[17] Thus, the PCA is considered by many as breakthrough or milestone legislation.[18]

The PCA has three key prohibitions as regards antitrust enforcement: (a) the prohibition on anti-competitive agreements, (b) the prohibition on abuse of dominant position, and (c) the prohibition on anti-competitive mergers and acquisitions. It is the second prohibition that is relevant to this analysis.

D. The Concept of Abuse of Dominance in the Philippines, US, and EU

The prohibition on abuse of dominant position is enshrined in Section 15 of the PCA, which states:

> It shall be prohibited for one or more entities to abuse their dominant position by engaging in conduct that would substantially prevent, restrict or lessen competition.

The section then lists particular acts that constitute abuse, including: (a) imposing barriers to entry or committing acts that prevent competitors from growing within the market in an anti-competitive manner;[19] (b) making a transaction subject to acceptance by the other parties of other obligations which, by their nature or according to commercial usage, have no connection with the transaction;[20] and (c) making the supply of particular goods or services dependent upon the purchase of other goods or services from the supplier which have no direct connection with the main goods or services to be supplied.[21]

It is deducible from the provision that in order for there to be abuse of dominant position, two essential elements must be met: *first*, dominance, and *second*, abuse. To be clear, Section 15 does not prohibit being dominant

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[16] *Id.* at 1.
[17] *Id.*
[18] *Id.*
[19] Rep. Act No. 10667 (2015) [hereinafter "PCA"], § 15(b). The Philippine Competition Act.
[20] § 15(c).
[21] § 15(f).

in the market *per se*. Instead, what the provision prohibits is the acquisition, maintenance, and increase of market share by substantially preventing, restricting, or lessening competition. Undoubtedly, there is wisdom in this proposition in that it is not unusual for a single company to become dominant in a certain industry. In other words, more often than not, there will most likely be a market leader in each particular industry.

In the US, abuse of dominance is encompassed by the term "monopolization." Monopolization is prohibited by Section 2 of the Sherman Act, which provides:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding USD 100,000,000 if a corporation, or, if any other person, USD 1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

In its entirety, this provision can be broken down into two facets: *first*, monopoly power, and *second*, the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.[22]

In the EU, on the other hand, abuse of dominant position is prohibited by Article 102 of the Treaty on the Functioning of the European Union ("TFEU"). The article states:

> Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

Similar to the PCA, the article also lists acts that constitute forms of abuse, such as: (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; (b) limiting production, markets or technical development to the prejudice of consumers; (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have

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[22] United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).

no connection with the subject of such contracts. Similar as well to its counterpart PCA provision, the two essential elements are dominance and abuse.[23]

Between Section 2 of the Sherman Act and Article 102 of the TFEU, the PCA is more akin to the latter. As can be gleaned from the aforementioned provisions, Section 15 of the PCA, like Article 102 of the TFEU, lists and describes acts that may constitute abuse. Table 1 below provides a facial comparison of the abuse of dominance provisions in US, EU and Philippine laws. Notably, the acts listed in Article 15 of the PCA not only encompass those listed in the TFEU, but in fact add to them.

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[23] *Antitrust Procedures in Abuse of Dominance* (July 2013), *available at* http://ec.europa.eu/competition/antitrust/procedures_102_en.html

Section 2 of the Sherman Act (US)	**Article 102 of the TFEU (EU)**	**Section 15 of the PCA (Philippines)**
Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony […]	Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in: (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; (b) limiting production, markets or technical development to the prejudice of consumers; (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.	It shall be prohibited for one or more entities to abuse their dominant position by engaging in conduct that would substantially prevent, restrict or lessen competition: (a) Selling goods or services below cost with the object of driving competition out of the relevant market: *Provided*, […] (d) Setting prices or other terms or conditions that discriminate unreasonably between customers or sellers of the same goods or services, where such customers or sellers are contemporaneously trading on similar terms and conditions, where the effect may be to lessen competition substantially: *Provided,* […] (e) Imposing restrictions on the lease or contract for sale or trade of goods or services concerning where, to whom, or in what forms goods or services may be sold or traded, such as fixing prices, giving preferential discounts or rebate upon such price, or imposing conditions not to deal with competing entities, where the object or effect of the restrictions is to prevent, restrict or lessen competition substantially: *Provided,* […] (i) Limiting production, markets or technical development to the prejudice of consumers, *provided* […]

TABLE 1. Abuse of dominant position in the US, EU, and the Philippines.

In any case, when switching costs come into play, the fact that Section 15 of the PCA is more similar to Article 102 of the TFEU becomes irrelevant. As will be discussed later in Part III, in monopolization or abuse of dominance, both US and EU jurisprudence would show that switching costs indeed play a key role. Particularly, the existence of switching costs, when substantial and strategically created or increased, ultimately supports a finding of the elements of dominance and abuse. Since the same elements are required under Section 15 of the PCA, it would come naturally, therefore, that the effects of switching costs in antitrust enforcement in the Philippines would be the same as that in the US or in the EU. The PCA neither adds to, nor subtracts from, what the Sherman Act or the TFEU requires.

III. A GENERAL OVERVIEW OF SWITCHING COSTS

A. Definition and Source of Switching Costs

In order to fully understand the role of switching costs in antitrust enforcement, a discussion on what exactly switching costs are is necessary. Klemperer defines switching costs as the costs consumers face in switching from a product or service to one of its substitutes.[24] According to Yosifon, switching costs are the costs arising from an initial act of consumption of a product or service with sunk costs advantages that make switching to otherwise preferable products or services too costly or difficult.[25] Bjorkroth defines switching costs as the direct monetary and non-monetary costs for a consumer to switch to an alternative supplier of a good or service.[26] Le consolidates the common point of the multiple definitions of switching costs by stating that they indicate "stickiness in consumer choice."[27]

Switching costs begin to exist even before the purchase of a product or a service. In other words, they are actually already present prior to the moment the consumer makes the purchase decision itself.[28] In general, switching costs arise as a result of the desire of a consumer for harmony

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[24] Paul Klemperer, *The Competitiveness of Markets with Switching Costs*, 18 RAND J. ECONOMICS 138 (1987).

