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Assessment of a Margin Squeeze as an Abuse of Dominant Position under EU Competition Law

JAEM01 Master Thesis

European Business Law

15 higher education credits

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Spring 2014

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Abstract

It is not illegal for an undertaking to have dominant position under EU competition law but such undertakings have a special responsibility to ensure that its conduct does not distort competition. Margins squeeze is one of the many different measures that can be construed as an abuse of an undertakings dominant position under Article 102 TFEU. Margin squeeze can be implemented by a vertically-integrated undertaking with a dominant position on the upstream level (wholesale) that supplies a key input to downstream operators (retail), and also competes on the downstream level in providing services to end users. The dominant undertaking can abuse its position by a margin squeeze by setting its upstream operations wholesale price and its downstream operations retail price at such a level that the margin spread between these two prices will be insufficient for an equally efficient competitor to profitably trade on the downstream market. This abuse has an exclusionary effect on the downstream market since competitors won't be able stay profitable as a result of the vertically-integrated dominant undertakings pricing practice. The EU case-law concerning the assessment of margin squeeze as an abuse of dominant position is relatively newly developed and has been the subject of lively academic debates and some controversy. The objective of this thesis is to analyze how margin squeeze has been assessed as an abuse of dominance by the EU judicature and the Commission and whether margin squeeze should be assessed under same requirements as refusal to deal when the dominant undertaking has voluntarily decided to deal with its downstream competitors.

Abbreviation

EU	European Union
ECJ	Court of Justice of the European Union
TFEU	Treaty on the Functioning of the European Union
Commission	European Commission
OJ	Official Journal of the European Union
US	United States of America
Idib.	Ibidem (“the same place”)
p.	page
pp.	pages
para.	paragraph
paras.	paragraphs

1. Introduction

1.1 Background

Having dominance on a particular market is not in itself illegal but undertakings in such position must compete on the merits and have a special responsibility to ensure that their conduct does not distort competition. Vertically-integrated dominant undertakings can distort competition and infringe EU competition law by abusing their dominant position by implementing a margin squeeze.

Before the beginning of the 21st century cases concerning margin squeeze as an abuse of dominant position were very rare and the subject did not attract much academic interest. In the years leading up to the end of the 20th century, many utilities markets were liberalized (telecommunications, electricity, gas and water) turning former monopolies into privately owned undertakings, which held control over former state owned infrastructure and networks. This market change created many vertically-integrated undertakings with significant market dominance on the wholesale level. These dominant undertakings provided access to their upstream inputs to downstream operators, as well as competing with those operators on the downstream market to provide end user service. Liberalization opened markets up to competition in end user services, but it also paved the way for vertically-integrated undertakings use of margin squeeze to exclude downstream competitors and is one of the reasons for the increase in margin squeeze cases within the EU. For the last couple of years the conduct of a margin squeeze has been one of the most debated competition law developments concerning abuse of dominant position. The objective of this thesis is to shed the light on the interesting and somewhat controversial subjected of margins squeeze as an abuse of dominant position and how it is assessed under EU competition law.

1.2 Purpose

The purpose of this thesis is to give an outline on how margin squeeze as an abuse of dominant position is assessed within the EU. Essentially, the thesis entails two main questions. First, how is margin squeeze as a pricing practice of a vertically-integrated undertaking assessed according to the case-law of the EU judicature and the Commission? Second, should margin squeeze be assessed in the same manner as refusal to deal when there is no regulatory obligation on the dominant undertaking?

1.3 Method and material

When analyzing the relevant case-law and other sources of law on the subject, the author has used a traditional legal dogmatic methodology. References to legal academic writing on the subject matter are utilized to supplement the analysis and rationale behind the author's opinions and conclusions.

The most important material used in this thesis is the relevant case-law concerning margin squeeze as an abuse from the ECJ, the General Court and decisions of the Commission. A range of academic articles, books and academic writing has been relied on to further support the content of the thesis. Further, the author has relied on legal communications and other disclosures from the Commission with regard to its own interpretation of margin squeeze, as well as discussion papers from other EU sources and international organizations. For the analysis of margin squeeze in the US, relevant US case-law will be used as well as academic written material.

1.4 Delimitation

The main focus of the thesis is the legal assessment of margin squeeze as an abuse of dominant position under EU competition law and how that assessment has been applied by the EU judicature and the Commission in its recent case-law. It is not the purpose of this thesis to explain the concept of dominant position and how to establish dominance. Margin squeeze is a very economic concept that involves a highly complex economic calculation and explanations of those calculations are beyond the intentions or capabilities of this thesis. The thesis will not go into in-depth analysis of the conflict that can comes up in margin squeeze cases between sector-specific regulation and competition law, and whether the latter should apply when the former is present. This thesis is not intended to review the objective justifications that dominant undertakings can bring forth to rationalize its alleged abusive conduct.

1.5 Outline

The thesis will be organized in the following manner. Chapter two will give a brief introduction in the legislative framework concerning margin squeeze within the EU. Chapter three will be an introduction to the concept of margin squeeze and the conditions that need to be present on the market. Chapter four will introduce both the earlier case-law and the recent case-law concerning margin squeeze. Chapter five will contain the assessment of margin squeeze, where the recent case-law will be analysed to draw forward what factors and conditions that matter and how they are applied by the EU judicature and the Commission. Chapter six contains a brief discussion on how the margin squeeze claims have been dealt with in the US to give the comparative overview of the two legal systems. Chapter seven consists of analysis on margin squeeze and refusal to supply and whether the margin squeeze should be assessed in the same manner as refusal to deal when there is no regulatory obligation on the dominant undertaking to deal. Finally, the thesis will be concluded with a summary of the thesis where the conclusion of each part will be highlighted.

2. EU legislative framework concerning margin squeeze

In the EU Article 102 TFEU protects competition from possible harmful unilateral conduct of dominant undertakings, where it provides as follows:

> Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:
>
> (a) directly or indirectly imposing unfair purchase or selling prices or unfair trading condition;
> (b) limiting production, markets or technical development to the prejudice of consumers;
> (c) applying dissimilar conditions to equivalent transaction within other trading parties, thereby placing them at a competitive disadvantage;
> (d) making the conclusion of contract subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contract.

Margin squeeze implemented by a vertically-integrated dominant undertaking is a conduct that may potentially infringe Article 102 TFEU and the Commission´s first legislative reference to margin squeeze was in its Notice on the application of the competition rules to access agreements in the telecommunications sector[1]. The Access Notice addressed issues with regard to competition law and procedure applicable to access agreements which were to be regulated after the liberalization of the telecommunications sector in the EU. After the liberalization, many former state monopolies still controlled necessary networks to provide service to end users and access agreements were used as regulatory tools to provide operator access to these networks. The Access Notice refers to multiple abuses that are possible in the newly liberalized markets, and in paragraph 117-118, it states:

> “A price squeeze could be demonstrated by showing that the dominant company's own downstream operations could not trade profitably on the basis

[1] Commission notice on the application of the competition rules to access agreements in the telecommunications sector – framework, relevant markets and principles [1998] OJ C 265/2 (Hereafter: „Access Notice“)

of the upstream price charged to its competitors by the upstream operating arm of the dominant company. [...] In appropriate circumstances, a price squeeze could also be demonstrated by showing that the margin between the price charged to competitors on the downstream market (including the dominant company's own downstream operations, if any) for access and the price which the network operator charges in the downstream market is insufficient to allow a reasonably efficient service provider in the downstream market to obtain a normal profit (unless the dominant company can show that its downstream operation is exceptionally efficient)."[2]

In 2009, after the concept of margin squeeze as an abuse of dominant position had been well established by the Commission and the EU judicature, the Commission in its Guidance on the Commission´s enforcements priorities in applying Article 82 EC[3] stated that margin squeeze was a form of constructive refusal to deal.[4] The Commission would consider margin squeeze and refusal to deal as enforcement priorities when the product or service is objectively necessary to be able to compete on the downstream market, it is likely to eliminate effective competition on that market, and it would be likely to cause consumer harm.[5] It also stated two exceptions in which placing an obligation to supply would be unlikely to have negative effect on investment incentives and innovation on the upstream market. First, there was an exception if the undertaking was already under regulatory obligation to supply; and second, there was an exception if the upstream dominance had been established under exclusive rights or state funding. Under those conditions the Commission would apply its regular enforcement standard of showing likely anti-competitive foreclosure, without considering the above mentioned conditions.[6] Notably, the case-law of the ECJ does not in all instances correspond with this Guidance given by the Commission and there is considerable debate as to whether some factors concerning the assessment of margin squeeze as an abuse of dominant position has developed in the right manner. This will be further addressed in chapter 7.

[2] Ibid, paras. [117]-[118]
[3] Guidance on the Commission´s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C 045/7 (Hereafter: „Guidance Paper")
[4] Ibid, para. 80.
[5] Ibid, para. 81.
[6] Ibid, para. 82.

3. What is a margin squeeze

3.1 Definition of a margin squeeze

A margin squeeze occurs when a vertically-integrated undertaking with a dominant position on the upstream market supplies a key input to an undertaking that it competes with on the downstream market and sets its upstream (wholesale) price, downstream (retail) price, or both, at such a level that the spread between the prices results in an insufficient profit for the equally or perhaps more efficient downstream competitor[7], see Figure 1.

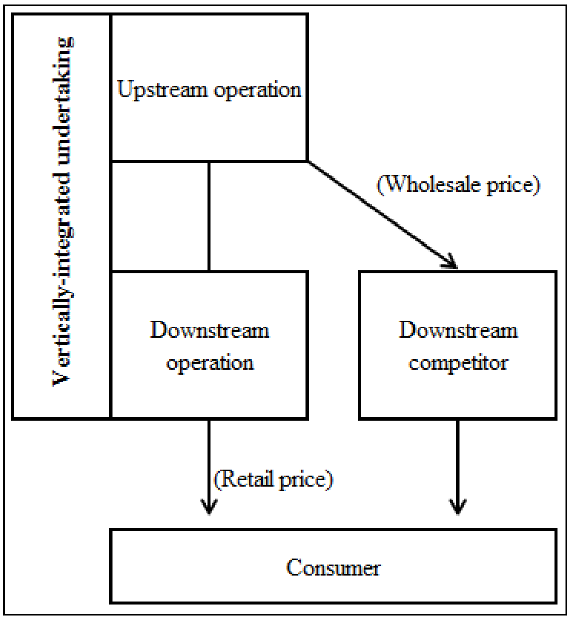

Figure 1: Explenation of the market condition under which a margin squeez occurs.

