Margin Squeeze in the EU

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1 INTRODUCTION

1.1 *TeliaSonera* – preliminary ruling by ECJ February 17 2011[1]

When a vertically integrated[2] undertaking supplies input to its competitors without leaving sufficient margin for them to effectively compete, it may constitute an abuse of Article 102 TFEU. Margin squeeze is one of the most controversial and also one of the least explored abuses in EU competition law.[3] The ECJ[4] judgment *TeliaSonera* significantly altered the concept of margin squeeze, and brought both important clarification and further controversy.

TeliaSonera is the operator of the Swedish fixed telephone network and the owner of the local loop[5] which provides most Swedish households with telephone and internet connections. As the former state monopolist, TeliaSonera still enjoys a dominant position[6] in the market for wholesale access to the local loop[7], which it supplies to downstream competitors[8] both under a regulatory obligation[9] and without such a duty[10]. In addition, TeliaSonera offers direct access to end-users.

In 2004 TeliaSonera was fined[11] by the Swedish Competition Authority for unlawful margin squeeze in the markets of ADSL products to wholesalers and to end users:[12]

> *"[…] applied a pricing policy under which the spread between the sale prices of ADSL products intended for wholesale users and the sale prices of services offered to end users was not sufficient to cover the costs which*

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[1] Case C 52/09: *Konkurrensverket vs. TeliaSonera Sverige AB*, judgment of the court 17.02.2011 (Hereafter *TeliaSonera*)

[2] A vertically integrated undertaking refers to a firm which operates on two levels of the value chain.

[3] Hou, L. "Some aspects of price squeeze within the EU: a case law analysis" E.C.L.R. 2011, 32(5), 250-257

[4] The European Court of Justice

[5] Local access metallic network (the physical circuit)

[6] A dominant position refers to a certain degree of market strength. The concept will be explained under para. 2.1.3

[7] Stämningsansökan 2004-12-21Dnr 1135/2004 para. 105 and 134 (Swedish text only)

[8] Downstream competitors are the competitors operating at a level of the value chain closer to the end-sale than the level of production or manufacture, which will be referred to as upstream competitors.

[9] Regulation (EC) No 2887/2000 of the European Parliament and of the Council of 18 December 2000 on unbundled access to the local loop OJ 2000 L 336, p. 4

[10] TeliaSonera offers an ADSL product directed towards the wholesale market

[11] Stämningsansökan 2004-12-21Dnr 1135/2004

[12] The proceedings in Stockholm's district court were stayed awaiting the preliminary ruling, and is to be resumed in October 2011. A judgment is expected late 2011 or early 2012.

TeliaSonera itself had to incur in order to distribute those services to the end users concerned."[13]

Stockholm's District Court referred ten questions regarding the criteria for margin squeeze to the ECJ.[14] The judgment from the Court changed the concept of margin squeeze, which was already subject to great debate. The opinions on margin squeeze ranged from not acknowledging the concept to considering it of utmost importance to prevent.[15] However, up until *TeliaSonera* the general view was that margin squeeze was a constructive refusal to deal.[16] The judgment disconnected the concepts. Margin squeeze is now a stand-alone abuse, subject to its own set of criteria.

1.2 Objective and methodology

This paper aims to clarify the criteria of margin squeeze in EU developed in *TeliaSonera* and the other main cases, *Deutsche Telekom*[17] and *Telefónica*[18], which will be presented below. The problem to be addressed is when a pricing practice amounts to an unlawful margin squeeze under Article 102 TFEU.

The main part of this dissertation will provide a normative description of the current legal situation in the EU. In addition, the great controversy and divergence in the area of margin squeeze will be illustrated with a comparison to the US regime. Critical remarks and the author's own comments will be saved for the concluding chapter.

When the Lisbon Treaty came into force on 1 December 2009 the European Community was superseded by the European Union, and the EC Treaty was renamed the Treaty on the

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[13] Supra note 1 para. 8

[14] Reference for a preliminary ruling from the Stockholm Tingsrätt lodged on 6 February 2009, *Konkurrensverket v TeliaSonera Sverige AB*, Case C-52/09

[15] See Sidak, J.G, "Abolishing the Price Squeeze as a theory of Antitrust Liability, J.C.L.& E., 2008, 4(2), 279–309, Art, J. "Highway 102: A Nice Turn with Still some Miles to Go" J.E.C.L. & Pract., 2011, Vol. 2, No. 3 183-184

[16] See Case C 52/09: *Konkurrensverket vs. TeliaSonera Sverige AB*, opinion of the Advocate General Mazák delivered on 2.9.2010 (Hereafter *TeliaSonera*, opinion of the Advocate General) and Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings 2009/C 45/02 (Hereafter the Enforcement Priority Guidance). For more information on refusal to deal see Jones, A. & Sufrin, B. "EU competition law" 4th edition (Oxford, 2011) chapter 7.12 and Faull, J. & Nikpay, A. "The EC law of competition" 2nd edition (Oxford 2007) para. 4.170.

[17] Case C•280/08 P, *Deutsche Telekom AG vs. the Commission*, Judgment of the court 14.10.2010 (Hereafter *Deutsche Telekom*, ECJ)

[18] Case COMP/38.784, *Wanadoo España vs. Telefónica*, Commission decision of 04.07.2007 (Hereafter *Telefónica*)

Functioning of the European Union[19] (TFEU). The competition provisions were not subject to material changes, however they were renumbered. In addition, the title of the Court of First Instance (CFI) was changed to the General Court (GC). For practical reasons only the current numbering and terminology will be used in the body of this paper.

1.3 Disposition

This paper will be organised as follows. Chapter two gives an overview of margin squeeze as an abuse of dominant position. The basic criteria for application of 102 will be examined along with an introduction to the concept of margin squeeze. The market conditions are of vital interest to the assessment, hence the markets in which margin squeeze usually takes place and the relationship between sector-specific regulation and competition law will also be scrutinized. Chapter three review the current criteria for margin squeeze and the possible objective justifications. The legal situations in the EU to the US are compared in chapter four. A critical assessment of the current criteria and concluding remarks are presented in chapter five.

1.4 Delimitation

An in-depth examination of the economic models which the assessment of margin squeeze is based on is beyond the scope of this paper. The actual assessment of margin squeeze must be done on a case by case basis, which can be very extensive cf. the Commission decision in *Telefónica*. This paper will focus on the legal assessment and the factors that must be taken into account. Furthermore, the sanctions and remedies available after an unlawful margin squeeze has been found will not be reviewed.

[19] C 115/47 9.5.2008, Consolidated Version of the Treaty on the Functioning of the European Union

2 INTRODUCTION TO THE CONCEPT OF MARGIN SQUEEZE AS AN ABUSE OF A DOMINANT POSITION

2.1 Article 102 TFEU

2.1.1 Introduction

Article 102 TEFU provides:

> *"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."*[1]

The provision aims to ensure that undertakings, which enjoy significant market power, are unable to distort the competitive environment. For Article 102 TEFU to apply, dominance within the internal market or in a substantial part of it is required. However, merely having a dominant position is not unlawful. In addition, an act performed by the undertaking in question must amount to an abuse which is likely to affect trade between member states.[2] In the following a brief introduction to the different elements of Article 102 TEFU will be given.

2.1.2 Definition of the relevant market

To establish a dominant position it is necessary to define the relevant market, since this enables market shares and concentration to be measured. The market definition is purely an analytical tool, aiming to establish which competitive constraints the undertaking in question faces.[3] A relevant market has a product dimension and a geographical dimension. In the assessment the Commission primarily relies on demand substitutability, which takes the viewpoint of the customers and examines what they regard as substitutes for the product or location of the undertaking in question.[4] The standard approach is the hypothetical monopolist test, which assess whether a small but significant non-transitory price increase (SSNIP) of 5-10% would lead to the customers substituting away from the product in question, hence

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[1] Article 102 TFEU

[2] See Faull, J. & Nikpay, A. "The EC law of competition" chapter 4

[3] Jones, A. & Sufrin, B "EU competition law" p. 293

[4] Commission Notice on the definition of relevant market for the purposes of Community competition law OJ C 372, 09/12/1997 P. 5-13 (Hereafter Notice on the definition of relevant market)

making the price increase unprofitable.[5] By including more and more products and areas until the SSNIPP is profitable, the relevant market is determined. While the circumstances in the case may lead to this test being impractical or erroneous, other methods available have the same aim; i.e. to find the products and competitors which exert a competitive constraint on the undertaking, and hence the relevant market.[6]

2.1.3 The concept of dominance

The concept of dominance is developed in case law:

> *"The dominant position thus referred to relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors , its customers and ultimately of the consumers."*[7]

There is a presumption that if the undertaking has a market share above 50% in the relevant market dominance is present.[8] However, this is only a presumption and may be rebutted depending on the case-specific facts. In several cases dominance has been found with a lower market share, for example if the market share ratio between the undertaking and its competitors is significant.[9]

The dominant position must be held within the internal market or in a substantial part of it. The purpose of this requirement is to ensure that purely local situations are not subject to intervention at Union level.[10]

It is not a violation of Article 102 TEFU to be dominant. A strong market position can very well be attributed to a superior product or more efficient production. Nevertheless, dominant

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[5] Ibid. para. 17

[6] Ibid. para. 56-58

[7] Case 85/76, *Hoffmann-La Roche & Co. AG v the Commission*, [1979] ECR 461 para. 38 (hereafter *Hoffman-La Roche*)

[8] Case C-62/86, *AKZO Chemie BV v the Commission*, [1991] ECR I-3359 (Hereafter *AKZO*)

[9] Case T-219/99: *British Airways plc vs the. Commission*, [2003] ECR II-1333 and Case 27/76, *United Brands Company and United Brands Continentaal BV vs. the Commission*, [1978] ECR 207

[10] Jones, A. & Sufrin, B. "EU competition law" pp. 267-268

undertakings have a "special responsibility"[11] which entails that conduct which is regarded as lawful below the dominance threshold, may constitute an abuse.