[25] David Yosifon, *Consumer Lock-in and the Theory of the Firm*, 35 SEATTLE U. L. REV. 1429, 1450 (2012).

[26] Tom Bjorkroth, *Exchange of Information and Collusion - Do Consumer Switching Costs Matter*, 6 EUR. COMPETITION J. 179, 184 (2010), *citing* AJ Padilla, *Revisiting Dynamic Duopoly with Consumer Switching Costs*, 2 J. ECONOMIC THEORY 520 (1995).

[27] Net Le, *Microsoft Europe and Switching Costs*, 27 WORLD COMPETITION 567, 572 (2004).

[28] Bjorkroth, *supra* note 26, at 184.

between his current purchase and his previous investment.[29] This previous investment may be a physical investment, an informational investment, a contractual investment, or a psychological investment,[30] and the kind of previous investment made by the consumer—whether one, any, or all of them—ordinarily determines the type of switching cost that would arise.

B. Types of Switching Costs

Although there is no standardized categorization of switching costs,[31] Klemperer classifies them into: (a) compatibility costs, (b) learning costs, (c) transaction costs, (d) uncertainty costs, (e) psychological costs, and (f) artificial or contractual costs.[32]

Compatibility costs arise when consumers purchase products or services that have consumable or replacement complements.[33] When there are complementary products, purchasing the original product (e.g. a razor, printer, pen, or camera) can lock the purchaser into buying the complementary product (e.g. blades, ink cartridges, refill cartridges, or lenses), or at the very least create costs for consumers who would opt to switch to a competitor.[34] Interconnected with compatibility costs is the concept of *network effects*,[35] which arise when the benefits of purchasing a product or a service increase with the number of people doing the same thing.[36] This means that the adoption of a product or service by additional users is complementary; and thus, "the benefits of adoption by any single user increases as other consumers adopt."[37]

Learning costs exist when the knowledge required to use one brand is not—or at least not completely—transferable to other brands of the same product or service, despite all brands being functionally identical.[38] Operating systems and software are the prototypical products with high

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[29] Paul Klemperer, *Competition When Consumers Have Switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade*, 62 REV. ECONOMIC STUDIES 515, 517 (1995).

[30] Aaron Edlin & Robert Harris, *The Role of Switching Costs in Antitrust Analysis: A Comparison of Microsoft and Google*, 15 YALE J.L. & TECH. 169, 178 (2013).

[31] *Id.* at 178.

[32] Klemperer, *supra* note 29, at 517.

[33] Edlin & Harris, *supra* note 30, at 178.

[34] *Id.*

[35] *Id.*

[36] Yosifon, *supra* note 25, at 1456.

[37] Edlin & Harris, *supra* note 30, at 178.

[38] Paul Klemperer, *Markets with Consumer Switching Costs*, 102 QUARTERLY J. ECONOMICS 375 (1987).

learning costs.[39] For example, if a consumer has learned how to use iOS for Apple products, such consumer may incur some learning costs when he switches to Android products. Similarly, if such consumer has invested in applications made for iOS, he may incur additional learning costs when he switches to these applications' Android counterparts. The more standardized the products or services are across the board, the lesser learning costs become.[40]

Transaction costs arise as a result of negotiating or arranging the transfer from one firm's product or service to that of a competitor. Transaction costs especially occur in services that are provided on a continuing or subscription basis.[41] Klemperer cites banking as a concrete example: "Two banks may offer identical checking accounts but there are high transaction costs in closing an account with one bank and opening another with a competitor."[42] An important element of transaction costs is risk,[43] as there is always a probability that the actual costs of switching will exceed the predicted costs of switching as a result of internal and external factors affecting the switching process.[44] Often times, it is the consumers themselves that amplify the risk of mistakes in the switching process because its occurrence is highly exasperating.[45]

Uncertainty costs represent the "differential between the experience a customer has had with the current supplier and the lack of experience with alternative suppliers."[46] When a consumer purchases a product or service from one firm, he learns of its advantages and disadvantages through experience.[47] For products or services that are hard to evaluate without such experience, the uncertainty costs tend to be high.[48] When other types of switching costs are low or inexistent, uncertainty costs are minimized: the consumer can try the product or service of one firm after that of another until he finds what he likes.[49] But when other types of switching costs are high, uncertainty costs tend to amplify them.[50] Fortunately, the Internet has

[39] *See* Edlin & Harris, *supra* note 30, at 182.
[40] *Id.* at 182.
[41] *Id.* at 180.
[42] Klemperer, *supra* note 38, at 375.
[43] Edlin & Harris, *supra* note 30, at 181.
[44] *Id.* at 181.
[45] *Id.*
[46] *Id.* at 182.
[47] *Id.*
[48] *Id.*
[49] Edlin & Harris, *supra* note 30, at 182.
[50] *Id.*

made it easier to reduce uncertainty costs through the sharing of experience via customer ratings and reviews.[51]

Psychological costs are also known as "non-economic brand loyalty."[52] Even when there is no "clearly identifiable economic reason" for a consumer to remain with a particular brand of product or service, the consumer hesitates to switch, and he would rather change his preferences to favor his usual brand than switch to another brand that actually meets such preferences.[53] For example, although iOS is less customizable than Android, an iPhone user would tend to change his preferences to favor a simple interface rather than switch to an Android phone.

Contractual or artificial costs are switching costs created specifically by contracts,[54] the device most commonly used by corporations to retain existing consumers.[55] For example, airline firms offer loyalty contracts or frequent flyer programs under which consumers who consistently choose to fly with them are rewarded with certain benefits.[56] Another example is how wholesalers offer discount contracts to consumers with either large purchases or large purchase commitments.[57] Mobile telecommunication firms offer subscription contracts through which they lock subscribers in through contract periods and pre-termination penalties.