3.2 Condition under which a margin squeeze can occur

There are four main conditions that need to be present so that a margin squeeze can occur on the market: 1) there must be a vertically-integrated undertaking that applies the margin squeeze, 2) the upstream part of the vertically-integrated undertaking must supply a key input downstream, 3) the upstream operation of the vertically-integrated undertaking must have a dominant position on the market for the key input, and 4) the key input must constitute a relatively high fixed proportion of the downstream operator´s fixed costs. If any

[7] Or perhaps a reasonably efficient competitor. See Alison Jones, 'Identifying an Unlawful Margin Squeeze: The Recent Judgment of the Court of Justice in Deutsche Telekom *and* TeliaSonera' [2012] 13 CYELS, 161, p. 161.

of these elements are not present on the market, it is difficult if not impossible for participants on the market to implement a margin squeeze.[8]

Every margin squeeze case involves a vertically-integrated undertaking. Thus, the undertaking is present on both an upstream market and a downstream market and the upstream arm of the undertaking supplies the downstream operator with an input that is a key element of the downstream operator's product. Vertical-integration can be characterized as a "double-sided-relationship" where there is a customer relationship on the wholesale level and a rival competition on the downstream retail level.[9] If the undertaking is only present on either the upstream or the downstream market, said undertaking cannot affect the margin spread, since it needs control or overview over prices at both levels to squeeze the margin. If a dominant undertaking is only present on the upstream market and raises its wholesale price, the retailers on the downstream market can pass the increased cost on to the consumers since the dominant undertaking has no downstream operation to hold the retail price at a level that would create the margin squeeze between the wholesale and the retail price. If only present in the downstream level the dominant undertaking cannot charge high wholesale price for the key input to make it harder for downstream competitors to compete with its retail prices. Vertical-integration is thus an essential market condition for margin squeeze to occur.[10]

The supply of a key input for downstream product or service coupled with the dominance of the upstream operation are essential conditions for the implementation of a margin squeeze. The undertaking must be dominant on the upstream market for the key input since active competition on the upstream market for the key input would most likely render margin squeeze ineffective. Obviously, this is because downstream competitors could attain the input from another undertaking on the upstream market. In addition to the upstream dominance, the dominant undertaking must also supply a key input to the downstream market that is in some sense essential.[11] If the downstream competitors have alternative inputs that they can choose from, the risk of a margin squeeze will diminish since they will not be dependent on the input price or the input itself.[12] Indeed, while it can

[8] Damien Geradin & Robert O'Donoghue, 'The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector' (2005) GCLC WP No. 04/05 <http://ssrn.com/abstract=671804 or http://dx.doi.org/10.2139/ssrn.671804> accessed 12 April 2014, pp. 6-7.
[9] Charlotte A Eijberts, 'The Margins Squeeze in th EU Telecommunications Sector; No changes thus far' (2011) 14 IJCL&P < http://ijclp.net/ojs/index.php/ijclp/article/view/32> accessed 20 May 2014, p. 4.
[10] Rober O´donoghue & A Jorge Padilla, *The Law and Economics of Article 82 EC* (1st edt, Hart Publishing 2006), p. 306.
[11] Damien Geradin & Robert O'Donoghue (no 8), p. 7.
[12] Ibid, p. 7. See also Rober O´donoghue & A Jorge Padilla (no 10), p. 310-311.

perhaps not be said with absolute certainty, it is likely that the undertaking would need some form of super dominance on the upstream market to successfully implement a margin squeeze; else there might be alternatives inputs for the downstream competitor. In *Industrie des Prodres Sphériques,* the General Court upheld the decision of the Commission to reject a claim of margin squeeze and one of its lines of reasoning was that there were alternative sources for the raw material available to the downstream competitors.[13] In *Deutsche Telekom*, where the ECJ found there to be a margin squeeze, the input—in the form of local loop access service—was indispensable for any actual or potential competitors on the downstream market.[14]

Finally, the last necessary element to establish the implementation of a margin squeeze is that the input supplied by the vertically-integrated company to its downstream rivals must constitute a relatively high fixed proportion of the downstream costs. If it is only a small portion of the costs or the usage of such an input is variable, it is difficult to derive the equally efficient competitor's lack of profitability to the dominant undertakings pricing of the key input.[15]

[13] Case T-5/97 *Industrie des Prodres Sphériques SA v Commission of the European Communities* [2000] ECR II-3755 (Hereafter: „IPS“), para. 139.
[14] Case C-280/08 P *Deutsche Telekom v European Commission* [2010] ECR I-9555 (Hereafter: „Deutsche Telekom“)
[15] Damien Geradin & Robert O'Donoghue (no 8), p. 7.

4. EU case-law on margin squeeze

In this chapter, the case-law on margin squeeze within the EU is examined. The following chapter will then examine how the EU judicature and the Commission assess margin squeeze as an abuse of dominant position in the most recent case-law.

4.1 Earlier case-law

4.1.1 National Carbonising

Margin squeeze in the EU case-law dates all the way back to 1976 in *National Carbonising*[16], where the Commission investigated an alleged margin squeeze by National Coal Board (NCB) which had a monopoly on the upstream market for coal production as well as super dominance[17] on the downstream market for coke through its subsidiary. National Carbonising Company (NCC) bought all of its coal from NCB and competed with NCB´s subsidiary on the downstream market for coke and sought interim relief since it was unable to operate economically on the market because of NCB´s pricing practices. The Commission rejected the complaint by NCC since it had found no abuse, but did recognize that the dominant undertakings pricing conduct could constitute and abuse:

> "[A]n undertaking which is in a dominant position as regards the production of a raw material and therefore able to control its price to independent manufactures of derivatives, and which is itself producing the same derivatives in competition with those manufactures, may abuse a dominant position if it acts in such a way as to eliminate competition from these manufactures in the market for derivatives. From this general principle the services of the Commission deduced that the enterprise in a dominant position may have an obligation to arrange its prices so as to allow a reasonably efficient manufacturer of the derivative a margin sufficient to enable it to survive in the long term."[18]

Although the court does not refer to the case of *Commercial Solvents*[19], it most certainly sets forth the possibility that the pricing practice of a dominant undertaking, that controls a

[16] *National Coal Board, National Smokeless Fuels Limited and the National Carbonising Company Limited* [1976] OJ L35/6 (hereafter: „National Carbonising")
[17] 90% market share.
[18] Ibid, para. 14.
[19] Joined case 6/73 and 7/73 *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v Commission of the European Communities* [1974] ECR 223 (Here after „Commercial Solvents")

supply of raw material, can be dealt with under the principle of refusal to supply (essential facility doctrine) which was first established in *Commercial Solvents*. The pricing practice of NCB might amount to exclusionary effect on the competitors similar to that of refusal to supply because of the insufficient margin.

4.1.2 Napier Brown - British Sugar

The second case that the Commission decided upon with regard to margin squeeze[20] was *Napier Brown v British Sugar*[21], where British Sugar (BS) was a dominant company on the upstream market for sale of bulk sugar and the downstream market for retail sugar, and Napier Brown (NB) was a competitor on the retail market. The Commission found that BS had abused its dominant position with a margin squeeze since its pricing practice resulted in an insufficient margin for an undertaking as efficient as BS to survive on the downstream market.[22]

4.1.3 Industrie des Poudres Sphériques

The case *Industrie des Poudres Sphériques*[23] concerns an application of annulment of a Commission decision where the Commission had rejected the request of Industie des Prodres Sphériques (IPS) to find that Péchiney Électrométallurgie (PME) had abused its dominant position by a margin squeeze. PME was the sole European producer of calcium metal and also marketed broken calcium metal on a downstream market. IPS was PME´s competitor on the derivative market for broken calcium metal and claimed that PME had abused its position with a margin squeeze by setting its wholesale price of calcium very high, while at the same time pricing the broken calcium metal very low, which thus had the effect that PME´s downstream competitors were forced to sell at a loss if they remained on the market. The General Court described a margin squeeze as follows:

> "Price squeezing may be said to take place when an undertaking which is in a dominant position on the market for an unprocessed product and itself uses part of its production for the manufacture of a more processed product, while at the same time selling off surplus unprocessed product on the market, sets the price at which it sells the unprocessed product at such a level that those who purchase

[20] Margin squeeze was just one of many other anti-competitive conducts aimed at excluding Napier Brown from the market.
[21] *Napier Brown v British Sugar* (Case IV/30.178) Commission Decision [1988] OJ L284/41 (Hereafter:" Napier Brown")
[22] Ibid, paras. [65]-[66].
[23] IPS (no 13)

it do not have a sufficient profit margin on the processing to remain competitive on the market for the processed product."[24]

Having stated the possibility of a margin squeeze, the General Court held that IPS had not proved that the pricing practice at neither the wholesale level nor the retail level was on its own abusive:

> "In the absence of abusive prices being charged by PEM for the raw material [...] or of predatory pricing for the derived product, namely broken calcium metal, the fact that the applicant cannot, seemingly because of its higher processing costs, remain competitive in the sale of the derived product cannot justify characterising PEM's pricing policy as abusive."[25]

This holding suggests that the General Court was not willing to establish a margin squeeze as a standalone abuse, and further, to establish a margin squeeze abuse it had to be proven on the ground of exploitative wholesale price or predatory retail price. The main reasoning behind the General Courts rejection of the claim by IPS was that the raw material from the upstream market was not indispensable for IPS's downstream production since there were alternative sources from which IPS could have acquired the input product[26].[27]

4.2 More recent case-law

While the earlier case-law on margin squeeze involves very mature industrial markets[28], the more recent cases, are somewhat more complex, since they all deal with margin squeeze within the telecommunications market which are relatively newly liberalized and involve one or more wholesale products for the purpose of providing multiple downstream products as well as involving technology that is raptly developing.

4.2.1 Deutsche Telekom

Deutsche Telekom[29] was the fourth margin squeeze cases in the EU and the first case considered by the ECJ. Following the liberalization of the telecommunications market in

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[24] Ibid, para. 178.
[25] Ibid, para. 179.
[26] The General Court reviewed the import form alternative suppliers of calcium outside of Europe. In 1996 China and Russia imported 155 tons (17,5% of European consumption), 65,5 tons came from Canada and 150 tons from US producers. See IPS (no 13), paras. [51]-[56]
[27] Ibid, para. 57.
[28] Old raw material markets that are stable in the sence that there is no grate technolocigal chnages effecting the market.
[29] Deutsche Telekom (no 14)

Germany, Deutsche Telekom, the operator of the German fixed telephone network, offered local loop access to its competitors at wholesale level and direct access service to end consumers. Deutsche Telekom was under regulatory obligation to offer fully unbundled access to the local loop from its upstream operation to its competitors on the downstream market and the wholesale prices were regulated and this market activity had to meet the prior approval of the German regulatory authority for telecommunications and post (RegTP)[30]. At the retail level, Deutsche Telekom offered narrow broadband connection (analogue and ISDN) or a broadband connection (ADSL). The retail price for narrow broadband was regulated under a price caps system[31], where RegTP determined a price ceiling and movement targets for all services grouped in baskets. The ADSL charges where not subject to advance regulations under the price cap system and Deutsche Telekom could set ADSL prices at its own discretion, although those charges were subject to possible subsequent review by RegTP.[32]

Following the lodging of complaints in 1999 from competitors of Deutsche Telekom, the Commission adopted a decision where DT was found to have committed an abuse in the form of a margin squeeze generated by an inappropriate spread between wholesale charges for local loop access service and retail charges for end-user services.[33] Both the General Court and the ECJ confirmed the Commission decision concerning all the main issues concerning the abuse. This case is the corner stone of margin squeeze as an abuse of dominant position in the EU since the Courts established margin squeeze as a standalone abuse and it was the first time that they had to deal with margin squeeze in a regulated market.

4.2.2 TeliaSonera

TeliaSonera[34] was the next case considered by the ECJ concerning the telecommunications market. TeliaSonera is the owner of the metallic access network to which almost all Swedish households are connected. They offered unbundled access to local loops to operators in accordance with its regulatory obligations[35] and without regulatory obligations,

[30] Regulierungsbehörde für Telekommunikation und post. Here after referred to as „RegTP“.
[31] The retail for connection to Deutsche Telekom´s network and for telephone calls were not regulated separately for each service, according to the individual cost of the service; they were regulated for a block of services at a time, with different services being grouped together in „baskets“.
[32] Deutsche Telekom (no 14), para. 2.
[33] Ibid, para. 3.
[34] Case C-52/09 *Konkurrensverket v TeliaSonera* [2011] ECR I-527 (Hereafter: „TeliaSonera“)
[35] The regulatory obligation was derived from the Regulation of the European Parliament and of the Council 2887/2000/EC on unbundled access to the local loop [2000] OJ L336/4

offered ADSL access at wholesale level, which enabled the operators to offer broadband connections to end users. At the same time TeliaSonera also offered broadband connections to end users.[36] Konkurrentsverket (The Swedish national competition authority) in its opinion found that TeliaSonera had abused its dominant position by using a margin squeeze, by setting the price of the wholesale (ADSL) and the retail product to its end users at such a level that the spread between them was insufficient to cover the costs that TeliaSonera itself had to incur to distribute those products to the end users. Konkurrentsverket brought proceeding before Stockholm's tingsrätt (the Stockholm District Court) requesting the court to order TeliaSonera to pay an administrative fine for the infringement.[37] The Swedish court referred ten questions to the ECJ concerning the assessment of margin squeeze as an abuse. The Courts interpretation and answers will be reviewed in the following chapter.[38]

TeliaSonera differs in some significant ways from its predecessor, *Deutsche Telekom*. First, it was a preliminary ruling under Article 267 TFEU and second, unlike Deutsche Telekom which was under strict regulatory obligations to supply to its downstream competitors, TeliaSonera was not under regulatory obligation to supply the upstream product to its downstream competitor and had thus done so voluntarily. Further, there were, according to the order for reference, also alternative inputs on the upstream market. This critical issue concerning whether an undertaking should be obliged to deal on specific terms when there is no regulatory obligation will be dealt with in chapter. 7.

