THE NON-INDISPENSABLE CONDITION IN “MARGIN SQUEEZE” CLAIMS

IN EUROPE

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1. INTRODUCTION

A margin squeeze is commonly understood to occur when a vertically integrated undertaking, holding market power in the wholesale (“upstream”) market, applies a pricing practice of such a kind that the spread between the prices applied in the upstream market and those applied in the retail (“downstream”) market does not allow for effective competition. In such circumstances, a downstream competitor that is as efficient as the undertaking would not have sufficient margin to cover the specific costs needed to gain access to that retail market.

The most recent judgment of European Union courts on this matter is the Telefónica case. Telefónica is the former State monopoly in the telecommunications sector in Spain. In July 2007 the European Commission (“Commission”) imposed a fine of EUR 152 million on Telefónica for allegedly abusing its dominant position by setting prices in the form of a margin squeeze in the Spanish broadband market, thereby infringing Article 102 of the Treaty on the Functioning of the European Union (TFEU). In October 2007

1 LL.M. Candidate, Columbia Law School (2013). The author has been counsel to a party in the proceeding discussed in this article. The views and opinions expressed in this publication are strictly personal and should not be attributed to any entity with which the author is affiliated.
5 Consolidated Version of the Treaty on the Functioning of the European Union (hereinafter “TFEU”), art. 102: “Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.”
Telefónica appealed the Decision before the General Court of the European Union (GCEU), and on March 29, 2012 – almost five years later – the GCEU upheld the Commission’s Decision, confirmed the fine, and dismissed Telefónica’s appeal in its entirety.

The factual background of this case, together with the rationale developed by Union’s institutions, feature a range of singularities that, combined, distinguish Telefónica from any other margin squeeze case examined thus far by European Union courts. Among the particularly noteworthy reasons that Telefónica is a truly sui generis case are: (i) the margin squeeze related to a wholesale product that was not necessary to compete in the downstream market; (ii) the relevant market was strictly regulated by the Spanish regulatory authority; (iii) the level of margin squeeze was positive, i.e. the input was lower than the retail price; (iv) the GCEU disregarded the non-indispensable nature of the wholesale product when assessing the effects of the pricing practice.

This note attempts to examine the first of these issues, the legal and economic characterization of a margin squeeze when it relates to a non-essential input.

2. **INDISPENSABILITY AS A DISPENSABLE CONDITION FOR A MARGIN SQUEEZE CLAIM IN EUROPE**

a. **Background**

Under European Union law, a margin squeeze has traditionally been classified as an instance of refusal to supply. As such, a margin squeeze could only be abusive if the wholesale product was objectively necessary to compete in the downstream market. The Court of Justice of the European Union (“CJEU”) established in the landmark case *Bronner*\(^6\) three conditions for a refusal to supply to be considered contrary to Article 102 TFEU: (i) the refusal had to relate to an indispensable input; (ii) the refusal was likely to

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\(^6\) Case C-7/97, Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG., 1998 E.C.R. I-07791 (hereinafter “*Bronner*”).

2
eliminate all competition in the downstream market; (iii) the refusal could not be objectively justified.\textsuperscript{7}

The Commission followed this approach in the Guidance Paper on Article 102 TFEU,\textsuperscript{8} where it stated that “the concept of refusal to supply covers a broad range of practices”\textsuperscript{9} including the “so-called ‘margin squeeze.’”\textsuperscript{10} The Commission found that these practices ought to be confronted with the three conditions established in Bronner,\textsuperscript{11} foremost whether the practice relates to an indispensable input.\textsuperscript{12}

Against this background, it was rather surprising how the CJEU responded to a reference for a preliminary ruling in TeliaSonera, a proceeding that concerned the interpretation of the criteria under which a pricing squeeze could be held abusive. The CJEU decided to ignore the criterion of its Advocate General\textsuperscript{13} and stated that “even where the wholesale product is not indispensable, a [margin squeeze] may be capable of having anti-competitive effects on the markets concerned.”\textsuperscript{14} It said, in other words, that a margin squeeze might be considered abusive, and hence contrary to Article 102 TFEU, even if the input is not necessary to compete in the downstream market. Further, the CJEU upgraded margin squeezes to the category of stand-alone abuses; according to the Court a margin

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\textsuperscript{7} See Bronner, \S 41. The CJEU also established two cumulative conditions for an input to be considered as indispensable under antitrust rules: (i) inexistence of any actual or potential substitute; (ii) impossibility for competitors to effectively duplicate the input.
\textsuperscript{8} Communication from the Commission — Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009 O.J. (C 45) 7 (hereinafter Guidance Paper).
\textsuperscript{9} Id. at \S 78.
\textsuperscript{10} Id. at \S 80.
\textsuperscript{11} Id. at \S 81.
\textsuperscript{12} Id.
\textsuperscript{13} Prior to the ruling, the Advocate General had concluded that “[i]f the dominant undertaking’s input is not indispensable, for instance, if there are substitutes available, it cannot be the subject of an abusive margin squeeze, because competitors do not need to acquire it, either at the dominant undertaking’s price or indeed at all.” See Opinion of Advocate General Mazák in TeliaSonera, \S 11.
\textsuperscript{14} See TeliaSonera, supra note 2 at \S 72.
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squeeze “may, in itself, constitute an independent form of abuse distinct from that of refusal to supply.”\textsuperscript{15}