C. Categories of Switching Costs

Nilssen categorizes the types of switching costs into two groups: endogenous switching costs and exogenous switching costs.[58] The basis of Nilssen's categorization is the relationship of a specific type of switching cost to the utility of the product or service.[59] *Endogenous switching costs* are those that can be internalized in the utility of the product or service. They are *directly* related to the usefulness of the product or service;[60] included in this group are uncertainty costs and psychological costs.[61] *Exogenous switching costs*, on the other hand, are those that are beyond the utility of the product

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[51] *Id.*
[52] Klemperer, *supra* note 29, at 518.
[53] *Id.*
[54] *Id.*
[55] Edlin & Harris, *supra* note 30, at 180.
[56] *Id.*
[57] *Id.*
[58] Tore Nilssen, *Two Kinds of Consumer Switching Costs*, 23 RAND J. ECONOMICS 579 (1992).
[59] *Id.*
[60] Le, *supra* note 27, at 573.
[61] *Id.*

or service. They are *indirectly* related to the usefulness of the product or service;[62] included in this group are compatibility costs, learning costs, transaction costs, and contractual costs.[63] These two categories are summarized in Table 2 below.

	Endogenous Switching Costs	**Exogenous Switching Costs**
Relation to the product/service utility	Direct	Indirect
Types of switching costs included	(1) Uncertainty costs (2) Psychological costs	(1) Compatibility costs (2) Learning costs (3) Transaction costs (4) Contractual costs

TABLE 2. Categories of switching costs.

D. Effect of Switching Costs on Competitiveness and Price

Klemperer studies the effect of switching costs on competitiveness and price using a two-period and a multiple-period economic model. In a *two-period model*, consumers have no switching costs in the first period, but develop switching costs in the second period as a result of their first-period purchases.[64] Meanwhile, firms acquire and develop market share in the first period,[65] and their first-period market share, in turn, determines their second-period profitability.[66] Klemperer finds that, ostensibly, second-period switching costs *lower* first-period prices.[67] However, upon closer examination, he concludes that the opposite is true—the effect of switching costs is *higher* prices.

The same can be said in a *multiple-period model*. In such case, firms have, in every period, two opposing incentives: on the one hand, the incentive to charge a high current price to exploit its locked-in customers, and on the other hand, the incentive to charge a current low price to attract new consumers, increase current market share, and increase future profit.[68]

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[62] *Id.*
[63] *See* Le, *supra* note 27, at 573.
[64] Klemperer, *supra* note 29, at 520.
[65] *Id.*
[66] *Id.*
[67] *Id.*
[68] *Id.* at 526.

Between these two incentives, Klemperer finds that the first one dominates. In totality, the effects of switching costs in both first and second periods (in a two-period model), and in both current and future periods (in a multiple-period model), are *higher prices* and *less competition*.

IV. SWITCHING COSTS AND ANTITRUST ENFORCEMENT

A. The Role of Switching Costs in Antitrust Enforcement in the US and EU

Having examined the general concept of switching costs, an analysis of its role in antitrust enforcement in the US and EU must follow. In both the US and EU, the term "switching costs" is rarely used in case law. This does not mean, however, that its implementation in US and EU case law is inexistent.[69] More accurately, the referral to switching costs in US and EU case law can be described as limited[70] since, oftentimes, the concept of switching costs is couched in a different term, such as "applications barrier to entry"[71] or "barriers to substitution."[72] More accurately, the implementation of switching costs in US and EU case law can be described as limited; not inexistent.[73] When implemented, switching costs play a key role in antitrust analysis[74] considering that they act as weighty variables that determine the presence or absence of the requirements for monopolization or abuse of dominant position.[75]

B. Illustrative Case: *United States v. Microsoft Corp.*

In *United States v. Microsoft Corp.*,[76] the US Department of Justice ("DOJ") argued that Microsoft's bundling of Internet Explorer ("IE") with Windows was not just for the purpose of adding functionality to Windows.[77] Instead, such act was considered a means employed by Microsoft to

[69] Le, *supra* note 27, at 575.

[70] *Id.*

[71] Edlin & Harris, *supra* note 30, at 185.

[72] *Commission Notice*, C372 O. J. EUROPEAN COMMUNITIES ¶42 (1997), *available at* https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:31997Y1209(01)&from=EN.

[73] Le, *supra* note 27, at 575.

[74] *See* Edlin & Harris, *supra* note 30; *and* Le, *supra* note 27.

[75] *Id.*

[76] 253 F.3d 34 (D.C. Cir.: 2001).

[77] Nicholas Echonomides, *The Microsoft Antitrust Case*, 1 J. INDUSTRY, COMPETITION AND TRADE 1, 5 (forthcoming Aug. 2001).

eliminate Netscape as a competitor, thereby protecting Microsoft's monopoly in the operating systems market.[78] Netscape posed a distinctive threat to Windows because applications could be written to be executed "on top" of Netscape.[79] Since Netscape was being made available across multiple operating systems, if a sufficient mass of useful programs were written to be executed via Netscape, it would force operating systems to compete on their own intrinsic merit, and not on the merits derived from the programs written for them.[80]

1. Role of switching costs in defining the relevant market

The US DOJ proposed, and the District Court and D.C. Circuit Court agreed, that the relevant market was that of operating systems for personal computers based on an Intel-compatible Central Processing Unit ("CPU").[81] This narrow market definition excluded Apple's Macintosh Operating System ("Mac OS") for the reason that consumers would not switch from Windows to Mac OS in response to a substantial price increase because the "costs of acquiring the new hardware needed to run Mac OS (an Apple computer and peripherals) and compatible software applications," as well as the "effort involved to learning the new system and transferring files to its format," were present.[82]

Noticeably, two types of switching costs played a key role in defining the relevant market: the "costs of acquiring new hardware" and the "effort involved in transferring files to its format," which pertained to *compatibility costs*, and the "effort involved to learning the new system," which pertained to *learning costs*. These switching costs led to a narrow market definition.[83]

