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The Regulation of a Margin Squeeze in the European Union and the Intersection of Competition Law and Sector-Specific Regulation

*Kathryn McMahon**

In a series of recent decisions, *Telefónica*, *Deutsche Telekom* and *TeliaSonera*, the European Commission and European Courts have imposed liability and extensive fines under Article 102 TFEU for the abuse of a margin squeeze in liberalized telecommunications markets. These decisions are important for their consideration of the "as efficient competitor" test under Article 102 in narrowly construed downstream markets and for their assessment of the relationship between competition law and sector-specific regulation. This paper will evaluate these margin squeeze decisions within the context of a broadening role for competition law in liberalized and regulated markets and the purported shift in the European Commission's Enforcement Priorities towards a "more economic" and "consumer welfare" approach. It will also seek to draw some comparisons with the treatment of a margin or price squeeze in the United States under section 2 of the US Sherman Act 1890, where the likelihood of a successful claim in this area has significantly diminished after the Supreme Court decision in *linkLine*.

1. INTRODUCTION

In a series of recent decisions, *Telefónica,*[1] *Deutsche Telekom*[2] and *TeliaSonera,*[3] the European Commission and European Courts have imposed liability and extensive fines under Article 102 of the Treaty Functioning of the European Union (TFEU) for the abuse of a margin squeeze in liberalized telecommunications markets. These decisions are important for their consideration of the "as efficient competitor" test under Article 102 in narrowly construed downstream markets and for their assessment of the relationship between competition law and sector specific regulation.

A margin squeeze typically arises in an industry where a vertically integrated dominant supplier prices wholesale access to a network or an input vital to the sale or manufacture of a downstream product or service at such a level that the downstream competitor of the dominant firm cannot purchase the input at that price and compete

* Associate Professor, School of Law, University of Warwick (kathryn.mcmahon@warwick.ac.uk). A version of this paper was presented at the Competition Law Scholars Forum (CLaSF) XXII Workshop on "Competition Law and Pricing Mechanisms", London, 1st May 2014. I would like to thank the organisers and participants of that workshop and an anonymous reviewer of this journal for their valuable feedback and comments.

1 Case COMP/38.784, *Wanadoo España vs. Telefónica*, Commission decision of 4 July 2007, OJ C 83, 2.4.2008 (Commission); Case T-336/07, *Telefónica and Telefónica de España v Commission*, ECLI:EU:T:2012:172; and Case C-295/12 P *Telefónica and Telefónica de España v Commission,* ECLI:EU:C:2014:2062.

2 Case COMP/C-1/37.451, 37.578, 37.579 *Deutsche Telekom AG,* 2003/707/EC; [2003] OJ L263/9, 14.10.2003 (Commission); Case T-271/03, *Deutsche Telekom v Commission* [2008] ECR II-477 (General Court); Case C-280/08 P *Deutsche Telekom v Commission* [2010] ECR I-955 (CJEU) (*Deutsche Telekom*).

3 Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB*, [2011] ECR I-527 (CJEU) (*TeliaSonera*).

with the downstream retail arm of the vertically integrated firm. Margin squeezes have traditionally been treated as a form of a constructive refusal to supply (necessitating the finding of indispensability of the input) and the requirement to consider the impact of a duty to deal, on the *ex ante* investment decisions of the input owner. In a number of these margin squeeze decisions, the presence of a regulated duty to deal, has meant that the regulator is assumed to have already determined the relevant weighing of the *ex ante* investment decisions against the promotion of downstream competition. The Commission and the Courts have also demonstrated a willingness to make this assumption in liberalized markets, even in the absence of a regulated duty to deal, when the dominant enterprise was developed under special concessions and state investment. The Court of Justice of the European Union (CJEU) in *TeliaSonera* and the General Court in *Telefónica* also dispensed with the requirement to find a constructive refusal to supply and viewed a margin squeeze as an independent form of abuse under Article 102, where the violation can be identified purely on the assessment of costs and prices. These costs are notoriously difficult to impute in vertically integrated and dynamic industries, where there are considerable sunk costs and the presence of network effects.

These decisions significantly broaden the scope of potential liability for a margin squeeze in regulated and non-regulated industries in the European Union. This legal position has the potential to distort *ex ante* upstream investment decisions and creates a disincentive for the dominant undertaking to supply the input in the first place. The failure to consider the abuse within the elements of a constructive refusal to supply means that an exclusionary purpose is not always identified. The likely outcome is that while competition may be maintained in the short term, the ensuing uncertainty of this standard may be ultimately detrimental for consumer welfare.

This paper will evaluate these margin squeeze decisions within the context of a broadening role for competition law in liberalized and regulated markets. In doing so it will place this discussion within the wider jurisprudence of Article 102 and the purported shift in the European Commission's "Guidance on the Commission's enforcement priorities in applying Article [102] (Guidance Paper on Article 102)" towards a "more economic" and "consumer welfare" approach.[4] It will also seek to draw some comparisons with the treatment of a margin or price squeeze in the United States (US) under section 2 of the US Sherman Act 1890, and in particular the Supreme Court decision in *Pacific Bell Telephone v linkLine Communications.*[5]

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4 In announcing the review of Article 102 TFEU, Philip Lowe, then EC Director General of Competition, stated "[a] credible policy on abusive conduct must be compatible with mainstream economics": Speech by the Director-General of DG Comp, Philip Lowe at Fordham Corporate Law Institute 30th Annual Conference on International Antitrust Law and Policy, 23 October 2003, 2; See Economic Advisory Group on Competition Policy (EAGCP), "An Economic Approach to Article 82" (July 2005), available at http://ec.europa.eu/dgs/competition/economist/eagcp_july_21_05.pdf; and, European Commission, "Guidance on the Commission's enforcement priorities in applying Article 82 [Article 102] of the EC Treaty to abusive exclusionary conduct by dominant undertakings", (2009/C 45/02) OJ 2009 C45 (Guidance Paper on Article 102), para 19.

5 *Pacific Bell Telephone Co. v linkLine Communications Inc.*, 129 S. Ct. 1109 (2009) (linkLine).

2. A PRICE OR MARGIN SQUEEZE IN THE UNITED STATES UNDER SECTION 2 OF THE SHERMAN ACT

The approach to the regulation of a margin squeeze in the EU represents a considerable divergence from the treatment of this conduct in the US under s2 Sherman Act[6] where after the Supreme Court decision in *linkLine*[7] the likelihood of a successful price or margin squeeze[8] suit has been significantly diminished.[9] This divergence is worthy of study because these approaches can be traced to differing conceptions of the purposes of dominant firm regulation in the US and EU, particularly in regulated markets, at a time when the EU has signalled a desire to move towards a "more economic", "effects based" and "consumer welfare" assessment of exclusionary abuses by dominant undertakings under Article 102.[10]

A group of eminent US antitrust professors and scholars, headed by Robert H. Bork and J. Gregory Sidak chose to highlight these differences in their *amicus curiae* brief to the US Supreme Court in the *linkLine* appeal from the Ninth Circuit Court of Appeals:

> "The alternative to consumer-welfare maximization is the view that antitrust law is simply one more tool of industrial policy, and thus its application may permissibly compromise consumer welfare to advance the welfare of competitors. Other nations evidently consider this normative proposition to be appropriate, if recent developments in the European Union are a valid indication. More than ever before, the United States and Europe appear to be at a fork in the road over whether the law of monopolization exists to protect consumers or to ensure that a specified number of firms will profitably populate a market."[11]

While the characterization of these normative differences in the *Amicus Brief* can be debated, it is also true that these differences in approach have only recently become more pronounced. The offence in both jurisdictions actually has identical origins as a

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6 Section 2 of the Sherman Act 1890 provides: "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony". The test to be applied under s2 was established by the Supreme Court in *United States v Grinnell Corp* i.e., the possession of monopoly power in the relevant market and "the wilful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident": 384 U.S. 563, 570-71 (1966).

7 *linkLine,* n 5.

8 "Price squeeze" is the term more commonly used by courts and commentators in the United States and "margin squeeze" in the European Union.

9 This paper draws on discussions in George Hay and Kathryn McMahon, "The Diverging Approach to Price Squeezes in the United States and Europe" (2012) 8 Journal of Competition Law and Economics 259.

10 See n 4. For use of an "effects based" approach by the European Courts see Case C-209/10 *Post Danmark A/S v Konkurrencerådet*, ECLI:EU:C:2012:172; cf Ekaterina Rousseva and Mel Marquis "Hell Freezes Over: A Climate Change for Assessing Exclusionary Conduct under Article 102 TFEU" (2012) 4 Journal of Competition Law & Practice 32.

11 *Brief of Amici Curiae Professors and Scholars in Law and Economics in support of the Petitioners*, *Pacific Bell Telephone Company v Linkline Communications* (No. 07-512) (October 2007), 5 (Amicus Brief); see J Gregory Sidak, "Abolishing the Price Squeeze as a Theory of Antitrust Liability", (2008) 4 Journal of Competition Law and Economics 279, 295.

form of a "constrictive refusal to supply" and it is therefore useful initially to set out briefly the US law on a price squeeze and its relationship to a "duty to deal".

The classic formulation of liability for a price squeeze in the US is that put forward by Judge Learned Hand in *United States v. Aluminum Co. of America et al (Alcoa)*.[12] Alcoa was charged with using its monopoly power in the upstream aluminium ingot market to squeeze the profits of rivals in downstream aluminium sheet manufacturing. The Court generally endorsed the plaintiff's theory that Alcoa:

> "consistently sold ingot at so high a price that the 'sheet rollers,' who were forced to buy from it, could not pay the expenses of 'rolling' the 'sheet' and make a living profit out of the price at which 'Alcoa' itself sold 'sheet' … That it was unlawful to set the price of 'sheet' so low and hold the price of ingot so high, seems to us unquestionable, provided, as we have held, that on this record the price of ingot must be regarded as higher than a 'fair price'."[13]

In *Town of Concord, Massachusetts, et al v Boston Edison Company*,[14] Judge Breyer, (as he then was) generally agreed with Learned Hand's formulation and conclusion that, at least in an unregulated context, a price squeeze can violate s2.[15] In *linkLine*[16] it was alleged that AT&T, a vertically integrated owner of the fixed telecommunications network which had previously been subject to regulation, set a high price for wholesale local loop access and a low price for its retail broadband Internet services, which squeezed the profit margins of the plaintiffs who were involved in the provision of retail broadband Internet services.[17] The Supreme Court divided the offence into two claims: a claim of refusal to supply upstream and one of predatory pricing downstream. The Court finding that the:

> "Plaintiffs' price-squeeze claim, looking to the relation between retail and wholesale prices, is thus nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level."[18]

Price squeezes in the US have traditionally been treated as a form of a "constructive refusal to deal" under s2 of the Sherman Act. While the classic duty to deal doctrine was established in the *United States v. Colgate & Company*,[19] subsequent Supreme Court decisions in *Aspen Skiing Co v Aspen Highlands Ski Corp*[20] and *Verizon Communications v*

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12 148 F.2d 416 (2d Cir. 1945). The first price squeeze scenario under s2 of the Sherman Act was found however in *Eastman Kodak Company of New York v. Southern Photo Materials Company* 273 U.S. 359 (1927).

13 *Alcoa*, *id*, at 437-438.

14 915 F .2d 17 (1st Cir. 1990).

15 Judge Breyer rejected the application of the price squeeze theory to firms whose upstream and downstream prices are subject to regulation.

16 *linkLine*, n 5.

17 The District Court and the Court of Appeals for the Ninth Circuit found for the plaintiffs: *linkline Communications, Inc. v SBC Cal., Inc.*, 503 F.3d 876 (2007).

18 *linkline,* n 5, at 1120.

19 250 US 300 (1919). Cf *Lorain Journal Co v United States* 342 U.S. 143 (1951).

20 472 U.S. 585 (1985).

Law Offices of Curtis V Trinko[21] have significantly reduced the circumstances where a duty to deal will be established under s2, particularly in regulated industries and/or where there has been no previous course of dealing.

In *Aspen,* the Supreme Court found that it was possible for a jury to infer that the dominant ski company's refusal to continue a joint venture with a rival was anticompetitive but left open the question of the existence and terms of any duty to deal had there been no prior course of dealing. In *Trinko*, it was claimed that Verizon, the incumbent local exchange carrier, provided insufficient assistance in the provision of telecommunication services to rivals in a market regulated by a federal and state statutory access regime. The Supreme Court described *Aspen* as:

> "at or near the outer boundary of s2 liability. The Court there found significance in the defendant's decision to cease participation in a cooperative venture. The unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end."[22]

The Supreme Court placed a great deal of emphasis on the absence of a prior supply agreement. Since the defendant (Verizon) in *Trinko* had never previously sold to the entity seeking cooperation, there would be no basis such as that in *Aspen* for any inference that the refusal was not motivated by legitimate business reasons.[23] Moreover, Verizon was not free to set the terms of any cooperation because the terms of dealing were effectively dictated by regulation.

The Supreme Court in *linkLine* relied on *Aspen* and *Trinko* to reject the price squeeze (constructive refusal to supply) claim. The defendant (AT&T) in *linkLine*, like the defendant in *Trinko* did not have a duty to deal because it had never voluntarily engaged in selling at the wholesale level (absent regulation). The Supreme Court stated:

> "The nub of the complaint in both *Trinko* and this case is identical -- the plaintiffs alleged that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market. *Trinko* holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal."[24]

The claim that the wholesale prices were too high also failed because AT&T did not have a duty to sell at reasonable prices.[25] High prices are also not considered

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21 *Verizon Communications v Law Offices of Curtis V. Trinko* 540 U.S. 398 (2004) (*Trinko*)

22 *Trinko, id* at 409.