b. The legal criterion applicable to margin squeezes under Telefónica

Given that there were substitutes readily available to Telefónica’s input, and the Commission’s Decision in Telefónica preceded TeliaSonera,\textsuperscript{16} the Commission had to circumvent the scope of Bronner in order to declare Telefónica’s pricing practice abusive. As such, the Commission articulated two exceptions to the Bronner framework. First, it argued that the conditions imposed in Bronner ought to be disregarded when an obligation to deal had been imposed by a regulatory authority.\textsuperscript{17} Second, it claimed that Telefónica’s \textit{ex ante} incentive to invest in its infrastructure was not at stake given that those investments were undertaken when Telefónica benefited from exclusive rights from the State.\textsuperscript{18}

The GCEU upheld the Decision on the basis of two main arguments: (i) it was the Spanish regulatory framework, and not the Commission itself, that had required Telefónica to supply to its competitors,\textsuperscript{19} and (ii) in light of TeliaSonera, a margin squeeze constitutes a stand-alone abuse, and thus it is not necessary to subject its lawfulness to the indispensability condition of Bronner.\textsuperscript{20} Otherwise, argued the GCEU, “any conduct of a dominant undertaking in relation to its terms of trade” would be conditioned on the principles established in Bronner, and this would “unduly reduce the effectiveness” of Article 102 TFEU.\textsuperscript{21}

\begin{footnotes}
\item[15] \textit{Id.} at ¶ 56.
\item[16] The Commission’s Decision in Telefónica was approved in July 2007, while the CJEU ruling in TeliaSonera was rendered in February 2011.
\item[17] See Decision, \textit{supra} note 4 at ¶ 303.
\item[18] \textit{Id.} at ¶ 304.
\item[19] See Telefónica, \textit{supra} note 3 at ¶ 179.
\item[20] \textit{Id.} at ¶ 181.
\item[21] It is worth noting that the GCEU did not echo the second of the Commission’s exceptions. This claim, which fundamentally argued for a lowering of the antitrust standard of intervention on the basis of past ownership, appears indeed economic and legally flawed. The market power derived from these special rights would have been \textit{ex ante} internalized in the sale price at the moment on
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i. The regulatory framework as a justification for antitrust enforcement

The first argument of the GCEU fails to distinguish between the respective roles of antitrust and regulation. As has been extensively argued, the existence of a regulatory duty to supply does not imply that such an obligation exists under antitrust rules, given that the regulator seeks different objectives and standards than the antitrust authority. Moreover, it seems notably unsound to justify antitrust enforcement on the basis of the existence of a regulatory framework, when the well-established antitrust principle runs precisely in the opposite direction.

United States antitrust law is uncontroversial in this regard; regulation diminishes the likelihood of antitrust harm and thus the added value of antitrust intervention is reduced, if not negative. In Trinko, a case in which a telecom company (Verizon) was required by statute to lease its network elements to downstream competitors, the United States Supreme Court held that the antitrust claim was not actionable given that, though there was a regulatory duty to supply, the company had no antitrust duty to deal with its rivals. The Supreme Court explained that “where such a [regulatory] structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny.”

The United States First Circuit Court of Appeals went even further in Town of Concord, another case that examined whether a price squeeze could violate antitrust rules

privatization. It would be thus a source of inefficiency to subject these assets ex post to special duties on the basis of a historical ownership, and would in any case reduce its value, which is contrary to the TFEU in as long as it cannot prejudice the national rules governing property ownership. See in this regard George Alan Hay and Kathryn McMahon, The Diverging Approach to Price Squeezes in the United States and Europe, 8 Journal of Competition Law & Economics 259, 259-96 (2012).


when it takes place in a regulated industry. In an opinion delivered by current Supreme Court Justice Stephen Breyer, the Court explained that

“An antitrust rule that seeks to promote competition but nonetheless interferes with regulatory controls could undercut the very objectives the antitrust laws are designed to serve. Thus, where regulatory and antitrust regimes coexist (…) antitrust analysis must sensitively recognize and reflect the distinctive economic and legal setting of the regulated industry to which it applies.”

24

ii. The long shadow of TeliaSonera

The second argument of the GCEU fundamentally relies on TeliaSonera, a ruling to which the GCEU makes constant references throughout its judgment. The GCEU argues that a margin squeeze constitutes a stand-alone violation that does not require an essential input in the upstream market; such a requirement, it argues, would unduly reduce the effectiveness of Article 102 TFEU. Two main objections may be raised with regard to this argument.