2.1.4 Abuse

Only conduct by a dominant undertaking amounting to an abuse is an infringement of Article 102 TEFU:

> *"'abuse' is an objective concept referring to the behaviour of an undertaking in a dominant position [...] through recourse to 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"*[12]

Abusive conduct can both be exclusionary or exploitive, however the enforcement priority of the Commission is for conduct which excludes other competitors from the market, since this is easier to remedy and of vital importance for protecting the competitive process.[13] Several different types of conduct can be exclusionary; pricing decisions such as margin squeeze is one of them.[14]

2.1.5 Effect on trade between member states

Article 102 TEFU applies only to conduct with a community dimension, i.e. the abuse must have an appreciable effect on trade between member states.[15] If the market in question is a single member state or only a part of it, the criteria may be fulfilled if imports or exports are sufficiently affected.[16]

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[11] Case 322/81, *NV Nederlandsche Banden Industrie Michelin vs. the Commission,* [1983] ECR 3461 para. 57

[12] Case T•271/03, *Deutsche Telekom AG vs. the Commission*, [2008] ECR II-477 para. 233, (hereafter *Deutsche Telekom*, CFI) citing *Hoffman La-Roche*

[13] The enforcement priority guidance para. 6 and 7

[14] See Article 102 TEFU (a)

[15] Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty, OJ 2004/C 101/07

[16] Ibid. para. 93 and 97

2.1.6 Economics

Economic reasoning plays an important role in any competitive assessment, as effective competition is an economic notion.[17] In addition, several of the concepts and tools used in competition law, like market definition, are based on economics.

Traditionally the application of Article 102 TEFU has been quite formalistic, condemning several actions as abusive per se.[18] However, in recent years a shift towards a more explicit use of economics and empirical evidence has been seen.[19] The focus of attention is now the effects of the conduct, not its form. An important distinction is made between using competition law to protect competitors and protecting competition. Since it is the effects on the customers, and ultimately the consumers, which are in focus, competition law aims only at preserving the competitive process.

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[17] Bishop, S. & Walker, M. "The economics of EC competition law: concepts, application and measurement" 3rd edition (Sweet and Maxwell 2010) p. 6

[18] Jones, A. & Sufrin, B. "EU competition law" p. 358

[19] See Bishop, S. & Walker, M. "The economics of EC competition law: concepts, application and measurement" p 9-10. The enforcement priority guidelines clearly reflect a more economic approach.

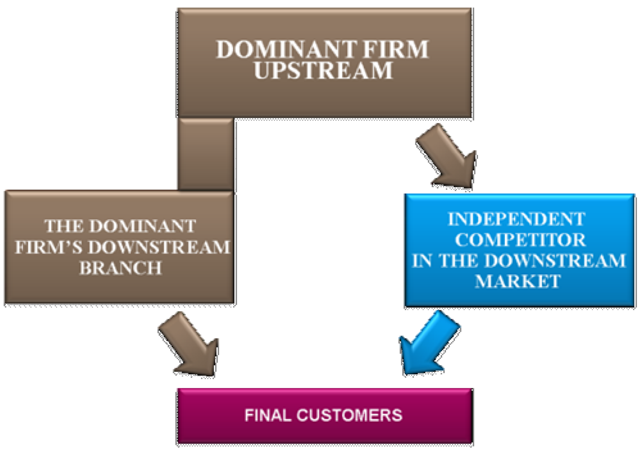
2.2 Introduction to the concept of margin squeeze

2.2.1 Introduction

Margin squeeze is a pricing practice by a dominant and vertically integrated firm amounting to an exclusionary abuse:

> *"A margin squeeze exists if the charges to be paid to [the applicant] for wholesale access, [...] are so expensive that competitors are forced to charge their end-users prices higher than the prices [the applicant] charges its own end-users for similar services."*[20]

In other words, if the spread between the prices is insufficient to compete, the margin is squeezed.[21] A model illustrates the concept:



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The existence and criteria of margin squeeze have been subject to intense debate.[23] The amount of case law on the subject is limited, however *TeliaSonera* presented above and also the cases, *Deutsche Telekom* and *Telefónica*, have clarified the legal situation significantly.

2.2.2 Vertical Integration

Margin squeeze requires that there is a vertically integrated firm, meaning that the undertaking must be active on both the upstream and the downstream markets.[24] If the

[20] Case COMP/C-1/37.451, 37.578, 37.579, *Deutsche Telekom AG, Commission decision* of 21 May 2003 para. 102 (Hereafter *Deutsche Telekom*, Commission decision)

[21] See Jones, A. & Sufrin, B "EU competition law" p. 413 following

[22] See Bishop, S. & Walker, M. "The economics of EC competition law: concepts, application and measurement" p. 338

[23] Hou, L. "Some aspects of price squeeze within the EU: a case law analysis"

undertaking is considered a single economic entity[25], the requirement of vertical integration is clearly fulfilled.

2.2.3 The initial cases

The EU case law regarding margin squeeze is limited, and until 2003 only three cases touched upon the issue. First was *National Carbonizing*[26] from 1976. The vertically integrated supplier was an upstream monopolist and super-dominant[27] downstream. Margin squeeze was treated as a specific form of refusal to deal, and the wording in this case was clearly influenced by the leading case on refusal to deal at the time, *Commercial Solvents*[28].

More than ten years later, British Sugar was accused of lowering their retail prices in the market for industrial sugar to a level which did not reflect its upstream costs.[29] Napier Brown, being supplied by British Sugar, was therefore unable to compete at retail level. There was an obligation to supply under the EU competition provisions, and a margin squeeze was found to exist, along with several other types of abuse.[30]

In contrast, neither the Commission nor the General Court accepted the margin squeeze claim in *Industrie des Poundres Sphériques*[31]. Dominant firm PEM was faced with competition from outside the Union; hence the product was not indispensable.[32] IPS claimed that PEM charged excessive prices at wholesale level and that the retail prices were predatory.[33] However, this was not the conclusion of the General Court. The terms of the Court led to some confusion regarding whether margin squeeze is dependent on one of the prices in

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[24] Petit, N. & Provost, E. "Abusive Margin Squeeze: An overview of European national case law" EU Competition Laws e-bulletin, November 2009, No29532

[25] Case C-73/95P, *Viho Europe vs .the Commission* [1996] ECR I-5457

[26] *National Coal Board, National Smokeless Fuels Limited and the National Carbonizing Company Limited*, 1976 OJ L35/6 (Hereafter *National Carbonizing*)

[27] Super-dominance is usually used to describe quasi-monopolists, see Jones, A. & Sufrin, B "EU competition law" p. 354

[28] Joined cases 6 and 7-73, *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation vs. the Commission*, [1974] ECR 223

[29] Case No IV/30.178, *Napier Brown vs. British Sugar*, Commission decision of 18 July 1988 (Hereafter *Napier Brown*)

[30] Ibid. para. 81

[31] Case T-5/97, *Industrie des Poudres Sphériques vs. the Commission*, [2000] ECR II-3755

[32] Ibid. para. 51-57

[33] Ibid. para. 179

question being abusive in itself,[34] i.e. excessive or predatory[35]. However, *Deutsche Telekom* undoubtedly classified margin squeeze as a stand-alone abuse in this regard.

2.2.4 Deutsche Telekom – ECJ judgment October 14 2010

Since the Commission decision[36] in 2003 *Deutsche Telekom* has been the leading case for margin squeeze. It was also the first margin squeeze case to ever reach the ECJ.

After several complaints from new entrants in the German telecommunication market, the Commission found that the former statutory monopolist, Deutsche Telekom, abused its dominant position in the markets for direct access to fixed telephone network. Deutsche Telekom was still a monopolist in the upstream market and dominant in all relevant downstream markets.[37]

Deutsche Telekom was obligated under sector-specific legislation to offer its competitors in the retail market full access to the local loop.[38] The fee was subject to preceding approval by the German authorities and was required to be cost-oriented.[39] At retail level there was no obligation to supply, however Deutsche Telekom still offered several variants of direct access. The retail charges for analogue services and ISDN lines were regulated under a price cap system.[40] Retail products relating to ADSL were not price regulated. However, the charges could be subject to subsequent review. In essence, this gave Deutsche Telekom discretion to adjust its prices within the price cap system; however any change in the price was subject to approval by the authorities.

The Commission decision, which was for all essential points upheld by both Courts, was significant in several ways. As mentioned above, it confirmed margin squeeze as a stand-alone abuse, separated from excessive or predatory pricing. After the judgment of the General Court, the Commission included margin squeeze in its enforcement priorities.[41] In addition, it

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[34] Buigues P., & Klotz, H. "Margin Squeeze in Regulated Industries: The CFI Judgment in the Deutsche Telekom Case"

[35] Predatory pricing, i.e. below cost pricing may, subject to criteria, constitute an abuse.

[36] Supra note 20

[37] Ibid. para. 96-101

[38] *Deutsche Telekom, ECJ* para. 5-8

[39] Supra note 20 para. 15-25

[40] Ibid. para. 26-33

[41] The enforcement priority guidance IV section D

contributed greatly in clarifying the relationship between sector-specific regulation and competition law.

2.2.5 Telefónica – Commission decision July 4 2007

Telefónica is the sole operator of a nation-wide fixed telephone network in the Spanish market. Before the liberalisation in Spain in 1998, it enjoyed a legal monopoly and it still enjoys a dominant position.[42]

Competitors had two options if they wanted to compete with Telefónica at retail level. They could build another local access network, however this required huge investments and no potential competitor would find this economically viable. Another option was to gain access to wholesale broadband by contract, exclusively supplied or dependent on input by Telefónica. De facto, all competitors relied on one of the wholesale products provided by Telefónica.[43]

At retail level Telefónica had a duty to supply its competitors at fair conditions and had to ensure the retail prices were replicable on the basis of their wholesale product. Existing commercial relationships could not be terminated without the prior consent of the authorities.[44] The Commission found a margin squeeze between retail prices and wholesale prices both at national and regional level. The decision followed the approach taken by the Commission in *Deutsche Telekom* and contributed to shed further light on the methodology for the margin squeeze assessment.

Telefónica is on appeal to the General Court and the first hearing was held on May 23 2011. Telefónica claimed, amongst other things, that the Commission had committed manifest errors when defining the relevant markets and establishing dominance, as well as in the application of Article 102 TEFU and in the assessment of the anti-competitive effects.[45] In addition, Spain has initiated legal action against the Commission seeking an annulment of the decision.[46]

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[42] *Telefónica* para. 220 and 246
[43] Ibid. para. 95
[44] Ibid. para. 81 and 89
[45] Case T-336/07, *Telefónica and Telefónica de España v Commission*, Action brought on 10 September 2007
[46] Case T-398/07, *Kingdom of Spain v Commission of the European Communities*, Action brought on 31 October 2007

2.3 Market conditions

2.3.1 Introduction

Article 102 TFEU does not distinguish between different markets where abuse might take place. However, an unlawful margin squeeze which requires a vertically integrated firm active at both wholesale level and retail level is liable to occur in some sectors more than others. The majority of margin squeeze cases, both at EU level[47] and in national courts[48], have taken place in liberalised industries, in particular the communications sector.[49] The dominant undertaking is typically a former monopolist who owns or controls the network and to which access is of vital importance for its competitors; the market is a so-called bottleneck monopoly.