23 The Court notes that the complaint failed to allege that, "Verizon voluntarily engaged in a course of dealing with its rivals, or would ever have done so absent statutory compulsion. Here, therefore, the defendant's prior conduct sheds no light upon the motivation of its refusal to deal—upon whether its regulatory lapses were prompted not by competitive zeal but by anticompetitive malice": *Id.*

24 *linkLine*, n 5, at 1119.

25 *Id*, at 1119.

objectionable because "[t]he opportunity to charge monopoly prices … is what attracts 'business acumen' in the first place".[26]

The second aspect of the plaintiffs' claim that the retail price was too low, also failed because it did not satisfy the requirements for predatory pricing set out in the Supreme Court's decision in *Brooke Group v Brown and Williamson Tobacco* (*Brooke Group*);[27] i.e. that the defendant's retail prices are below a relevant measure of costs for the vertically integrated entity and there is a "dangerous probability" that they will recoup any lost profits from the period of predation.[28]

Referring to *Alcoa* the Supreme Court states:

> "Given developments in economic theory and antitrust jurisprudence since *Alcoa*, we find our recent decisions in *Trinko* and *Brooke Group* more pertinent to the question before us."[29]

It is difficult therefore to see whether any liability remains in the US under s2 for a price squeeze after the decision in *linkLine.*

3. Margin Squeeze Decisions in the European Union under Article 102 TFEU and the Importance Placed on the Goal of Integration of the Internal Market

While there have been a number of EU decisions on a margin squeeze under Article 102 of the TFEU since the Commission's earliest decision in 1975,[30] attention has focused on three recent cases concerning the provision of broadband services by former state-owned monopolies in the liberalized European telecommunications market.[31] In *Telefónica* the Commission imposed a fine of almost €152 million on the

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26 *Trinko,* n 21, 407.

27 *Brooke Group v Brown and Williamson Tobacco* 509 U.S. 209 (1993) (*Brooke Group*).

28 *linkline,* n 5, at 1120.

29 *Id*, at 1120.

30 The earliest decision in 1975 was the Commission's adoption of interim measures in the *National Carbonising* case. (Commission Decision of 29 October 1975 adopting interim measures concerning the National Coal Board, National Smokeless Fuels Limited and the National Carbonising Company Limited, [1976] OJ L35/6). In Case No IV/30.178 *Napier Brown/British Sugar* [1988] OJ L284/41, 19.10.1988, British Sugar, which was dominant in both the wholesale markets for the supply of raw sugar and the downstream retail sugar product market, was found by the Commission to have imposed prices for the two products where the margin was "insufficient to reflect that dominant company's own costs of transformation … with the result that competition in the derived product is restricted": id at 66. In Case T-5/97 *Industrie des Poudres Sphériques SA v Commission* [2000] ECR II-3755 the General Court recognized the concept of a margin squeeze but upheld the Commission's rejection of the complaint because it was based on the applicant's desire to set its retail prices to cover its higher processing costs.

31 See generally Damian Geradin and Robert O'Donoghue, "The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector", (2005) 1 Journal of Competition Law & Economics 355 (2005); Robbie Downing and Alison Jones, "Margin Squeezes in Telecommunications Markets in Intellectual Property: New Frontiers", ch 10, Steven Anderman and Ariel Ezrachi (eds), *Intellectual Property and Competition Law: New Frontiers* (Oxford Univ. Press, 2011); Richard Whish and David Bailey, *Competition Law*, 754-759 (7th ed, Oxford Univ. Press, 2012); Robert O'Donoghue and A. Jorge Padilla, *The Law and Economics of Article 102 TFEU*, 364-422 (Hart Publishing, 2nd ed, 2013).

Spanish telecommunications operator Telefónica for a margin squeeze in the Spanish broadband market from 2001-2006.[32] The decision was upheld by the General Court in 2012[33] and the CJEU.[34] In *Deutsche Telekom* the European Commission fined Deutsche Telekom AG €12.6 million for a margin squeeze.[35] The Commission's decision was upheld on appeal to the General Court[36] and CJEU.[37] In *TeliaSonera Sverige AB*[38] the CJEU was requested by the Stockholm District Court to provide a preliminary ruling on the application of Article 102 in a margin squeeze case. The Swedish Competition Authority (*Konkurrensverket*) had fined TeliaSonera the equivalent of €15.1 million for a margin squeeze in breach of Article 102 and its national law equivalent.

These decisions are significant for three main reasons: first, they send a strong message that the EU will impose very large fines for this conduct in liberalized and regulated markets and second, they display a willingness to consider the conduct as a "standalone abuse" distinct from that of a "constructive refusal to supply" and third, the decisions signify a major divergence between the EU and the US treatment of this conduct.

These EU decisions considered largely similar industry structures, involving a vertically integrated telecommunications operator, which owned and operated the fixed telephone network, enjoying a monopoly in the wholesale and (up until liberalization) the retail provision of fixed-line telecommunications services, and selling a range of downstream retail services including broadband Internet access and telephone call services. The wholesale and retail telecommunications services in *Deutsche Telekom*[39] and *Telefónica*[40] were subject to some form of sector-specific regulation while the provider in *TeliaSoneria*[41] had previously been subject to regulation. Following liberalization, these

32 *Telefónica* (Commission), n 1.

33 *Telefónica* (General Court) n 1.

34 *Telefónica* (CJEU) n 1.

35 *Deutsche Telekom* (Commission), n 2.

36 *Deutsche Telekom* (General Court), n 2

37 *Deutsche Telekom* (CJEU), n 2.

38 *TeliaSonera,* (CJEU) n 3.

39 Deutsche Telekom is the vertically integrated telecommunications operator in Germany. It enjoyed a monopoly in the wholesale and retail provision of fixed-line telecommunications services until the German telecommunications market was liberalized on 1 August, 1996, by force of the *Telekommunikationsgesetz* (German Law on Telecommunications "TKG"). Its first competitor entered the retail market in 1998. Following liberalization, Deutsche Telekom was required to offer entrants in the German telecommunications market fully unbundled wholesale access to the local loop. Its wholesale charges and retail rates for analogue and broadband were subject to some form of regulation by the German telecommunications authority (Reg TP).

40 Prior to liberalisation of the Spanish telecommunications markets in 1998, Telefónica was owned by the Spanish State and had a legal monopoly in the retail provision of fixed-line telecommunications services and supplied broadband services through its subsidiaries. Wanadoo España SL (now France Telecom España SA) complained that the margin between the wholesale prices which the subsidiaries of Telefónica charged their competitors for the wholesale supply of broadband access in Spain and the retail prices which they charged end users was not enough to allow competitors of Telefónica to compete with it.

41 The CJEU considered the case in a preliminary ruling. TeliaSonera was charged with pricing its wholesale access services to competitors and its broadband ADSL internet services to end-users at prices which were insufficient to cover the incremental cost which it had to incur in providing end user services.

firms were required to offer unbundled access to the local loop but competitors claimed that the wholesale prices charged by owner of the fixed telephone constituted a margin squeeze in that it pitched its wholesale price at such a level that they were unable to obtain wholesale access and profitably sell retail access services in competition with the dominant undertakings own retail access services.[42]

What clearly emerges from an examination of these decisions is the emphasis the EU Courts have placed on the goal of the single market: the "integration of the internal market". The EU focus on preserving rivalry, preventing foreclosure and ensuring "competition on the merits" is derived from an institutional and political history which prioritizes market integration and sets out a system ensuring that competition in the internal market is not distorted.[43] It favours the fostering of short term competitive rivalry as the best way to ensure long term investment incentives.[44] This explains the emphasis these margin squeeze decisions have placed on the promotion of "equality of opportunity" and market access. In *Deutsche Telekom* the General Court and the CJEU claimed that undistorted competition could only be guaranteed if "equality of opportunity" was secured as between the various economic operators.[45] Market integration also explains why the courts have borrowed terminology from "freedom of movement" jurisprudence and, as we will see, decisions under Article 106 where the conferral of special or exclusive rights may distort competition and "equality of opportunity" through an absence of "competitive neutrality".[46]

The goal of market integration also explains why the courts have not found it necessary to demonstrate that the margin squeeze had an actual effect on the markets concerned but that the conduct must tend to restrict competition or be capable of having that effect, even if the result hoped for may not be achieved.[47] The CJEU in *Deutsche*

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42 Deutsche Telekom did not contest the finding that it had a dominant position on the wholesale market in local loop access services and on the retail market in end-user access services. The Commission in *Telefónica* found that Telefónica was dominant in both the upstream market (for wholesale broadband at regional and national levels) and the downstream retail market (for all standard broadband products through ADSL or any other technology): see discussion below.

43 Formally found in Article 3(1)(g) of the EC Treaty. Article 3(3) of the Treaty on the EU (TEU) states that the European Union is to establish an internal market, which, in accordance with *Protocol (No 27) on the internal market and competition*, annexed to the Treaty of Lisbon, OJ C 115, 9.5.2008, 309–309 is to include a system ensuring that competition is not distorted. Articles 101 and 102 form part of the competition rules referred to in Article 3(1)(b) TFEU: see *TeliaSonera, n* 3, paras 20-22. EU competition law has its theoretical foundations in the political and economic ideas of "ordoliberalism", which originated in the 1930s in Germany, particularly at the University of Freiburg: see David J Gerber, *Law and Competition in Twentieth Century Europe, Protecting Prometheus*, ch 7 (Oxford Univ. Press, 1998). Under this view "there is neither unconstrained private power nor discretionary governmental intervention in the economy... competition is a value in itself and not just a means by which purely economic objectives – such as efficiency – are to be achieved": Alison Jones and Breda Sufrin, *EU Competition Law*, 34 (5th ed, Oxford Univ. Press 2014).

44 See, for example, the General Court decision in *Microsoft Corp v Commission* (2007) ECR II-3601, para 783; David Howarth and Kathryn McMahon, "'Windows has performed an illegal operation': The Court of First Instance's Judgment in Microsoft v Commission", (2008) 29 European Competition Law Review 117.

45 *Deutsche Telekom* (General Court), *id*, para198; *Deutsche Telekom* (CJEU), n 2, para 230, 233; *Telefónica* (General Court), n 1, para 204; and, see discussion below.

46 See discussion below.

47 *Deutsche Telekom* (CJEU), n 2, paras 183, 253-254. See discussion below.

Telekom states: "[h]owever, in the absence of any effect on the competitive situation of competitors, a pricing practice such as that at issue cannot be classified as exclusionary if it does not make their market penetration any more difficult".[48] Notwithstanding the views of the Commission in its "Guidance Paper on Article 102",[49] the European Courts have been more reluctant to embrace an "effects based" approach. The EU model of competition law, as embedded in Articles 101 and 102 TFEU, has been traditionally associated with rules to safeguard the totality of the competitive process rather than the US embrace of efficient outcomes and "total welfare". As the CJEU in *Deutsche Telekom* points out, Article 102 "refers not only to practices which may cause damage to consumers directly, but also to those which are detrimental to them through their impact on competition"[50] and it aims "to protect consumers by means of undistorted competition".[51] Unlike the US where under s2 Sherman Act "there is no duty to aid competitors",[52] a dominant undertaking under Article 102 has a special responsibility "not to allow its conduct to impair genuine undistorted competition on the common market"[53] through recourse to methods different from those governing normal competition in products or services.[54]

The importance of the market integration goal goes some why to explain the differences between the approach in the EU and that of other competition law jurisdictions which do not share this objective, such as the United States. In the discussion which follows it is also important to consider however whether the courts have appropriately balanced the importance of this goal against other goals such as that of consumer welfare. The appropriate balance, and apparent tension, between these goals is a consistent theme of EU competition law.

4. The Elements of the Offence of a Margin Squeeze under Article 102 TFEU

As previously stated, a margin squeeze typically arises in an industry where a vertically integrated dominant supplier prices wholesale access to a network or an input vital to the sale or manufacture of a downstream product or service at such a level that "an equally efficient" downstream competitor of the dominant firm cannot purchase the input at that price and compete with the downstream retail arm of the vertically

48 *Id,* para 254.

49 European Commission, "Guidance Paper on Article 102", n 4.

50 *Deutsche Telekom* (CJEU), n 2, para 176, citing Case C-202/07 P *France Télécom v Commission* [2009] ECR I-2369 (*France Télécom*) (CJEU), para 105 and the case-law cited therein.

51 *Deutsche Telekom* (CJEU), n 2, para 180, citing Joined Cases C-468/06 to C-478/06 *Sot. Lélos kai Siaand Others* [2008] ECR I-7139, para 68; cf *TeliaSonera,* n 3, para 24.

52 *Trinko,* n 21, at 411. "Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities": *id,* at 407-8.

53 *Deutsche Telekom* (CJEU), n 2, para 176.

54 *Id*, para 174, citing Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, para 91; Case 322/81 *Nederlandsche Banden-Industrie-Michelin v Commission* [1983] ECR 3461, para70; Case C-62/86 *AKZO v Commission* [1991] ECR I-3359, para 69; Case C-95/04 P *British Airways v Commission* [2007] ECR I-2331 (CJEU), P C-202/07 (*British Airways*) (CJEU), para 66; and *France Télécom* (CJEU), n 50, para 104.

integrated firm. The inability of an "equally efficient" competitor of paying the input price and competing at the downstream market has led to margin squeezes being traditionally treated as a form of a "constructive refusal to supply". The treatment therefore necessitates a finding of whether a "duty to deal" exists and whether the input is indispensable, including a consideration of the impact of a duty to deal, on the *ex ante* investment decisions of the input owner. The abuse is understood as a form of leverage whereby the owner of an upstream monopoly uses its market power to gain a competitive advantage in a downstream market where it may (or may not) have market power and thereby raising rivals' costs and damaging competition on the downstream market.[55] While there is no need to prove actual effect on a downstream market the conduct must be capable of an exclusionary effect. The defendant may also argue an objective justification for the conduct.