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[36] TeliaSonera (no 34), paras. [3]-[7].
[37] Ibid, paras. [8]-[9].
[38] The questions refered to the ECJ were the following: ***(1)***Under what conditions does an infringement of Article [102 TFEU] arise on the basis of a difference between the price charged by a vertically integrated dominant undertaking for the sale of ADSL input products to competitors on the wholesale market and the price which the same undertaking charges on the end-user market? *(2)* Is it only the prices of the dominant undertaking to end users which are relevant or should the prices of competitors on the end-user market also be taken into account in the consideration of question 1? *(3)* Is the answer to question 1 affected by the fact that the dominant undertaking does not have any regulatory obligation to supply on the wholesale market but has, rather, chosen to do so on its own initiative? *(4)* Is an anti-competitive effect required in order for a practice of the kind described in question 1 to constitute abuse and, if so, how is that effect to be determined? *(5)* Is the answer to question 1 affected by the degree of market strength enjoyed by the dominant undertaking? *(6)* Is the dominant position on both the wholesale market and the end-user market of the undertaking engaging in the practice required in order for a practice of the kind described in question 1 to constitute abuse? *(7)* For a practice such as that described in question 1 to constitute abuse, must the good or service supplied by the dominant undertaking on the wholesale market be indispensable to competitors? *(8)* Is the answer to question 1 affected by the question whether the supply is to a new customer? *(9)* Is an expectation that the dominant undertaking will be able to recoup the losses it has incurred required in order for a practice of the kind described in question 1 to constitute abuse? *(10)* Is the answer to question 1 affected by the question whether a change of technology is involved on a market with a high investment requirement, for example with regard to reasonable establishment costs and the possible need to sell at a loss during an establishment phase?

4.2.3 Telefónica

Telefónica[39] is the most recent margin squeeze case in the EU and like the two previous cases it concerned an abuse by a telecommunications operator. The Commission defined three relevant product markets: the retail broadband market and two distinct wholesale markets—wholesale access to the regional level (WAR)[40] and wholesale access at national level (WAN)[41]. Telefónica was under regulatory obligation to supply access at the wholesale level and also provided broadband access for end users at retail level. Telefónica was found to be super dominant on both wholesale markets[42] and also dominant on the retail market. In the Commission's decision[43], which the General Court upheld, Telefónica was found to have abused its dominant position by a margin squeeze from 2001 to 2006, on the grounds that the margin between its retail price and wholesale prices on both relevant wholesale markets had been insufficient for an operator as efficient as Telefónica on the downstream market to cover the costs to provide broadband access to end users. The decision of the General Court has been appealed to the ECJ.

[39] Case T-336/07 *Telefónica de España SA v European Commission* [2012] ECR II-nyp (Hereafter:"Telefónica")
[40] Requires a network roll-out to reach the 109 regional points that concentered the network traffic.
[41] Does not require any network roll-out for the operator and concentrates the traffic through one point.
[42] In 2004, 98% of retail ADSL lines were based in Telefónica´s WAN or WAR.
[43] *Wanadoo España v Telefónica* (Case COMP/38.784) Commission Decision [2007] (hereafter: „Telefónica, Commission decision")

5. Assessment of margin squeeze under EU competition law

The emphasis of this chapter is how an abusive margin squeeze is assessed within the EU from the recent case-law in *Deutsche Telekom*, *TeliaSonera* and *Telefónica*. Each subchapter will deal with element or factor that is considered by the EU courts and the Commission.

5.1 Standalone abuse

The conduct of a margin squeeze does indeed have similarities with other abuses of dominant position under Article 102 TFEU. If the wholesale price is very high it could just as well be construed as excessive pricing[44]. The conduct of the dominant undertaking on the downstream market when it sets its retail prices at a low level can be construed as predatory pricing[45] under Article 102 TFEU if it has a dominant position on that market. In *Industrie des Poudres Sphériques* the court seemed to hint that margin squeeze could not be a standalone abuse without proving abusive conduct on either the wholesale or the retail price level. In *Deutsche Telekom* the applicant argued that the Commission should have to prove the predatory nature of the retail price within the margin squeeze was abusive, since the applicant did not have the scope to adjust the wholesale price.[46] The court dismissed this argument of the applicant and found that margin squeeze was a standalone abuse of dominant position that is derived from the unfair spread between the wholesale and the retail price. It is not the level of the wholesale price or the level of retail price within the margin squeeze, which are contrary to Article 102 TFEU, but the spread between them,[47] as the court states in *Deutsche Telekom*:

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[44] Excessive pricing – Similarities: The dominant upstream company can set its prices at such a high level that it might be construed as exploitative pricing abuse, where the dominant company sets the high price [often referred to as monopoly price] not to exclude its competitors, but rather to exploit its dominant position for profitability. Difference: margin squeeze is a combination of two prices [the margin spread], the wholesale and the retail price, whilst the excessive pricing focuses on the abusive nature of the individual price. The undertaking setting the excessive price does also not need to be vertically-integrated for it to be an abuse.

[45] Predatory pricing – Similarities: Margin squeeze can entail a low retail price that could be construed as predatory pricing and they are both construed as exclusionary methods. Difference: The vertically-integrated undertaking does not necessarily incur losses since it might be making up for the low price on the retail market with high prices on the wholesale market. A non-vertically-integrated undertaking using predatory pricing will incur losses in the short term while its predation continues. The downstream arm of the vertically-integrated undertaking that is applying the predatory pricing, does also not necessarily have to be dominant on the downstream market, unlike the un-vertically-integrated undertaking.

[46] Deutsche Telekom (no 14), para. 152. See also Case T-271/03 Deutsche Telekom AG v Commission of the European Communities [2008] ECR II-477 (Hereafter: „Deutsche Telekom GC“), para. 153.

[47] Deutsche Telekom (no 14), para 159. See also Deutsche Telekom GC (no 46), para. 166.

> "[M]argin squeeze is capable, in itself, of constituting an abuse within the meaning of Article 82 EC in view of the exclusionary effect that it can create for competitors who are at least as efficient as the appellant. The General Court was not, therefore, obliged to establish, additionally, that the wholesale prices for local loop access services or retail prices for end-user access services were in themselves abusive on account of their excessive or predatory nature, as the case may be."[48]

In *TeliaSonera* the establishment of margin squeeze as a standalone abuse was confirmed by the ECJ. The court stated that margin squeeze would constitute an abuse where; "*the spread between the wholesale price for ADSL input service and the retail price for broadband connection service to end users were either negative or insufficient […] so that the spread does not allow a competitor which is as efficient as that undertaking to compete for the supply of services to end users [retail service]*".[49] Under these circumstances the competitor might be able to operate on the market only at a loss or at an artificially reduced level of profitability, although the competitor might be as efficient as the dominant undertaking. The unfairness of a pricing practice is linked to the very existence of the margin squeeze and it is not necessary to establish that the wholesale price or the retail price is in themselves abusive.[50] Individually, the downstream and the upstream prices are irrelevant to the assessment of an abusive margin squeeze; it is the combination of the two market prices that create the margin which must be assessed when analyzing the abusive pricing practice.[51]

5.2 The imputation test

The imputation test, as it is often called, is applied to ascertain whether the pricing policy of a vertically-integrated dominant undertaking allows a downstream competitor to earn sufficient profit. When allegations of a margin squeeze come forth, this test will be critical in assessing whether the margin spread is abusive.

In the 1998 Access Notice the Commission put forward two possible methods of implementation of the imputation test. The first method is the "equally efficient operator" test (EEO). It focuses on whether the downstream operation of the vertically-integrated

[48] Deutsche Telekom (no 14), para. 183.
[49] TeliaSonera (no 34), para. 32.
[50] Ibid, paras. [33]-[34].
[51] Liyang Hou, 'Some Aspects of Price Squeeze within the EU: a Case Law Analysis' [2011] ECLR 32(5), 250, p. 255.

dominant undertaking could trade profitably if it had to pay the same input price as its downstream competitors. The EEO test compares the margin between the upstream and the downstream price of the vertically-integrated dominant undertaking with its own downstream costs.[52] The second method is the so-called "reasonably efficient operator" test (REO) which focuses on whether a reasonably efficient operator on the downstream market could achieve a "normal profit" whilst paying the upstream input price. In the REO test the vertically-integrated undertaking is expected to set its pricing policy as to accommodate for the inefficiencies of its reasonably efficient competitor, by considering the reasonably efficient competitors smaller scale or ignoring other cost advantages of the dominant undertaking. This test compares the margin between the upstream and the downstream price with an actual or estimated cost of the reasonably efficient competitor.[53]

In the first margin squeeze case, *National Carbonising*, the Commission hinted at the use of the ROE method. In the *Napier Brown v British Sugar* the Commission and in *Industrie des Poudres Sphériques* the General Court referred to the EEO method when addressing the margin squeeze. However since the General Court rejected the claims brought before them, the EU judicature had not dealt with what method was to be applied to identify a margin squeeze. Referring to *AKZO*[54], where a predatory pricing practice of a dominant undertaking was found to be abusive by taking account of the dominant undertakings own charges and cost, the General Court in *Deutsche Telekom* ruled that the method to identify an abuse of margin squeeze should in principle be applied on the basis of the dominant undertakings own situation, rather than its competitors.[55] This principle was confirmed by the ECJ in *TeliaSonera*, and a margin squeeze will be determined on whether the dominant undertakings own downstream operator could trade profitably if it had to pay the wholesale price which it charges to its downstream competitors.[56]

One of the main rationales behind the use of the EEO test is that it protects the principle of legal certainty. The vertically-integrated undertaking has no information about its competitors cost structure or how to estimate the cost structure of the hypothetical reasonably efficient competitor. It does however know its own costs and can therefore foresee whether its pricing practice on the downstream and the upstream market might be

[52] Geoff Edwards, 'Margin Squeeze and the Insufficient "Equally Efficient" Operator' [2011] ECLR 32(8), 402, p. 402.
[53] Ibid, p. 402.
[54] Case C-62/86 *AKZO Chemie BV v Commission of the European Communities* [1991] ECR I-3359 (hereafter: "AKZO")
[55] Deutsche Telekom GC (no 46), para. 188
[56] Ibid, para.201. See alsoTeliaSonera (no 34), para. 42.

squeezing its own margin if it were being charged its own wholesale price,[57] as the ECJ specifically stated in *Deutsche Telekom*:

> "Such an approach is particularly justified because, […] it is […] consistent with the general principle of legal certainty in so far as the account taken of the cost of the dominant undertaking allows that undertaking, in the light of its special responsibilities under Article [102 TFEU], to assess the lawfulness of its own conduct. While s dominant undertaking knows what its own costs and charges are, it does not, as a general rule, know what its competitors' costs and charges are."[58]

The court in *TeliaSonera* further validated the test with the same reasoning as it had done in *Deutsche Telekom*.[59] If the REO would apply then the dominant undertaking would be in a situation where it would be extremely hard for the dominant undertaking to determine whether it is infringing Article 102 TFEU with a margin squeeze. This might even result in the undertaking implementing an illegal measure to acquire information about its competitor or even acquiring the information with the consent of its competitors and thus possibly leading to an infringement of Article 101 TFEU.[60]

There are also efficiency reasons for using the EEO test. The REO standard is more of an *ex ante* rule for regulatory authorities, where the goal is mainly to promote entry into the market of undertakings that initially are perhaps not as efficient as the vertically-integrated dominant undertaking but may, over time, become as efficient and might thus have positive effect on the market.[61] While this rational is understandable for the regulators that are in the business of effecting the market conditions to promote competition, the method when it comes to competition law does not fall so well into place with the principle of competition on the merits, which does not entail a dominant undertakings need to take account of its competitors inefficiencies so that it does not distort competition.[62] By using the EEO the market maintains an efficiency standard of the vertically-integrated dominant undertaking as a benchmark and thus does not protect inefficient competitors on the market.