2. Role of switching costs in assessing market power

After defining the relevant market, the US DOJ then had to prove Microsoft's possession of monopoly power.[84] For this purpose, the US DOJ endeavored to show that Microsoft had a share totaling over 95% of the market for personal computer operating systems ("PC OS") based on Intel-

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[78] *Id.*
[79] *Id.*
[80] Edlin & Harris, *supra* note 30, at 185.
[81] *Id.*
[82] *Id.*
[83] *Id.* at 188.
[84] *Id.* at 185.

compatible CPUs.[85] Apart from this, a crucial part of the DOJ's argument was what was called the "applications barrier to entry."[86] During that period, Windows had access to around 70,000 applications, most of which were not available on the Mac OS or on Linux.[87] The US DOJ argued, and again the District Court and D.C. Circuit Court agreed, that the abundance of applications written for Windows created a barrier to entry in the market, and that this barrier, coupled with Microsoft's huge market share, was what ultimately gave Microsoft monopoly power.[88]

Again, switching costs played a key role in this set up. What the US DOJ and the District Court and D.C. Circuit Court referred to as "applications barrier to entry" pertained to *compatibility costs*. These compatibility costs made the connection between Microsoft's large market share and monopoly power even more convincing.[89] It should be noted at this point that a large market share does not necessarily lead to a finding of monopoly power since the expansion of the remaining suppliers or the entry of new ones remains possible. This means, therefore, that it is possible for a firm with a large market share to possess only a limited power to raise prices.[90] What gave Microsoft this ability, however, was the fact that numerous applications written for Windows, which were incompatible with other operating systems, impeded existing competitors from expanding and prevented new competitors from entering.[91] As a result, the effect of switching costs in assessing market power is made clear and, as has been illustrated, supports a finding of monopoly power.

3. How switching costs establish exclusionary conduct

If a court finds that monopoly power exists, it will thereafter determine whether the defendant had acquired or maintained that power through exclusionary or anticompetitive conduct.[92] Although the D.C. Circuit Court overturned some of the District Court's findings of certain exclusionary conduct, it nonetheless found that Microsoft had engaged in a long list of other exclusionary acts.[93]

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[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.* at 190.

[90] *Id.*

[91] *Id.*

[92] Samuel Weinstein, *United States v. Microsoft Corp.*, 17 BERKELEY TECH. L.J. 273, 275 (2002).

[93] *Id.* at 283.

The numerous restrictions imposed by Microsoft on original equipment manufacturers, through licenses for Windows, was held to be exclusionary in character as these restrictions reduced the usage of rival browsers through contractual limitations rather than on the basis of a superior Microsoft product.[94] The exclusion of IE from the "Add/Remove Programs" utility and the commingling of the browser code with other codes so that a user trying to get rid of IE would destroy the entire system was also found to be anticompetitive.[95] Similarly, the maximization of the difficulty with which applications written to be executed "on top" of Netscape could be ported from Windows to other platforms, and vice versa, was also found to be exclusionary.[96]

Essentially, the problem, viewed from Microsoft's perspective, was that Netscape threatened to *lower* switching costs for consumers who wanted to change operating systems.[97] Microsoft's strategy was therefore to make sure that as many users as possible received IE as their default browser, and to make switching away from IE as difficult as possible.[98] This would maintain the incompatibility of applications so that it would be costly for users to switch away from Windows.[99] As can be gleamed from the discussion thus far, Microsoft's exclusionary behavior revolved heavily around switching costs.[100] Microsoft maintained its monopoly power not by simply being the innocent beneficiary of high switching costs, but by *strategically* and *substantially* raising switching costs.[101] Thus, the distinction between inherent (or endogenous) and strategic (or exogenous) switching costs is fundamentally important to antitrust enforcement,[102] as it establishes how strategic switching costs supports a finding of exclusionary conduct.

C. Illustrative Case: *European Commission v. Microsoft Corp.*

European Commission v. Microsoft Corp.[103] began when Sun Microsystems ("Sun") filed a complaint with the European Commission

[94] *Id.* at 282.
[95] *Id.*
[96] *Id.*
[97] Edlin & Harris, *supra* note 30, at 187.
[98] *Id.*
[99] *Id.*
[100] *Id.*
[101] *Id.*
[102] *Id.* at 176.
[103] Case COMP/C-3/37.792 Microsoft Corp., Comm'n Decision (Mar. 24, 2004).

("Commission") against Microsoft accusing the latter of violating, among others, Article 86 (now Article 102 on abuse of dominant position) of the TFEU.[104] Sun raised the issue of *interoperability*, contending that Microsoft enjoyed a dominant position in the market, and that Microsoft refused to provide it with necessary information (particularly, Application Programming Interfaces or APIs) to enable Sun's server programs to fully interoperate with Windows.[105]

1. Role of switching costs in assessing dominance

The Commission defined two relevant markets: *first*, the market for client PC operating systems ("PC OS");[106] and *second*, the market for work group server operating systems ("Server OS").[107] In both markets, the Commission found that Microsoft enjoyed a dominant position[108] considering that the facts showed not only that Microsoft enjoyed a large market share, but more importantly, that there were barriers to entry.[109] These barriers to entry were in the nature of switching costs.

As to the market for PC OS, the Commission found that the quasi-totality of commercial applications for client PCs were mostly written for Windows.[110] As such, it would be difficult and costly for consumers to switch to a competitor PC OS, thereby rendering it practically impossible for new competitors to enter into the market.[111] For a new operating system to enter the PC OS market, it would be necessary either that such product is able to support a mass of existing Windows-dependent applications, or that such mass of applications should be readily written for the new platform.[112]

As to the market for server OS, the Commission noted that Microsoft's behavior of withholding interoperability information built an *artificial* barrier to entry in the market.[113] This posed a problem because the Commission found that there was a strong need for PC OSs and server OSs

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[104] Francisco Lorca, *Microsoft Corporation vs. The U.S. Court of Justice and the European Community*, 9 JEAN MONNET/ROBERT SCHUMAN PAPER SERIES 1, 8 (2009).

