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“Margin Sqeeze as a Stand-alone Form of Abuse?

A Comparative Analysis under Art. 102 TFEU and Sec. 2 Sherman Act”

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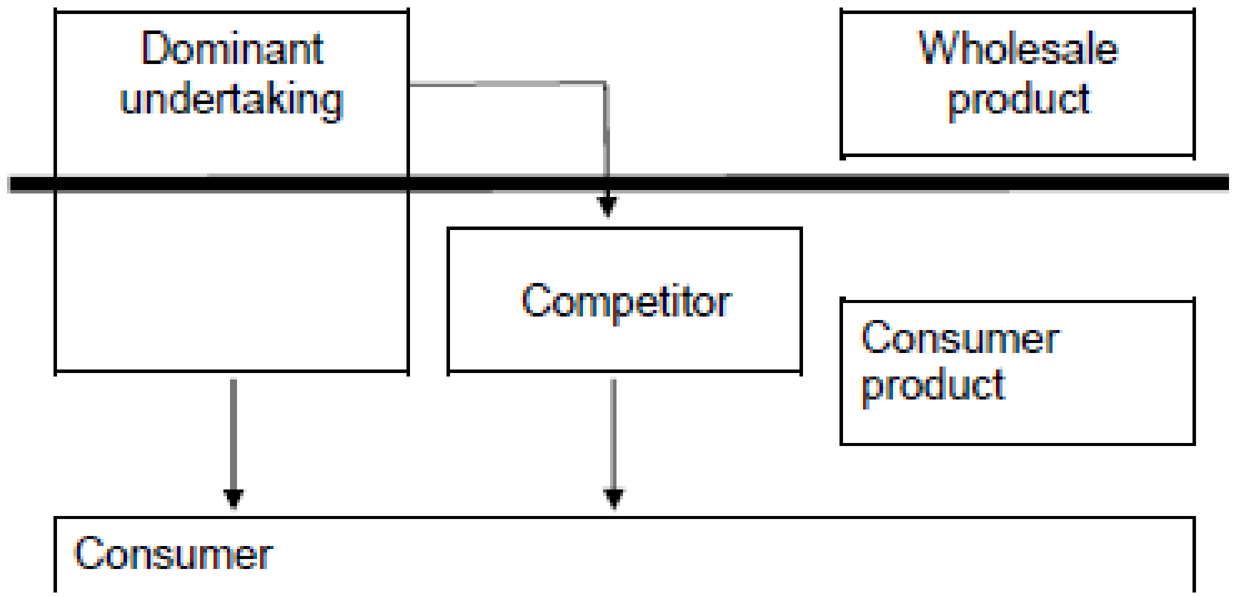
Overview

I. Introduction (1)

- What is a price or margin squeeze?
  In essence it is an exclusionary form of abuse of dominance that involves a strategy whereby a vertically integrated dominant firm the uses its control of the input price and the retail price of a product to “squeeze” the profit margins of downstream rivals to whom it also supplies the input.

- How does it work?
  The vertically integrated dominant firm can render the activities of its non-integrated downstream rivals unprofitable by
  - raising the price for the upstream input (at wholesale level),
  - lowering the price for the downstream product (at retail level),
  - doing both at the same time.

I. Introduction (2)



I. Introduction (3)

- What is its practical importance?
  Most cases arise in liberalized industries such as telecommunications where former monopolists continue to have control over essential inputs supplied to downstream competitors. But it may also occur in other industries, see e.g. *Napier Brown/British Sugar* (1988) (Commission decision).

- Is price or margin squeeze a special, stand-alone form of anticompetitive action? Or is it economically equivalent to other well-established forms of abusive conduct such as excessive pricing or refusal to deal in the upstream market and predatory pricing or price discrimination in the downstream market?

I. Introduction (4)

- The position of the U.S. Supreme Court in the *linkLine* case (2009) (*Pacific Bell Telephone Co. v. linkLine Communications, Inc.*, 129 S. Ct. 1109):

- no independent competitive harm justifying antitrust intervention under Sec. 2 Sherman Act unless
  - there is a violation of an <u>antitrust duty to deal</u> in the upstream market (a regulatory duty to supply the wholesale product is not sufficient), or
  - the dominant firm engages in predatory pricing in the down-stream market.

I. Introduction (5)

- The approach of the European Court of Justice (ECJ) in Deutsche Telekom v Commission (14 October 2010, Case C-280/80), Konkurrensverket v TeliaSonera Sverige AB (17 February 2011, Case C-52/09) and in Telefónica and Telefónica de España v Commission (10 July 2014, Case C 295/12 P):
  - price squeeze is capable, in itself, of constituting an abuse under Art. 102 TFEU, no need to establish that the wholesale price or the retail price are in themselves abusive on account of their excessive or predatory nature;
  - it is sufficient to show potential exclusionary effects, i.e. to prove possible anticompetitive effects by which competitors which are at least as efficient as the dominant undertaking may be driven out of or excluded from the market.