[57] Geoff Edwards (n 52), p. 403.
[58] Deutsche Telekom (no 14), para. 202.
[59] TeliaSonera (no 34), para. 44.
[60] Damien Geradin & Robert O´Donoghue (no 8), p. 37.See also Robert O´Donoghue & Jorge Padilla (no 10), p. 317.
[61] Edwards, Geoff. (no 52), p. 403.
[62] Gianluca Faella & Roberto Perdolesi, 'Squeezing Price Squeeze under Antitrust Law' (2009) < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1478937> accessed 12 April 2014, p.19. See also Damien Geradin & Robert O´Donoghue (no 8), pp. 37-36.

Protecting inefficient undertakings may, for example, lead to higher price levels since it might discourage competition and also be a disincentive for less efficient undertakings to gain efficiency, both of which will not benefit consumer welfare.[63]

Although the EEO has been confirmed as the principle test to be applied in margin squeeze cases, the ECJ in *TeliaSonera* did determine that there could be circumstances where it might be relevant to make exceptions and take account of competitor's costs and prices when assessing the margin squeeze:

> "That might in particular be the case where the cost structure of the dominant undertaking is not precisely identifiable for objective reasons, or where the service supplied to competitors consists in the mere use of an infrastructure the production cost of which has already been written off […], or again where the particular market conditions of competition dictate it, by reason, for example, of the fact that the level of the dominant undertaking's costs is specifically attributable to the competitively advantageous situation in which its dominant position places it."[64]

The Court did not elaborate in any way on the reasoning behind the exceptions but it is clear that the REO test could be approved in some circumstances. But, in light of the general principle of legal certainty, there would have to be concrete reasoning behind the decision to deviate from the use of the EEO test.[65]

5.3 The margin spread

Having established the relevant test to determine whether a margin squeeze can be identified, the margin between the wholesale and the retail price must be assessed. The spread between the vertically-integrated undertaking's retail and wholesale price can yield a negative, positive, or a zero margin. If the wholesale price is higher than the retail price, then the margin spread will be negative, in which case the margin squeeze will be detected without having to take into account the product-specific costs. If the retail price is higher than the wholesale price, then the spread will be positive and the assessment must be based on whether the margin spread is sufficient to cover the cost of providing the service to the

[63] Gianluca Faella & Roberto Pardolesi (no 62), p. 20
[64] TeliaSonera (no 34), para. 45.
[65] Alison Jones (no 7), p. 181.

end user.[66] In *Deutsche Telekom* the margin spread between the wholesale and the retail price between 1998 and 2001 was found to be negative and thus there was no need to assess whether that spread was sufficient to cover the product specific costs over that time period.[67]

5.3.1 The appropriate cost measure – downstream costs

When a positive margin exists between the wholesale and the retail price, the product specific costs of the dominant undertaking downstream operation must be identified to detect whether the spread is sufficient to cover those costs. The cost measure used by the Commission in both *Deutsche Telekom* and *Telefónica* was the long run average incremental cost (LRAIC), and according the Commission's Guidance Paper the LRAIC is determined to be the cost measure that the Commission will generally rely on when assessing a margin squeeze.[68] This cost measure takes account of all variable and fixed costs that are specific to the downstream service being provided to end users and disregards all joint or common costs and overheads that are not derived from the downstream activity being provided.[69] The Commission made this clear in *Deutsche Telekom*:

> "To determine DT´s product-specific costs for providing retail access to the local network, it is necessary to deduct the overheads, i.e. the cost of merely providing the network infrastructure, form the total costs. Product specific costs would arise from any special equipment required to provide analogue, ISDN and ASDL, services and from DT´s customer relations"[70]

The incremental costs are equivalent to those which the vertically integrated undertaking would avoid if it decided to stop providing the service to the end users without changing any other form of service that the undertaking provides, whether upstream or downstream,[71] as the Commission explains in *Telefónica*:

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[66] Deutsche Telekom AG (Case COMP/C-1/37.451, 37.578, 37.579) Commission Decision [2003] OJ L236/9 (hereafter: „Deutsche Telekom, Commission decision"), para. 138.
[67] Ibid, para. 153.
[68] Guidance Paper (no 3), para. 81
[69] DG Competition paper on the application of Article 82 of the treaty to exclusionary abuses (2005) < http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf> accessed 16 April 2014, para. 65. See also Pietro Crocioni, 'Price Squeeze and Imputation Test: Recent Development' [2005] ECLR 26(10), 558, p. 564.
[70] Deutsche Telekom, Commission decision (no 66), para. 155.
[71] Ibid, para. [319]-[320]. See also Pietro Crocioni (no 69), page. 564. See also Copenhagen Economics, 'Applied Margin Squeeze Study' (2010) <http://eng.npt.no/market/market-regulation-smp/financial-regulation/margin-squeeze/_attachment/3391?_ts=13a405f63fb> accessed 4 May 2014, pp. 37-38.

"The long run incremental cost of an individual product refers to the product-specific costs associated with the total volume of output of the relevant product. It is the difference between the total costs incurred by the firm when producing all products, including the individual product under analysis, and the total costs of the firm when the output of the individual product is set to zero, holding the output of all other products fixed. Such costs include not only all volume sensitive and fixed costs directly attributable to the production of the total volume of output of the product in question but also the increase om the common costs that is attributable to this activity."

"Since the long run incremental cost of the individual product also includes the increase in the common costs resulting from the provision of the product in question, the mere fact that one cost is common to different operations does not necessarily imply that the long run incremental cost due to the activity in question is zero for any individual product. One must assess whether such common cost would have been incurred, partially or totally, if the company would have decided not to provide the product in question."[72]

5.3.2 The appropriate test to established profitability

When assessing profitability, after the relevant cost has been determined, there are two methods that have been used. The method that has most commonly been used and accepted by the ECJ and the Commission is the period-by-period method. It is a historical method, where the profitability is calculated by comparing the actual revenues and costs of the dominant undertakings downstream operator for each year of the relevant period.[73] This profitability method was used in both *Deutsche Telekom* and *Telefónica*.[74] The other method that has been used is the discount cash flow method (DCF) which consists in assessing the overall profitability over an adequate period, which is usually seven years[75]. The future growth of the company is taken into account by aggregating the expected future cash flow over time in order to arrive at a single measure, the net present value (NVP). In *Telefónica*, the Commission stated that both methods address the same underlining issue of recovering costs over some period of time but in different ways:

[72] Telefónica, Commission decision (no 43), paras. [319]-[320].
[73] Ibid, para. 328.
[74] Deutsche Telekom (no 14), para. 160. See also Ibid, para. 349.
[75] The period in Telefónica was five years and four months since that corresponded to the average lifetime of Telefónica´s network assets See Ibid, paras. [357] and [359].

"The DCF looks at the profitability of a business over a reasonably long period of time (several years); it does not specify how costs should be recovered in distinct sub-periods (every year). It considers the evolution of revenues or costs during the period employed for the analysis and calculates the net present value (NVP) of the business. On the contrary, with the period-by-period method, static models with standard accounting techniques result in some costs being treated as expenses and allocated only to the period in which they incurred and other costs being capitalised and allocated more than on time period, typically through linear depreciation."[76]

The Commission in *Telefónica* recognised that both methods are not perfect and that there is a margin for error when applying both methods. For that reason both of them were used to calculate profitability to avoid finding a margin squeeze that would be the result of an accounting distortion resulting from the lack of maturity of the Spanish broadband market.[77]

5.4 Anti-competitive effect

Article 102 TFEU does not set forth a requirement that the abusive conduct has as its objective or effect the prevention, restriction or distortion of competition as is specifically stated in Article 101 TFEU. Thus it has for some time been debated whether the abusive conduct of a dominant company is subject to proof of the effect it had on competition or whether the harmful effect could be presumed if the objective of the conduct was anti-competitive.[78] Earlier case-law on Article 102 TFEU clearly dictated that if the abuse has as its object the distortion of competition, such conduct would also be liable to have anti-competitive effect.[79] In *Deutsche Telekom* the Commission upheld this formalistic approach by stating that it was sufficient to detect an existence of a margin squeeze and that this, in itself, was enough to prove an abuse without having to establish the anti-competitive effect of the conduct.[80] Despite its position on margin squeeze being *per se* abusive under Article

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[76] Telefónica, Commission decision (no 43), para. 330.
[77] Ibid, para. 349.
[78] Liza Lovdahl Gormsen, 'Are Anti-competitive Effect Necessary for an Analysis under Article 102 TFEU' [2013] WC < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2400371> accessed 10 May 2014, pp. 224-226. See also Nicolas Petit, 'From Formalism to Effect? The Commission´s Communication on enforcement Priorities in applying Article 82 EC' WC < http://lawprofessors.typepad.com/files/from-formalism-to-effects---the-commissions-guidance-on-article-82-ec---final-2.pdf> accessed 10 May 2014, pp. 485-486.
[79] Case T-203/01 *Manufacture française des pneumatiques Michelin v Commission of the European Communities* [2003], ECR II-4071. See also AKZO (no 54), para. 71.
[80] Deutsche Telekom, Commission decision (no 66), paras. [179]-[180].

102 TFEU, the Commission still undertook an analysis of the market to show that there were barriers to market entry.[81]

Both the General Court and the ECJ rejected the finding of the Commission that the existence of a margin squeeze by a dominant undertaking was enough to constitute an abuse without the necessity of demonstrating anti-competitive effect.[82] The Courts still found the Commission had done enough to establish that the conduct could have exclusionary effect on competitors as efficient as Deutsche Telekom and that the margin squeeze created a barrier to entry on the downstream market. The courts identified two main factors that could give indication of an anti-competitive effect. First, there was no alternative infrastructure to access the local loop provided by Deutsche Telekom and the input was for that reason indispensable for its competitors to be able to enter the downstream market and compete with Deutsche Telekom. The only way for the competitor to enter the downstream market was by acquiring the input from Deutsche Telekom; but, because of the margin spread between the wholesale and the retail service, an as efficient competitor could not participate on the market without incurring losses.[83] Second, Deutsche Telekom´s competitors had only acquired a very small[84] amount of market share after the liberalisation of the German telecommunications market which was an indicator of anti-competitive effect, resulting from Deutsche Telekom´s pricing practices.[85]

In *Telefónica* the Commission undertook a rather in-depth effects analysis of the margin squeeze by examining the restrictions that the pricing practice could have on the relevant market as well the harmful effect it could have on the consumer. The Commission found that the margin squeeze implemented by Telefónica had restricting effect on competition by imposing pricing conditions that lead to losses for the equally efficient competitor, that would either drive competitors out of the market or make entry extremely difficult.[86] The only viable way of entering the market was to duplicate Telefónica´s wholesale service for local loop unbundling, which would take a long time and huge investments.[87] Relating to consumer harm, the Commission concluded that retail prices in

[81] Ibid, para. [181]-[183].
[82] Deutsche Telekom (no 14), para. 250. See also Deutsche Telekom GC (no 46), para. 235.
[83] Ibid, para. 255. See also Ibid, para. 237.
[84] All of its competitors held a market share of 4,4% in the narrowband access and 10% in broadband access. In the end of 2002 its 64 competitors all together held only 2.35 million of the total of 53,72 million telephone channels in Germany.
[85] Ibid, paras. [255] and [257]. See also Ibid, paras. [237] and [239].
[86] Telefónica, Commission decision (no 43), para. 564.
[87] Ibid, para. 553.