In the following discussion these main elements of the test will be addressed in turn: 1) the "as efficient competitor" test; 2) the conduct must be capable of having an exclusionary effect on the downstream market; and, 3) The requirement of a "duty to supply" and indispensability of the input. Finally a consideration will be made of the application of a price-squeeze in a regulated market.

5. THE "AS EFFICIENT COMPETITOR" TEST

A margin squeeze involves the imposition of "unfair prices", contrary to Article 102(a) of the TFEU, when:

> "the difference between the retail prices charged by a dominant undertaking and the wholesale prices it charges its competitors for comparable services is negative, or insufficient to cover the product-specific costs to the dominant operator of providing its own retail services on the downstream market."[56]

The test is that of an "as efficient competitor"[57] whereby the difference in prices does not need to be negative but merely:

> "insufficient to enable an equally efficient operator to cover its product-specific costs of supplying retail access services. A potential competitor which is just as

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[55] See Thomas G Krattenmaker and Steven C Salop, "Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price", 96 Yale L.J 209 (1986); Steven C Salop, "Refusal to Deal and Price Squeezes by an Unregulated, Vertically Integrated Monopolist", 76 Antitrust L.J. 709 (2010); Dennis W. Carlton, "Should 'Price Squeeze' Be a Recognised Form of Anticompetitive Conduct?", (2008) 4 Journal of Competition & Economics 271.

[56] *Deutsche Telekom* (Commission), n 2, para 107; cf *Deutsche Telekom* (General Court), n 2, para 166.

[57] Cf *TeliaSonera* (CJEU) also applied the test of the "as efficient competitor": n 3, paras 32, 42; *Telefónica* (General Court) n 1, paras 194, 204. The test is also applied by the European Commission in its "Guidance Paper on Article 102", n 4, para 80. For an application of the test in a margin squeeze case in the United Kingdom water sector see *Albion Water Ltd v Dwr Cymru Cyfyngedig* (Water Services Regulation Authority and others intervening) [2008] All ER 314; [2008] EWCA Civ 536 (Court of Appeal); *Albion Water Ltd v Water Services Regulation Authority* [2006] CAT 26 (Competition Appeals Tribunal).

> efficient as the applicant would not be able to enter the retail access services market without suffering losses".[58]

The relevant costs are the incumbents own costs and not the costs of the competing undertaking.[59] The "as efficient competitor" test seems to reject therefore the broader reading of the earlier US decision in *Alcoa* (though Learned Head actually applied Alcoa's own costs) that the dominant firm's pricing must be such as to permit a rival, regardless of its efficiency, to earn a normal or "living profit".[60] It also rejects the "reasonably efficient competitor test" which examines the costs of a hypothetical reasonably efficient rival. The "reasonably efficient competitor" test is presented as an alternative to the "as efficient competitor" test in the EU regulatory framework for electronic communications.[61] In *National Carbonising,* the Commission stated that the dominant firm's pricing must "allow a reasonably efficient manufacturer of the derivative a margin sufficient to enable it to survive in the long-term", but ultimately applied the dominant firm's own costs.[62] In *Telefónica* the Commission stated that both the "equally efficient competitor" test and the "reasonably efficient competitor" test applied but ultimately applied the "equally efficient competitor" test.[63] The Commission in its "Guidance Paper on Article 102" states that it will generally use the benchmark of the Long Run Average Incremental Cost (LRAIC) of the downstream division of the integrated dominant undertaking in margin squeeze cases but may rely on the LRAIC of a non-integrated downstream competitor when it is not possible to clearly allocate the dominant undertaking's cost to downstream and upstream operations.[64] As the General Court in *Deutsche Telekom* pointed out a focus on the rival's costs (whether actual or hypothetical) can be contrary to legal certainty.[65] It also raises potential collusion and price fixing problems as it can promote discussions between rivals concerning costs and prices.[66] The test can also lead to the protection of less efficient rivals. While some may view the "reasonably efficient competitor" test as appropriate to promote competition in newly liberalized markets where entrants with a higher cost structure may not be able to achieve the economies of scale and efficiencies

58 *Deutsche Telekom* (General Court), n 2, para 237. The dominant undertaking "would have been unable to offer its own retail services without incurring a loss if … it had had to pay the wholesale access price as an internal transfer price for its own retail operations": *Deutsche Telekom* (Commission), n 2, para 140; *Telefónica* (General Court) n 1, para 194.

59 *Deutsche Telekom* (General Court), n 2, para 192; cf *TeliaSonera,* n 3, para 41.

60 Cf *Industrie des Poudres Sphériques*, n 30.

61 European Commission, Notice on the application of the competition rules to access agreements in the telecommunications sector (98/C 265/02), para 118; cf para 117.

62 n 30, para 14. In rejecting the complaint, the General Court in *British Sugar* stated that the test was that of an "equally efficient competitor": *Napier Brown/British Sugar,* n 30, paras 66, 180-82.

63 *Telefónica* (Commission), n 1, paras 311-12. *Telefónica* (General Court) n 1, paras 190-193.

64 *Guidance Paper*, n 4, para 79, n 55.

65 *Deutsche Telekom* (General Court), n 2, para 192; cf *TeliaSonera,* n 3, para 41; *Telefónica* (General Court) n 1, para 192.

66 Gianluca Faella and Roberto Pardolesi, "Squeezing Price Squeeze under EC Antitrust Law", (2010) 6 European Competition Journal 255, 277; and, Sidak, n 11, at 297.

of the dominant firm,[67] this would seem to be a regulatory rather than an antitrust issue.[68]

5.1. The imputation of costs and rejection of predatory pricing as a necessary component

The "as efficient competitor" test, like the "fair price" for the wholesale product in *Alcoa,* however raises problematic issues concerning what constitutes an "insufficient price" to enable an equally efficient operator to cover its product-specific costs of supplying retail access?[69] The positive element, where the price is merely "insufficient to cover the vertically integrated firm's cost of providing its own services", is particularly problematic and it is uncertain how this is determined in practice. It is important that mere profit-sacrifice, for example, is not confused with a claim that pricing does not cover imputed costs. In regulated industries this may be a consequence of the regulator setting a wholesale price too high.[70]

It is difficult to impute costs in vertically integrated telecommunications firms where markets are subject to network effects and where end-user access services, call services and other telecommunications services are mostly offered in a bundle. Requiring the dominant firm to be mindful of such specificity in pricing decisions, in order to avoid liability, imposes potentially unreasonable transaction costs which can result in higher prices, the protection of inefficient competitors and obstacles to growth and innovation.[71]

The Commission and the Courts clearly rejected however the US approach in *linkLine* that the downstream prices must constituted predatory pricing. There is no need to demonstrate that the wholesale and retail prices in themselves were abusive "on

[67] Bernard Amory and Alexandre Verheyden, "Comments on the CFI's Ruling in Deutsche Telekom v. European Commission", GCP Magazine 9, 11 (2008). For criticism of this as the sole test see Geradin and O'Donoghue, n 31, at 392-93. O'Donoghue and Padilla point out however that the as efficient competitor test does not take account of the situation in a regulated market where the dominant firm may be required to use a higher cost input than its rivals due to duties to provide a range of technical access solutions or to undertake certain universal service obligations. They note that *France Telecom* does not allow a "meeting competition" defence to a claim for predatory pricing where the dominant firm may want to price below cost in order to compete with lower cost rivals: *France Télécom* (CJEU) n 50, paras 45-48. As Advocate General Mazák pointed out, competition law does not provide an "inefficiency defence": Opinion of Advocate General in Case C-280/08 P *Deutsche Telekom* [2010] ECR I-9555, para 50. They go on to suggest however that this situation is unlikely to give rise to anticompetitive effects: n 31, at 422.

[68] Faella and Pardolesi, n 66, at 276.

[69] One method which is used by regulators to determine a "fair price" at the wholesale level is the Efficient Component Pricing Rule (ECPR). This generally allows the incumbent to maintain all or a substantial part of the downstream profits it would have earned in the absence of supply (the opportunity cost) thereby reducing the incentives for exclusion: see generally Geradin and O'Donoghue, n 31, at 374-75. cf *Telecom Corp of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385. The incumbent may also elect to incur rather than avoid costs by selling to the downstream competitor: Sidak, n 11, at 302.

[70] Sidak, *id*, 287. Deutsche Telekom had in fact argued that its retail price did cover its product specific costs.

[71] The higher wholesale price may also reflect higher transaction costs in supplying the input to rivals as opposed to the cost savings brought about by the vertically integrated provider: Faella and Pardolesi, n 66 at 279-280.

account of their excessive or predatory nature".[72] The abusive nature of the conduct was connected not with the level of the wholesale or retail price but with the "unfairness of the spread".[73] This is so, notwithstanding the apparent inconsistency that in order to avoid the margin squeeze, the dominant undertaking would have to increase its retail prices, inviting a possible abuse claim for excessive pricing.[74] It also poses the same possible risk of collusion between rivals which arise from the application of the "reasonably efficient competitor" test as it invites the dominant firm to hypothesize about its rivals' costs in order to ensure they have a sufficient margin in order to avoid liability. As Bork *et al* point out, faced with this uncertainty the dominant firm will likely "default to a strategy of refraining from pricing 'competitively'… a dominant firm's safe strategy is to raise its retail price to the level at which the least-efficient retailer does not complain … [and] act as the price leader and intentionally cede market share to the benefit of its rivals."[75]

The determination of a "fair" or "adequate" margin between the wholesale and retail price lacks clarity as a standard of abuse. As the US Supreme Court in *linkLine* stated, the finding of a margin squeeze requires the courts to regulate wholesale and retail prices and "courts would be aiming at a moving target, since it is the *interaction* between these two prices that may result in a squeeze".[76] This supervisory function would also expect to continue as costs change over time.[77]

Such a test leads to the very criticism that the US courts in *Trinko* and *linkLine* ascribe to the determination of a duty to supply, which requires "antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing – a role for which they are ill suited".[78] The *Amicus Brief* in *linkLine* noted "price-squeeze theory is a regulatory undertaking, not an antitrust cause of action".[79] The pricing of bottleneck inputs for vertically integrated monopolists is a common regulatory task[80]

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72 *Deutsche Telekom* (CJEU), n 2, par 183; There is no need for the wholesale or retail prices to be abusive in themselves or that any losses be capable of recoupment: *Teliasonera* (CJEU), n 3, paras 34, 99. On recoupment in predatory pricing in the EU, see *France Télécom* (CJEU), n 50. Cf European Commission, *Margin Squeeze: Working Paper No. 2 on Competition and Regulation*, DAF/COMP/WP2/WD(2009)32, para 4.

73 *Deutsche Telekom* (Commission), n 2, para 107; *Deutsche Telekom* (General Court), n 2, para 167; *Deutsche Telekom* (CJEU), n 2, para 159.

74 *Deutsche Telekom* (CJEU), n 2, paras 179-181.

75 *Amicus Brief,* n 11, at 3-4; Sidak, n 11, at 297. Carlton points out that these higher retail prices "would in essence impose a tax on consumers of [the downstream product]": n 55, at 275.

76 *linkLine,* n 5, at 1121; Sidak, n 11, at 296.

77 *Amicus Brief*, n 11 at 9. These concepts demonstrate the vast distinction between the EU and US approaches to the abuse of monopoly and provide the basis for the claim made in the *Amicus Brief* in *linkLine* that EU law protects competitors while US law protects consumer welfare: "It becomes necessary to hypothesize what an efficient competitor would be and then determine whether the defendant's wholesale and retail prices permit the efficient competitor to earn some level of profit deemed to be sufficient": *Amicus Brief*, n 11 at 7.

78 *Trinko,* n 21, at 408.

79 *Amicus Brief*, n 11, at 14; Sidak n 11, at 296.

80 *Amicus Brief*, *id*, 6; cf Sidak *id,* 282, 296; William J Baumol & J Gregory Sidak, "The Pricing of Inputs Sold to Competitors", (1974) 11 Yale Journal on Regulation 171.

and such complicated specialist determinations may be best left to a sector specific regulator such as the German regulator in *Deutsche Telekom*.

In determining liability, the Commission in *Deutsche Telekom* applied the regulatory principle of tariff rebalancing, separating the costs for the provision of retail access services from call charges.[81] It was assumed that "as efficient competitors" were obliged to offset losses incurred in relation to local network access by higher call charges and that this would distort competition not only in the (end-user) access market but also in the telephone calls market.[82]

Is it appropriate however to separate access services from telephone calls for the purposes of this analysis? [83] It might be more in keeping with commercial practice and economic efficiency in these markets if the court considered the profitability of a cluster of services offered by the competitors including telephony services where they could acquire additional revenue and efficiency savings rather than access services alone.[84] If services are usually bundled, cross-subsidies and price discrimination may not always be detrimental. Clearly the CJEU in *Deutsche Telekom* was also of the view that counterstrategies were unavailable to rival firms, stating that a "dominant undertaking cannot drive from the market undertakings which are perhaps as efficient as the dominant undertaking but which, because of their smaller financial resources, are incapable of withstanding the competition waged against them".[85]

Geradin and O'Donoghue argue that where products are bundled in telecommunications markets the cost structures of rivals should be considered because they can make cost savings:

> "In markets where there is no simple, linear chain of production a margin squeeze test based only on the cost structure of the dominant firm may therefore give a misleading picture of rivals' costs and competitive constraints."[86]

Because ascertaining a rival's costs introduces uncertainties, it may therefore serve competition and avoid false positives in these particular markets to defer to the reasonable pricing decisions of the dominant firm.[87]

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81 *Deutsche Telekom* (Commission), n 2, para 120; *Deutsche Telekom* (General Court), n 2, paras 196-7. Tariff rebalancing seeks to increase access prices and reduce those for services to ensure that the underlying cost of providing that service is reflected. As Deutsche Telekom argued, tariff rebalancing is primarily used by regulators to avoid cross-subsidisations as a result of universal service provision and not for determining liability for abuse of dominance in an antitrust case: *Deutsche Telekom* (CJEU), n 2, para 211.