This chapter provides a brief overview of the liberalised telecommunication sector in the EU which is subject to significant sector-specific regulation. The relationship between sector-specific regulation and competition law is examined, as well as the attribution of infringement when national regulation permits conduct which is prohibited by Article 102 TFEU. An increasing number of industries are rapidly changing because they rely heavily on new technology. The impact this has on the competitive assessment is also analysed.

2.3.2 Liberalised industries

Liberalised industries such as the telecommunication sector are particularly challenging from a competition law perspective, because these industries usually retain significant traces of former monopolies. Therefore, competition law has often been regarded as inadequate for maintaining effective competition.[50]

The three most recent cases[51] on margin squeeze concern the telecommunication industry, which was liberalised in the EU from the late 1980s.[52] From this point the European telecommunication market has gradually been exposed to competition before full

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[47] For example *TeliaSonera* and *Deutsche Telekom*

[48] For example the Spanish case *Uni2/ Telefónica Móviles* TDC, 22 December 2004, 571/03

[49] Petit, N. & Provost, E. 'Abusive Margin Squeeze: An overview of European national case law'

[50] See Case C•280/08 P, *Deutsche Telekom AG vs. the Commission*, opinion of Advocate General Mazák delivered on 22 April 2010 (hereafter *Deutsche Telekom*, opinion of Advocate General) para. 15

[51] *Telefónica*, *TeliaSonera* and *Deutsche Telekom, ECJ*

[52] Waverman, L. & Sirel, E., "European Telecommunications Markets on the Verge of Full Liberalization" Journal of Economic Perspectives 1997 vol. 11, nr. 4 113-126

liberalisation was achieved in 1998.[53] However, as the liberalisation process commenced, the industry became subject to sector-specific regulation. A detailed regime was established,[54] aiming to provide an effective liberalisation process and to ensure that effective competition was able to replace the monopolistic markets. Later a new regulatory package[55] continuing these objectives was introduced.

When defining the relevant market in a liberalised sector, the general principles provided by the Commission[56] are valid and are the basis of the assessment. However, in this industry liberalisation typically creates a second type of market;[57] markets for access to facilities needed to provide a downstream service. The Commission[58] emphasises that a dynamic and variable market definition is necessary due to the rapidly changing technology that characterises this market.[59] For example, if a network can be used to provide different kinds of services, supply-side substitution may play a more important role that it usually does in market definitions.[60]

Margin squeeze is dependent on two vertically neighbouring markets and therefore telecommunications and similar bottleneck industries are more prone to such abuses:

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[53] Commission Directive 96/19/EC of 13 March 1996 amending Directive 90/388/EEC with regard to the implementation of full competition in telecommunications markets, OJ L 74, 22.3.1996, p. 13–24, in some countries liberalisation took place prior to the Union-wide liberalisation, e.g. Germany from 1 August 1996 see the German Law of Telecommunication

[54] Council Directive 90/387/EEC of 28 June 1990 on the establishment of the internal market for telecommunications services through the implementation of open network provision OJ L 192, 24.7.1990, p. 1–9

[55] Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive), Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive), Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive)

[56] Notice on the definition of relevant market

[57] Notice on the application of the competition rules to access agreements in the telecommunication sector, Framework, Relevant markets and Principles, 98/C 265/02 (hereafter Notice on access agreements) para. 44

[58] Guidelines on the application of EEC competition rules in the telecommunications sector OJ C 233 06/09/1991 p. 2 – 26 (Hereafter Guidelines on competition rules in telecommunication)

[59] Ibid. para. 25

[60] Supra note 42 para. 147

> *"Some incumbent [...] may be tempted to resist providing access to third party service providers or other network operators, particularly in areas where the proposed service will be in competition with a service provided by [...] itself. [...] often manifest itself as unjustified delay in giving access, a reluctance to allow access or a willingness to allow it only under disadvantageous conditions."*[61]

When the strong position of the dominant firm has been developed under state protection and funding, it can be questioned whether the special responsibility of the undertaking should be further increased. The Advocate General in *TeliaSonera* stated that the special responsibility cannot automatically be enlarged due to the former state intervention.[62] Much of the aging infrastructure has been subject to massive improvements and it is therefore appropriate to say that the funding has been mixed. In addition, old infrastructure may not always be an advantage in a high technology market. Hence, arguments relating to how the dominant position has arisen must be examined in each case.[63]

2.3.3 The relationship between sector-specific regulation and EU competition law

Regulation is often deemed necessary to hinder the impediment of competition by former monopolists in liberalised sectors.[64] Sector-specific regulation contains precise rules imposed ex ante by various regulatory authorities. Competition law constitutes general standards enforced by the Commission or a national competition authority ex post. In the EU today there is a mixture of sector-specific regulation and general competition law,[65] which makes it necessary to clarify the relationship between them.

Sector-specific regulation differs from competition law in that it is meant to promote competition, in contrast to maintaining it.[66] In addition, such regulation may aim at promoting

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[61] Notice on access agreements para. 52

[62] *TeliaSonera*, opinion of the Advocate General para. 24

[63] Ibid. para. 27-28

[64] Antitrust enforcement in regulated sectors working group, int'l competition network, report to the third annual conference, April 2004

[65] Psarakis G. "Sector-specific regulation and competition law in the electronic communications sector against the backdrop of the internal market"

[66] Ibid.

other public policy issues, for example harmonisation, which competition authorities may not be able to take into account.[67]

The relationship between competition law and sector-specific regulation is mostly complementary. The primary goal of both is to control the conduct of market incumbents, however their specific aims and remedies differ. Ex ante regulation provides flexibility and the level of detail only prior instructions can achieve. General competition law intervenes ex post, and provides a broad-spectre and mature regime.[68] While this regime is usually less intrusive than sector-specific regulation, it also gives the incumbents in the market less legal certainty.

In regulated sectors, undertakings must satisfy the conditions of the sector specific regulation, and the general competition provisions.

> *"Conflicts should not arise with other [EU] rules because [EU] law forms a coherent regulatory framework. Other [EU] rules, and in particular those specifically governing the telecommunications sector, cannot be considered as provisions implementing Articles [101 and 102] in this sector."*[69]

The competition provisions can be regarded as minimum principles, while sector-specific regulation may contribute to ensuring a competitive environment where these provisions are insufficient.[70] National regulatory authorities may never take over the control of the application of Article 102 TFEU at the expense of the Commission's authority,[71] hence sector-specific regulation does not preclude the application of competition law:

> *"[ECJ and GC] have consistently held that the competition rules may apply where the sector-specific legislation does not preclude the undertakings it governs from engaging in autonomous conduct that prevents, restricts or distorts competition."*[72]

67 Ibid.
68 Ibid.
69 Guidelines on competition rules in telecommunication para. 15
70 Supra note 50 para. 15
71 Ibid. para. 19-21
72 Supra note 20 para. 54

Even though an undertaking is complying with the relevant sector-specific regulation or acting in accordance with the competition provision, it is not exempted from the obligation to comply with other EU rules.[73]

Even though the relationship between the legal regimes seems clear, the action initiated by Spain against the Commission[74] shows that the issue may cause difficulties. In addition to pleas concerning the Commission's lack of cooperation, the Spanish government contends that the intervention by the Commission disturbs the balance between regulation imposed ex ante and competition law. Spain claims the decision against Telefónica is contradictory to the regulative framework and that it impedes the Spanish authority from achieving the policy the regulation is meant to promote. These arguments were met with scepticism from the reporting judge.[75] She questioned the argumentation, stating that the only way the Commission's powers could have exceeded its competence was if they in fact were enforcing the national regulation, or that the current competition provisions in the EU give the Commission too much power and should be altered.[76] This view corresponds to what is seen above; that national regulatory authorities have no power to limit the competence of the Commission enforcing Article 102 TFEU. At the time of writing, the General Court has yet to hand down a judgement. However, it seems unlikely that Spain will prevail with its arguments.

Sector-specific regulation may require a certain conduct, for example an obligation to supply or a specific pricing regime. When appropriate, such regulations may be used to interpret the competition provisions, as they provide the competitive conditions in the relevant market. Sector-specific legislation is required to harmonise with TFEU, hence it will be interpreted accordingly.[77] From this point of view competition law can be seen as an additional tool, if the sector-specific legislation proves insufficient. Such a scenario was seen in *Deutsche Telekom*. Although the conduct of Deutsche Telekom was subject to regulation, its violation would not have been remedied without the intervention of competition authorities.[78]

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[73] Ibid. para. 55

[74] Case T-398/07, *Kingdom of Spain v Commission of the European Communities*, Action brought on 31 October 2007

[75] Minutes of the hearing can be found at http://www.mlex.com/Attachments/2011-06-08_E35DMCOW1X8SC0M1/T398_07%20ES%20RAP.pdf (Spanish text only)

[76] Ibid.

[77] Notice on access agreements para. 62

[78] Heimler A. "Is a margin squeeze an antitrust or a regulatory violation?" J.C.L. & E. 2010, 6(4), 879-890

In some circumstances, sector-specific regulation can be viewed as a substitute for competition law. It protects competition and consumers, and hence makes intervention by competition authorities unnecessary. For example if ex ante legislation regulates the price level of a dominant firm, a possible infringement and following intervention may be prevented. However, if the regulation proves insufficient, competition authorities will intervene.

The system of competition law and sector-specific regulation as complementary may be problematic from the undertaking's point of view, as it creates a complex legal environment. The so-called *ne bis in idem* principle provides that one and the same conduct should not be subject to more than one regulatory regime with the same objective. It has been argued that if a sector-specific regulation does not address the anticompetitive issues in an appropriate way, it is a better solution to amend or revise the regulation than to intervene with competition law as well.[79] However, the current legal situation is that the presence of a sector-specific regulation does not exempt the conduct from being subject to competition law.

Sometimes a regulation will restrict competition, for example by stipulating conduct which constitutes a barrier to entry. For the dominant firm the question then concerns the attributability addressed below.