Spain had been 25% above the average in the EU,[88] and this was likely to some extent to be the result of Telefónica´s abusive conducts. Had Telefónica not implemented such pricing practices the market would have been likely to witness more vigorous competition and deliver grater benefits for the consumer in the form of lower prices and more choice.[89]

TeliaSonera confirmed that the effect based approach taken in *Deutsche Telekom* and by the Commission in *Telefónica* was the correct way with regard to the assessment of the illegality of a margin squeeze. When assessing whether the conduct is abusive, the pricing practice must have some anti-competitive effect on the market and it is sufficient to show that such effect may potentially exclude as efficient competitors form the market. It is not necessary for the effect to be concrete in a sense that the implemented pricing practice has actually had the exclusionary effect on competitors. Further, "*a [margin squeeze] cannot be classified as exclusionary practice where the penetration […] in the market concerned is not made any more difficult by the practice*".[90] It was left up to the national court to determine whether the pricing practice of TeliaSonera was likely to hinder as efficient competitors entry on the market. The ECJ stated that when examining the anti-competitive effect all specific circumstances must be taken into account and stressed that two particularly important factors concerning the functional relationship between the wholesale and the retail product needed to be analysed.[91] First, in circumstances where the wholesale input is indispensable[92] for the as efficient competitor to provide the retail service to end users, anti-competitive effect is probable when the as efficient competitor will be put at disadvantage on the market as a result of the dominant undertakings margin squeeze—which prevents or restricts the access to the market or the growth of its activities thereon, because the competitor is unable to operate on the market without a loss or reduced profitability.[93] If the wholesale input is not indispensable, it cannot however be ruled out that a margin squeeze can potential produce anti-competitive effect, by taking account of the dominance on the wholesale market.[94] Second, the level of the margin squeeze is important in determining the anti-competitive effect. When there is a negative margin between the wholesale and the retail price, the effect of potential exclusion is probable since the equally efficient competitor would be forced to deal at a loss. With a positive

[88] Ibid, para. 595.
[89] Ibid, para. 616.
[90] TeliaSonera (no 34), para. 66.
[91] Ibid, para. 69.
[92] The Indispensability criteria will be viewed in more depth in chapter. 7, where the relationship between refusal to deal and margin squeeze will be analysed.
[93] Ibid, para. 72.
[94] Ibid, para. 73.

margin there is a need to demonstrate that the margin squeeze would result in reduced profitability, making it at least more difficult to trade on the market.[95] The Court also held that there could be objective justifications that could counterbalance the exclusionary effect, in terms of efficiencies which could benefit the consumer.[96]

Because of the economic complexity of margin squeeze cases there is always the possibility of error when applying the equally efficient competitor test, thus the effect based approach that the EU judicature and the Commission have established in margin squeeze cases is important. By at least reviewing the possible or likely effect that the margin squeeze may have on the competitive structure, the Courts and the Commission can minimise the likely hood of wrongly finding an abusive margin squeeze due to the mere fact that an undertaking did not pass an imputation test.[97]

5.5 Regulated markets

This chapter is intended to give a brief overview of how certain issues concerning the relationship between sector-specific regulation and margin squeeze have been dealt with in the EU.

In recent years many major utilities markets have transitioned from those featuring state-owned monopolies to liberalized, competitive markets. In many cases the former state-owned monopolies overtook the infrastructure or network that was already in place for the supply of the service to the end user. To uphold a competitive structure on the market, the national legislator set up *ex ante* sector-specific regulatory obligations on the dominant undertaking to allow access to its infrastructure or network so that potential competitors could enter the downstream market and provide service for end users. The reason for the implementation of such measures is that the dominant undertaking on the upstream level is thought to hold a key input for the downstream market. There are some key differences with competition law and economic regulations. While competition law objectives are mainly to protect the competitive process on the market and consumer welfare, the regulator focuses on affecting the structural aspects of the market, for example, by controlling entry and exits, price, and quantity of goods and services. One of the main issues concerning the relationship between sector-specific regulation and competition law is

[95] Ibid, paras. [73]-[74].
[96] Ibid, paras. [75]-[76].
[97] Damien Geradin &Robert O'Donoghue (no 8), p. 50.

whether or not competition law should apply when the market has been regulated in such a manner as to protect the competitive process.

5.5.1 Competition law supplementing regulation

The EU judicature and the Commission has taken the stance that competition law is complementary to the regulatory framework in the sense that, if a dominant undertaking abuses its position despite the regulatory framework, competition law will apply *ex post*, even though the market has been regulated to protect the competitive process. In *Deutsche Telekom*, the ECJ stated, with regard to the relationship between *ex ante* regulation and *ex post* review that, "*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*."[98] Dominant undertakings are thus not just subject to the rules that regulate their market environment, but their conduct also has to remain with the boundaries of competition law rules.

5.5.2 Attributability

The fact that a vertically-integrated dominant undertaking follows its regulatory obligations does not guarantee that its conduct is satisfactory with regard to its obligations and special responsibilities under competition law and, specifically, as to its obligation to refrain from conduct that might impair undistorted competition.[99] In *Deutsche Telekom* the dominant undertaking was under regulatory obligation to supply access to local loop unbundling and its wholesale prices on the upstream market were fixed by RegTP with its retail prices similarly in some manner under regulatory scrutiny. Deutsche Telekom argued that it did not have the necessary scope[100] to affect the retail price so that the infringement in the form of margin squeeze could be attributed to its conduct.[101] The ECJ stated that Articles 101 and 102 TFEU, would not apply, 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*".[102] The Articles will however apply where the legislation leaves open the possibility that the undertakings autonomous conduct can prevent, distort, or restrict competition on the market. Since

[98] Deutsche Telekom (no 14), para. 92.
[99] Ibid, para. 83.
[100] The ability to affect its prices.
[101] Ibid, para. 66.
[102] Ibid, para. 80.

Deutsche Telekom had scope to adjust its retail prices for end-users access service, the margin squeeze was attributable to the undertaking own autonomous conduct.[103] Under EU competition law it is thus sufficient for a margin squeeze to be attributed to a vertically-integrated dominant undertakings if it has some scope to affect either the retail or the wholesale price, even where the price setting scope is under supervision of the regulator.

5.5.3 Decisions taken by national regulatory authority

Another argument that Deutsche Telekom made was that RegTP had reviewed the retail price levels on several occasions and found that there was neither a margin squeeze that infringed the national regulation or Article 102 TFEU, and that it had to be able to rely on such review. The ECJ and the General Court both found that the review of the national authority was irrelevant since the Commission could not be bound by a decision made by a national authority. Even if the national authorities had misapplied Article 102 TFEU, that could not affect the scope that Deutsche Telekom had to adjust the retail price.[104] It can be inferred from the Court's ruling that for Deutsche Telekom to be able to prevent an infringement by a margin squeeze, they should have disregarded the decision and reviews of the national authorities even though its prices were examined under Article 102 TFEU.

5.6 Conditions not relevant to the assessment

The preliminary reference sent to the ECJ in *TeliaSonera* laid out ten questions concerning whether specific conditions were relevant to the assessment of an abusive margin squeeze. This chapter will be a brief summary of the main conditions that the Court deemed not to be relevant to the assessment.

5.6.1 Recoupment of losses

When it comes to predatory pricing practice, the dominant undertaking incurs short time losses to exclude competitors with the objective of recouping those losses in the long run by raising prices at a later stage. Thus, the predatory pricing practice involves two different phases: loss-making and the recoupment phase. The ECJ has established that in predation cases the proof of recoupment of losses is not a necessary condition to find an abuse of dominant position.[105] With regard to margin squeeze, the vertically-integrated undertaking

[103] Ibid, para. 85.
[104] Ibid, paras. [89]-[91].
[105] Case C-202/07 *France Télécom SA v Commission of the European Communities* [2009] ECR I-2369, para. 110.

does not necessarily need to be operating at an overall loss. It can, for example, have a low retail price and a high wholesale price, making up for the possible profit lost on the downstream operation with the profit it earns through the upstream operation, thus making the recoupment and the loss period simultaneous.[106] One of the questions that was referred to the ECJ in *TeliaSonera*, concerned whether it was relevant to finding an abusive margin squeeze that the dominant undertaking had opportunity to recoup its losses. The Court stated that an undertaking engaging in a margin squeeze does not necessarily suffer losses and even if it did, there can be no requirement to find an abusive margin squeeze, based on the ability of the undertaking to recoup those losses since the pricing practice is only concerned with the margin spread which may cause its competitors losses.[107]

5.6.2 Dominance of the undertaking

Another question that was referred to the ECJ was whether the degree of market dominance was relevant to the assessment. The Court stated that the level of market strength was not relevant as long as the undertaking had the economic strength that is required under Article 102 TFEU.[108] The case-law of the EU refers to dominance of undertaking ranging from 50% market share in the relevant market and upwards. Although the Court deemed the dominance on the upstream market not relevant to the assessment, it is a necessary factor for the undertaking to have significant dominance, if not a super dominance or approaching monopoly on the market for the input, if it is to be able to effectively implement a margin squeeze.[109]

It has usually not been thought to be a necessary factor whether the vertically-integrated undertaking has a downstream dominance for the assessment of the abuse as such.[110] One of the questions referred was if it was necessary to also establish a downstream dominance. Referring to the *Tetra Pak*[111] cases the Court stated that conduct of a dominant undertaking that has effect on the dominant market or a non-dominant market can be characterized as abuse. Where the vertically-integrated undertaking’s conduct consists of driving out equally efficient competitors on the downstream market by applying

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[106] Damien Geradin & Robert O´Donoghue (no 8), p. 14.
[107] TeliaSonera (no 34), paras. [99]-[101].
[108] Ibid, paras. [80]-[81].
[109] Robert O´Donoghue & Jorge Padilla (no 10), p. 306. See also Cento Veljanovski and Pietro Crocioni, ‘Price Squeezes, Foreclosure, and Competition Law: Principles and Guidelines’ (2003). 4 JNI <http://ssrn.com/abstract=1963659> accessed 18 April 2014, p. 39.
[110] In Telefónica the Commission also stated that it was not necessary to establish that the vertically-integrated undertaking was dominant on the downstream market. See Telefónica, Commission decision (no 43), para. 6.
[111] Case C-333/94 *Tetra Pak International SA v Commission of the European Communities* [1996] ECR I-5951

margin squeeze, this act can constitute an abuse and does not depend on downstream dominance of the undertaking.[112] Although not relevant to establish an abuse, it is very likely that for a vertically-integrated undertaking to implement a successful margin squeeze it would need dominance on the downstream market so that it might be better equipped to capture end-users form excluded rivals.[113]

5.6.3 New costumers

The Commission´s Guidance Paper states that termination of existing supply arrangements between a dominant undertaking and its competitor is more likely to be found to be abusive then when an undertaking rejects a new costumer. In existing supply relationship the input could be construed as indispensable on the fact that the downstream competitor had made relationship-specific investments to use the input. Commission also stated that the dominant undertaking that found it in its interest to supply was an indication that the dominant undertaking had been satisfied with compensation from the competitor and it would therefore have to demonstrate an objective commercial justification as to its reason for the termination.[114] In *TeliaSonera* the ECJ found the new consumer factor had no relevance to the assessment since it had already established that margin squeeze was an abuse based on the insufficient margin and that could drive out the existing as well as new competitors.

5.6.4 New technology

The last question that the Court addresses was whether it was relevant, that the market concerned was growing rapidly and involves new technology which requires a high level of investment. The Court stated that the application of Article 102 TFEU did not depend on the maturity of the market and the objectives of the Article required quick action to prevent the distortion of the competitive structure in rapidly growing markets.[115] The Court still stated a fundamental consideration about emerging markets and investments of the dominant undertaking:

> “[T]he conditions of competition in the dominated market and, in particular, the costs of establishment and investment of the undertaking which has a dominant position in that market, must be taken into consideration as part of the analysis

[112] TeliaSonera (no 34), paras. [85]-[89]
[113] Robert O´Donoghue & Jorge Padilla (no 10), p. 306.
[114] Guidance Paper (no 3), para. 84.
[115] TeliaSonera (no 34), paras. [108]-[109].

> of that undertaking's costs, an analysis which […] must be carried out in order to establish whether a margin squeeze exists."[116]

This was one of the reasons that the Commission applied both the DCF and the period-by-period method when calculating profitability in *Telefónica* because of the lack of maturity of the Spanish telecommunications market.