82 See *Deutsche Telekom* (General Court), n 2, para 199.

83 The CJEU found that the retail market for end-user access services constitutes a separate market and "those other telecommunications services fall within markets that are distinct from the latter market": *Deutsche Telekom* (CJEU), n 2, para 236.

84 *Deutsche Telekom* (General Court), n 2, para 194.

85 *Deutsche Telekom* (CJEU), n 2, para 199, citing Case C-62/86 *AKZO v Commission* [1991] ECR I-3359, para 72; cf *TeliaSonera* (CJEU), n 3, para 40. See generally Frank H. Easterbrook, "Predatory Strategies and Counterstrategies" (1981) 48 University of Chicago Law Review 263.

86 Geradin and O'Donoghue, n 31, at 394.

87 This was largely the response of the German regulator in *Deutsche Telekom* which rejected a margin squeeze claim because rival operators could offer their end-users competitive prices by resorting to cross-subsidized

In *Deutsche Telekom* the General Court and the CJEU claimed that undistorted competition could only be guaranteed if "equality of opportunity" was secured as between the various economic operators.[88] The General Court in *Telefónica* stated that: "[e]quality of opportunity means that *Telefónica* and its at least equally efficient competitors are placed on an equal footing on the retail market".[89] As we have seen the concept of "equality of opportunity" is largely derived from the importance placed in EU competition law on the goal of the integrated market. Is the concept of "equality of opportunity", always a useful antitrust standard however? Its application, particularly in circumstances where markets are highly regulated and costs are not easily isolated, may have the propensity to create false positives and further distortion of competition. Equality of opportunity also lacks meaning when one firm is a vertically integrated owner of the fixed network and the other an entrant in the downstream market.[90] As the Supreme Court noted in *linkLine,* citing Areeda and Hovenkamp: "[I]t is difficult to see any competitive significance [of a price squeeze] apart from the consequences of vertical integration itself".[91]

The phrase "equality of opportunity" is incapable, in itself, of providing a standard for the substantive assessment of abusive conduct under Article 102, as it is not linked to any "theory of harm" for the identification of an exclusionary purpose such as, for example, "profit sacrifice". It is indeed superfluous to the application of the "as efficient competitor" test which, putting aside the specification issues inherent in this test which we have already identified, is the preferred test for the assessment of a margin squeeze under Article 102.

Other cases which have invoked this terminology derive mainly from litigation under Article 106 which prohibits Member States from depriving competition rules of their effectiveness by measures adopted by public undertakings or by the granting of special or exclusive rights to undertakings.[92] The CJEU stated, for example, in *France v Commission* that the granting of exclusivity to an undertaking with the sole task of drawing up specifications for terminal equipment for connection to a public telecommunications network infringed Article 106(1) because "a system of undistorted competition, as laid down in the Treaty, can be guaranteed only if equality of opportunity is secured as between the various economic operators".[93]

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charges for access services and call charges: *Deutsche Telekom* (General Court), n 2, para 116; see discussion below.

88 *Deutsche Telekom* (General Court), *id*, para 198; *Deutsche Telekom* (CJEU), n 2, para 230, 233.

89 *Telefónica* (General Court), n 1, para 204.

90 Inequality, as the General Court defines it, is inevitable because the owner of the vertically integrated network does not need to rely on wholesale [local loop access] services in order to be able to offer [end-user] access services: *Deutsche Telekom* (General Court), *id*, para 238.

91 *linkLine,* n 5, at 11, citing Philip E. Areeda and Herbert Hovenkamp, *Antitrust Law*, 126 (2nd ed, Aspen Publishers, 2002).

92 The broad principle is that Member States should not take action that would render EU competition law ineffective: Article 4(3) TEU (ex Article 10 EC Treaty) and Protocol 27 (ex Article 3(g) EC Treaty).

93 Case C-202/88 *France v Commission* [1991] ECR I-1223, para 51.

The central question under Article 106 is whether distortions flow from the mere conferral of exclusive or special rights[94] or is some further evidence required of likely abuses of dominance following on from the grant? The latter view seems to have prevailed, requiring at least the potential for the exercise of those exclusive rights to infringe the competition rules, such as Article 102.[95]

It is not surprising that the terminology of "equality of opportunity" has been linked to Article 106 where the conferral of exclusive rights may distort competition through an absence of "competitive neutrality". The requirement seems to have much less relevance however to the determination of a margin squeeze under Article 102. As we have seen even Article 106 requires the determination of a likely abuse under Article 102 (linkage to an identifiable harm) before an infringement of Article 106 can be determined. In other words "inequality of opportunity" between operators in itself has very little substantive content.

The concept of "equality of opportunity" (and the "as efficient competitor" test) is also difficult to apply in circumstances where the dominant firm, unlike its competitors, is subject to obligations derived from sector-specific regulation regarding unbundling, non-discriminate access, universal service and tariff rebalancing and the requirement to offer its customers operator (pre)selection, or "call-by-call" selection.[96] Any attempt to incorporate these differences within a calculus to determine "equality of opportunity" is ultimately ineffectual and raises similar analytical difficulties to the "reasonably efficient competitor" test and the "living profit" requirement in *Alcoa,* which as we have seen, have largely been rejected by the EU courts.

5.2. The "as efficient competitor" test in dynamic network markets with learning effects

The "as efficient competitor" test is also difficult to apply in dynamic markets. Prices for high technology services, such as broadband, in innovative and emerging markets, are often priced low initially, achieving lower levels of profitability or even a loss, in

94 Case C-320/91 *Corbeau* [1993] ECR I-2533 seemed to suggest that this may be the case by shifting the justification for the rights onto Article 106 (2) which provides limited protection to those undertakings entrusted with services of general economic interest (SGEI). There is a question as to what extent this provision interferes with the ability of Member States to create monopolies or confer exclusivities: cf Case C-18/88 *RTT v GB-Inno-BM SA* [1991] ECR I-5973, para 25; Case C-49/07 *Motosykletistiki Omospondia Ellados NPID (MOTOE) v. Ellinko Dimosi* [2008] ECR I-4863, para 51. The concept has been applied in this manner by the CJEU to entrants in telecommunications markets in the context of freedom to provide services: Joined Cases C-544/03 and C-545/03 *Mobistar SA v Commune de Fléron and Belgacom Mobile SA v Commune de Schaerbeek* [2005] ECR I-7723, para 49.

95 The General Court in Case T-169/08 *Dimosia Epicheirisi Ilektrismou AE (DEI) v European Commission,* ECLI:EU:T:2012:448 stated: "the abuse of a dominant position by the undertaking enjoying an exclusive right may either result from the possibility of exercising that right in an abusive way or be a direct consequence of that right. However it does not follow from the case-law that the mere fact that the undertaking in question finds itself in an advantageous situation in comparison with its competitors, by reason of a State measure, in itself constitutes an abuse of a dominant position": para 103. It is not sufficient "to establish that a State measure distorts competition by creating inequality of opportunities between economic operators, without it being necessary to identify an abuse of the dominant position of the undertaking": para 105, on appeal to the CJEU, Case C-554/12 P, *Commission v. DEI.*

96 *Deutsche Telekom* (CJEU), n 2, paras 190, 203.

order to take into account likely revenues through future network and learning effects. High start-up costs are seen as an investment in future profits where costs can be averaged over a larger customer base. In this way prices, although they do not cover notional product-specific costs in the short run, may not reflect an exclusionary purpose because network effects can have consumer benefits.

The dominant undertaking in *Telefónica* had argued that it was using lower prices to stimulate demand and take account of likely future earnings in a non-mature new technology market.[97] The Commission applied the Long Run Average Incremental Cost (LRAIC) benchmark to make allowance for the higher fixed costs and long run lower incremental costs in these network markets.[98] Difficulties arise however concerning how the common costs of the downstream asset should be allocated.[99] The Commission applied both the "period by period"[100] and the discounted cash flow (DCF) approaches to examine profitability. The latter approach allowed some idea of the firm's future growth and profitability to be taken into account by aggregating the expected future cash flows to result at Net Present Value (NPV) over the economic life of the asset, allowing the recovery of initial losses by future profits.

The Commission was wary however of a positive NPV under the DCF approach as it could equally be interpreted as either the absence of a margin squeeze or as the outcome of abusive behaviour:

> "That is, short-run losses might lead to higher long-run profits, not due to any natural development in the market, but due to the strengthening of the dominant undertaking's market power."[101]

The DCF could be biased because it can include the rewards from anticompetitive behaviour.[102]

While the Commission was ready to acknowledge that significant economies of scale or strong learning effects, in exceptional cases, could justify temporary prices below LRAIC, these could not serve to legitimise a margin squeeze that enables the vertically integrated company to impose losses upon its competitors that it does not incur itself.[103]

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97 *Telefónica* (Commission), n 1, para 646.

98 *Id*, paras 317 -318, 323. The Commission indicated in its "Guidance Paper on Article 102" that they will generally use the benchmark of the LRAIC of the downstream division of the integrated dominant undertaking in margin squeeze cases: n 4, para 80.

99 *Telefónica* (Commission), n 1, para 431.

100 As applied in *France Telecom* (CJEU), n 50.

101 *Telefónica,* (Commission), n 3, para 334.

102 European Commission, "Margin Squeeze: Working Paper No. 2 on Competition and Regulation", DAF/COMP/WP2/WD(2009)32, para 28. In order to deal with this problem a time period was chosen to determine a terminal value. "The size of this terminal value is the cost of unrecovered assets (physical assets and acquisition costs) remaining to be recovered after the five-year period of analysis": *Telefónica* (Commission), n 3, para 363.

103 *Telefónica* (Commission), n 3, paras 650, 652. Both methods, according to the Commission exhibited a margin squeeze: *id*, para 541; "Telefónica's downstream losses cannot be regarded as temporary or aimed at

It is unclear however when these exceptional circumstances will arise for the Commission. In dynamic markets the exclusionary/non-exclusionary basis of these projected earnings will rarely be clear, particularly if they require a profit projection where there are likely network effects. In the US this level of uncertainty in innovation and network markets will largely caution against antitrust intervention to avoid the risk of false positives and possible discouragement of significant and risky investment.[104]

The CJEU in *TeliaSonera* was also asked to decide whether the test for a margin squeeze should be modified in the case of a rapidly developing technology market.[105] Instead of acknowledging that intervention in these markets may be problematic, the contrary approach was adopted by the CJEU in *TeliaSonera*:

> "Particularly in a rapidly growing market, Article 102 TFEU requires action as quickly as possible, to prevent the formation and consolidation in that market of a competitive structure distorted by the abusive strategy of an undertaking … before the anti-competitive effects of that strategy are realised."[106]

The CJEU went on to state that intervention was particularly important when the market was still highly influenced by the former state monopolistic structure.[107] In *Telefónica* the Commission goes even further and states that the provision of the broadband services did not require significant new investment because:

> "Telefónica's infrastructure is to a large extent the fruit of investments that were undertaken well before the advent of broadband in Spain and that thus bore no relation to the provision of broadband services (but for the provision of traditional fixed telephony services)."[108]

The cost incurred to upgrade the network did not compare with the cost of building a completely new upstream infrastructure.[109] Prior knowledge of a duty to supply would not have affected the investment decision.[110]

searching scale economies and learning effects because Telefónica's downstream activity still generates losses more than 5 years after its start": *id*, para 650. There were other less restrictive ways of achieving these efficiencies. On appeal, the General Court found that Commission "did not make a manifest error of assessment" in determining Telefónica's costs: *Telefónica* (General Court) n 3, paras 198-265.

104 See generally George Priest, "Flawed Efforts to Apply Modern Antitrust Law to Network Industries" in R. Hahn (ed), *High Stakes Antitrust* (Washington DC, AEI-Brookings Joint Center for Regulatory Studies, 2003); see Richard A. Posner, *Antitrust Law*, 199-200 (2nd ed, University of Chicago, 2001), ch 8.

105 *TeliaSonera,* n 3, para 12.

106 *TeliaSonera,* n 3, paras 108, 111. The Commission in *Telefónica* stated that Article 102 does not provide for an exception for new technology markets where the market is growing rapidly and is not fully mature: *Telefónica,* n 1, para 623; cf T-340/03 *France Telecom v Commission* [2007] ECR II-107 (General Court), para 107. Similar views were expressed by the General Court in *Microsoft Corp v Commission* [2007] ECR II-3601, para 562.

107 *TeliaSonera,* n 3, para 109. See discussion below.

108 *Telefónica* (Commission), n 1, para 304.

109 *Id,* para 305

110 *Id*, para 306.

Even if this is true, it is difficult for an antitrust court to make this distinction (the requirement of significant new investment versus the development of existing ex-state funded infrastructure) in order to determine intervention in a dynamic market.