II. Economic background and competitive concerns (1)

- Basic economic conditions for a price squeeze
  - Existence of a vertically integrated firm that operates simultaneously in upstream and downstream markets
  - Significant market power in the upstream market, usually a dominant position resulting from the supply of an essential input or “bottleneck” good which cannot easily be replicated or substituted and is indispensable for entering the downstream market.
  - Some degree of market power in the downstream market (influence on retail prices).
- Other relevant factors may include barriers to entry and re-entry, product differentiation etc.

II. Economic background and competitive concerns (2)

- The primary competitive concern with price squeezes is that the dominant firm may limit, restrict or prevent the development of competition in the downstream market and thereby also causes consumer harm.
- In particular the success of reforms in newly liberalized branches such as telecommunications could be undermined by exclusio-nary effects that result from cutting or destroying the profit margins of downstream competitors of the dominant incumbent.
- Potential pro-competive justifications (e.g., efficiencies) should also be taken into account in appropriate cases.

III. The approach of the U.S. Supreme Court in the linkLine case

- Plaintiffs alleged a price squeeze in violation of Sec. 2 Sherman Act by Pacific Bell, a monopoly seller of unbundled local loops that also competed downstream in the provision of high-speed DSL internet access services.
- Pacific Bell charged competing internet service providers high wholesale prices for DSL transport, and its own downstream customers low retail prices for DSL internet service.
- S.Ct. denied monopolization claim because Pacific Bell had no “antitrust duty” to deal with its competitors (even though it was under a regulatory duty to provide local loops to downstream service providers), and it could not be established that retail prices were predatory according to the test in Brooke Group (prices below cost and dangerous probability of recoupment of losses).
- Relationship to sector-specific regulation: no supplementary application of the antitrust laws, therefore no antitrust duty to deal.

IV. The assessment of price squeezes under EU competition law (1)

- From 1998-2001 ***Deutsche Telekom*** charged its downstream competitors higher fees for wholesale local loop access than its own customers at the retail level for fixed line access; from 2002 wholesale prices were lower than retail prices but the margin was insufficient to cover Deutsche Telekom's own costs for the supply of the retail services.
- The ex ante approval of Deutsche Telekom's prices by the regulator did not immunize it from the application of competition law since DT still had discretion to request different prices.
- ECJ recognized the price squeeze as a distinct, stand-alone claim whereby the abusive character of the pricing practices results from the negative or insufficient margin between the wholesale and retail prices. The spread is too small if it does not cover the incumbent's own product-specific costs for providing retail services.
- There is no need to establish that the prices on either level are in themselves abusive on account of their excessive or predatory nature.

IV. The assessment of price squeezes under EU competition law (2)

- The approach was confirmed in ***TeliaSonera*** and extended to a case where there was no regulatory duty to provide an ADSL product at wholesale level.
- According to the ECJ a potential anticompetitive effect of the price squeeze must be demonstrated which relates to the degree of competition in the retail market. It is sufficient to show that equally efficient competitors may be excluded from the market.
- Further clarifications as to the conditions of the price squeeze claim:
  - No need for a position of super-dominance or quasi-monopoly on the upstream market
  - No need for a dominant position on the downstream market
  - No recoupment test
  - No duty to supply on the upstream market.

IV. The assessment of price squeezes under EU competition law (3)

- In its recent **Telefónica** decision the ECJ again confirmed that it is sufficient to prove that the margin squeeze has potential anticompetitive effects, i.e. that a competitor which is at least as efficient as the dominant undertaking may be driven out of or be excluded from the market.

- The Court also clarified that the indispensability of the wholesale product is just a factor to be taken into account when assessing the likely effects of the incumbent's conduct but no prerequisite for finding an illegal margin squeeze with anticompetitive effects.

V. Comparative analysis and assessment (1)

1. Price squeeze as a distinct form of abuse

- Even though the concept of price squeeze is very close to excessive pricing and/or duty to deal on the upstream market and predatory pricing downstream, it is different from both and should be treated as a distinct form of abuse.
- Possible arguments include inter alia
  - Two markets involved instead of one
  - Vertical integration provides dominant undertaking with more options to implement exclusionary practices
  - Extent of exclusionary effects depends on the spread between wholesale and retail prices, not on the absolute price on either market.
  - Stronger incentives to engage in price squeezes than in predatory pricing since no below cost sales are necessary in order to reduce or destroy the profitability of a rival's business in the downstream market.