[116] Ibid, para. 110.

6. Margin squeeze in the US

This chapter contains a brief summary of how margin squeeze has been dealt with in the US to give the reader an overview on how the concept of margin squeeze as an abuse of dominance differs between the US and the EU.

The first time that margin squeeze was acknowledged as a form of antitrust liability in the US was in the Alcoa judgment in 1945 of the Court of Apples for the Second Circuit.[117] The cases concerned an unregulated market for virgin aluminum ingot where Alcoa had a monopoly in the US. Alcoa used that material to produce sheet aluminum as well as selling the virgin aluminum to its competitors on the sheet aluminum market. One of the charges against Alcoa was for infringing Section 2 of the Sharman Act with a margin squeeze since Alcoa had sold ingot at such a high price that the sheet rollers, who were forced to buy from Alcoa, could not pay the expenses of rolling the sheets and make a living profit out of the price at which Alcoa itself sold sheets. Alcoa had become aware of the squeeze and had done nothing to remedy it and, therefore, intent could be established. The conduct was construed as an unlawful monopolistic offence under Section 2 of the Sherman Act:

> “[I]t 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."”[118]

A conduct of a margin squeeze would infringe Section 2 of the Sherman Act when the vertically-integrated undertaking holds a monopoly power on the upstream market and upstream price was higher than a “fair price”, and the downstream price is so low that its competitors on the downstream market cannot match the price and sustain a “living profit”.[119]

The judgment received some significant criticisms in large part due to the criteria of “fair price” and the “living profit“ which were thought to be inconstant with the tendency toward the consumer welfare approach of antitrust law in the decades following the decision.[120] Despite the criticism, the opinion in *Alcoa* remained a fundamental reference

[117] *United States v Aluminum Co. of America*., 148 F.2d 416 (2d Cir. 1945) (hereafter: „Alcoa“)
[118] Ibid, p. 438.
[119] Gianluca Faella & Roberto Pardolesi (no 62), p. 5.
[120] Ibid, p. 5. See also Niamh Dunne, ‘Margin squeeze: theory, practice, policy: Part 1 [2012] ECLR 33 (1), 29, p. 14.

point for lower Courts and other Courts of appeal for several years. In 1990 in *Town of Concord*,[121] Judge Breyer‘s opinion criticized the concepts of "fair price" and "living profit" because of their vagueness and the obligation on the Courts to act as regulators. He thought that, in accordance with Alcoa interpretation, price squeeze could violate Section 2 of the Sherman Act in unregulated markets,[122] but rejected the possibility where wholesale and retail prices were subject to regulation since the regulatory framework reduced the risk of consumer harm.[123] Since *Alcoa* and *Town of Concord*, the view of margin squeeze as an abuse of dominant position has drastically changed and the EU and the US are greatly diverging on this matter.

In 2004 the Supreme Court gave its ruling in *Trinko*[124] which was a refusal to deal case but the reasoning given in *Trinko* was in large part also applied in margin squeeze cases as can be seen below in the *LinkLin*e case. Verizon and AT&T were competitors on the downstream market for telecommunications service and Verizon was also dominant on the upstream market. Further, Verizon was under regulatory obligation to share its network with new entrants and to allow them access to the operation support services. Trinko, a costumer of AT&T, brought an antitrust complaint against Verizon for failure to provide adequate access to the operation support service for AT&T, for limitations placed on entry to the market, and further claimed that the conduct constituted a constructive refusal to deal.

In essence the Court established very strict requirements for the establishment of an antitrust obligation to deal. The Court stated that there could be exceptions to the well-established contractual freedom of traders. Such an exception could exist when a trader has had previous voluntary dealing with its competitor. But, Verizon was under regulatory obligation to deal and there was no proof that it would have done so voluntarily.[125] The insufficient service was not recognized as an antitrust claim under the precedence of the Court in refusal to deal cases. When the firm had no antitrust duty to deal with its competitors, it had no obligation to provide them with "sufficient" level of service.[126] Even

[121] *Town of Concord v Boston Edison Co*. 915 F.2d 17 (1st Cir. 1990)
[122] Ibid, p. 18.
[123] Ibid, p. 25. See also George A Hay & Kathryn McMahon, 'The Diverging Approach to Price Squeeze in the United States and Europe' [2012] JCL&E 8(2), 259, p. 266-267.
[124] *Verizon Communications inc v Law Office of Curtis V. Trinko, LLP* 540 US 398 (Supreme Court 2004) (hereafter: „Trinko")
[125] Ibid, pp. [408]-[409].
[126] Fernando Díez Estella, 'Jurisprudence of the EUJC on margin squeeze: from Deutsche Telekom to *TeliaSonera* and beyond...to Telefonica!' (2011) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851315> accessed 15 April 2014, p. 13.

if the Court would establish that an essential facilities doctrine would be a valid claim, the insufficient assistance in the present case would not suffice as a refusal to deal liability.[127]

The *Trinko* case is also significant in terms of the relationship between the sector-specific regulation and antitrust law. Conduct of a dominant undertaking can be subject to US antitrust law in regulated sectors unless it is specifically provided for within the legal framework that antitrust law shall not apply.[128] According to *Trinko*, where a regulatory structure exists that is designed to deter and remedy anti-competitive harm, the "*additional benefit to competition provided by antitrust enforcements will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny*."[129] The Supreme Court will thus weigh the antitrust functionality of the regulatory structure and whether it is, as the Court stated, "*an effective steward of the antitrust function.*"[130] The difference in the EU and the US is that antitrust law does not automatically supplement sector-specific regulation. The Supreme Court will evaluate on a case-to-case basis whether the regulatory scheme has antitrust functionality.

In *LinkLine*[131] the Supreme Court was given the opportunity to clarify the law concerning margin squeeze and whether it would constitute a standalone abuse. The facts of the case are similar to those of *Deutche Telekom* and *Telefónica*. In the case, AT&T was a vertically-integrated undertaking that controlled most of the local telephone networks and sold both DSL access to internet service providers and competed on the downstream market for services to end users at retail level. Until 2005 AT&T was under a regulation obligation to provide access to local loop to its competitors in order to develop a competitive market for internet services. After that period, AT&T was bound to supply the wholesale DSL access to independent firm at a price no greater then the retail price of AT&T's retail service.[132] The plaintiffs were competitors of AT&T on the retail market and brought a suit on the grounds that AT&T had engaged in margin squeeze by setting a high wholesale price for DSL and a low retail price for DSL internet and by doing so excluded and impeded competition.[133]

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[127] Trinko (no 124), p. 410.
[128] Caroline Cavaleri Rudaz, 'Did *Trinko* Really Kill Antitrust Price Squeeze Claims? A Critical Approach to the *LinkLine* Decision Through a Comparison of E.U. and U.S. Case Law' (2012) 43 VJTL <http://www.vanderbilt.edu/jotl/manage/wp-content/uploads/Rudaz-CR-_Final_.pdf> accessed 5 May 2014, p. 1111.
[129] Trinko (no 124), p. 412.
[130] Ibid, p. 413.
[131] *Pacific Bell Telephone Co. v. linkLine Communications, Inc*. 555 U.S. 07-512 (Supreme Court 2009) (hereafter: "LinkLine")
[132] Ibid, p. 1.
[133] Ibid, p. 2.

Instead of assessing the alleged abuse on the basis of the margin spread, the Court looked separately at whether there was an abuse at the wholesale and the retail market. Referring to *Trinko* the Court stated that where a firm has no antitrust duty to deal with its competitors at wholesale level, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous and that the only duty to deal obligation for AT&T was derived from national regulation.[134] The Court made no distinction between the insufficient assistance claim in *Trinko* and margin squeeze claim in the present case. Concerning the duty to deal the Court stated:

> "If AT&T had simply stopped providing DSL transport service to the plaintiffs, it would not have infringed the Sherman Act. Under these circumstances, AT&T was not required to offer this service at the wholesale price that the plaintiffs would have preferred."[135]

It then went on to analyze whether the price on the retail level were predatory. To constitute predatory practice the prices had to be below appropriate measure of its rivals costs and there had to be a dangerous probability that the defendant could recoup its losses as a result of its below-cost pricing. The Court stated that a price squeeze claim would not be recognized where the retail price remained over cost since that might deter firms from aggressive competition and make them raise prices to avoid antitrust liability.[136]

After having established that there was neither an antitrust duty to deal or predatory pricing practice, the Court stated that a claim based on the spread between the retail and the wholesale level was meritless and "*if there is no duty to deal on the wholesale level and no predatory pricing at the retail level, then a firm is certainly not required to price both of these services in a manner that preserves its rivals´ profit margin*."[137] The Court was not willing to recognize that a margin squeeze could constitute abuse of dominant position. When "*both the wholesale price and retail price are independently lawful, there is no basis for imposing antitrust liability simply because a vertically integrated firm´s wholesale price happens to be greater than or equal to its retail price*".[138]

The legal systems seem to have diverged entirely concerning the abuse of dominant position by a margin squeeze. While the US Supreme Court does not except a margin

[134] Ibid, p. 9.
[135] Ibid, p. 10.
[136] Ibid, p. 11.
[137] Ibid, p. 12.
[138] Ibid, p. 15.

squeeze as a claim under Section 2 of the Sherman Act and holds that the wholesale and retail conduct must be viewed individually when establishing an antitrust infringement, the EU judicature has firmly established margin squeeze as a standalone abuse of dominant position even where there is no regulatory or competition law duty to deal.

7. Margin squeeze and refusal to deal

Margin squeeze is a relatively newly established standalone abuse of dominant position within the EU and there are some issues that are still unsolved and debated amongst academics and practitioners. One issue in particular that stands out concerning the assessment of margin squeeze within the EU is when a vertically-integrated dominant undertaking voluntarily deals with its downstream rivals without having any regulatory obligation—as was the case in *TeliaSonera*. Such factual circumstances, however, have made no difference in the ECJ´s assessment and they've found that margin squeeze is a standalone abuse whether or not the undertaking was under regulatory or a competition law obligation to deal. The Court's line-of-reasoning has been debated vigorously, in light of the strong link between margin squeeze and refusal to deal, when the undertaking has voluntarily decided to deal. On the other side of the Atlantic, the US Supreme Court has taken a strict view on this matter; first, where there is no antitrust duty to deal, there is no duty for an undertaking to deal on terms that preserves their rivals´ profit margin; and second, margin squeeze is not valid as a standalone antitrust claim under Section 2 of the Sherman Act. This chapter will look at the relationship between margin squeeze and refusal to deal and whether, under the above mentioned circumstances, margin squeeze deserves different assessment from refusal to deal under EU law.

7.1 Refusal to deal – *Bronner* and Commission Guidance Paper

The abuse of a dominant undertaking by refusal to deal can be traced back to 1979, in *Commercial Solvent*[139], where ECJ ruled that a dominant undertaking's refusal to supply raw material to the downstream competitor of its own subsidiary would eliminate that competitor and was an infringement of article 102 TFEU. In *Bronner*[140] the ECJ set the relevant standard for refusal to deal cases in the EU. *Bronner* was brought before the ECJ through a preliminary reference from an Austrian Court. The facts of the case are that Mediaprint (a newspaper publisher that had developed a national delivery system) had refused the request of Oscar Bronner, a newspaper publisher with a small market share in the Austrian daily newspaper market, access to Mediaprint´s delivery system. The Austrian Court referred the question of whether such a refusal could amount to an abuse of dominant

[139] Commercial Solvents (no 19)
[140] C-7/97 *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG* [1998] ECR I-7817 (Hereafter: „Bronner“)

position under article 102 TFEU. The Court stated that for the refusal by Mediaprint to be abusive it had to be "*likely to eliminate all competition in the daily newspaper market on the part of the person requesting the service and that such refusal be incapable of being objectively justified, but also that the service in itself be indispensable to carrying on that person's business, in as much as there is no actual or potential substitute in existence for that home-delivery scheme.*"[141] The Court found that to meet these conditions it would have to be proven that the system was indispensable by showing that the creation of such a delivery system was not a realistic alternative since it would not be economically viable for the downstream competition.[142] The Court also pointed out that there were other alternative methods of distribution, such as, through post and sale in shops and kiosks, and even though they were in some way disadvantageous, publishers of newspapers still used those methods.[143] The Court found that under the conditions set forth by the referring Court, the conduct could not constitute abuse of dominance.