6. THE CONDUCT MUST BE "CAPABLE OF AN EXCLUSIONARY EFFECT"

It is not necessary to demonstrate that the pricing had an actual effect on the markets concerned but the conduct must tend to restrict competition or be capable of having that effect, even if the result hoped for may not be achieved.[111] As we have seen, the EU Courts have been reluctant to embrace an "effects based" approach.[112] They prefer to focus on damage not to consumers directly, but also on that conduct which is detrimental to consumers through its impact on competition[113] and aim "to protect consumers by means of undistorted competition".[114] The question must be asked however whether consumer detriment always flows from distortion of competition and a reduction in equality of opportunity? In assessing whether the margin squeeze was capable of having an anticompetitive effect on the market,[115] the CJEU in *TeliaSonera* does not apply the *Oscar Bronner*[116] requirement of the likelihood of the elimination of all competition on the downstream market (applicable to a refusal to supply) but rather finds it sufficient if the conduct creates barriers or hinders growth, "making it more difficult" to penetrate the market.[117] Even in the more problematic circumstances when the pricing margin is positive, the CJEU considers it is enough if there is "reduced profitability" or it is made "at least more difficult for the operators concerned to trade on the market concerned".[118]

In *Deutsche Telekom* the distortion brought about by the margin squeeze resulted in "limitation of the choices available to them [consumers] and, therefore, of the prospect of a longer-term reduction of retail prices as a result of competition".[119] The General Court stated that this anticompetitive effect related to the "possible barriers to entry which the applicant's pricing practices could have created for the growth of competition in that market".[120] The CJEU considered that pricing practices can be

111 *Deutsche Telekom* (CJEU), n 2, paras 183, 253-254*;* cf *TeliaSonera,* n 1, paras 61 – 64; *Telefónica* (General Court) n 1, para 268; cf Case T-219/99 *British Airways v Commission* [2003] ECR II-5917 (General Court), para 293. The Commission in *Deutsche Telekom* stated that once a margin squeeze was established, it was not necessary to examine any effects on competition but it went on to examine those effects: n 2, paras 179-183.

112 Compare the move towards a more "effects based" approach in Case C-209/10 *Post Danmark* A/S v *Konkurrencerådet*, n 10, with the approach in Case C-549/10 P *Tomra Systems v European Commission* ECLI:EU:C:2012:221.

113 *Deutsche Telekom* (CJEU), n 2, para 176, citing Case C-202/07 P *France Télécom,* n 50, para 105 and the case-law cited therein.

114 *Deutsche Telekom* (CJEU), n 2, para 180, citing Joined Cases C-468/06 to C-478/06 *Sot. Lélos kai Siaand Others* [2008] ECR I-7139, para 68; cf *TeliaSonera,* n 3, para 24.

115 *TeliaSonera,* n 3, para 72.

116 Case C-7/97 *Oscar Bronner GmbH & Co KG v Mediaprint* [1998] ECR I-7791.

117 *TeliaSonera,* n 3, paras 66-67, citing *Deutsche Telekom* (CJEU), n 2, para 254.

118 *Id*, para 74.

119 *Deutsche Telekom* (CJEU), n 2, para 182.

120 *Deutsche Telekom* (General Court), n 2, para 235.

abusive where access for competitors is "made more difficult"[121] and "the practice tends to remove or restrict the buyer's freedom to choose his sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage".[122]

It is difficult to see how non-predatory pricing practices can create barriers to entry in these circumstances. The General Court *Deutsche Telekom* found that:

> "the small market shares acquired by the applicant's competitors in the retail access market since the market was liberalized … are evidence of the restrictions which the applicant's pricing practices have imposed on the growth of competition in those markets."[123]

These small market shares could be explained by other factors, however, especially when new entrants in other liberalized markets within the EU Member States also experienced limited growth.

7. A Margin Squeeze as a "Constructive Refusal to Supply" and the Establishment of an "Exclusionary Purpose"

The European Commission in its "Guidance Paper on Article 102" states that it regards a margin squeeze as a form of "constructive refusal to supply" and requires the establishment of the elements of a duty to deal under Article 102.[124] The EU courts, unlike those in the US which, as we have seen, have considerably diminished the circumstances when a duty to deal will be found, have imposed such a duty under Article 102 in a number of decisions.[125] In *Oscar Bronner,* the applicant newspaper publisher sought access to the existing newspaper distribution network of the dominant publisher (Mediaprint) rather than develop its own distribution scheme. For a refusal to supply under Article 102 the CJEU required that the refusal must be likely to eliminate all competition (or effective competition)[126] in the relevant market, the service in itself must be indispensable to carrying on that person's business (inasmuch as there is no actual or potential substitute) and the refusal must be incapable of being objectively justified.[127] In determining the issue of "indispensability" the CJEU stated that other

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[121] *Deutsche Telekom* (CJEU), n 2, para 178.

[122] *Deutsche Telekom* (CJEU), *id*, para 175, citing *Michelin,* n 54, para 73 and *British Airways* (CJEU), n 54, para 67; see *Telefónica* (General Court) n 1, para 269.

[123] *Deutsche Telekom* (General Court), n 2, para 239, cited by the *Deutsche Telekom* (CJEU), n 2, para 257.

[124] European Commission, "Guidance Paper on Article 102"*,* n 4, para 79. These elements are: the refusal relates to a product or service that is objectively necessary to be able to compete effectively on a downstream market; the refusal is likely to lead to the elimination of effective competition on the downstream market; and the refusal is likely to lead to consumer harm: *id*, para 81.

[125] Cases 6 and 7/73 *Istituto Chemioterapico Italiano Spa and Commercial Solvents Corp v Commission* [1974] ECR 223, [1974] 1 CMLR 309; Cases C-241-241/91 P, *RTE & ITP v Commission* [1995] ECR I-743, [1995] 4 CMLR 718; *Oscar Bronner, n* 116; Case C-418/*01 IMS Health v NDC Health* [2004] ECR I-5039; [2004] 4 CMLR 28; *Microsoft*, n 44.

[126] As it has been subsequently defined.

[127] *Oscar Bronner,* n 91, para 41.

methods of distributing daily newspapers existed, even though they may be less advantageous:[128]

> "Moreover, it does not appear that there are any technical, legal or even economic obstacles capable of making it impossible, or even unreasonably difficult, for any other publisher of daily newspapers to establish, alone or in cooperation with other publishers, its own nationwide home-delivery scheme and use it to distribute its own daily newspapers".[129]

The CJEU declared that it was "not enough to argue that it is not economically viable by reason of the small circulation".[130] It inquired instead whether it was economically viable to create a second nation-wide home-delivery network for a newspaper with a comparable circulation to allow it to compete on equal terms with the incumbent.[131]

The importance of linking the conduct of a "margin squeeze" to the establishment of the elements of a "constructive refusal to supply" is that it requires the finding of an exclusionary purpose: whereby the firm is leveraging its market power in the upstream market to gain a competitive advantage downstream. The dominant firm may gain market power through "profit sacrifice" (in this case loss of upstream sales) which has the effect of raising rivals costs. As Justice Breyer[132] points out in his separate concurring judgment in *linkLine,* a price squeeze can be exclusionary conduct, in the sense recognized by *Trinko* and *Aspen*, where conduct, even if profitable, indicates a "willingness to forsake short-term profits to achieve an anticompetitive end".[133] As Justice Breyer notes:

> "As a matter of logic, it may be that a particular price squeeze can only be exclusionary if the refusal by the monopolists to sell to the 'squeezed customer' would also be exclusionary. But a court, faced with a price squeeze rather than a refusal to deal, is unlikely to find the latter (hypothetical) question any easier to answer than the former."[134]

One of the initial objections raised against a finding of abuse is what incentive does the upstream dominant firm have to "constructively refuse to supply" when the "single monopoly profit" theorem[135] queries the ability to gain downstream market power in this way. Judge Breyer, when raising this objection in *Town of Concord* also suggested circumstances where the squeeze might actually benefit consumers, for example, when

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[128] *Id*, para 43.

[129] *Id*, para 44

[130] *Id*, para 45.

[131] *Id*, para 68. The CJEU referred to the opinion of the Advocate General: *id*, para 46.

[132] Justice Stevens, Justice Souter and Justice Ginsburg joined with Justice Breyer's opinion.

[133] *linkline*, n 5, at 1124 (Breyer J), citing *Trinko,* n 21, at 409 and *Aspen,* n 20, at 610-611.

[134] *Id.*

[135] The argument is based on the view that there is only one monopoly profit to be made in a chain of production. The firm in a monopoly position cannot increase its profits by extending or leveraging that monopoly into a vertically adjacent market: see generally Robert Bork, *The Antitrust Paradox: A Policy at war with itself*, 156 (Basic Books, 1978) at 141; Posner, n 104, 199-200; Ward S Bowman, "Tying Arrangements and the Leverage Problem"*,* 67 Yale L. J 19 (1957).

it eliminates a less efficient competitor in the downstream market or when it eliminates a separate monopolist in the downstream market, thereby avoiding "double marginalization".[136] More recent literature suggests however that the single monopoly theorem rests on rather simplistic assumptions and does not take account of information asymmetries and the role of market power at the downstream level.[137]

If the conditions in both the upstream and downstream markets (in particular the presence of barriers to entry) are conducive to leverage, the establishment of the elements of a "refusal to deal" are vital to the establishment of an "exclusionary purpose" on the part of the dominant firm. This is so because only firms supplying indispensable inputs can ensure that their "profit sacrifice" will have the desired leverage effect and eliminate effective competition on the downstream market. A finding of an "indispensable input" also eliminates the possibility of the applicant "free riding" on the dominant firm's investment and *ex ante* investment incentives (the issue the CJEU in *Oscar Bronner* was careful to take into account).

7.1. "Indispensability" in a regulated market

The question then arises whether the *Oscar Bronner* principles must always be established in a margin squeeze case or does a regulated duty to supply equate with the determination of "indispensability" of the input, meaning that there "is no actual or potential substitute".[138]

This issue was considered by the Commission and General Court in *Telefónica* and by the CJEU in *TeliaSoneria*. Telefónica argued that the appropriate test for a margin squeeze was that of *Oscar Bronner* and a "constructive refusal to supply".[139] It argued further that, (as in *Trinko*), it did not have a duty to supply its wholesale products absent the requirement under Spanish Telecommunications law.[140]

The Commission in its "Guidance Paper on Article 102" and in *Telefónica* and the CJEU in *TeliaSonera* have stated that if there is a regulated duty to supply, there is no need to

136 The exercise of market power downstream can increase the price of the end- product beyond the price that results from just one firm's extraction of monopoly profit: *Town of Concord,* n 14, at 24-25.

137 See generally Einer Elhauge, "Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory" (2009) 123 Harvard Law Review 397.

138 The EU regulatory framework provides that *ex ante* regulation is generally required in circumstances of market failure where there is insufficient competition in alternative inputs such as satellite, wireless and cable and where national and Community competition law remedies are not sufficient to address the problem: cf para 27 of Directive 2002/21/EC (Framework Directive), [2002] OJ L180/33.

139 *Telefónica* (Commission), n 1, paras 271-272, 300-301. The Commission in *Telefónica* interprets *Bronner* as requiring an assessment of whether an undertaking with an efficiency level comparable to that of the infrastructure owner is able to replicate the input: *Telefónica* (Commission), n 1, para 300.

140 Applying the requirements in *Bronner*, Telefónica argued that; (i) there were real and/or potential alternatives to its wholesale access services (ULL and wholesale access to cable networks), (ii) the regional and national wholesale access services of Telefónica could be replicated, and (iii) the alleged conduct is not likely to eliminate all competition on the downstream market: *Telefónica* (Commission), n 1, para 301. On appeal, the General Court rejected Telefónica's argument that the Commission made an error of law applying a margin squeeze to a non-essential input on the basis that a margin squeeze could constitute an independent form of abuse distinct from that of a refusal to supply: *Telefónica,* (General Court) n 1, paras 180-182, 184; see discussion below.

consider a margin squeeze within the elements of a refusal to supply as determined by *Oscar Bronner* because the relevant questions about balancing of the *ex ante* investment decisions and the promotion of competition in the downstream market have already been undertaken by the regulatory authority. The Commission in *Telefónica* stated:

> "It is clear from the considerations underlying both the EC and Spanish law and regulation that Telefónica's duty to supply the relevant upstream products results from a balancing by the public authorities of the incentives of Telefónica and its competitors to invest and innovate. This is because the need to promote downstream competition in the long term by imposing access to Telefónica's upstream inputs exceeds the need to preserve Telefónica's *ex ante* incentives to invest in and exploit the upstream infrastructure in question for its own benefit."[141]

But the question of indispensability of the input under *Oscar Bronner* is a broader investigation than the question whether imposing a duty to supply will be detrimental to the incumbent's *ex ante* investment incentives.[142] *Oscar Bronner* examines the *ex post* investment incentives in the market. A duty to deal will not be imposed in circumstances where investment is economically viable, by the applicant alone or with others, in infrastructure of the size or scope of the incumbents. This is a broader inquiry than a purely regulatory one which aims to foster new entry or greater competition in a newly liberalized market. Regulators must also take into account objectives that differ from those applicable under competition law.[143] Applying competition law in these circumstances does not merely supplement regulation *ex post* to prevent abuses of market power but reconstitutes competition law as a form of *de facto* regulation in liberalized markets.[144]

Even if a regulated duty to supply is deemed sufficient for indispensability, the remaining elements of the *Oscar Bronner* test such as the requirements of the likelihood of the elimination of effective competition and objective justification should still be considered. As previously pointed out, the assessment of the likelihood of

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141 *Telefónica* (Commission). n 1, para 303. The Commission sets out this approach in its "Guidance Paper on Article 102", n 4, para 82. The Commission found in any event that Telefónica was dominant in both the upstream market (for wholesale broadband at regional and national levels) and downstream retail market (for all standard broadband products through ADSL or any other technology). It also found that it was uneconomic to duplicate the local access network. These factors, as Geradin argues, would most probably result in a finding of indispensability in any event "as there did not seem to be a serious alternative to Telefónica's DSL network": Damian Geradin, "Refusal to supply and margin squeeze: A discussion of why the '*Telefónica* exceptions' are wrong", 4, available at http://SSRN.com/abstract=1750226. Similarly the Commission in *Deutsche Telekom* found that there were insufficient alternatives to the wholesale local loop access services: *Deutsche Telekom* (Commission), n 2, para 83; *Deutsche Telekom* (General Court), n 2, paras 236-37.