First, this claim contradicts the consensus view among economists that margin squeezes should be characterized as constructive refusals to supply – an outright refusal to supply is equal to a margin squeeze in which the upstream price is set infinitely high. It does not seem economically nor legally sound to declare legitimate a margin squeeze with an infinite price while condemning a margin squeeze with a finite price for the only reason that the concerned product is not indispensable. Indeed, any company supplying a non-

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24 Town of Concord, Mass. v. Boston Edison, 915 F.2d 17 (1st Cir. 1990). See also Pacific Bell Telephone Co. v. Linkline Communications, Inc., 555 U.S. 438 (2009): “when a regulatory structure exists to deter and remedy anticompetitive harm, the costs of antitrust enforcement are likely to be greater than the benefits.”

25 From the perspective of a downstream competitor, it does not make a difference whether the upstream supplier provides the input at a price which makes its downstream commercialization impossible, or whether it does not provide the input at all. See for instance Steven C. Salop, Refusals to Deal and Price Squeezes by Unregulated, Vertically Integrated Monopolist, 76 Antitrust L.J. 709 (2010), where the author suggests an identical test for margin squeezes and refusals to supply. See also Guidance Paper, where the Commission identifies margin squeezes with “constructive refusals,” supra note 8 at ¶ 79.
essential input worried about being charged with a margin squeeze claim could simply refuse to supply the downstream firm at all in order to avoid antitrust scrutiny.\textsuperscript{26}

Second, the GCEU fails to explain how in Telefónica, where the dispute related to the price for access to a dispensable input and not “other terms of trade” such as tying or exclusive dealing, the reliance on the Bronner principles “might unduly reduce the effectiveness” of Article 102 TFEU. On the contrary, intuition leads to an opposite conclusion.

An effective application of Article 102 TFEU should ensure that market practices that achieve the same results are confronted with the same legal tests. Otherwise, companies could circumvent the rules and anticompetitive behaviors would outwit legal provisions.\textsuperscript{27} A margin squeeze could exclude an “as-efficient competitor” but probably not a “more efficient competitor.” However, an outright refusal to deal will exclude every competitor, not only those equally efficient, and consequently may produce greater anticompetitive effects. Subjecting such a practice (outright refusal to deal), which is likely to cause greater consumer harm, to a more lenient standard of proof that requires the existence of an indispensable upstream input would actually result in less effective enforcement of Article 102 TFEU.\textsuperscript{28}

3. IMPOSING LIABILITY FOR THE PROVISION OF A NON-ESSENTIAL INPUT MAY UNDERMINE COMPETITION

Imposing liability for the provision of a non-essential wholesale product might not only be unfair; it might also undermine the very same goals sought by antitrust rules.

\textsuperscript{26} See Einer Elhauge & Damien Gerardin, Global Antitrust Law and Economics 477 (2nd ed. 2011).

\textsuperscript{27} Jordi Gual et al., Report by the EAGCP “An Economic Approach to Article 82” 2 (July 2005), http://ec.europa.eu/dgs/competition/economist/eagcp_july_21_05.pdf.

\textsuperscript{28} See Salop, supra note 25.
First, it may reduce the incentive for the vertically integrated firm to invest in efficient facilities. A rule that imposes a risk of liability if a company voluntarily provides the input, despite the absence of an antitrust duty to do so, will tend to discourage the upstream company from selling the input at all. As a consequence, goods might be withdrawn from the market, provided the upstream supplier can do so, to the detriment of consumers, as firms stop dealing with each other so as to avoid liability.

Second, it may reduce the incentive for the competitor of the vertically integrated firm to invest in efficient facilities. If access to the upstream facility were too easily allowed, there would be no incentive for an entrant to develop competing facilities, or to invest and innovate in the upstream market.

Third, false positives might chill investment. Margin squeezes involving non-essential inputs may not actually result in anti-competitive effects, but under the Telefónica standard the practice would be condemned. It is well known that the social cost of false positives in the field of antitrust is enormous, particularly given that they discourage the same conduct that antitrust laws are designed to protect.

4. CONCLUSION

This note has provided a brief assessment of the Telefónica judgment as regards its extension of liability for the provision of a non-essential input within a margin squeeze.

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29 See Dennis W. Carlton, Should Price Squeeze Be a Recognized Form of Anticompetitive Conduct? 4 Journal of Competition Law and Economics 271. See also Opinion of the Advocate General in Bronner: “the incentive for a dominant undertaking to invest in efficient facilities would be reduced if its competitors were, upon request, able to share the benefits,” ¶ 57.

30 Id.

31 See Opinion of the Advocate General in Bronner, ¶ 57: “if access to a production, purchasing or distribution facility were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term.”

claim. It has been argued that, insofar as a margin squeeze is equivalent to a constructive refusal to supply, both practices should be confronted with the conditions established in *Bronner*, including the one requiring a duty to supply under antitrust rules. Given that Telefónica’s input was not indispensable for a rival to be able to compete in the downstream market, its pricing practice should not have been held abusive.

Further, imposing liability for the provision of a non-essential input might undermine the same goals that antitrust is designed to protect, inasmuch as: (i) enforcement of antitrust rules in heavily regulated markets might undermine competition; (ii) subjecting outright refusals to supply and constructive refusals to supply to different standards of proof might reduce the effectiveness of Article 102 TFEU; and (iii) the extension of liability might reduce incentives to invest.