In the Guidance Paper[144] the Commission followed the approach that that had been established in *Bronner* when addressing refusal to deal. In the paper the Commission states that it is not necessary for there to be an actual refusal on the part of the dominant undertaking; constructive refusal to deal is sufficient. Such a constructive refusal could be in the form of a margin squeeze, where the pricing practice of the dominant undertaking on the upstream, downstream market or both, does not allow an equally efficient competitor to trade profitably on the downstream market on a lasting basis.[145] According to the Guidance Paper the Commission would treat refusal to deal as well as margin squeeze as an enforcement priority if 1) the product or service is objectively necessary to be able to compete on the downstream market, 2) it is likely to eliminate effective competition on that market, and 3) it would be likely to cause consumer harm. The Commission also considered that these conditions would not have to be considered in cases where the dominant undertaking was already under regulatory obligation to supply or when the upstream position had been developed with state resources.[146] The former exceptions are in line with the *Deutche Telekom* and *Telefónica* where the regulator deemed the input necessary by imposing an obligation to supply. The later exception will be analysed in chapter 7.6.

[141] Ibid, para. 41.
[142] Ibid, para. 45.
[143] Ibid, para. 43.
[144] Guidance Paper (no 3)
[145] Ibid, paras. [79]-[80].
[146] Ibid, para. 82.

7.2 Advocate General Mazák opinion in *TeliaSonera*

As has been stated earlier, the margin squeeze allegations in *TeliaSonera* were based on a margin spread between Teliasonera´s retail price of the downstream operation and the wholesale price for ADSL accesses on the upstream level, which TeliaSonera voluntarily provided access to without being under any regulatory obligation. In the case, the question arose whether the principle that had been established in *Bronner* should apply when there was no regulatory obligation to supply. TeliaSonera argued that to protect the economic initiative of the dominant undertaking, they should be free to fix their terms of trade as long as those terms are not so disadvantageous for its competitors, that the might be regarded as constructive refusal to deal under the *Bronner* conditions. ECJ rejected this argument by stating that if it was required that a conduct of a dominant undertaking "*in relation to its terms of trade could be regarded as abusive the conditions to be met to establish that there was a refusal to supply would in every case have to be satisfied and the would unduly reduce the effectiveness of article 102 TFEU*."[147] In light of the importance of the question, it must be said that the rationalization based solely on the reduction of effectiveness of Article 102 TFEU without any further explanation is quite unsatisfactory. In essence the ruling of the Court means that if the undertaking decides to voluntarily deal to its downstream competitors, it will not be subject to the same conditions as it would have had it decided not to deal at all since that would render article 102 TFEU less effective.

Advocate General (AG) Mazák's opinion went a different direction, concurring with the arguments of TeliaSonera. He first stated that the most important questions that had been brought before the Court in this particular case were whether a regulatory obligation to supply and indispensability of the product were necessary conditions to establish a margin squeeze. The AG stated that TeliaSonera was right when it argued that margin squeeze was only abusive where a dominant undertaking either has a regulatory obligation to supply an input or where that input is indispensable to provide the downstream service. The dominant undertaking could not be subject to abusive margin squeeze if the input is not indispensable—for instance, if there are substitutes available, because downstream competitors do not need to acquire the input at the dominant undertakings price or at all.[148] The AG´s opinion will be further referred to in the discussion below.

[147] TeliaSonera (no 34), para. 58.
[148] Case C-52/09 *Konkurrensverket v TeliaSonera* [2011] ECR I-527, Opinion of AG Mazák (Hereafter: „TeliaSonera AGO), para. 11

7.3 Economical equivalence of margin squeeze and refusal to deal

In the OECD Policy Roundtable on margin squeeze, it states as a key point that *"[e]conomically-equivalent actions or economically-equivalent market structures merit equivalent treatment under competition law*."[149] The difference between refusal to deal and margin squeeze is an obvious one: the former conduct entails outright refusal to deal with a downstream costumer while the latter conduct entails dealing on terms that may be disadvantageous for the competitor. The reason behind treating these two situations in the same manner is that they are, in essence, economically equivalent. An outright refusal to deal will have the effect that the downstream competitor will not be able to compete on the downstream market since he will be deprived of a necessary input from the dominant undertaking and will thus be excluded from the market. When a dominant undertaking implements a margin squeeze, the main distinction from refusal to supply is that the downstream competitor will not be deprived of its necessary input and will thus be able to remain on the downstream market, but the end result of exclusion is the same. Instead of refusing to supply the input, the dominant undertaking simply sets its wholesale and retail price at such a level that it will render it unprofitable for an equally efficient downstream competitor to stay on the market and, thus, in a constructive manner eventually operating as a refusal to deal.[150] Besides the possible loss of investment, neither the competitor nor the consumer will be harmed any more when a dominant undertaking implements a margin squeeze.[151] As AG Mazák stated in his opinion:

> "EU case-law has established that the effect of an abusive refusal to supply is the elimination of competition in the downstream market and, in my view, the concern is precisely the same in margin squeeze cases. There is no independent competitive harm caused by the margin squeeze above and beyond the harm which would result from a duty-to-deal violation at the wholesale level."[152]

In his view the two conducts were the same, whether the undertaking was obliged to deal or do so at a specific price. It is the view of many scholars and also of OECD competition authorities that because of the economical equivalence of the two conducts, they should be

[149] OECD, 'Margin Squeeze' (Policy Roundtable) DAF/COMP (2009)36, p. 24.
[150] Alison Jones (no 7), p. 165. See Martin Rauber, 'Case C-52/09, Konkurrentsverket v TeliaSonera Sverige AB, [2011] ECR I-527 – confirming an inappropriate assessment framework for margin squeeze' [2013] ECLR 34(9), 490, p. 495.
[151] Erik N. Hovenkamp & Herbert Hovenkamp, 'The Viability of antitrust price squeeze claims' [2008] ALR 51, 273, p. 277.
[152] TeliaSonera AGO (no 148), para. 16.

treated in the same manner when there is no regulatory obligation that affects the economical equivalence.[153]

7.4 What is indispensability condition?

The most important condition when it comes to placing an obligation to deal on undertakings is the indispensability of the upstream input. The Commission in its discussion paper referred to the indispensability as an objective necessity of the input for the downstream competitor, and stated the following explanation:

> "[A]n input is indispensable where there is no actual or potential substitute on which competitors in the downstream market could rely on as to counter - at least in the long-term – the negative consequence of the refusal. In this regard the Commission will normally make an assessment of whether competitors could effectively duplicate the input produced by the dominant undertaking in the foreseeable future. The notion of duplication means the creation of an alternative source of efficient supply that is capable of allowing competition to exert a competitive constraint on the dominant undertaking in the downstream market."[154]

The case-law concerning the indispensability corresponds with this assessment criteria set forth in the Guidance Paper. In *Industrie des Poudres Sphériques* the input, calcium metal, was not indispensable for the competitor since there were other producers that imported the input to the EU and there were thus alternative sources of supply.[155] In *Bronner* the Court first pointed out that there were alternative methods to distribute newspapers, in shops and kiosks, although they were less advantageous than the methods that were used by other newspaper publishers. It then stated that there were no technical, legal or economical obstacle for newspaper publishers to replicate the dominant undertakings delivery scheme and that in order to prove indispensability of the service it must be shown that it would not be economically-viable to replicate the delivery scheme.[156] In both *Deutsche Telekom* and *Telefónica*, the only infrastructure available at the time was the network of the dominant

[153] Ruber, Martin (no 150), p.495. See also Hendrik Auf'mkolk, 'The 'Feedback Effect' of Applying EU Competition Law to Regulated Industries: Doctrinal Contamination in the Case of Margin Squeeze' [2012] JECL&P 3(2), 149, p. 155. See also Gianaluca Faella & Roberto Pardolesi (no 62), 14. See also OECD (no 149) pp. 29 and 32.
[154] Guidance Paper (no 3), para. 83.
[155] IPS (no 13), para. 57.
[156] Bronner (no 140), paras. [43]-[46].

undertakings and in *Telefónica*, it was expressly stated that the roll out of a new network (replicating it) would not be economically-viable since it required considerable investments and could take a long time to replicate. It follows from the above mentioned case-law that where the indispensability of the input is assessed, possible substitutes and economical-viability of replicating the input are the factors that need to be taken into account.

7.5 The importance of the indispensability condition

The major concern with the ECJ not establishing that the *Bronner* conditions should apply in margin squeeze cases was that they did not acknowledge the condition that the input product had to be objectively necessary (indispensable) for the downstream competitors. Instead it reduced the indispensability condition merely to a factor in determining the anti-competitive effect of the abuse so that even if the input was not indispensable there could still be potential anti-competitive effect.[157]

According to the order for a reference in *TeliaSonera* there were alternative technologies available to provide the end users with the broadband service and also that TeliaSonera´s network might be replicated by its competitors or third parties, indicating that it would not constitute an indispensable input under the case-law on refusal to deal. If there is no regulatory obligation to provide a non-indispensable input, then—as AG Mazák stated in his aforementioned opinion—the dominant undertaking should not be charged with margin squeeze abuse.[158] In other words, if there is no obligation to deal then there is no obligation to deal on terms that are advantageous for the downstream competitors.

Placing an obligation on a vertically-integrated dominant undertaking to deal on specific terms when the input is not indispensable can have an adverse effect on competition on the downstream market. Under these conditions the incentives of dominant undertakings to supply the input could be undermined because of the threat of competition law liability. This might result in undertakings opting rather to refuse to deal, and in doing so reducing the competition on the downstream market.[159] If a vertically-integrated undertaking decided to supply to a downstream competitor, this might reduce the incentive for the undertaking to compete effectively on the downstream market and the undertaking would likely raise its retail prices to lessen the probability of being charged with a margin squeeze.[160] It could have a deterrent effect on the undertakings incentive to further invest in

[157] TeliaSonera (no 34), p. 72.
[158] TeliaSonera AGO (no 148), para. 21.
[159] Ibid, para. 21.
[160] Ibid, para. 21.

its input since it would be forced to share those investments with its rivals on terms that they themselves would not find advantageous. It might also have negative effect on innovation if undertaking were to be obliged to share the benefits of its inventions on terms that preserved there competitors profitability.[161]

The indispensability factor must also be considered in connection with the strength of the dominant undertaking on the upstream market. Indispensability would require some sort of super dominance on the upstream market since such input could not be easily substituted. In *TeliaSonera* the ECJ did not just disregard indispensability as a condition but also stated that super dominance was not relevant to finding an abuse.[162] When neither the condition of indispensability nor super dominance are a part of the assessment of whether a dominant undertaking is abusing its position, the only factors that need to be present are the insufficient margin spread for the equally efficient competitor and dominance on the upstream market. Considering the low threshold for dominance in the EU,[163] this might be construed as placing a "bull's eye" on all vertically-integrated dominant undertakings that supply an important input downstream not just those with super dominance. This broadness creates uncertainty for vertically-integrated undertakings that might view refusal to supply as a more viable option rather than risking competition law liability for trading on terms that may or may not be disadvantageous for the competitors. Creating such an uncertainty neither benefits the competitive process nor consumer welfare—both of which are part of competition law's objectives. Indeed, it can be concluded from the broad approach taken by the ECJ with regard to the indispensability factor not being a necessary condition for the establishment of margin squeeze as an abuse that 1) this judicial approach will most likely not promote the effectiveness of Article 102 TFEU, and 2) such a broad interpretation might even be harmful rather than helpful.