142 Geradin expresses a similar view: Geradin, *id*, at 8; cf Faella and Pardolesi, n 66, at 271.

143 Geradin argues that the Commission's approach is fundamentally flawed as the decision by the regulator under the liberalisation framework centres on a more narrow determination of "substantial market power" that brings into place automatic access obligations which are made at a different time and in different market conditions to the issue which arises under Article 102: Geradin, *id*, at 9.

144 See Faella and Pardolesi, n 66, 272; cf Giorgio Monti, "Managing the Intersection of Utilities Regulation and EC Competition Law", (2008) 4 Competition Law Review 123.

anticompetitive effect was equated to mere "equality of opportunity" in *Deutsche Telekom*.[145] An examination under *Oscar Bronner* would move the focus from the access service market to the cluster of retail services and require the consideration of other potential sources of competition in the downstream market (including cable, mobile, wireless and satellite services). If a rival firm is found to have market power in this market, a margin squeeze could be procompetitive because it may prevent the possibility of "double marginalization".

The Commission in *Telefónica* goes on to state that:

> "In any event, Telefónica's *ex ante* incentive to invest in its infrastructure are not at stake in the present case ... those original investments were undertaken in a context where Telefónica was benefiting from special or exclusive rights that shielded it from competition. The investment criteria used by the former monopoly at that time would have led to the investment being made even if there would have been a duty to supply."[146]

This analysis introduces special duties for former state owned enterprises as opposed to privately owned enterprises. The market power derived from the special or exclusive rights would have already been reflected in the sale price of the asset on privatisation. It is not appropriate therefore to subject these assets to special duties (beyond those conferred by regulation) on account of historical ownership.[147] If the assets are only partially privatised, it is also not appropriate to confer more onerous duties and reduced profitability (treasury and shareholder returns) on the "citizen/owners" as opposed to "private-owners" of comparable assets.[148] The risk imposed by these higher duties will

[145] The Commission in *Telefónica* did examine the effect on competition, n 1, paras 543-4, finding that the margin squeeze was a profitable rational strategy for Telefónica and that Spanish retail prices were excessive and well above the EU average. It found that "by reducing the competitive constraints at the retail level, Telefónica is able to sustain a high level of retail prices … The profits extracted from a high level of retail prices surpass by far the forsaken profits related to the forsaken wholesale sales as a result of high wholesale prices (relative to the retail prices)": *id*, para 611. In the context of *linkLine,* Sidak questions the probability of recovering lost profits from mass market sales to large numbers of customers when wholesale prices are raised to niche market ISP players: Sidak, n 11, at 288. This finding would require a complex factual analysis in any event which was not undertaken here. The Commission's assessment also ignores that in order to avoid price squeeze liability Telefónica would have to raise retail prices to the detriment of consumers.

[146] *Telefónica,* n 1, para 304. cf The CJEU in *TeliaSoneria* noted that the "competitive structure is also still highly influenced by the former monopolistic structure": *TeliaSoneria,* n 3, para 109; cf Opinion of Advocate General Poiares Maduro in Case C-109/03 *KPN Telecom BV/ Onafhankelijke Post* [2004] ECR I-11273; cf Joined Cases C-544&545/03 *Mobistar* [2005] ECR I-7723, para 49.

[147] A duty is already imposed by regulation on infrastructure assets with "significant market power" by the liberalization framework. The CJEU clearly maintains that liberalization policy is a relevant consideration for competition law because it found that the Commission was entitled to characterize Deutsche Telekom's margin squeeze as a serious offence which strengthened "the barriers to entry to the recently liberalised markets": *Deutsche Telekom* (CJEU), n 2, para 275. Advocate General Jacobs in *Bronner* also indicated that state funding may result in an asset being indispensable on the basis of cost alone. The cost of duplicating a facility might alone constitute an insuperable barrier to entry "[t]hat might be so particularly in cases in which the creation of the facility took place under non-competitive conditions, for example, partly through public funding": *Oscar Bronner,* n 116, para 66 (AG Jacobs).

[148] The requirement of a partially privatised firm to pursue the objective of profit maximization also imposes a restraint on the otherwise greater incentive and ability of a fully state-owned enterprise to engage in anti-competitive conduct such as price predation through recourse to cross-subsidizations or by incurring non-

also considerably reduce the value of the assets on privatisation. As Advocate General Mazák pointed out in his Opinion in *TeliaSonera,* it is not always easy to determine whether the source of funding was public or private in origin. He argued that Article 102 does not provide a textual basis for this distinction and Article 345 TFEU does not permit discrimination between property rights along these lines.[149]

If this approach has validity then, as Telefónica argued, it should also be applied to its competitors in the market.[150] The firms seeking wholesale access to Telefónica's services were generally not small startup enterprises in need of special protection, but the subsidiaries of ex-state monopolies such as France Telecom, developed under similar exclusive rights in other European member states.

7.2. A margin squeeze as a "stand-alone" abuse from a "refusal to supply"

The question remains, in the absence of a regulated duty to supply, is it a requirement for a margin squeeze in the EU to establish the elements of a refusal to supply or is a finding of "insufficient spread" between the wholesale and retail prices enough?[151] In *TeliaSonera*[152] CJEU stated that a margin squeeze can "constitute an independent form of abuse distinct from that of refusal to supply"[153] and that there was no need to apply the elements as set out in *Oscar Bronner* in the absence of a regulated duty to supply. The test for a margin squeeze in the EU is one therefore solely focused on the spread (whether positive or negative) between the wholesale and retail prices.

This approach is, as we have seen, contrary to that proposed by the Commission in its "Guidance Paper on Article 102" and to the Opinion of Advocate General Mazák in *TeliaSonera* where he stated:

> "charging a price (margin squeeze) which prevents an as-efficient competitor from competing downstream operates in effect as a refusal to deal and implies that the same framework of analysis and the general concerns about the incentives of dominant undertakings to invest should apply… the NCA claims that there is an abusive margin squeeze merely on the basis of the insufficient spread between

recouped losses: see generally J. Gregory Sidak, "Acquisitions By Privatized Firms: The Case of Deutsche Telekom and VoiceStream", 54 Fed. Comm. L.J. 1 (2001); David E.M. Sappington and J. Gregory Sidak, "Competition Law for State-Owned Enterprises" (2003) 71 Antitrust Law Journal 479.

149 Mazák in *TeliaSoneria*, n 3, para 27. As we have seen, the CJEU in *TeliaSonera* and the Commission in *Telefónica,* invoked Article 102 to support their view that the Treaty does not discriminate between mature and non-mature markets, yet they wish to apply a different standard, which has no foundation in the Treaty, to former state monopolies as opposed to private enterprises.

150 *Telefónica* (Commission), n 1, para 340; cf para 348.

151 In margin squeeze cases in non-regulated markets such as *Napier Brown* this question did not necessarily arise because the input was arguably indispensable: *Napier Brown,* n 30, para 66. In *Telefónica* the Commission disputes this interpretation however, stating that a finding of indispensability of the input has not been a requirement for a finding of a margin squeeze abuse in previous decisions, even in non-regulated markets. It explains the *Napier Brown* finding as related to the question of dominance not indispensability: *Telefónica* (Commission), n 1, para 734.

152 *TeliaSonera*, n 3.

153 *Id*, para 56; see also *Telefónica* (General Court) n 1, paras 180-181.

> wholesale and retail prices, irrespective of the indispensability of the input. I consider that this approach is incorrect and insufficient."[154]

Mazák argues that if a dominant undertaking could lawfully have refused to provide the products then it "should not be reproached for providing those products at conditions which its competitors may consider not advantageous. Indeed, it is difficult to see how in such a case the alleged insufficient margin could be anti-competitive".[155]

The CJEU in *TeliaSonera* likened a margin squeeze, where access had been given voluntarily, to a situation of the law regulating terms of a contract, similar to the abuse of tying under Article 102. The CJEU stated that the *Oscar Bronner* elements were inapplicable when the facts involve "supplying services or selling goods on conditions which are disadvantageous or on which there might be no purchaser"[156] and that these "constitute an independent form of abuse distinct from that of a refusal to supply"[157] because not all aspects of the terms of trade by a dominant undertaking need to be considered under a refusal to supply.[158] The CJEU noted that in *Oscar Bronner,* Mediaprint was also alleged to have abused its position by refusing Oscar Bronner access to its home delivery service unless it was also willing to purchase a package of services including printing and marketing through other sales points such as kiosks.[159]

But a margin squeeze differs in a fundamental way from a "conditional sale" contract which is characteristic of tying and exclusive dealing.[160] The EU case law in these areas can also be criticized as being excessively formulaic and not always mindful of the economic consequences of these agreements.[161] In fact, these cases, in as far as they deal with the issues of leverage and raising rivals' costs, would also be better dealt with under the *Oscar Bronner* principles.

The CJEU did add however that in the assessment of whether the conduct was capable of an exclusionary effect, a finding of indispensability was a relevant, though not a necessary, element:[162]

> "the possibility cannot be ruled out that, by reason simply of the fact that the wholesale product is not indispensable for the supply of the retail product, a

154 Opinion of Advocate General Mazák in *TeliaSonera*, n 3, para 16, citing *Bronner,* n 116.

155 Mazák, *id*, para 21.

156 *TeliaSonera*, n 3, para 55.

157 *Id*, para 56.

158 *Id*, para 58.

159 Oscar Bronner had argued that Mediaprint had discriminated against it contrary to Article 102 in making their delivery service available to another rival newspaper *Wirtschaftsblatt* which had purchased these services as part of a package: *Oscar Bronner, n* 116, para 8. Given the Court's ruling on the refusal to supply issue it was not necessary to answer this question: *id*, paras 48, 49.

160 See, for example the decisions on tying or exclusive purchasing: Case T-65/98 *Van den Bergh Foods Ltd v Commission* [2003] ECR II-4653; Case C-552/03 P *Unilever Bestfoods v Commission* [2006] ECR I-9091; *Microsoft,* n 44; cf comments of Mazák, n 3, para 22-23.

161 See e.g. *Microsoft,* n 44.

162 *TeliaSonera,* n 3, paras 64- 69.

> pricing practice which causes margin squeeze may not be able to produce any anti-competitive effect, even potentially."[163]

Even so, the notion of indispensability here is more narrowly construed than in *Bronner*. It is defined as the "functional relationship of the wholesale products to the retail products"[164] where the "supply of the wholesale product is indispensable for the sale of the retail product".[165] It is dependent on how the retail market is defined. For example, if the retail product market is narrowly defined as the ADSL broadband market, then TeliaSonera's wholesale product will be an indispensable input to this downstream "secondary" market. Indispensability of the input under *Oscar Bronner* is a broader question than merely being requested or required by a downstream retail competitor to supply.[166] As noted in the Opinion by Advocate General Mazák, a number of alternative technologies were apparently available to provide end users with broadband services and TeliaSonera's network could have been replicated by its competitors (jointly or severally) and/or by third parties.[167]

As previously discussed the CJEU in *TeliaSonera* does not apply the *Oscar Bronner* requirement of the likelihood of the elimination of all competition on the downstream market but rather finds it sufficient if the conduct creates barriers or hinders growth, "making it more difficult" to penetrate the market.[168] This approach is problematic and potentially detrimental to consumer welfare. This is true *a fortiori* when it is applied in circumstances where there is no regulated duty to supply and the general elements of the test for a refusal to supply in *Oscar Bronner* are not required.[169]

The CJEU in *TeliaSoneria* also established that liability for a margin squeeze should not be dependent on whether the wholesale supply concerned a previous course of dealing or supply to a new customer.[170] As we have seen in *Trinko* and *linkLine,* the US courts are unlikely to impose a duty to deal (and therefore liability for a margin squeeze) in circumstances were there has been no previous voluntary arm's length dealing. This reasoning is derived from the finding in *Aspen* where the termination of a presumably profitable supply agreement (joint venture) without legitimate business reasons suggested a willingness to forsake short-term profits to achieve an anticompetitive end, giving rise to an inference of an exclusionary purpose. The same inferences, of a possible anticompetitive motive being drawn from the defendant's prior conduct,

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163 *Id*, para 72; see *Telefónica* (General Court) n 1, para 182.

164 *Id*, para 69.

165 *Id*, para 70.

166 Cf *IMS Health,* n 125.

167 Mazák, n 3, para 20.

168 *TeliaSonera*, n 3*,* paras 66-67, citing *Deutsche Telekom* (CJEU), n 2, para 254.