[105] *Id.* at 10.

[106] Case COMP/C-3/37.792 Microsoft Corp., Comm'n Decision (Mar. 24, 2004), at ¶ 342.

[107] *Id.* at ¶ 401.

[108] *Id.* at ¶¶ 471, 541.

[109] *Id.*

[110] *Id.* at ¶ 452.

[111] *Id.* at ¶ 453.

[112] *Id.*

[113] *Id.* at ¶ 524.

to interoperate.[114] The resulting barrier to entry in the market[115] thus made it unrealistic to envisage potential competitors profitably entering the market.[116]

2. Role of switching costs in establishing abuse of dominance as to the interoperability issue

Finding Microsoft to be in a dominant position, the Commission then had to prove their having abused the same. Article 82(b) of the TFEU provides that abuse as prohibited by that Article may consist in limiting technical development to the prejudice of consumers.[117] The Commission construed the lack of interoperability of competing server OS products with the Windows domain architecture to mean that an increasing number of consumers would find themselves locked into a homogeneous Windows solution.[118] This does not only impair the ability of such consumers to benefit from innovative server OS features brought to the market by Microsoft's competitors, but also limits the prospect for such competitors to successfully market their innovations. This, in turn, discourages competitors from developing new products altogether.[119] If, however, Microsoft's competitors had access to the interoperability information that Microsoft refused to supply, then they could use such disclosures to innovate advanced features of their own products.[120]

In defense, Microsoft argued that there was a lack of evidence proving that its refusal to disclose interoperability information caused prejudice to consumers.[121] It argued that contrary to the findings of the Commission, consumers were satisfied with the degree of interoperability available.[122] The Commission, however, did not give credence to this argument. Jurisprudence provided that Article 82 of the Treaty "covers not only abuse which may directly prejudice consumers but also abuse which indirectly prejudices them by impairing the effective competitive structure as envisaged by Article 3(f) of the Treaty."[123] The Commission explained that Microsoft's refusal to supply had already enabled it to gain a dominant

[114] *Id.*
[115] *Id.*
[116] *Id.* at ¶ 525.
[117] *Id.* at ¶ 893.
[118] *Id.* at ¶ 694.
[119] *Id.*
[120] *Id.* at ¶ 695.
[121] *Id.* at ¶ 702.
[122] *Id.*
[123] *Id.* at ¶ 704.

position in the market for server OS, and as such, Microsoft's behavior is impairing the effective competitive structure in the market.[124]

Le criticizes this part of the Commission's decision as being its weakest point.[125] According to him, the Commission ruling was made without showing a concrete example of actual detriment to the consumer in terms of money loss.[126] He argues that the Commission could have reached the same conclusion by highlighting a factor that seems to have been understated in the Commissioner's analysis: switching costs.[127]

Le explains that it is detrimental to consumers when there is a loss of utility to them.[128] This may be illustrated by this example: suppose that in a given situation, (1) there are two competing products, (2) consumers are rational, and (3) information is complete.[129] When the utility of Product 2 is higher than the utility of Product 1, consumers would opt to switch to the former to maximize their utility.[130] The resulting difference between the utility of Product 2 and that of Product 1 is the "consumer demand" or "utility surplus."[131] The failure to satisfy this consumer demand means that there is a loss of opportunity to gain utility, and this leads to a disadvantage for consumers.[132] This is because, as confirmed in many cases, it is detrimental for consumers to have a "specific, constant and regular" demand for new products that remains unsatisfied by the incumbent without any justification.[133]

Switching costs can explain consumer detriment in the context of the interoperability issue.[134] Particularly, by creating compatibility costs between Windows and rival server OSs, Microsoft denied a reasonable demand of server users.[135] The three major server OSs at that time were Microsoft, Linux, and UNIX.[136] UNIX was the oldest server OS, and its users eventually had to switch to either Linux or Microsoft.[137] If a

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[124] *Id.*
[125] Le, *supra* note 27, at 570.
[126] *Id.*
[127] *Id.* at 567.
[128] *Id.* at 571.
[129] *Id.*
[130] *Id.*
[131] *Id.*
[132] *Id.*
[133] *Id.*
[134] *Id.* at 583.
[135] *Id.*
[136] *Id.*
[137] *Id.*

comparison between Microsoft and Linux were to lead to a conclusion that a reasonable server user would have chosen Linux had it not been for the compatibility problem, then such incompatibility is deemed as having created a "force" that prevents consumers from switching.[138] The higher this "force" is in relation to the consumer demand or utility surplus between Linux and Microsoft—that is, the difference between the utility of Linux and the utility of Microsoft—the higher the utility Linux must provide in order to offset it.[139] In strengthening this "force" by refusing to supply interoperability information, Microsoft effectively created and exploited the resulting economic gap.[140]

The presumption of consumers preferring Linux over Microsoft were it not for the compatibility problem was supported by statistics during that time.[141] Data showed that a switch from UNIX to Linux would have cost the users less than an equivalent switch from UNIX to Microsoft because of the similarity between UNIX and Linux.[142] However, consumers who needed server OSs primarily for sharing files and printing would switch from UNIX to Microsoft rather than Linux not because of the inferior quality of Linux or the high price that Linux engineers charged users, but because of the incompatibility between the desktop OS (Windows) and the server OS.[143] The consumers who suffered detriment from Microsoft's incompatibility tactic were the consumers of Microsoft software at the desktop level.[144] Their disutility, such as inconvenience in login, file sharing, and printing synchronization were due not to the inferior technology of Linux, but solely to Microsoft's tactic.[145]

D. The Role of Switching Costs in Antitrust Enforcement in the PH

As mentioned in Part I, because the elements of abuse of dominance under the PCA, the Sherman Act, and the TFEU are substantially the same, the role of switching costs in antitrust enforcement under the two latter laws, as elucidated by US and EU jurisprudence, is naturally and logically applicable to antitrust enforcement under the PCA. In fact, although there may be no exact mention of the term "switching costs"