2.3.4 Attributability of the infringement

Article 102 TFEU deals with abuse by a dominant undertaking and thereby implicitly requires that the conduct can be attributed to the firm itself, i.e. autonomous conduct is necessary.[80] The starting point is that the TFEU competition provisions apply regardless of whether an agreement or conduct has been approved by national regulation authorities. Only under strict conditions can there be exceptions to the principle that conduct is attributable to the undertaking performing it.[81]

Deutsche Telecom confirmed[82] that national regulation is only a defence when it leaves the undertaking with no other option than the infringement. The fact that the regulation leaves

[79] Antitrust enforcement in regulated sectors working group, int'l competition network, report to the third annual conference, April 2004

[80] Supra note 12 para. 85

[81] Supra note 50 para. 15

[82] Previously this principle had been set out in Notice on Access Agreements para. 60 and 61 and the Guidelines on Competition Rules in Telecommunication para. 14

room for an infringement, or even encourages it, cannot be sufficient to exempt the undertaking from its responsibility.[83]

Due to sector-specific regulation Deutsche Telekom was only able to adjust its retail prices and these changes were subject to approval by the German authority.[84] However, if the infringement cannot be ascribed solely to national legislation, the undertaking can be held responsible.[85] *TeliaSonera* confirmed and summarised when an undertaking cannot be held responsible for its conduct:

> *"[...] Article 102 TFEU applies only to anti-competitive conduct engaged in by undertakings on their own initiative. If anti-competitive conduct is required of undertakings by national legislation or if the latter creates a legal framework which itself eliminates any possibility of competitive activity on their part, Article 102 TFEU does not apply."*[86]

Therefore a company may infringe Article 102 TFEU by unlawful margin squeeze, even though the prices are subject to national regulation. As long as the undertaking has sufficient scope to reduce or remove the margin squeeze, it is responsible. *Deutsche Telekom* has been criticised because the actual problem was deemed to be the high wholesale price set by the national authorities. Hence a more appropriate solution would have been to adjust the wholesale price by changing the sector-specific regulation.[87]

Deutsche Telekom claimed that finding an abuse of a dominant position would be in breach of the principle of legal certainty.[88] They argued that if an undertaking act on the basis of national legislation, it can assume its conduct is legal, also in relation to EU law. This argument was not accepted by the Court.[89] The Advocate General elaborated on this point, stating that no previous practice in the decisions from the national authorities would exempt conduct from the application of Article 102 TFEU. Hence there was no legitimate

[83] Supra note 38 para. 80-84
[84] Supra note 20 para. 15-33
[85] Supra note 12 para. 107
[86] *TeliaSonera* para. 49
[87] Dunne N. "Margin squeeze: from broken regulation to legal uncertainty" C.L.J. 2011, 70(1), 34-37
[88] Supra note 38 para. 68
[89] Ibid. para. 66-73

expectation for Deutsche Telekom to rely on national law. The decision of a national authority can never pre-empt the Commission's review.[90]

If national authorities have erroneously assessed the conduct, without any reference to Article 102 TFEU, the approval of a pricing practice cannot create any legitimate expectations regarding the compatibility of the conduct with Article 102 TFEU.[91] Even though an assessment of Article 102 TFEU has been undertaken, responsibility of the dominant firm is not precluded.[92] As seen above, the relationship between sector-specific legislation and competition law is mostly complementary and national regulations and decisions are not binding on the Commission.[93] The undertaking can therefore not rely on the regulation authority's assessment of the conduct.

The principle of legal certainty will also be an essential aspect of the ongoing case between Spain and the Commission.[94] Spain claims that when a subsequent competition law intervention changes the regulatory framework imposed by national authorities, it creates uncertainty not just for the dominant firm subject to the intervention, but for all incumbent undertakings and also potential competitors. However, as seen above, the relationship between sector-specific legislation and competition law is, in principle, harmonised and complementary, and this argument will therefore probably not be heard.

National regulation authorities are obliged to respect EU law. The fact that the Member State also may be liable does not alter the fact that the undertaking can be responsible.[95] The fact that the aim of the regulation was to enhance the competitive environment also has not influence on the assessment of attributability.[96]

To sum up, *Deutsche Telekom*[97] and *TeliaSonera*[98] confirm that even when a dominant firm has autonomy only over one price parameter, the abuse may still be attributed to it. The fact that the undertaking relied on the sector-specific regulation or a decision from a national

[90] Supra note 50 para. 33-34
[91] Supra note 12 para. 267-269
[92] Ibid. para. 120
[93] Supra note 38 para. 90
[94] Case T-398/07, *Kingdom of Spain v Commission of the European Communities,* Action brought on 31 October 2007
[95] Supra note 12 para. 265
[96] Supra note 38 para. 91-92
[97] Ibid. para. 85
[98] Supra note 86 para. 51

regulatory authority in good faith does not preclude responsibility of the undertaking in question.[99]

2.3.5 Immature markets

Article 102 TEFU does not distinguish between markets of different maturity or by any other characteristic. However, in a rapidly growing market some specific features must be taken into account.[100]

In *Wanadoo*[101] the Commission's analysis was significantly altered, due to the fact that the technology in the question was rapidly changing. The Advocate General in *TeliaSonera* followed this approach:

> *"[...] while dynamic or fast-growing markets are not exempted from the application of Article 102 TFEU the fact remains that, wherever justified, the Commission and the NCAs should intervene in such markets with particular caution, modifying if necessary their standard approach as was done successfully in Wanadoo."*[102]

The ECJ did not accept this opinion[103] and stressed that in immature industries leverage from a dominant position in a neighbouring market may alter the very course of competition. New operators may not be willing to operate with losses over a period of time. In contrast, an incumbent who has already suffered necessary sunk costs[104] may be more persistent and willing to suffer loss. Hence, abusive conduct in immature markets may prevent the market from developing as it would under normal competitive conditions.

In immature markets, prompt intervention by competition authorities may be necessary, as it is important to prevent anticompetitive effects from materialising.[105] Several markets in the telecommunications industry are driven by technical developments and rapid changes, however they are also highly influenced by the fact that the industry used to be a regulatory

[99] Supra note 50 para. 15
[100] Notice on access agreements para. 44
[101] Case COMP/38.233, *Wanadoo Interactive*, Commission decision of 16 July 2003, The Commission decision was upheld in Cases T•340/03 and C•202/07 P *France Télécom vs. Commission.* This case concerned predatory pricing.
[102] Supra note 62 para. 57
[103] Supra note 86 para. 106
[104] Sunk costs are costs which cannot be recovered.
[105] Supra note 86 para. 108

monopoly. It is of vital importance that the lack of competition in these markets is not allowed to impair the growth of related markets in the same sector. The enforcement of Article 102 TFEU can therefore by no means be relaxed when the market in question is immature.

3 THE CURRENT ASSESSMENT OF MARGIN SQUEEZE

3.1 Establishing margin squeeze

3.1.1 Introduction

TeliaSonera clarified to a great extend the factors in the margin squeeze assessment that have to be taken into account and those which do not. The following section provides a normative description of factors currently relevant in the margin squeeze assessment. However, it is of vital importance that each case is assessed on its facts, and all fact-specific circumstances must be taken into account.[1]

3.1.2 The appropriate benchmark

3.1.2.1 The reasonably efficient competitor test or the equally efficient competitor test

Several different cost-based analyses have been suggested to determine whether a margin squeeze would exclude downstream competitors.[2] The Commission have suggested the "equally efficient competitor" test or the "reasonably efficient competitor" test:

> *"A price squeeze could be demonstrated by showing that the dominant company's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company. [...]*
> *In appropriate circumstances, a price squeeze could also be demonstrated by showing that the margin between the price charged to competitors on the downstream market [...] is insufficient to allow a reasonably efficient service provider in the downstream market to obtain a normal profit"*[3]

This statement has been seen as a sign of the Commission wishing to maintain its flexibility in choosing the appropriate test.[4] However, although the reasonably efficient competitors test is not ruled out, the general rule is currently the equally efficient competitor test.[5] This test is in

[1] *Telefónica* para. 287
[2] Faella, G. & Pardolesi, R., "Squeezing Price Squeeze under EC Antitrust Law", Euro.C.J., April 2010 p.255-284
[3] Notice on access agreements para. 117 and 118, see also the enforcement priority guidance section III C
[4] Faella, G. & Pardolesi, R., "Squeezing Price Squeeze under EC Antitrust Law"
[5] *TeliaSonera* para. 41

accordance with previous case law[6] concerning predatory pricing. Hence, it is the costs and charges of the dominant undertaking which are relevant. The question to be asked is whether the dominant undertaking, if faced with its own charges, would be able to, without incurring losses, offer its own retail price in the downstream market. Several reasons point towards the use of the equally efficient competitor test.

First of all, the equally efficient competitors test is in accordance with the principle of legal certainty. The dominant firm will ordinarily not have access to the competitor's costs and therefore the assessment of its conduct with such a benchmark will unavoidably be speculative. A reasonable efficient competitor test will be hypothetical and therefore determining the cost level would involve serious difficulties and the risk of being arbitrary. Its own costs, on the other hand, are always available to the dominant undertaking, and the company can therefore evaluate the lawfulness of its own conduct with much greater certainty.[7]

Second, the protection of less efficient competitors is not an appropriate task for competition law authorities. Such an interruption is artificial and is more coherent with the regulatory authority's policy and remedies.[8] If the market is functioning, an equally efficient competitor should theoretically be able to obtain the financial resources to survive an initial period of below-cost sales. In liberalised industries in which sunk costs may be significant, this can be more problematic, however as seen above, regulators often take measures to remedy this.[9]

Third, when protecting only the equally efficient competitor, incentives for passing on the efficiency gains originating from the vertical integration are preserved.[10] It may be the case that distributing the service and product in question to other competitors brings additional costs. In addition, the equally efficient competitor test is more favourable to the undertaking because in contrast to the reasonably efficient competitor, it allows the undertaking to enjoy economies of scale, scope or vertical integration, which the competitors may not have.[11]

A margin squeeze is therefore unlawful when it is excluding actual or potential competitors which are as efficient as the dominant firm. Any competitors that produce the good or service

[6] *Akzo* para. 27
[7] Supra note 5 para. 44
[8] Faella, G. & Pardolesi, R., "Squeezing Price Squeeze under EC Antitrust Law"
[9] Ibid.
[10] Ibid.
[11] Supra note 1 para. 311-315

in question at a higher price, lower quality or in other ways that are inferior to the dominant undertaking, are not and should not be protected by competition law.