V. Comparative analysis and assessment (2)

- Extremely restrictive position of the U.S. Supreme Court:
  - Price squeeze no independent antitrust infringement, absent an antitrust duty to deal (upstream) or predatory pricing (downstream)
  - In case of sector-specific regulation no supplementary application of the Sherman Act.
  - S.Ct. allows monopolists maximum discretion in their commercial affairs based on policy arguments that “the opportunity to charge monopoly prices – at least for a short period – is what attracts business acumen” and is productive of “innovation and economic growth” (Trinko).

V. Comparative analysis and assessment (3)

- Critique: The U.S.Supreme Court neglects the role of barriers to entry and does not recognize any "special responsibility" of dominant firms for not interfering with the remaining, already weakened competition other than by clearly competing on the merits.
- Thinking of Supreme Court obviously influenced by the "single monopoly profit theory" of the (original) Chicago School which denies that an upstream monopolist has an incentive to foreclose its downstream rivals because there is only a single monopoly rent to be earned in the industry.
- More recent ("post Chicago") economic approaches have questioned the single monopoly rent theory and identified situations where margin squeeze is a viable anticompetitive strategy as a means for restricting output and restoring the dominant firm's market power upstream, deterring entry or otherwise relaxing competition downstream.

V. Comparative analysis and assessment (4)

2. Additional qualifying factors for constituting an abuse?

- Should super-dominance or quasi-monopoly be required on the upstream market?
- Must the incumbent also have a dominant position on the retail market?
- Is it necessary that the dominant firm has the ability to recoup any losses incurred during the period of practicing a price squeeze?
- Must the dominant undertaking be under a **duty to deal in the upstream market**?
  - U.S. Supreme Court: (+)
  - ECJ (TeliaSonera): (-)

V. Comparative analysis and assessment (5)

- Better reasons argue for **not requiring a duty to deal** in the upstream market:
- The often levied criticism that absent a duty to deal margin squeeze cannot be harmful is not convincing: Refusal to supply is not a natural default counterfactual to margin squeeze. Even if an undertaking could legally refuse to supply its downstream competitors, this does not mean that it would do so. The relevant counterfactual is what <u>would</u> have happened otherwise – not what an undertaking <u>could</u> do but has no incentive to do. A dominant undertaking may have the wish to foreclose down-stream competition not entirely but to keep it on a weak level.
- With regard to other exclusionary pricing practices such as certain (loyalty) rebate schemes it is generally recognized that they may have exclusionary effects even though the dominant undertaking is under no duty to supply.

V. Comparative analysis and assessment (6)

3. The relevant cost/price-method

- The “equally efficient competitor test”
  - In general, the margin must be large enough to enable a competitor which is at least as efficient as the incumbent firm to effectively compete in the downstream market.
  - The test provides legal certainty for the incumbent since it knows its own cost for providing retail services. At the same time it ensures that individual, less efficient competitors on the downstream market will not be protected.
  - The test is in conformity with the test for predatory pricing which also relates to the dominant undertaking’s cost.
- The “reasonably efficient competitor test”
  - In some situations, however, it may be necessary to protect firms which are not yet as efficient as the long-term incum-bent but have the realistic chance to gain considerable mar-ket shares in the foreseeable future

IV. Summary and conclusion (1)

- The decisions of the U.S. Supreme Court in linkLine and of the ECJ in Deutsche Telekom, TeliaSonera and Telefónica highlight the different approaches in dealing with anticompetitive unilateral conduct of vertically integrated undertakings under sec. 2 Sherman Act and Art. 102 TFEU.
- The position of the U.S. Supreme Court appears to be too restrictive at least in two respects:
  - Sticking to a separate analysis of the upstream and downstream markets misses the point that vertically integrated dominant undertakings have additional leeway for anti-competitive strategies.
  - In addition, the denial of a supplementary application of the Sherman Act in case of any sector-specific regulation unnecessarily weakens the protection of competition. At least the existence of a regulatory duty to deal should be treated as being equivalent to an antitrust duty to deal.

IV. Summary and conclusion (2)

- The recognition of price squeeze as a distinct, stand-alone competition claim by the ECJ is effect-based and makes sense from an economic point of view
  - Focus on the spread between prices at wholesale and retail level and the exclusionary effect resulting from a negative or insufficient margin is reasonable.
  - Determination whether the margin is sufficient to cover the dominant firm's own product-specific costs ("equally efficient competitor test") as a general rule; only in exceptional cases reference to the costs of a "reasonably efficient competitor".
  - No additional qualifying factors other than dominance of the vertically integrated firm on the upstream market and indispensability of the product or service for entering the downstream market, in particular no duty to deal required on the upstream market.

IV. Summary and conclusion (3)

- A careful individual analysis of potential exclusionary effects remains necessary even if there is no regulatory or antitrust duty to deal. An important factor is the indispensability of the wholesale product, but it is not a prerequisite for finding an illegal margin squeeze.

Thank you very much for your attention !

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