169 The CJEU goes on to state that an exclusionary effect can be outweighed by proof of efficiencies as an objective justification: *Id*, para 76. A successful efficiency argument, however, should lead to an initial finding that the vertically integrated dominant supplier's prices do not constitute a margin squeeze, as found by the German regulator in *Deutsche Telekom.* See discussion below.

170 *TeliaSonera,* n 3, para 95.

cannot be drawn however either in a situation of a regulated duty to deal or where there has been no previous voluntary course of dealing.

This highlights a crucial difference between the EU and US approaches to competition law and the regulation of a margin squeeze in particular. In the US an understanding of prior conduct is crucial to the antitrust question of whether an exclusionary purpose exists. In the EU the prior conduct is considered irrelevant[171] because it is thought to have no bearing on the effect of the conduct on an "as efficient competitor" or the creation of barriers which prevent new entrants.[172] The EU is less focused on investigating whether the defendant has an exclusionary purpose and more focused on ensuring an "adequate margin" between the wholesale and retail prices. Sidak argues that the need to increase competition in previously state owned or state-granted industries may provide an explanation (or perhaps even justification) for the EU approach,[173] but the *TeliaSoneria* principle is not confined to these liberalized markets.

The decision of the CJEU in *TeliaSonera* significantly broadens liability for a margin squeeze in non-regulated industries. Liability will be imposed when a vertically integrated dominant undertaking sets its upstream and downstream prices negatively or merely insufficiently to cover downstream incremental costs. Apart from its lack of specificity as an antitrust standard, the dominant firm has an incentive to avoid liability by increasing downstream prices to the detriment of consumers. Most significantly, in the absence of a regulated duty to supply, it serves as a disincentive for the dominant undertaking to supply the input in the first place. Alternately, where there is a duty to supply the wholesale input under Article 102 the undertaking may decide to withdraw from the downstream retail market altogether, thereby reducing (or distorting) competition and efficiency in that market.[174] It is also in opposition to the general principle under Article 102 that being in a dominant position *per se* is not an abuse,[175] as the charging of a monopoly price is generally lawful for a dominant undertaking. While this latter principle is qualified in the EU by the abuse of excessive pricing, as we have seen, wholesale or retail prices do not have to be abusive in themselves for a finding of a margin squeeze.

8. THE INTERACTION BETWEEN EU COMPETITION LAW AND SECTOR-SPECIFIC REGULATION

These EU decisions also raise important issues regarding the interaction of national regulatory authorities (NRAs) and EU competition law. The decisions concerned previous state-owned monopolies in liberalized telecommunications markets and many

[171] Previous EU case law has placed emphasis on the existence of a previous course of dealing but for reasons that differ from *Aspen* and which mainly concern the effect the refusal will have on the customer's relationship-specific investments, made in the expectation of continuance of the supply agreement: *United Brands v Commission* [1978] ECR 207, [1978] 1 CMLR 429, para182; cf *Liptons Cash Registers/ Hugin* [1978] OJ L22/23, [1978] 1 CMLR D19.

[172] *TeliaSonera,* n 3, para 94.

[173] Sidak, n 11, n 69.

[174] Carlton, n 55, at 278.

[175] *Michelin,* n 54, para 57.

of the access and pricing issues in *Deutsche Telekom* and *Telefónica* were also subject to national regulation.

As O'Donoghue and Padilla point out substantive issues can arise for the determination of a margin squeeze in regulated markets where the regulated upstream access price is higher than the incumbent's actual costs, permitting the dominant firm to set lower prices to downstream retail customers, without pricing below its own cost, and not permitting equally efficient rivals to compete.[176] Another situation arises where regulation requires the dominant firm to provide a technical means of access to rivals but can lower costs itself through use of a different, more efficient, means of access. They argue that the principle in *Bronner* means that the dominant firm should not have to "compensate rivals for higher costs that are the result of a technical means of access under regulatory principles that is less efficient" than a different means of access used by dominant firm.[177]

Deutsche Telekom claimed that it could not be guilty of a margin squeeze because its wholesale charges for local loop access had been approved by the German telecommunications regulatory authority "Reg TP".[178] Its retail rates for analogue and broadband were also regulated under a price cap system.[179] Reg TP had even considered, on at least five occasions, whether Deutsche Telekom's pricing could amount to a margin squeeze.[180] It found there was a negative spread between the wholesale and retail prices but, unlike the Commission, declared that other operators could offer their end-users competitive prices by resorting to cross-subsidised charges for access services and call charges.[181] Thus, RegTP found in its decision of 29 April 2003 that:

> "[C]ompetitors are not so prejudiced with regard to their competitive opportunities in the local network by the slight difference between retail and wholesale prices as to make it economically impossible for them to enter the market successfully or even to remain in the market. ... [That difference] was not so significant as to deprive competitors of any opportunity themselves to cross-subsidise their retail prices in order to be able to offer their end-users connections at a price as attractive as that offered by the applicant, or even at a lower price. That applies particularly to the higher-value and costlier ISDN and ADSL

176 O'Donoghue and Padilla, n 31 at 419-421, citing the decision of Italian Antitrust Authority: Case A 351 *Telecom Italia*, Decision of 19 November 2004.

177 O'Donoghue and Padilla, n 31 at 421.

178 The TKG states that wholesale "[r]ates shall be based on the costs of efficient service provision": para 24(10).

179 Deutsche Telekom's retail rates for analog and broadband which consist of a basic monthly charge and a one-off charge for a new connection are regulated under a price cap system. Prices for services were not regulated separately but were regulated within a basket consisting of groupings of different services. A new system was introduced from 2002 with differing baskets. Some prices for services within the basket were subject to prior notification of price increases. ADSL charges were not subject to advance notification of price changes.

180 *Deutsche Telekom* (General Court), n 2, para 115.

181 *Id,* para 116.

> connections, which have increased markedly in number on account of the significant expansion of internet penetration, as well as of the marketing of faster and better access to the internet."[182]

Deutsche Telekom argued that the principle of legal certainty demanded that they should be able to rely on the correctness of the national regulation and that instead of a competition law investigation under Article 102 an action should instead be brought against Germany for failure to observe its obligations under Article 258 TFEU (ex Article 226 EC Treaty).[183] The CJEU stated:

> "such possibilities are irrelevant at the stage of the present appeal, not least because, according to the case-law of the Court, under the system laid down by [Article 258 TFEU], the Commission has a discretion to bring an action for failure to fulfil obligations, and it is not for the Courts of the European Union ('Courts of the Union') to assess whether it was appropriate to do so".[184]

The CJEU in *Deutsche Telekom* found that while the regulatory framework applicable to the telecommunications sector was a relevant factor in the application of Article 102 to the undertaking,[185] it was not meant to remove or diminish the role of competition law:

> "since the competition rules laid down by the EC Treaty supplement in that regard, by an *ex post* review, the legislative framework adopted by the Union legislature for *ex ante* regulation of the telecommunications markets."[186]

The CJEU pointed out that liability for an abuse could only be avoided because it has been required by national regulation in the very limited circumstances where:

> "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 ... In such a situation, the restriction of competition is not attributable, as those provisions implicitly require, to the autonomous conduct of the undertakings."[187]

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[182] *Id*, para 117.

[183] *Deutsche Telekom* (General Court), *id*, para 117.

[184] *Deutsche Telekom* (CJEU), n 2, para 47; *Telefónica* (General Court), n 1, para 307.

[185] *Id*, para 224.

[186] *Id*, para 92; *Telefónica* (General Court), n 1, para 293

[187] *Id* para 80. Articles 101 and 102 may apply, however, "if it is found that the national legislation leaves open the possibility of competition which may be prevented, restricted or distorted by the autonomous conduct of undertakings": Joined Cases C-359/95 P and C-379/95 P *Commission and France v Ladbroke Racing* [1997] ECR I-6265, paras 33-34 and the cases cited therein; Cf *TeliaSonera,* n 3, para 49. There have been very few decisions which have accepted that liability under the Treaty has been avoided by national legislation: *Deutsche Telekom*, *id* para 81, see Case 41/83 *Italy v Commission* [1985] ECR 873, para 19; Joined Cases 240-242, 261, 262, 268 & 269/82 *Stichting Sigarettenindustrie and Others v Commission* [1985] ECR 3831, paras 27-29; and Case C-198/01 *CIF* [2003] ECR I-8055, para 67. The "Court has held that if a national law merely encourages or makes it easier for undertakings to engage in autonomous anti-competitive conduct, those undertakings remain subject to Articles [101] and [102 TFEU]": *id*, para 82, citing Joined Cases 40-48, 50, 54-56, 111, 113 & 114/73 *Suiker Unie and Others v Commission* [1975] ECR 1663, para 36–73 and Case C-198/01 *CIF* [2003] ECR I-8055, para 56.

The Commission found that Deutsche Telekom had the scope or autonomy to avoid the margin squeeze by adjusting the retail prices of its narrowband access services to end-users, while respecting the overall ceilings for baskets of residential and business services. The German regulator's finding did not create a legitimate expectation that the charges were lawful under Article 102[188] as Deutsche Telekom could not jettison its special responsibility under the Treaty not to distort competition.[189]

It is difficult however in practice to apply the standards "required by national legislation" and "a legal framework which itself eliminates any possibility of competitive activity" to determine the relative spheres and limits of expertise for national regulators (*ex ante*) versus the Commission (*ex post*) in competition law decisions. Reasonable decision-makers can differ in their application of standards such as the "as efficient competitor", especially when the assessment is based on such uncertain facts as the imputed costs of the vertically integrated firm. Could, for example, a pricing decision made by a sector-specific regulator (particularly when the possibility of a margin squeeze has been considered) within the context of the EU regulatory framework, qualify as one made under "a legal framework which itself eliminates any possibility of competitive activity"?

In this case, for example, the German regulator applied the "as efficient competitor" test to the margin squeeze issue but merely came to a different conclusion based on a more dynamic assessment of competition in the market in the long-term. While the Commission is not bound to adhere to the national regulatory decision, if reasonable minds can differ on the determination of the economic issues, there should be greater deference to the regulator who has sector-specific knowledge especially where the market is characterized by dynamic competition.

The assessment of the "legal framework which eliminates any possibility of competitive activity" requires a factual analysis of the level of detail of the regulatory scheme and cannot easily be determined in advance. This rule lays down a very narrow ground for the circumstances of when an undertaking may rely on the decision of a NRA to avoid liability for the application of EU competition law. It operates even in circumstances where the NRA has wide powers to set wholesale and retail prices and concurrent competition powers and in circumstances where it has already, as was the case in *Deutsche Telekom*, made a finding of non-infringement of the competition provision. Mere reliance on NRA rules is insufficient protection, and does not even give rise to a legitimate expectation.

In *Telefónica* the Commission also rejected the argument that a decision by the Spanish Regulator (CMT) precluded review by the Commission under Article 102 and that such an intervention would not be contrary to the principles of subsidiarity.[190] On appeal to

188 *Id*, para 269; approved by CJEU *Deutsche Telekom* (CJEU), n 2, para 67. The Commission reduced the fine by 10% on this basis however.

189 *Deutsche Telekom* (CJEU), n 2, para 67.

190 The Commission applied a similar approach in *Telefónica*. After liberalization of the Spanish telecommunications market in 1998, Telefónica became subject to a regulated duty to supply. Unlike the German regulator in *Deutsche Telekom*, the Spanish Commission for Telecommunications Markets (CMT) had

the General Court Telefónica argued that that the use of the Commission's powers "for regulatory purposes … would run counter to the principles of subsidiarity, proportionality and legal certainty, since it interferes without good reason in the exercise of the powers of the CMT".[191] The General Court rejected the arguments, stating that the CMT was a regulatory not a competition authority and had not intervened to enforce Article 102. In any event, even if the CMT had considered liability under Article 102, the Commission would not be precluded from finding an infringement, as the Commission cannot be bound by a decision taken by a national authority.[192]

The General Court also referred to what they regarded as the inadequacy of the information and the cost model used by the CMT in making its *ex ante* pricing decisions. The General Court stated that these models were not based on recent estimates of Telefónica's historical costs but rather on estimates made by external consultants which had underestimated Telefónica costs.[193] The Court therefore rejected the argument that CMT was particularly active with respect to reviewing Telefónica's pricing policy.[194]

The approach of the General Court highlights the difficulties which may arise from an attempted substitution of the role of the NRA with that of the Commission. Information asymmetries, whereby the regulated firm will always have more information in its possession than the regulator, are difficult to avoid in regulated markets. While regulators can try to remedy this through requests for information, inevitable market failures will still arise through the provision of inadequate or imprecise information, especially in dynamic markets. Regulatory decision-makers must balance an assessment of the costs of obtaining more precise information against the risks of false positives. In these circumstances it should not be the role of competition authorities, or the courts, to micro-manage the quality of the information available to the NRA. While the situations are not equivalent, the assessment suggested by the General Court certainly goes beyond the ordinary standard of judicial review of "manifest error" by the European Courts regarding the appraisal of matters of complex economic assessment by the Commission.[195]

These decisions raise considerable difficulties and costs for dominant firms who may be subject to conflicting decisions and must comply with both non-competition and

not ruled on the margin squeeze question but in any event the Commission found that Telefónica had autonomous action available to it to avoid the margin squeeze. Only 30% of the prices the Commission found subject to a margin squeeze (amounting to one of the two upstream products) were also subject to maximum prices set by the Spanish regulator with the apparent implication that the company could possibly have avoided liability by raising prices on the other 70%: *Telefónica* (Commission), n 1, para 675.

191 *Telefónica,* (General Court), n 1, para 296.

192 *Id*, para 301.

193 The CMT had asserted on a number of occasions that it did not have certain information which it needed in order to examine the margin squeeze in relation to Telefónica: *id*, para 302.