3.1.2.2 Exceptions to the equally efficient competitor test

Fact-specific circumstances may make it appropriate to assess margin squeeze under other parameters than the equally efficient test. If there is, for objective reasons, no method to assess the cost structure of the dominant undertaking, the costs and charges of the competitors can be taken into account. Likewise, if the costs of the supplied good or service have been written off, then the current costs of the dominant firms will give a misleading result with regard to the exclusionary practice.[12]

Sometimes the competitor's costs should be assessed due to the market conditions, for example if the level of the dominant undertaking's costs is only attributable to that undertaking because it is in a privileged position when it comes to market strength.[13] However, the general rule is the equally efficient competitor test, regardless of the market and regulatory conditions. The vertically integrated undertaking will never be in the exact same position as its competitors and this alone is no reason to alter the general test.[14] The fact that the dominant undertaking is not as efficient as its competitors is not sufficient to justify taking the competitor's costs and charges into account, because there is no "inefficiency defence" in EU competition law.[15]

However, competitors may in fact have a higher margin than the dominant firm, due to differentiated costs or products. This does not necessarily mean that the competitors are more efficient, it could be attributed to an inferior product. Commentators[16] have suggested that in this situation the authorities should demonstrate that both the equally efficient competitor-test and the actual competitor[17] test are satisfied. However, the actual competitor test faces a lot of the same practical problems as the reasonably efficient competitor test, and none of the cases regarding margin squeezed have used the actual competitor test or addressed this issue.

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[12] Supra note 5 para. 45

[13] Ibid.

[14] *Deutsche Telekom*, Opinion of the Advocate General para. 52

[15] Ibid. para. 50

[16] Faella, G. & Pardolesi, R., "Squeezing Price Squeeze under EC Antitrust Law",

[17] The actual competitor test uses the actual competitors in the market as benchmark.

3.1.3 The products taken into account

3.1.3.1 Distinct products

Margin squeeze necessarily involves two products on different levels of the value chain. Practical issues may arise where there is no apparent distinction between the wholesale service or product and the retail product or service.[18] For example, dominant firms have argued that since the products intrinsically are the same on both levels, a margin squeeze could not be found.[19] In France a dominant electricity provider argued that margin squeeze never transpires if there is no intermediate service or the wholesale product is used as a raw material.[20] The French competition authority, relying on *Napier Brown,* held that the form of the electricity supplied was differentiated on each level and thus constituted two distinct products for the purpose of margin squeeze.

Even though there must be two distinct products, the product provided at wholesale level must be comparable to the product provided at retail level. Their technical features must be the same or at least allow for a comparable or derivate service or product to be provided.[21]

3.1.3.2 The actual selection of the relevant products

In several cases the actual selection of which product should be taken into account has caused practical problems.[22] In many industries, like telecommunications, one wholesale service may be used to provide several different services at retail level. On the other hand, several wholesale products from one provider may be used as input for one distinct retail product. In addition, the assessment may be further complicated by bundling practices or differentiated marketing and so on. The question is which level of product aggregation the assessment should be based on.

While the Commission in both *Deutsche Telekom* and *Telefónica* performed such assessments, the legal situation is not fully clarified. Case-specific facts were mostly decisive,

[18] Petit, N. & Provost, E. “Abusive Margin Squeeze: An overview of European national case law”

[19] For example UK case OFWAT, CA98/01/2004, 26 May 2004, *Albion Water against Dwr Cymru,* Case CA98/00/48.

[20] French EDF/Direct Energie, Décision n° 07-MC-04, 28 June 2007, on appeal Décision n° 07-D-43, 10 December 2007

[21] *Deutsche Telekom*, Commission decision para. 109

[22] For example *Deutsche Telekom*, ECJ and Danish case *Song Networks/TDC- SONOFON*, 28 April 2004, 3/1120-0100-0557/MHA/SEK

for example if sector-specific regulations affect the competitive conditions in the market these must be taken into account.[23]

In *Deutsche Telekom* one specific wholesale service, analogue access, was compared with a number of derivate retail services. National regulation imposed a single price on the wholesale product; hence it had to be seen as one.[24] The Commission calculated the average monthly charge at both levels, a so-called “weighted approach”.[25] To ensure that the services were comparable the wholesale charge was determined by subtracting a reasonable margin from the comparable retail charge; the “retail-minus approach”.[26]

A similar method was applied in *Telefónica*. At upstream level, the question is whether the prices charged by the dominant firm are replicable at the downstream level. Each wholesale product should be assessed individually because entry to markets, in particular where large, sunk costs are required, is usually done by climbing the investment ladder, i.e. a step-by-step approach. Hence it is important that there is no margin squeeze in any of these steps.[27]

Using an aggregated approach downstream the Commission takes the view that the competitors must be able to replicate the portfolio of the vertically integrated firm, in contrast to each specific product provided at retail level.[28]. Taking common costs into account, this approach is most favourable to the dominant firm and it also reflects the decision making process of the entrant since undertakings will review the profitability of its network of products as a whole.[29]

> *“This approach (referred as to the “aggregated approach”) is based on the principle that competitors must at least be able to profitably replicate Telefónica’s product pattern.”*[30]

However, not every retail product somehow connected to the wholesale service is to be included. The fact that competitors can use access to the wholesale product to develop new

[23] *Deutsche Telekom*, ECJ para. 224
[24] Supra note 21 para. 113
[25] Ibid. para. 148 and 151
[26] Ibid. para. 113
[27] Supra note 1 para. 392
[28] Supra note 21 para. 127
[29] Supra note 1 para. 386-388
[30] Ibid. para. 388

retail products not provided by the dominant firm are not to be taken into account in the assessment, as it is the undertaking's own costs which are the basis of the evaluation.[31]

In *Deutsche Telekom*, call services were bundled with the end-user services in question, however they were not included in the analysis due to sector-specific regulations.[32] The community-principle of tariff rebalancing required that the charges for a service had to reflect the underlying costs, in contrast to the widespread cross-subsidies between different services seen before liberalisation.[33]

Even though the competitive disadvantage of the competitors relying on the wholesale service is present also in markets other than the market for end-user access services, the costs and charges of these products are not to be taken into account. As long as the markets are distinct, it is therefore an equally efficient competitor in this particular market, which is the basis of the analysis.[34]

In some cases there may be reasons to depart from the aggregated approach and perform the margin squeeze test on each individual retail product:

> *"In some circumstances, it may be appropriate to conduct the test at the level of each individual offer. This would be the case for a new offer giving rise to a margin squeeze, which is currently subsidised by other profitable offers but whose volumes could increase substantially in the future, subsequently leading to an overall negative margin in the future."*[35]

However, although there are examples of national authorities adopting such an individual assessment[36], the aggregated approach where equality of opportunity is in focus is currently the preferred method.

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[31] *Deutsche Telekom*, CFI para. 204

[32] Ibid. para. 200

[33] Supra note 21 para. 121

[34] Supra note 23 para. 233-236

[35] Supra note 1 para. 387

[36] See the Danish case *TDC A/S mod Konkurrencerådet*, 10. februar 2006, 04 134.896. This was overturned on appeal and cannot be given any legal authority in an EU context.

3.1.4 The analysis of the spread

3.1.4.1 Profitability analysis

After determining which product should be taken into account, the spread is found by comparing the charges imposed by the dominant firm at wholesale level and retail level. Three scenarios are possible: the margin can be positive, negative or zero.

If the margin is negative, this means that the charge for wholesale access is actually higher than the price charged by the vertically integrated firm at downstream level. A margin squeeze is then present, without further cost analysis needed.

However, the fact that the margin is positive or zero does not mean that no margin squeeze has occurred. The retail charges must be sufficient to cover the product-specific costs of supplying the downstream product in question.[37] The product-specific costs are the costs related to the additional services necessary to provide the downstream product, such as customer care, administrative expenses or transport.[38] If the spread between the upstream charges and the downstream price of the vertically integrated undertaking is smaller than the product-specific costs of the undertaking in the downstream market, there is a margin squeeze. Consequently, if the margin is zero, margin squeeze will most likely occur. If it is positive, an analysis of the product-specific costs is required.

3.1.4.2 The appropriate cost measure

The Commission has in several margin squeeze decisions used long-run average incremental costs (LRAIC) as the appropriate cost measure when determining the product-specific costs.[39] The incremental costs are the costs which accumulate only from the undertaking's business at downstream level. It must however be noted that while the wording in *Telefónica* is more general than in *Deutsche Telekom*, they still limit the appropriate cost standard to the telecommunications sector,[40] and hence it cannot be ruled out that another standard will be used in future cases.

The difference between the total costs of the firm taking all its products in account, and the total costs of the firm excluding the output of the individual product in question, must be

[37] Art, J. "Highway 102: A Nice Turn with Still some Miles to Go"
[38] Supra note 21 para. 138
[39] Supra note 1 para. 318, see also supra note 21 para. 155-157
[40] Supra note 1 para. 318

calculated.[41] Variable, total and common costs are included as long as they are incremental to the downstream product.

The actual calculation of an average wholesale and retail price must be done on a case by case basis.[42] The question is whether the spread between the upstream and the downstream prices of a dominant and vertically integrated undertaking covers at least the downstream LRAIC of that undertaking.

3.1.4.3 Historic costs or Discounted Cash Flow Method

Profitability can be measured by two methods: a historical “period-by-period approach” or the Discounted Cash Flow Method (DCF). The former is a comparison of the annually (or another period) observed revenues and costs, taken from the company’s accounts. Here the expenses affected by investments will already have been deducted. The latter is an overall evaluation of the profitability of the firm, generally taken over several years.[43] In cases regarding price abuse, the profitability of the dominant firm is usually assessed under the “period by period”-method.[44] In *Telefónica* the Commission applied both tests.[45]

The tests deal with cost recovery in different ways and neither of them can be said to be without any shortcomings. While the DCF method risks taking into account faulty forecasts, which may lead to a false positive in a growing market, the period-by-period method might lead to accounting distortions. Learning by doing, decreasing input costs due to new technology etc. makes it expected that the cost of a unit will fall over time, hence historic costs may not be reliable. In addition, initial investments calculated to be recouped at a later point may very well occur. However, *Telefónica* also seems to rely on the period-by period method as the general rule:

> *“The use of the DCF method would be appropriate in the present case only in order to avoid a situation where the 'period-by-period' method would*

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[41] See the enforcement priority guidelines para. 26 footnote 2

[42] Supra note 21 para. 142-149

[43] Supra note 1 para. 328-330

[44] Case C-333/94 P: *Tetra Pak International SA v. the Commission,* [1996] ECR I-5951 (hereafter *Tetra Pak*) and *AKZO*

[45] Supra note 1 para. 327

point to a margin squeeze due to accounting distortions resulting from the fact that the market is growing."[46]

3.1.5 Is margin squeeze refusal to deal?

There is no general requirement on any firm to supply, to supply on certain conditions, or to subsidise its competitors in any way:

> *"[...] any undertaking, whether dominant or not, should have the right to choose its trading partners and to dispose freely of its property."*[47]

The Commission[48] has categorised margin squeeze as a type of refusal to deal and stated that enforcement would only be prioritized when the product in question is objectively necessary to compete on the downstream market.[49] However, the guidance is enforcement priorities only and the legal categorisation of margin squeeze has been uncertain.[50]

Nevertheless, in all EU cases prior to *TeliaSonera* where margin squeeze has been found, there has been an obligation to supply, by regulation or under competition provisions. *Telefónica* clarified that if there is a regulatory obligation to supply, the rationale behind establishing an obligation to supply under competition provisions is no longer valid and hence such a duty to deal cannot be required.[51] When the obligation to supply is established by regulation, the main question is of attributability, as seen above.[52] However, without such an obligation, the question of whether a duty to supply is necessary also arises.