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[138] *Id.*
[139] *Id.*
[140] *Id.*
[141] *Id.*
[142] *Id.*
[143] *Id.*
[144] *Id.* at 584.
[145] *Id.*

in the PCA, its provisions and its implementing rules expressly and implicitly take switching costs into consideration:

1. The PCA considers switching costs in defining the relevant market

Section 4(g) of the PCA defines dominance, or "dominant position," as

> a position of economic strength that an entity or entities hold which makes it capable of controlling the relevant market independently from any or a combination of the following: competitors, customers, suppliers, or consumers[.][146]

To determine dominance, Section 27 provides that "[t]he share of the entity in the relevant market and whether it is able to fix prices unilaterally or to restrict supply in the relevant market" shall be considered.[147] Necessarily, defining the relevant market would be the primary step in determining dominance.

In defining the relevant market, Section 23 of the PCA provides that factors which affect the "substitutability among goods or services constituting such market and the geographic area delineating the boundaries of the market" shall be considered. Among these factors are the "extent to which substitutes are available to consumers" and the "time required for such substitution,"[148] both of which pertain to switching costs. Although there may be substitutes, the "extent to which [these] substitutes are available" (compatibility costs), and the "time required for such substitution" (transaction costs, learning costs), would add to "stickiness in consumer choice,"[149] thereby reducing substitutability. When there are little to no substitutes, the relevant market becomes narrow.

2. The PCA considers switching costs in determining dominance

After defining the relevant market, the entity's "position of economic strength" in that market shall be determined. To do so, factors aside from the market share of entity are taken into consideration.

[146] *See also* Rules and Regulations to Implement the Provisions of Republic Act No. 10667 (2016) [hereinafter "Rules"], Rule 2.

[147] Rule 8, § 2.

[148] PCA, § 23(a); *see also* Rules, Rule 5, § 1(a).

[149] Le, *supra* note 27, at 572.

Remarkably, Section 27 of the PCA explicitly states that the "power of its customers to switch to other goods or services" shall be considered.[150] This is a direct recognition of switching costs and its functions. Moreover, the same provision also invites the consideration of the "existence of barriers to entry" as well as "elements which could foreseeably alter" said barriers.[151] These barriers to entry, as discussed in the illustrative cases, may be, and more often than not are, in the form of switching costs.

3. The PCA considers switching costs in establishing abuse

If the entity were found to be enjoying market dominance in the relevant market, the next step would be to establish abuse. At first glance, the list of acts that may be considered abuse in Section 15 of the PCA may seem exhaustive: "It shall be prohibited for one or more entities to abuse their dominant position by engaging in conduct that would substantially prevent, restrict or lessen competition: […]" Section 2, Rule 3 of the Rules, however, clarifies that the list allows for analogous scenarios to likewise be considered as abuse: "It shall be prohibited for one or more entities to abuse their dominant position by engaging in conduct that would substantially prevent, restrict, or lessen competition, including: […]" The word "including" connotes that the list is not exclusive.

As long as a dominant firm uses switching costs in a manner that would substantially prevent, restrict, or lessen competition, it is not difficult to imagine that such firm may be found to be abusing its dominance. This is especially so considering that "[i]mposing barriers to entry or committing acts that prevent competitors from growing within the market in an anti-competitive manner, except those that develop in the market as a result of or arising from a superior product or process, business acumen, or legal rights or laws"[152] are considered forms of abuse. This contemplates the strategic and substantial creation or increase of exogenous switching costs as previously illustrated by Microsoft's conduct in the *United States v. Microsoft Corp.* case.

V. ILLEGALITY OF CONTRACTUAL LOCK-IN AND VI. MOBILE NUMBER (UN)PORTABILITY

[150] *See also* Rules, Rule 8, § 2(i).
[151] Rule 8, § 2(c).
[152] PCA, § 15(b).

Parts I to IV have laid down the framework necessary to analyze the legality of contractual lock-in and mobile number (un)portability in light of the PCA and the concept of switching costs. The present Part shall now apply such framework.

A. Relevant Market

This analysis begins with the premise that the relevant market is that of mobile telecommunications services. In defining the relevant market, the key is substitutability. Section 24 of the PCA provides that factors "affecting the substitutability among goods or services constituting such market and the geographic area delineating the boundaries of the market" shall be considered. Applying this, the market for fixed-line (or landline) services is properly excluded. In essence, fixed-line services cannot be considered substitutes to mobile telecommunications services because of their nature, i.e. their lack of mobility. In other words, they are excluded not because of the switching costs, but because of the inferior utility these services provide. Satellite services are also properly excluded because these are generally not available to consumers of mobile telecommunications services as they are significantly more expensive.[153] Thus, similar to landline services, they are excluded because of their higher price point. Ultimately, switching costs matter when, despite the *similarity* in price and utility, consumers are prevented from switching.

B. Collective Dominance

Section 15 of the PCA prohibits "one or more entities" from abusing their dominant position. The use of the phrase "one or more" implies a recognition of collective dominance. In fact, the Rules explicitly state that "[d]ominance can exist on the part of one entity (single dominance) or of two or more entities (collective dominance)."[154] Neither the PCA nor the Rules, however, define the circumstances in which more than one entity can be said to occupy a dominant position. In this respect, resort to foreign jurisprudence is helpful.

Article 102 of the TFEU prohibits the abuse of a dominant position by "one or more undertakings." The meaning of collective dominance in the EU has been developed through cases decided by the Courts of Justice and Court of First Instance under both Article 102 of the TFEU and the

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[153] *SmartSat Plans and Rates*, *available at* https://smart.com.ph/Satellite/smart-sat/plans-and-rates (last accessed Dec. 14, 2018).

[154] Rules, Rule 8, § 1.