194 *Id,* para 303.

195 See Case T-65/98 *Van den Bergh Foods Ltd v Commission* [2003] ECR II-4653, Case C-12/03 P, *Commission v Tetra Laval* [2005] ECR I-987.

competition policies. Dominant firms may have to resort to applications to the regulator to raise wholesale or retail prices to avoid the risk of an infringement and the possibility of considerable fines. Regulators may also prefer to err on the side of setting higher prices which can detract from, rather than promote, efficient European-wide telecommunications markets in the longer term and increases regulatory costs for both the undertakings and the NRAs.

As Giorgio Monti points out, "applying EC competition law without any regard to the regulatory framework is undesirable"[196] especially in the context of the Modernization of EU competition law which increases the role of the national competition authorities and national courts of the Member States.[197] While national regulators are obliged to respect the provisions of the TFEU, they are also expected to apply national law which may, as regards telecommunications policy, have objectives which differ from those of EU competition policy.[198] These national objectives may also serve important public policy goals such as universal service provision.[199]

As we have seen, on other occasions the Commission and the Courts have taken account taken of issues within the sphere of national regulation.[200] In *Deutsche Telekom* the Commission applied the regulatory tool of "rebalancing" to Deutsche Telekom's retail prices but refused to take account of the differing regulatory burdens imposed on the dominant undertaking due to operator (pre)selection and universal service when they applied the concept of "equality of opportunity". The Commission in *Telefónica* and in its "Guidance Paper on Article 102"[201] and the CJEU in *TeliaSonera* have also stated that if there is a regulated duty to supply there is no need to consider whether the margin squeeze constitutes the abuse of a refusal to supply because the relevant questions about balancing the *ex ante* investment decisions and the promotion of competition in the downstream market had already been undertaking by the regulatory authority.[202]

8.1. The intersection of antitrust and sector-specific regulation in the United States

In order to avoid these apparent inconsistencies, the EU courts may be advised to adopt the approach of the US Supreme Court in *Trinko* of a diminished role for antitrust in regulated industries where the presence of a federal and state statutory

196 Monti, n 144, at 127. Cf Geradin and 0'Donoghue, n 31, at 417-18.

197 Regulation 1/2003. See discussion below.

198 See *Deutsche Telekom* (General Court), n 2, para 113; *Deutsche Telekom* (CJEU), n 2, para 227.

199 For a discussion of, for example, the goal of security of energy supply versus competition goals in national energy markets see Monti, n 144, at 136-138.

200 Telefónica's argument on appeal that the Commission's decision was ultra vires in that it had exceeded its powers by encroaching on the powers of the CMT by invoking certain concepts such as "ladder of investments" which were "of a regulatory nature [and which do] not belong to competition law" was rejected by the General Court: *Telefónica* (General Court) n 1, para 290.

201 European Commission, "Guidance Paper on Article 102", n 4, para 82.

202 Cf Case C-501/06 P, *GlaxoSmithKline Serives v Commission* [2009] ECR I-9291, where the particular context of regulation in the pharmaceutical sector was taken into account in an Article 101 decision.

access regime in the telecommunications market in *Trinko* was thought to "significantly diminish the likelihood of major antitrust harm",[203] making it unnecessary to impose a judicial doctrine of forced access under section 2 of the Sherman Act.[204] The Supreme Court stated that antitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue, including awareness of the significance of regulation:[205]

> "In short, the regime was an effective steward of the antitrust function. Against the slight benefits of antitrust intervention here, we must weigh a realistic assessment of its costs."[206]

In *linkLine,* AT&T had been previously required by regulation to supply the wholesale service. Justice Breyer in his separate concurring judgment, stated that a price squeeze case should not be available to a purchaser from a regulated firm when "a regulatory structure exists to deter and remedy anti-competitive harm, the costs of antitrust enforcement are likely to be greater than the benefits".[207]

The US framework may not be so easily transferable however to the historical and institutional context of the EU. Utility assets in the US have traditionally been privately owned and the issue of bottleneck inputs in vertically integrated industries is normally considered to be an exclusively regulatory matter. The EU telecommunications sector only began to undergo liberalization in the 1990s after a period of predominate state ownership. In this context, the EU approach may therefore be more conducive to harmonization of law within the Member States, particularly after Modernization. The supremacy of EU Law and the duties imposed on Member States to enforce the Treaty differ in fundamentally distinct ways to the situation of the application of two federal statutes (Sherman Act and the Telecommunications Act 1996) in *Trinko*. The US statutory scheme for telecommunications is also far more detailed than the EU general framework Directive for electronic communications (which leaves the design of detailed rules to NRAs).[208] The harmonization of EU law and the liberalization framework may be jeopardized if national interests, such as preserving a national champion, are prioritized by regulators (which may also be subject to regulatory capture). Even so, however, if concerns regarding the efficacy of the national regulation formed the basis of the EU margin squeeze decisions, the more appropriate remedy is an action against the NRA rather than a competition law solution which imposes

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203 *Trinko,* n 21, at 412; cf *Credit Suisse Securities LLP v Billing* 127 S. Ct. 2383, 2397 (2007).

204 Trinko, *id,* at 411.

205 *Id,* at 410-11.

206 *Id*, at 414.

207 *linkline*, n 5, 1124, citing *Town of Concord,* n 14 (in that case both wholesale and retail prices were subject to regulation).

208 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 2009/140/EC [2009] OJ L337/3 on a common regulatory framework for electronic communications.

uncertain liability on dominant firms and creates an incentive to increase retail prices to the determinant of consumers.[209]

8.2. Towards a 'regulatory space' for sector-specific regulators and the Commission

Given the expansion of the EU and the importance of the Community liberalization framework across a number of European industries, these problems of regulatory coordination and intersection are likely to continue. This is especially true given the rise in the number of sector-specific regulators, many of which have concurrent competition powers.[210] The EU by its Directive on a common regulatory framework for electronic communications has determined that this is a sector where there is market failure and it is not possible to regulate through competition law alone. Sector-specific regulation and competition laws are therefore required to coexist. It is therefore appropriate to ensure that an effective system of governance is in place to deal the relationship between and among the NRAs and the Commission.

It has been argued that EU governance, by virtue of the Modernization Regulation, is moving towards a more multilevel experimentalist governance of networked actors which blurs "the distinction between centralized and decentralized decision-making",[211] where regulatory actors, in return for peer and performance review, are given autonomy in decision-making within the framework goals determined by the formal competences of EU institutions.[212] The central framework for this process of coordination and co-operation among and between the National Competition Authorities and the Commission is the European Competition Network (ECN) which establishes modes of mutual learning through the exchange of information and best practice, rather than a hierarchical system based on command and control.[213]

The Body of European Regulators for Electronic Communications (BEREC), which replaced the European Regulators Group (ERG)[214] has a similar mandate, under the electronic communications framework Directive, to develop cooperation and coordination among and between NRAs and the Commission in accordance with principle of subsidiarity.

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209 *Amicus Brief,* n 11, at 10.

210 In the UK sector-specific regulators such as Ofcom, Ofgen and Ofwat have concurrent powers with the Competition and Markets Authority to apply the competition provisions of the *Competition Act* 1998 and the *Enterprise Act* 2002. Recent amendments have extended some competition powers to the Financial Conduct Authority (FCA).

211 Charles F. Sabel and Jonathan Zeitlin, *Experimentalist Governance in the European Union: Towards a New Architecture* (Oxford University Press, 2010) at 2.

212 *Id* at 3.

213 Yane Sveitiev, "Networked Governance in the EU: Centralization, Decentralization, or Experimentalist Architecture?" in Sabel and Zeitlin, n 211, ch 5.

214 Regulation (EC) No 1211/2009 of the European Parliament and of the Council of 25 November 2009 establishing the Body of European Regulators for Electronic Communications (BEREC), OJ L 337, 18/12/2009.

Yet the more hierarchical role adopted by the Commission in these few margin squeeze cases arguably does not facilitate the development of a regulatory space that provides the NRAs with the necessary autonomy to develop the technical expertise required for accountable decision-making in these complex markets.[215] While not rejecting the legitimate role of the Commission and the Courts in enforcing the Treaty, should this form of intervention be rather the last resort in circumstances where the intersection between the role of regulation and competition is unclear? A more appropriate remedy in these circumstances is an action against the NRA[216] and/or a request by the Commission, though the BEREC, to make a new decision, taking into account, for example, the more relevant information concerning costs considered appropriate in the *Telefónica* decision? The General Court in *Telefónica,* clearly did not think so, stating that it was not the duty of the Commission under Article 7 of the Directive 2002/21/EC (Framework Directive) to monitor the regulatory measures adopted by the CMT.[217] In *Telefónica*, the General Court merely stated: "the CMT is not a competition authority but a regulatory authority".[218] The principle of subsidiarity, like the principle of legitimate expectation arising from the NRA decision in *Deutsche Telekom*, was considered irrelevant and did not prevent the Commission from exercising its power. As the Commission continues to intervene we can expect more references to the CJEU such as *TeliaSonera* as undertakings/NRAs/national courts try to grapple with the ensuing uncertainty.

In the US, where Federal agencies may compete in addition to having overlapping competencies, a form of governance is instituted where regulators are encouraged to coordinate their "shared regulatory space".[219] While, as we have argued, it may be difficult to compare the US and EU institutional schemes, it may be important to envisage a situation, especially in dynamic and factually complex markets, where the Commission's role is less hierarchical and more focused on the oversight of a framework where NRAs are provided more autonomy to determine and apply particular rules; in other words, a regulatory framework which fosters "responsive regulation"[220] and is mindful of the particular industry structure.[221] As Eberlein points out, competition law:

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[215] In the US the importance of deference to expertise of the regulatory agency in its interpretation of legislation was determined by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 US 837 (1984).

[216] Geradin and O'Donoghue, n 31, at 419.

[217] *Telefónica* (General Court), n 1, para 294. This is so even where Recital 15 aims to "ensure that decisions at a national level do not have an adverse effect on the single market or other Treaty objectives".

[218] *Telefónica* (General Court), n 1, para 301.

[219] Jody Freeman and Jim Rossi, "Agency Coordination in shared regulatory space" 125 *Harvard Law Review* 1131 (2012).

[220] Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1997).

[221] The Commission recent adoption of Commitments in the Google investigation, rather than proceeding to a formal finding of infringement, is partly an acknowledgment of the need to provide a more flexible response in dynamic markets where the anti-competitive effects are more uncertain: see http://europa.eu/rapid/press-release_MEMO-14-87_en.htm?locale=en.

> "is even less able [than legislation] to substitute for detailed, recursive rule development. Based as it is on single-case procedures, it is more of a negative control instrument, a check on and incentive for the type of fine-tuned regulatory development performed by experimentalist processes".[222]

9. CONCLUSION

In these recent margin squeeze cases the EU has sent a strong message that it will impose considerable fines for this conduct in liberalized and regulated markets. Uncertainties still remain however regarding the manner in which the abuse of a margin squeeze is determined, particularly regarding the imputation of costs and setting of prices in vertically integrated network industries, operating in dynamic and evolving markets. Faced with the uncertainty that this standard poses, the dominant firm has an incentive to avoid liability by hypothesizing about its rivals costs and raising its retail price to the level of the least-efficient retailer. There is also a willingness to forego the establishment of the elements of a "constructive refusal to supply" and particularly the identification of the "indispensability of the input" in markets subject to a regulated duty. The CJEU in *TeliaSonera* and the General Court in *Telefónica* have even gone further and in viewing a margin squeeze as an independent form of abuse under Article 102 where the violation can be identified purely on the assessment of costs and prices. These decisions significantly broaden the scope of potential liability for a margin squeeze in non-regulated industries in the EU. This legal position has the potential to distort *ex ante* upstream investment decisions and creates a disincentive for the dominant undertaking to supply the input in the first place. The failure to consider the abuse within the elements of a constructive refusal to supply under *Oscar Bronner* means that an exclusionary purpose would not be identified.

The likely outcome is that while competition may be maintained in the short term, the failure to consider this issue within the context of an exclusionary purpose may be ultimately detrimental for consumer welfare. This approach also continues to place significant distance between the position of the European courts and that of the Commission's purported move towards a "more economic" and "consumer welfare" interpretation of competition law more generally.

This examination has also identified significant differences in approach to the regulation of a price or margin squeeze in US and EU competition law. In *Trinko* the presence of a statutory regime imposing a duty to deal significantly reduced the scope for an antitrust claim. After *linkLine* the likelihood of a successful claim for a price squeeze has been significantly diminished. This is true particularly where there has been no prior course of voluntary dealing and no evidence of predatory pricing at the downstream level.

The adoption of the US approach whereby there is a limited role for a "duty to deal" absent compulsion and the downstream prices must be abusive in themselves, is not recommended however. EU competition law has evolved from different historical and

[222] Burkard Eberlein, "Experimentalist Governance in the European Energy Sector" in Sabel and Zeitlin, n 211, at 73-74.

ideological circumstances which have prioritised the goals of market integration and the "freedom to compete". EU competition law has an important role in the regulation of newly liberalized markets, particularly on enlargement of the EU. Rather than the adoption of the US approach in *linkLine,* the EU would do well to examine the earlier US price squeeze decisions, and associated commentary, which set out the requirements for the establishment of an exclusionary purpose as a "constructive refusal to supply". As noted above, the uncertainties which still surround the elements of the current EU test and its interaction with sector-specific regulation, require further clarification if the price squeeze is to be an effective tool of competition law rather than a *de facto* tool of regulation in these liberalized markets.