Intuitively, an unlawful margin squeeze should contain an obligation to supply the wholesale product to its competitors.

> *"one particular manifestation of a refusal to deal occurs in the case of an abusive margin squeeze (or 'constructive refusal to deal') where, instead of refusing entirely to supply the essential/indispensable input in question, the dominant undertaking supplies the input to its competitors on the*

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[46] Ibid. para. 346

[47] The enforcement priority guidance para. 75

[48] Ibid.

[49] Ibid. para 81

[50] Petit, N. & Provost, E. "Abusive Margin Squeeze: An overview of European national case law"

[51] Supra note 1 para. 299, 304-309

[52] See section. 2.3.4

downstream market at a price which does not enable those competitors to compete effectively on the downstream market."[53]

From this perspective it seems reasonable that the criteria for the two types of abuses are the same, as there is no substantial difference between imposing a duty to deal and imposing a duty to deal on specific terms.

The criteria for establishing an obligation to supply are strict,[54] because an obligation to supply may be damaging to the dominant undertaking's incentive to innovate or invest. Imposing such obligations may easily lead the competition authorities into a role as state planners determining terms of trade, a position the undertakings in the market are much better suited to occupy.

TeliaSonera was not under a regulatory obligation to supply and the product in question was not indispensable.[55] The ECJ rejected the argument that a duty to deal is required in an establishment of margin squeeze:

"[I]t cannot be inferred [...] that the conditions to be met in order to establish that a refusal to supply is abusive must necessarily also apply when assessing the abusive nature of conduct which consists in supplying services or selling goods on conditions which are disadvantageous or on which there might be no purchaser.

Such conduct may, in itself, constitute an independent form of abuse distinct from that of refusal to supply."[56]

The ECJ held that if all possible abuses relating to the terms of trade would have to meet the criteria for refusal to supply, the effectiveness of Article 102 TFEU would be significantly impaired.[57] The indispensability of the product was assessed by the Court only in relation to the anti-competitive effects; hence it implicitly states that this is not a requirement for finding

[53] *TeliaSonera,* Opinion of the Advocate General para. 16
[54] Case C-7/97, *Oscar Bronner GmbH & Co. KG vs. Mediaprint*, [1998] ECR I-7791
[55] Supra note 53 para. 20
[56] Supra note 5 para. 55 and 56
[57] Ibid. para. 58

abusive margin squeeze.[58] The current position is that there is no criterion for an obligation to supply to establish margin squeeze.

3.1.6 Anti-competitive effect

As seen in chapter two, the Commission now undertakes an economic assessment, focusing on the effects of the conduct.[59] In contrast, the 2003 Commission decision of *Deutsche Telekom*[60] represented a formalistic approach, holding that the mere existence of a margin squeeze would amount to an abuse.[61] This was rejected by both the General Court and the ECJ.[62]

> *"The concept of abuse [...] is an objective concept relating to the conduct of a dominant undertaking which, on a market [...], has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition"*[63]

However, it is not necessary that an actual effect has materialised, a potential effect is sufficient. In other words, the conduct must be capable of restricting competition. If there is in fact an implemented margin squeeze intended to affect competitive environment, there is no requirement that the strategy has succeeded.[64]

Anti-competitive effects may materialise in several ways and the effects of an unlawful margin squeeze will often appear as barriers to market entry. This is typical of liberalised industries where a former regulatory monopolist may maintain its strong position by unlawful means.[65] The fact that an intended strategy to exclude competitors by reducing the margins was unsuccessful is not sufficient to disqualify the practice as an abuse.[66]

In particular, two aspects are relevant in the assessment of effects. First, if the product is indispensable, anti-competitive effects are probable. However, as seen above, indispensability is not a requirement and there are no presumptions that margin squeeze relating to a

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[58] Ibid. para. 70-72
[59] The enforcement priority guidance para. 5
[60] Supra note 21
[61] Ibid. para. 180
[62] Supra note 23 para. 250
[63] Ibid. para. 174, confirmed in *TeliaSonera* para. 27
[64] Supra note 5 para. 65
[65] See supra note 31 para. 235
[66] Supra note 23 para.252 -254

dispensable product cannot have an anti-competitive effect.[67] Second, if the margin is negative, anti-competitive effects are plausible. In this situation competitors would not be able to compete without incurring losses. If the margin is positive, an anti-competitive effect on equally efficient competitors must be shown.[68]

The assessment focuses on the long-run effects. To end the unlawful margin squeeze, Deutsche Telekom should have increased its retail prices, giving the end-users a higher price.[69] The low retail prices deterred effective competition and would, in the long run, have led to consumer harm. This approach must not be confused with protecting the competitors; consumer welfare is determining, but it is the long-term effects that matters.

As evidence of anticompetitive effect, the General Court in *Deutsche Telekom* accepted numbers showing that the competitors had captured a very small market share since liberalisation.[70] The fact that the competitors had been more successful in some areas within the relevant market was not sufficient to offset the conclusion that there was an anti-competitive effect. Developments in the competitive environment of other member states inferior to the development in Germany could be attributed to several other reasons and were therefore not relevant.[71]

If an actual margin squeeze has occurred, the question of the burden of proof in relation to the necessary effects arises. The wording of ECJ in *Deutsche Telekom*[72] could give the impression that when a margin squeeze is established the undertaking in question must refute a presumption of anti-competitive effects. However, *TeliaSonera* shows that it is not incumbent on the defendant to demonstrate lack of anti-competitive harm; the burden rests on the authorities. The Court did not provide any guidance about the standard of proof, however other case law[73] addressing hypothetical anti-competitive harm provides guidance on this

[67] Supra note 5 para. 70-72
[68] Ibid. para. 73
[69] Supra note 23 para. 182
[70] Supra note 31 para. 239 and 242
[71] Ibid. para. 243
[72] Supra note 23 para. 258
[73] Case T-5/02, *Tetra Laval BV vs. the Commission*, [2002] ECR II-4381

question. "Convincing evidence"[74] must substantiate that the margin squeeze is in fact capable of having an anti-competitive effect.[75]

3.1.7 Is dominance required in both the wholesale and the retail market

Article 102 TEFU requires a dominant position, however gives no further guidance about in which market dominance must present itself. Margin squeeze involves two markets and the question is whether dominance is required in only one market or in both. Dominance at upstream level is undoubtedly a criterion.[76] The abuse and hence the anti-competitive effects materialise downstream, however the absence of dominance here does not necessarily remove the applicability of Article 102 TEFU.[77] In special circumstances, meaning there must be a sufficient link between the conduct and the effects, an abuse in a neighbouring market may be an infringement.[78]

TeliaSonera established that when a vertically integrated firm attempts to leverage its dominant position in the upstream market into the downstream market, there is a sufficient link.[79] Consequently, in margin squeeze cases there is no requirement of dominance in the downstream market. This prevents the intervention from having to wait until the anti-competitive effects from the margin squeeze, in form of dominance, have materialised in the downstream market. From a consumer welfare perspective this is definitely preferable.

3.1.8 The degree of market strength

The concept of "super-dominance" has appeared in previous EU case law[80] to describe a position of monopoly or quasi-monopoly. *TeliaSonera* rejected that the extent of market strength should be pertinent when establishing whether there is abusive conduct.[81] The only requirement relating to market strength is that dominance must be present.

However, the degree of market power may be given weight when assessing the actual or potential effects from the conduct.[82] For example, a margin squeeze almost certainly harms

[74] Ibid. para. 155
[75] Jean-Yves Art "Highway 102: A Nice Turn with Still some Miles to Go"
[76] Petit, N. & Provost, E. "Abusive Margin Squeeze: An overview of European national case law"
[77] Supra note 44 para 27-31
[78] Ibid.
[79] Supra note 5 para. 87-88
[80] For example in the joined Cases C-395/96 P and C-396/96 P, *Compagnie Maritime Belge Transports and Others vs. Commission* [2000] I-1365
[81] Supra note 5 para. 80-82
[82] Ibid. para. 81

competition if the vertically integrated firm is a monopolist in the upstream market, because the product or service then will be indispensable.

3.1.9 New or existing customer

The refusal to deal doctrine distinguishes between the duty to supply a new customer and the duty not to cut off existing customers without a valid reason. The Advocate General of *TeliaSonera* found margin squeeze to be a constructive refusal to deal, and was therefore of the opinion that an unlawful margin squeeze was more likely to take place in an ongoing business relationship than in relation to a new customer.[83]

However, margin squeeze can no longer be seen as a category of refusal to deal. After *TeliaSonera* there is no distinction between conducting a margin squeeze towards new entrants or incumbent competitors already supplied by the dominant undertaking.[84] The only requirement is that an equally efficient competitor could be excluded from the market and that the conduct is capable of having an anti-competitive effect.

3.1.10 Recoupment

The possibility of recoupment has been subject to great debate in the area of predatory pricing, as this is a requirement in the US[85] and not in the EU[86]. However, margin squeeze is a stand-alone abuse and several aspects distinguish it from predatory pricing, so a below cost charge at retail level is not required in margin squeeze. Even a negative spread can be solely attributed to high wholesale prices; [87] hence margin squeeze may very well take place without the vertically integrated firm incurring losses.

Even though losses have been incurred by the dominant undertaking, a demonstration of the possibility to recoup cannot be required. When this is not required in predatory pricing, it should also not be necessary in margin squeeze.[88]

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[83] *Deutsche Telekom*, Advocate General para. 50
[84] Supra note 5 para. 92-93
[85] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993),
[86] Supra note 44
[87] Supra note 5 para. 96-100
[88] Ibid. para. 97

3.1.11 *Intent*

The concept of dominance in EU competition law is an objective concept.[89] The undertaking needs only to be aware of the fact that it carries out the conduct in question, not the fact that this constitutes an infringement.[90]

However, relying on intent may be useful in the enforcement, because data on a deliberate strategy may act as evidence[91] and it can give the authorities a better view of the effects of the conduct.[92] Furthermore, exclusionary intent may eliminate the possibility of objective justification, which will be addressed below.