European Commission Merger Regulation[155] ("ECMR"). The first of these cases was *Italian Flat Glass*, where the phrase "one or more undertakings" was confirmed to mean that economically independent undertakings, when united by economic links, could jointly occupy a dominant position in the market.[156] Later, in *Almelo*, it was made clear that "economic links" enable otherwise independent undertakings to adopt common conduct and operate as a single entity.[157] What remained unclear, however, was what constituted an economic link and how these links enabled undertakings to adopt common conduct.[158] The decision in *Airtours*,[159] an ECMR case, provided a welcome clarification on this matter.[160]

In *Airtours*, it was held that a collective dominant position exists when a number of firms, aware that it is ultimately more profitable for them to adopt a common policy, adopt such common policy without an agreement or resort to a concerted practice.[161] Because tacit coordination enables independent firms to act as a single entity, it is included in the meaning of collective dominance.[162] In order for such implied undertakings to be construed as having been done by a single entity comprised of the practicing firms, it was held that three conditions must be met: transparency, sustainability, and absence of competitive constraints.[163] *Transparency* means that a mutually beneficial market strategy can be identified, and firms can monitor adherence to the common policy.[164] *Sustainability* means that there must be a disincentive for deviating from the common policy.[165] *Absence of competitive constraints* means that it must be likely that neither current nor future competitors, nor consumers, can react in a manner that makes the common policy unprofitable.[166] These requirements were affirmed and further elaborated on in *Impala*.[167]

If the three-fold test is satisfied, the firms operating these undertakings, notwithstanding the lack of explicit coordination, are deemed

155 Okeoghene Odudu, *Collective Dominance Clarified?*, 63 CAMBRIDGE L. J. 44 (2004).
156 *Id.*
157 *Id.*
158 *Id.*
159 *Id.*
160 *Id.* at 43.
161 *Id.*
162 *Id.* at 44.
163 *Id.*
164 *Id.*
165 *Id.* at 45.
166 *Id.* at 46.
167 *Id.*

able to act as a single entity.[168] Consequently, if these undertakings are found to be dominant, then such can be said to be collectively dominant.[169] Taking the analysis within the context of the mobile telecommunications market in the Philippines, can it be said that Globe and Smart act as a single entity? Applying the three-fold test, it is submitted that they may.

First, market strategies for the mobile telecommunications market are very transparent. Subscribers avail of mobile telecommunications services primarily through subscription contracts that readily provide the salient terms and conditions and form part of the carriers' market strategies. For example, the subscription contracts provide for the contract duration and the penalty for early termination. This evidences a market strategy for consumer lock-in. In fact, contract duration is explicitly advertised in their websites. Even before a subscriber avails of their services, he is already informed of the contract duration. It would not be difficult for Globe to see how Smart offers its services. *Second*, having a common market policy is sustainable. Given that there are only two major players in the market, and given that these entities are profit-oriented, deviation from the common policy by one would logically lead to retaliation by the other. Retaliation is, thus, a disincentive from deviation. *Third*, there is an absence of competitive restraints. Obviously, Globe and Smart have no other competitors that can disrupt their common policy. Neither can the subscribers react in a way that makes the common policy unprofitable because they have no other carrier to switch to.

The next question, therefore, is whether Globe and Smart, treated as a single entity, are dominant. Section 27 of the PCA provides "a rebuttable presumption of market dominant position if the market share of an entity in the relevant market is at least 50%, unless a new market share threshold is determined by the [Philippine Competition] Commission for that particular sector." Globe and Smart, treated as a single entity, virtually comprise the whole market for mobile telecommunication services. Following this, the presumptive conclusion must necessarily be that they are indeed collectively dominant.

C. Abuse of Dominance: Contractual Lock-in

Lock-in periods fall under the type of switching costs called *contractual or artificial costs*. Contractual costs are categorized as *endogenous*

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[168] *Id.*
[169] *Id.*

switching costs as they are not directly related to the usefulness of the product or service they correspond to. In antitrust enforcement, the presence and imposition of endogenous switching costs raises a red flag since, as discussed in the case of *United States v. Microsoft Corp.*, the strategic and substantial creation or increase by a dominant firm of endogenous switching costs is considered exclusionary or abusive. It may be easy to conclude at this point that Globe and Smart's imposition of lock-in periods, an endogenous switching cost, is an abuse of their dominant position. An argument may be made, however, that this is not the case for the reason that lock-in periods, or contractual costs for this matter, are voluntarily assumed by the subscribers; they are a product of a meeting of minds. Thus, a deeper analysis to establish the abuse is required.

Edlin and Harris, in their discussion of contractual costs, explain that not all exclusive provisions in contracts that can effectively lock-in a consumer are problematic.[170] In certain instances, knowing and willing buyers and sellers can realize gains from trade by making such commitments to each other.[171] Contractual costs only begin to be problematic when a buyer feels that he has to accept the terms from a seller because he is dependent on that seller in some way.[172] Such a possibility suggests the importance of examining the competitiveness of the market in which one observes these exclusive contracts or other contract provisions that raise switching costs.[173] Logically, therefore, the more competitive a market is, the more valid exclusive provisions become. In the same manner, the less competitive a market is, the less valid these provisions become. If these provisions were found to be illegal for being abusive, then the principle of autonomy of contracts would not be applicable.

The market for mobile telecommunication services in the Philippines is far from competitive. As discussed, the market is highly concentrated with Globe and Smart virtually comprising the whole of the market. Furthermore, the market is replete with other types of switching costs. *Transaction costs* are present. Switching providers is not as easy as simply halting payment of monthly dues. The subscriber has to call or go to the provider, settle remaining balances, notify friends and family of the change of number, and sometimes even buy a new phone. *Uncertainty costs* are also present. Although gathering information is easier nowadays, information acquired tends to be incomplete. The subscriber remains not

170 Edlin & Harris, *supra* note 30, at 180.
171 *Id.*
172 *Id.*
173 *Id.*

entirely sure whether the cell signal in a particular area is strong, or whether a particular area is covered by LTE. *Compatibility costs* are also high. The mobile telecommunication services market is characterized by *network effects*, whereby the benefits of subscribing to a provider increase with the number of people doing the same thing. This is because cross-network calls or texts tend to be more expensive than inter-network calls or texts.