[89] See amongst others *Hoffmann-La Roche*

[90] Supra note 23 para. 124-127

[91] The enforcement priority guidance para. 20

[92] Bavasso, A. & Long, D. "The Application of Competition Law in the Communications and Media Sector: A Survey of 2010 Cases" Journal of European Competition Law & Practice, 2011, Vol. 2, No. 3

3.2 Objective Justification

3.2.1 Introduction

Although Article 102 TFEU does not contain any exceptions, conduct can be exempted from constituting a violation by objective justification.[93] The scope of objective justification is vague and has been interpreted narrowly; the threshold for success is very high.[94]

Objective justification defences comes in several forms, depending on the conduct in question. Since no margin squeeze case from the EU has ever accepted an objective justification and is unlikely to do so, this topic does not deserve a lengthy discussion. However, three possible defences will be assessed in brief: the meeting competition defence, efficiency defence and a defence related to protection of investments.

3.2.2 Meeting competition defence

A dominant undertaking is entitled to look after its commercial interests.[95] If for example a competitor lowers its prices below costs, a dominant firm may undertake a suitable, indispensable and proportionate response.[96] While the meeting competition defence is recognised, it may be the most futile justification. It was not included in the Commission's enforcement guidelines, perhaps a way to "silently kill" [97] this doctrine. The meeting competition defence does not benefit the consumers in the same way as the other objective justifications.

It is difficult to see how the meeting competition defence can be successfully invoked in a margin squeeze case. There cannot be any other economically practical and less anti-competitive options, which is highly unlikely. When the abuse enables the undertaking to impose losses on its competitors which it does not suffer itself, the defence may not legitimise conduct which has the effect of leveraging an upstream dominant position.[98] The meeting

[93] The enforcement priority guidance section III D
[94] Rousseva, E., "Rethinking Exclusionary Abuses in EU Competition Law", (Hart 2007) p.259
[95] See amongst others Case 27/76, *United Brands Company and United Brands Continentaal BV v Commission of the European Communities*, [1978] ECR 207
[96] Supra note 1 para. 639
[97] Gravengaard M. & Kjaersgaard N. "The EU Commission guidance on exclusionary abuse of dominance - and its consequences in practice"
[98] Supra note 1 para. 638

competition defence can be used only if exclusionary intent is not present,[99] and the mere presence of an insufficient margin may be regarded as evidence of a purpose to foreclose competitors.[100]

3.2.3 Efficiency defence

When assessing a potential abuse, it is the overall effects on consumer welfare which are decisive. If efficiencies from the conduct in question outweigh the anti-competitive harm, it should not constitute an infringement.[101] In contrast to Article 101 TFEU, Article 102 does not contain any express method for the assessment of efficiencies; hence objective justifications have been used for this purpose.

While the company must demonstrate the efficiencies beneficial to consumers, it is still incumbent on the authorities to show that these are not sufficient to outweigh the negative effects.[102] The incentives to pass on efficiencies to consumers are likely to be related to the degree of competitive pressure on the firm. The strong position of Telefónica, combined with the adverse conditions Spanish customers in fact were facing, precluded the applicability of the efficiency defence.[103] Short-term efficiency gains cannot outweigh a long-term reduction in competition.

Possible efficiencies from a margin squeeze are benefits stemming from the vertical integration, for example elimination of double marginalisation or economies of scale. However, as the benchmark for abuse is an equally efficient competitor, it is highly unlikely that an efficiency defence will be successful in a case regarding margin squeeze.[104]

3.2.4 Protection of investments and incentives to invest

A growing market cannot legitimise abuse as an investment in future profitability.[105] If a firm is already dominant or in a position where it can leverage a dominant position in a neighbouring market, market penetration considerations cannot be heard. As seen in chapter four, immature markets are in no way exempted from the application of Article 102 TFEU, if anything more rapid enforcement is required. .

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99 *Akzo*

100 Supra note 1 para. 640

101 Ibid. para. 655

102 Case T-201/04 *Microsoft vs. the Commission* [2007] ECR II-3601

103 Supra note 1 para. 648

104 Faella, G. & Pardolesi, R., “Squeezing Price Squeeze under EC Antitrust Law”

105 Supra note 1. para. 622-625

In cases relating to refusal to deal, arguments concerning the dominant undertaking's incentives to invest are often submitted. If there already is an obligation to supply justification is highly unlikely[106]as the impairment of the firm's incentive to invest will have been assessed. Since margin squeeze is now disconnected from the refusal to deal it can be argued that the protection of incentives to invest should be a valid objective justification. However, the scope will probably still be extraordinary narrow.

[106] Supra note 1. para. 659-663

4 COMPARISON TO THE US REGIME

4.1 Introduction

On February 25 2009 the Supreme Court unanimously ruled[1] that margin squeeze is not a violation of section 2 of the Sherman Act[2] (hereafter s.2 SA), which is the US provision governing the conduct of monopolists. A monopolist is in essence the US equivalent to a dominant firm, however the threshold of market power required is higher.[3] It is safe to say that margin squeeze is one of the areas within competition law where the difference between the EU and US is most visible and acute.[4]

Margin squeeze has been considered unlawful monopolisation in US antitrust since *Alcoa* in 1945. Since then substantial developments have taken place. This chapter will give a brief summary of the legal situation in regards to margin squeeze in the US. Following this, the reasons for the diverging approaches will be examined.

4.2 US - the situation after *Linkline*

The Supreme Court's ruling in *Linkline* has for the time being rejected margin squeeze as a valid claim under s.2 SA. The uncertainty concerning margin squeeze began when *Trinko*[5] limited the concept of duty to deal under antitrust provisions to an extraordinarily narrow one. Subsequently, several lower courts[6] reached conflicting conclusions when assessing whether margin squeeze should in fact be seen as a refusal to deal, and hence apply the criteria from *Trinko* or as a stand-alone violation related to monopoly leveraging.[7] *Linkline* was a typical margin squeeze case from the telecommunications sector. Four independent internet service providers contended they where unable to compete with vertically integrated firm AT&T because its wholesale prices were too high and its retail prices were too low. AT&T possessed infrastructure and facilities needed to operate at the retail level and was subject to a regulatory

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[1] *Pacific Bell Telephone Co v Linkline Communications* Inc 129 S.Ct. 1109 (2009) (Hereafter *Linkline*)

[2] Sherman Act, July 2, 1890, ch. 647, 26 Stat. 209, 15 U.S.C. §§ 1–7

[3] See amongst others *United States v Alcoa*, 148 F.2d 416 (2d Cir.) (1945) (hereafter *Alcoa*) and *United States v. Grinnell Corp*., 384 U.S. 563 (1966)

[4] Rudaz, C. "Did Trinko really kill antitrust margin squeeze claims? A critical approach to the Linkline decision through a comparison of EU and US case law" Vanderbilt Journal of Transnational Law, 43:1077 2010

[5] Verizon Communications Inc. V. Law Offices of Curtis V. Trinko, LLP - 540 U.S. 398 (2004) (hereafter *Trinko*)

[6] See *Linkline Communications, Inc. v. SBC California*, Inc., 503 F.3d 876 (9th Cir.) (2007) and *Covad Communications Co v. BellSouth Corp*., 374 F.3d 1044 (11th Cir.) (2004)

[7] Faella, G. & Pardolesi, R., "Squeezing Margin squeeze under EC Antitrust Law"

duty to deal up until 2005. Subsequently, the firm was bound only by a compulsory interconnection requirement which was a previous merger condition.

The lower courts of *Linkline* denied AT&T's petition to dismiss the case due to the fact that *Trinko* foreclosed the possibility of margin squeeze; *Trinko* did not address margin squeeze claims. The Supreme Court reversed, holding that the reasoning applied to refusal to deal was valid also in margin squeeze claims:

> *"[...] if a firm has no antitrust duty to deal with its competitors at wholesale, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous."*[8]

Linkline has been interpreted such that no price-related claims other than predatory pricing will be accepted by US courts.[9] The scope for predatory pricing claims is narrow, because the plaintiff needs to demonstrate below-cost pricing and a dangerous possibility of recoupment.[10] The current situation in US with regards to margin squeeze is that if there is no unlawful refusal to deal under antitrust rules and no predatory pricing, a pricing practice is not a violation of s. 2 SA.

The *Linkline* judgment was welcomed by several commentators[11] who claimed that a concept of unlawful margin squeeze reduces the incentives of dominant firms to invest and innovate and that regulation of pricing practices is no job for antitrust authorities. On the other hand, the judgment has been criticised[12] for taking a dogmatic position in its assessment, at the sacrifice of a true examination of the alleged monopolisation. Several signs of an inadequate assessment of the criteria of monopolisation leave the impact of the judgment uncertain.[13] First of all, it contained no assessment of the relevant market. It appears as if the market definition from the sector regulation was used in the assessment. This is inappropriate because these delimitations pursue different goals. Second, the assessment of market power is at best

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[8] Supra note 1

[9] Nguyen, T, "Price squeezing: Linkline in the United States - no link to the European Union" IIC 2010, 41(3), 316-336

[10] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)

[11] Sidak, J.G, "Abolishing the Margin squeeze as a theory of Antitrust Liability" and Carlton, D. "Should "price squeeze" be a recognized form of anticompetitive conduct?" J.C.L.& E. 2008, 4(2), 271-278

[12] Rudaz, C. "Did Trinko really kill antitrust margin squeeze claims? A critical approach to the Linkline decision through a comparison of EU and US case law"

[13] Ibid.

insufficient. The Supreme Court did not ask whether AT&T was monopolising or attempting to monopolise, they only asked whether there was an antitrust duty to deal.[14]

Trinko did not address margin squeeze. Therefore when the *Linkline* court relied on this case to subordinate all margin squeeze claims to a version of duty to deal it stretched *Trinko* beyond its intended reach.[15] However, it seems that thus far *Linkline* has been followed by lower courts,[16] and at least at this point in time it must be accepted that the divergence between the EU and US is as large as it can be.

4.3 The divergence between EU and US

Although the economic principles and legal reasoning behind competition law are basically the same, the approach to margin squeeze in the EU and US contrasts entirely. *Linkline* did not recognise margin squeeze as a violation of s.2 SA. *TeliaSonera* confirmed that margin squeeze may be an infringement of Article 102 TFEU, regardless of any obligation to supply or whether the prices individually are excessive or predatory.

While the different goals of EU competition law and US antitrust traditionally have been used as explanations for diverging approaches, this argument can no longer be valid.[17] Both regimes focus on enhancement of consumer welfare, which must be protected if dominant firms or monopolist compete by other means than on merit. However, the EU regime is generally more intrusive.

When assessing the reasons of divergence between the EU and US, the institutional structures cannot be overlooked. While the Commission has the authority to issue decisions and administrative fines, the US authorities are heavily dependent on the courts. In particular, the Supreme Court has taken a very conservative approach to monopolisation cases in recent years.[18]

The anticompetitive effects of margin squeeze usually materialise as barriers to entry. In the EU the conduct must only be capable of restricting competition, and such an effect is

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[14] Rudaz, C. "Did Trinko really kill antitrust margin squeeze claims? A critical approach to the Linkline decision through a comparison of EU and US case law"
[15] Ibid.
[16] *John Doe 1 and John Doe 2 v. Abbott Laboratories*, 571 F.3d 930 (9th Cir.) (2009)
[17] Rudaz, C. "Did Trinko really kill antitrust margin squeeze claims? A critical approach to the Linkline decision through a comparison of EU and US case law"
[18] For example *Trinko* and *Linkline*.

therefore sufficient. Although US antitrust does protect consumers indirectly, actual effects are required.[19] This stops the US authorities from taking a more regulatory role, which in contrast is accepted in the EU. *Linkline* rejected that the creation of barriers to entry is a relevant anticompetitive effect.[20]

A main explanation for the difference may be the diverging views on who should deal with negative effects stemming from a margin squeeze. In contrast to the EU, the prevailing view in the US is that antitrust intervention should be avoided where the area is subject to sector-specific regulation.[21] *Credit Suisse*[22] states that antitrust law is not applicable where a regulatory regime with an operating authority is present, and there is a possibility of conflict between antitrust and the regulation within this area. Hence, in the US, margin squeeze in a regulated area should be dealt with by regulators, not by antitrust authorities.[23] The concurring opinion of Judge Breyer in *Linkline* illustrated this reasoning:

> *"[...] respondents could have gone to the regulators and asked for petitioners' wholesale prices to be lowered in light of the alleged margin squeeze."*[24]

In relation to the clear division of work between various regulatory authorities and the antitrust enforcers, is the great scepticism towards antitrust courts acting as state planners. Courts are reluctant to interfere with business decisions and are generally considered ill-suited to making such decisions. Determining prices is viewed as a task exclusively reserved for the company in question. For example, and contrary to the EU, excessive pricing is never a violation of s. 2 SA.

> *"[...] antitrust courts normally avoid direct price administration, relying on rules and remedies [...] that are easier to administer."*[25]

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[19] Rudaz, C. "Did Trinko really kill antitrust margin squeeze claims? A critical approach to the Linkline decision through a comparison of EU and US case law"

[20] Ibid.

[21] *Linkline Communications, Inc. v. SBC California, Inc.*, 503 F.3d 876 (9th Cir.) (2007)

[22] *Credit Suisse Securities (USA) LLC v. Billing*, 551 U.S. 264 (2007)

[23] Jacobsen J, & Rucker, V. "Whither Margin squeeze Antitrust?" The online magazine for global competition law, Jan. 2008 (1).

[24] *Linkline*, concurring opinion

[25] *Town of Concord v Boston Edison Co* 915 F.2d 17 (1st Cir.) (1990)

The Supreme Court found margin squeeze to be particularly hard to remedy, because there are two different prices involved, which together create a moving target.[26] To remedy a margin squeeze would involve adjusting and monitoring both upstream and downstream charges, a complicated task which the antitrust authorities in no way should undertake. None of the European cases concerning margin squeeze address this issue.

As seen above, the equally efficient competitor test is the preferred test in the EU. The rationale behind choosing to rely on the company's own costs and charges is to a great extent the principle of legal certainty and the undertaking's ability to assess its own conduct. In *Alcoa*, the margin squeeze test was articulated with terms such as "a fair price" and "living profit".[27] The company's own costs and LRAIC were used to determine whether the margin was insufficient.[28] *Linkline* rejected this test due to lack of previous jurisprudence. Curiously, in the EU this test has been further developed.[29] The *Linkline* court emphasised that if margin squeeze is recognised as an independent violation of s. 2 SA, there would be no safe harbour for pricing practice of the firms and it would be difficult for the businesses to calculate prices that certainly are lawful.[30] The arguments concerning legal certainty are used for different purposes in the different regimes; in the EU to choose the appropriate test, in the US to reject the concept as a whole.

In contrast to the EU, the US antitrust enforcement is much more dependent on the political environment. The Obama administration has announced[31] more intrusive antitrust enforcement with regards to monopolisation. The Supreme Court's judgment in *Linkline* has been held to be the nadir of monopolisation enforcement in US,[32] and it is yet to see whether the announcements of more intrusive enforcement will have any effect in practice. While the financial environment in recent years has lead to a more pro-regulatory attitude in the US, a change in the composition of the Supreme Court may be needed before any significant developments can take place.[33] While there may be a relaxation of the conservative approach

[26] Supra note 1
[27] *Alcoa* para. 437-438
[28] Rudaz, C. "Did Trinko really kill antitrust price squeeze claims? A critical approach to the Linkline decision through a comparison of EU and US case law"
[29] Ibid.
[30] Supra note 1
[31] Varney C., Vigorous Antitrust Enforcement in This Challenging Era, May 11, 2009, http://www.justice.gov/atr/public/speeches/245711.htm
[32] Crane, D., "Linkline's Institutional Suspicions", Cato Supreme Court Review, 2008-2009, p. 111-132
[33] Ibid.

seen in *Linkline* and also other monopolisation cases, it is highly unlikely that the US will reach the immensely intrusive approach from *TeliaSonera*. Therefore the divergence in relation to margin squeeze is likely to continue.

5 CONCLUSION

The recent EU cases have contributed significantly to the development of a properly defined analytical framework for the margin squeeze assessment. The effects based approach relying on economics undertaken by both the Commission and the Courts[1] must be considered an important improvement, and the undertakings subject to Article 102 TFEU is provided with more legal certainty.

The use of the equally efficient competitor test and LRAIC as the appropriate cost measure clearly shows that the assessment is to be based on economics, and that the effects on consumer welfare are decisive. *TeliaSonera* has also ruled out any uncertainty relating to whether the factors such as the degree of market strength or maturity of the market should be a part of the assessment. Excluding such factors is appropriate as it simplifies the analysis, hence avoids unnecessary uncertainties, for example relating to when a market is considered immature. This again makes it easier for the undertakings in question to assess their own conduct.

Although the legal situation of margin squeeze is extensively clarified, further precedence is needed to obtain a satisfactory degree of certainty in relation to margin squeeze. *Deutsche Telekom* and *Telefónica*, although highly influential, are largely limited to their own facts. *TeliaSonera* does not go into detail on the practical assessment of a margin squeeze situation.

In addition, the legal situation presented in *TeliaSonera* is not necessarily settled as the correct approach. In particular one aspect of the current margin squeeze assessment can be questioned; the highly controversial disconnection of margin squeeze from the concept of refusal to deal.

As seen above[2] margin squeeze is intuitively a constructive refusal to deal. From a consumer harm perspective, it does not make sense to prohibit margin squeeze if the dominant firm is entitled to forego supplying all together. In *TeliaSonera* the ECJ held that:

> *"[...] a requirement that before any conduct of a dominant undertaking in relation to its terms of trade could be regarded as abusive the conditions to be met to establish that there was a refusal to supply would in every case*

[1] For example *TeliaSonera* and *Deutsche Telekom*, ECJ

[2] See section 3.1.5

have to be satisfied, and that would unduly reduce the effectiveness of Article 102 TFEU."[3]

The Court gives no reasons why this would unduly reduce the effectiveness of the provision, and several arguments supports that it might have gone one step too far. The criteria for an obligation supply under competition rules are strict for good reasons. The incentives to invest must be balanced with protection of competition and the threshold for interrupting the contractual freedom should be significant.[4] Obviously, the dominant undertaking can stop supplying at upstream level; hence avoid the risk of liability. In addition, if the dominant firm keeps supplying the competitors, the fear of allegations of margin squeeze may keep it from lowering its retail prices. It might even act as a price umbrella so all incumbent firms are able to collectively maintain higher retail prices.[5] Hence, the extension of the margin squeeze abuse will not necessarily have a pro-competitive effect.

In the EU margin squeeze abuses are in focus and it must be expected that several cases will come before the Commission and the Courts within the next couple of years. It remains to see whether the Court will take one step back and reconnect the concepts of refusal to deal and margin squeeze. This seems appropriate as the concepts are instinctively linked together.

The current position in the US represents the opposite view in the margin squeeze debate. By removing almost entirely the scope for antitrust intervention, the *Linkline* court has, particularly in bottleneck industries, eliminated an important tool to prevent disruption of effective competition. When there is a concept of unlawful predatory pricing, not recognising margin squeeze creates a loop hole for vertically integrated companies to exploit.[6] The undertaking may execute its exclusionary intent by reducing the margin instead of only its retail price. Hence it can use margin squeeze to gain the same result as with predation. As seen in chapter four, the *Linkline* judgement can be questioned, and together with the signals from the current government we might see a softening of the current rejection of the concept, which from a consumer welfare perspective is advisable.

A middle course between the EU and the US regime appears as the reasonable approach to margin squeeze abuses. It would still be connected to refusal to deal, but separated from both

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[3] *TeliaSonera* para 58

[4] The enforcement priority guidelines para. 75

[5] Faella, G. & Pardolesi, R., "Squeezing Price Squeeze under EC Antitrust Law"

[6] Nguyen, T, "Price squeezing: Linkline in the United States - no link to the European Union"

predatory and excessive pricing. The approach taken in *Telefónica*, where no distinction was made between when the obligation to supply came from a sector-specific regulation or competition law provisions seems appropriate. What is important is that an evaluation of the product's indispensability and the dominant undertakings incentives to invest has been undertaken.

After *TeliaSonera* the outlook for Telefónica's appeal[7] of the Commission decision is not good. Telefónica has raised a number of issues, amongst them that there is a lack of causal link between the conduct in question and the alleged anticompetitive effects. The judgement to come will hopefully provide further guidance to the margin squeeze analysis. However, as Telefónica was under regulatory obligation to deal, the problems relating to margin squeeze without any such duty will not come to a head.

The final word in relation to margin squeeze has not been said. It remains to see whether the ECJ will uphold its intrusive position or change course with a reconnection to refusal to deal. In any case both the Commission and the Courts will develop the margin squeeze analysis further, and provide further guidance to the dominant firms.

[7] Case T-336/07, *Telefónica and Telefónica de España v Commission*, Action brought on 10 September 2007

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