The presence of these various switching costs bolster the lack of competitiveness in the market. As discussed in Part II, the effect of switching costs, whether in a two-period model or in a multiple-period model, are less competition and higher prices. On this score, lock-in periods should be invalidated for being contrary to law considering that their imposition is "conduct that would substantially prevent, restrict or lessen competition."[174]

Another ground to invalidate the imposition of lock-in periods is Section 15(b) of the PCA. It provides that "[i]mposing barriers to entry or committing acts that prevent competitors from growing within the market in an anti-competitive manner," when committed by a dominant firm, is abuse of its dominant position. The only exception, which is provided for in the same provision, is when the barrier imposed or act committed is one "that develop[s] in the market as a result of or arising from a superior product or process, business acumen, or legal rights or laws." Essentially, there are three requirements to be met in order to fall under Section 15(b): *first*, there must be an imposition of barrier to entry, or a commission of an act that prevents competitors from growing within the market; *second*, the barrier was imposed or the act was committed in an anti-competitive manner; and *third*, the imposition or the act must not arise from, or be the result of, superior product or process, business acumen, or legal rights or laws. The imposition of lock-in periods satisfies all of these requirements.

In *United States v. Microsoft Corp.*, as well as in *European Commission v. Microsoft Corp.*, barriers to entry were in the form of compatibility costs. Particularly, the former case involved the numerous applications written to run on Windows, while the latter case involved Microsoft's refusal to provide interoperability information. The lesson to be learned from these cases is that barriers to entry, which may be in the form of switching costs, are anticompetitive when competitors are prevented from growing *despite* offering more utility in terms of function or price. How lock-in periods imposed by Globe and Smart could prevent a new entrant from growing despite offering better utility is not difficult to imagine. With a substantial

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[174] PCA, § 15.

portion of the market locked-in to either Globe or Smart, a new entrant, even if it offers better service, would have nobody else to serve, except those whose contracts are about to expire, or those who have yet to avail of any postpaid service. Lock-in periods are also far from being the result of a "superior product or process, business acumen, or legal rights or laws." They arise from contracts; they are artificial. The mobile telecommunication services industry is already dotted with other barriers to entry, such as high capital expenditures, such that the imposition of another barrier, artificial at its core, by a dominant entity, is plain abuse.

D. Abuse of Dominance: Mobile Number (Un)portability

The effect of MNP, by allowing consumers to retain their number, is to lower switching costs,[175] particularly compatibility costs and transaction costs. In refusing to allow consumers to retain their mobile numbers, Globe and Smart are, in effect, building an artificial barrier to entry by maintaining avoidable switching costs. This refusal is not so dissimilar to Microsoft's refusal to provide interoperability information in *European Commission v. Microsoft Corp.*, which was found to be abusive. Under Article 15(b) of the PCA, this refusal is tantamount to an illegal imposition of a barrier. In a highly-concentrated market, the fact that the barrier to entry is artificial is a circumstance from which its anti-competitive nature may be inferred.[176] Since the barrier to entry created by Globe and Smart's refusal to allow MNP is artificial, its imposition is anti-competitive. All three elements for the violation of Article 15(b) are, thus, satisfied.

In many countries, MNP has either already been implemented or is at least under consideration. Commendably, the Philippine Senate approved, on February 20, 2018, Senate Bill No. 1636, or the proposed "Lifetime Cellphone Number Act."[177] Under this bill, public telecommunications entities in the Philippines are required to provide consumers with mobile number portability, allowing them to transfer from one network provider to another free of charge.[178] Whether it will ripen into law is anyone's guess.

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[175] *Id.*

[176] *See* Timothy Bresnahan & Peter Reiss, *Entry and Competition in Concentrated Markets*, 99 J. POLITICAL ECONOMY 977, 977-1009 (1991), studying the effects of entry in concentrated markets and concluding that competitive conduct changes quickly as the number of incumbents increases.

[177] Chad de Guzman, *Senate OKs Bill of Lifetime Cellphone Numbers*, CNN PHILS., Feb. 20, 2018, *available at* http://cnnphilippines.com/news/2018/02/20/senate-lifetime-cellphone-numbers.html.

[178] *Id.*

VII. CONCLUSION

This research has used the provisions of the PCA in relation to the prohibition on abuse of dominant position and the concept of switching costs to show the illegality of contractual lock-in and mobile number (un)portability imposed by Globe and Smart. This research has explained that, in the enforcement of the prohibition of abuse of dominance in the PCA, switching costs have the effect of narrowing the relevant market, thereby supporting a finding of dominance and abuse. Particularly, when a dominant firm substantially and strategically creates or increases switching costs, its conduct is tantamount to abuse. Taking this into consideration vis-à-vis the mobile telecommunication business as the relevant market, Globe and Smart, being collectively dominant, should be deemed as abusing their dominant position through the imposition of contractual lock-in.

First, with respect to contractual lock-in, because the relevant market is highly concentrated and fraught with switching costs, the fact that such an arrangement was agreed to by the subscriber becomes irrelevant. Provisions in subscription contracts imposing lock-in periods are illegal for being anticompetitive. Lock-in periods are in the nature of barriers to entry that do not develop in the market as a result of or arising from a superior product or process, business acumen, or legal rights or laws. Being artificial at its core, lock-in periods constitute abuse.

Second, with respect to mobile number (un)portability, similar to contractual lock-in, the refusal to provide MNP is an illegal and anticompetitive imposition of a barrier to entry. In a highly concentrated market, the fact that the barrier to entry is artificial is a circumstance from where the fact that the manner of its imposition is anti-competitive may be inferred. If the proposed Lifetime Cellphone Number Act does not ripen into law, antitrust enforcement remains to be an option.

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