In my view the indispensability condition is a necessity when it comes to an abuse of margin squeeze to strike a fair balance between these two economically equivalent conducts. Although I agree with AG Mazák and many scholars that an undertaking should not have duty to deal on specific terms if it would not have a duty to deal at all, the main problem with the way the ECJ treats the indispensability condition is that it both 1) rules it out as a condition for establishing the abuse and 2) leaves open the possibility that anti-competitive effect can be found absent the indispensable input. I consider it irrelevant

[161] C-7/97 *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG* [1998] ECR I-7817, Opinion of Advocate General Jacobs (hereafter: "TeliaSonera AGO"), para. 57.
[162] TeliaSonera (no 34), para. 81.
[163] Ranging from 50% and above.

whether the indispensability condition is placed in the assessment of the abuse itself or the assessment of anti-competitive effect, since the important factor is that the condition should be construed as necessary when finding that a margin squeeze as an abuse of dominant position has infringed article 102 TFEU. AG Mazák seems in some sense to share this view in his opinion where he refers to a French case in which the Court stated that anti-competitive effect of a margin squeeze could only be presumed when the input supplied by the dominant undertaking to its competitors is indispensable for them to be able to compete on the downstream market.[164] It should be mandatory to do a thorough analysis of the input to establish that it is indispensable to the downstream competitor; and, this analysis should be based on alternatives and the economic-viability of replicating the input, before placing terms of trade obligation on the property rights of the dominant undertaking that has voluntarily decided to deal with its competitors, as AG Jacobs stated in his opinion in *Bronner*:

> "[T]he justification in terms of competition policy for interfering with a dominant undertaking's freedom to contract often requires a careful balancing of conflicting considerations."[165]

By making indispensability a necessary condition—whether part of the abuse assessment or anti-competitive effect assessment—the conflict between the freedom of the undertaking to trade its property and the protection of the competitive structure would be more optimally balanced. In doing so, the likelihood of a false positive in margin squeeze cases will diminish[166] and the competitive structure and consumer welfare would be well protected.

It must also be pointed out that even if margin squeeze was only deemed to be illegal when the dominant undertaking had either a regulatory or competition law duty to deal, it would not mean that the prices of the undertaking could not individually be abusive. All the recent margin squeeze case-law involves undertakings that are both dominant on the upstream and the downstream market. That means that both the wholesale price might be able to infringe article 102 TFEU as excessive pricing practice and the retail price might be so low that it might constitute an infringement as predatory pricing.[167] Placing stricter requirements on margin squeeze would thus in no way free vertically-integrated

[164] TeliaSonera AGO (no 148), para. 19.
[165] Bronner AGO (no 161), para. 57.
[166] Robert O´donoghue & A Jorge Padilla (no 10), p. 327.
[167] TeliaSoneraAGO (no 148), para. 32.

undertakings of their special responsibilities as dominant undertakings not to distort competition.

7.6 The second Guidance Paper exception

As was stated in chapter 7.1., in the Guidance Paper the Commission set forth two circumstances when refusal to deal and margin squeeze would not be subject to assessment under the *Bronner* conditions. First, margin squeeze would be not assessed under *Bronner* when there was already a regulatory duty to deal such as in *Deutche Telekom* and *Telefónica*. Second, the *Bronner* conditions would not be applicable when the upstream market position has been developed under protection of special or exclusive rights or had been financed by state resources. The ECJ did not give any indication that the reason for not applying the *Bronner* conditions was based on the second exception, which is understandable since the exception is not based on any previous case-law and this exception seems to be without merit, as AG Mazák pointed out in his opinion.[168]

There are many ways that an undertaking can obtain ownership over its property, whether it is through state resources, an undertaking's own investment, or possibly development that entails no specific investment for the undertaking. The way the undertaking acquires its property should not have the effect that the undertakings conduct will be subject to less strict requirements under Article 102 TFEU.[169] Although the dominant position of the undertaking on the upstream market had been establishes under state resources, a former monopoly's infrastructure might have been significantly improved after liberalisation and would need maintenance, which would have been funded by the private undertaking. It might thus be very problematic to determine which infrastructure was derived from private financing or from state resources.[170] The exception can also have deterrent effect on the undertaking's incentive to further invest in the infrastructure when it has knowledge that even though there are alternative methods for its competitors, they can rely on the dominant undertaking's infrastructure not on the basis of the indispensability of the property but on the manner of which that property originated.[171] This exception might be justified if provided by regulatory obligation, but lowering the competition law

[168] Ibid, paras. [26]-[28].
[169] Damien Geradin, 'Refusal to supply and margin squeeze: A discussion of why the "*Telefonica* exceptions" are wrong!' (2011) TILEC DP 2011-009 <http://ssrn.com/abstract=1762687> accessed 13 April 2014, p. 9.
[170] TeliaSonera AGO (no 148), para. 27. See also Ibid, p. 9.
[171] Damien Geradin (no 169), pp. 9-10.

standards on these grounds is, however, incompatible with its objective of prohibiting anticompetitive conduct.[172]

[172] Hendrik Auf'mkolk (no 153), p. 156.

8. Conclusion

There are many things that must be considered with regard to the assessment of margin squeeze as an abuse of dominant position. The ECJ has firmly established, first in *Deutsche Telekom* and most recently in *TeliaSonera*, that margin squeeze is a standalone abuse of dominant position based on a dominant undertaking's negative or insufficient margin spread between the wholesale and retail price for an as efficient competitor.

To detect if there is a negative or insufficient margin, there are two ways that have been accepted: 1) the equally or as efficient competitor test and 2) the reasonably efficient competitors test. The former is based on whether the downstream operation of the dominant undertaking could trade profitably if itself had to pay the wholesale price which it charges its competitors and takes account of the dominant undertakings own downstream product-specific costs. The latter is based on either the downstream competitor's cost structure or that of a hypothetical, reasonably efficient competitor. Legal certainty is the main reason that the former test has been chosen, since the dominant undertaking knows its own costs and could not foresee the unlawfulness of its conduct if it is determined by unknown economic factors. A rationale behind not using the reasonably efficient competitor test is that it would be more likely to promote inefficiencies on the market and has been seen as more of a regulatory tool to promote entry for less efficient firms on to the market.

Margin squeeze abuse can be established in two ways by the equally efficient competitor test. If the margin spread is negative then there is no need for further analysis of whether the margin is sufficient for the competitor to trade profitably. If it is positive then a calculation of profitability must be performed to establish an abuse, which is done by examining whether the positive margin is sufficient to cover the product-specific costs of the dominant undertaking's downstream operation. To calculate the profitability, the downstream operations product-specific costs must be identified. The relevant cost-standard that the Commission has used is the long run average incremental costs, which are equivalent to the cost that the downstream operation would avoid if it were to stop providing the downstream product or service. The period-by-period method, which was used in *Deutsche Telekom*, is the most commonly used method to calculate profitability. The Commission has also used the discount cash flow method, as it did in *Telefónica*, since it is thought to be better suited for immature markets.

Deutsche Telekom and *TeliaSonera* firmly established that margin squeeze is not a *per se* abuse of dominance under Article 102 TFEU and potential anti-competitive effect must be shown. In *Deutsche Telekom* and *TeliaSonera*, anti-competitive effect was probable if the product was indispensable. In the latter case however the Court did open up the possibility that anti-competitive effect could be possible in the absence of the indispensability. *TeliaSonera* also referred to the relationship of the wholesale and the retail price. Where the margin spread was negative, exclusion of competitors was probable and if positive the reduced profitability would have to make it more difficult for the competitor to operate on the market. Other factors such as lack of acquisition of market shares by the competitors and consumer harm relating to the price development on the retail market over the relevant period could also give indication to an anti-competitive effect of the margin squeeze.

EU competition law is complementary to sector-specific regulation and dominant undertakings cannot hide from competition liability if they have scope to act autonomously under the regulatory framework. Moreover, any action taken by the national regulatory authorities concerning the legality of the undertakings alleged margin squeeze does not bind the Commission which can later find to the contrary, that the conduct amounted to an abusive margin squeeze.

In *TeliaSonera* the ECJ also clarified that recoupment of losses of the dominant undertaking, the level of dominance on the upstream and the downstream level, whether the margin squeeze was directed at new costumers and whether the market was growing rapidly or involved new technology, was not relevant to whether margin squeeze was abusive.

Although the preliminary case-law in the US accepted margin squeeze as an abuse in some instances, the recent case-law clearly shows that the US and EU are diverging when it comes to accepting margin squeeze a standalone abuse of dominant position. The US Supreme Court in its *LinkLine* case did not accept that the margin spread could be abusive and rejected margin squeeze as a claim under Section 2 of the Sherman Act. Margin squeeze would either need to be abusive on the wholesale level in the form of refusal to deal, which in *Trinko*, the Court has established strict requirements. Where no such duty existed the undertaking had no duty to deal on terms that would protect its rivals 'profit margin. It could also be abusive on the downstream level through predatory pricing practice, which also had strict requirements of below cost retail prices and that the undertaking could recoup its losses.

Out of the EU case-law on margin squeeze, *TeliaSonera* is the most controversial. It has been widely debated whether the Court was correct in holding that when a dominant undertaking has voluntarily decided to deal, it is thus obligated to deal on specific terms if it is not under obligation to deal based on the conditions set forth in *Bornner*. Two years before the decision in *TeliaSonera* the Commission in its Guidance Paper stated that margin squeeze is a constructive refusal to deal and would be an enforcement priority under the conditions established in *Bronner* when: 1) the product was objectively necessary, 2) the margin squeeze would likely eliminate competitors, and 3) the margin squeeze would likely cause consumer harm. The ECJ in *TeliaSonera* rejected the argument that margin squeeze should be assessed under the *Bronner* conditions since it could reduce the effectiveness of Article 102 TFEU. AG Mazák on the other hand thought that margin squeeze could not be an abuse unless the undertaking was under regulatory obligation to deal or the product was indispensable for the competitor to provide the downstream service. Although margin squeeze and refusal to deal differ with regard to the time at which the competitor will be excluded, they are economically-equivalent conducts because they both involve vertically-integrated undertakings making decisions on the wholesale level either by refusing to deal the product or dealing on terms that will create an insufficient margin for its competitors, leading to the same exclusionary result and thus meriting the same treatment under competition law. Under the current case-law these two conducts will not been treated under the same requirements since the ECJ reduced the necessity of indispensability of the input in margin squeeze cases to criteria to show potential anti-competitive effect and that such potential effect could even be present in the absence of the condition of indispensability. With this decision it has been made possible that an undertaking's decision to deal with its competitor on the downstream level will be subject to competition liability for having traded on terms that might not yield sufficient profit margin for the equally efficient competitor, even though that undertaking would not have been under such liability if it had decided, from the offset, not to deal. By not establishing the indispensability condition as a necessity for finding that a margin squeeze has infringed Article 102 TFEU, the EU Courts may adversely affect competition instead of enhancing the effectiveness of the provision. Vertically-integrated undertaking's knowledge that competition authorities can possibly place upon them obligation to deal on specific terms even when the input is not objectively necessary for its competitors might reduce their willingness to deal, since they might find refusing to deal more suitable to avoid infringing competition law. It might also reduce the competitive aggression of those undertakings that do deal, resulting in undertakings raising retail prices to avoid a margin squeeze and possibly reducing investment incentives in the upstream input as well as innovation incentives.

In my view it is understandable to supplement regulatory obligation with competition law obligations even if the input is not indispensable since it has been deemed to be so by the regulator. My view is turned hundred and eighty degrees when an undertaking has voluntarily dealt its upstream input to its competitor. Under those conditions the indispensability of the product is a necessary requirement to place an obligation on an undertaking to trade its property on specific terms to its competitors since it interferes greatly with the undertaking's freedom to deal and should thus be subject to strict requirements. Whether that requirement comes into consideration to establish an abuse or as a factor to determine potential anti-competitive effect is irrelevant since it would in both cases lead to the conclusion that the conduct did not infringe Article 102 TFEU in the absence of indispensability of the input.

The second Guidance Paper exception states that the *Bronner* conditions will not be applied in margin squeeze cases if the upstream dominance had been developed under exclusive rights or by states resources has no basis in any EU case-law. How an undertaking acquires its property should not increase the likelihood of infringing competition law. Even though the property might have originated from exclusive rights or state funding, the undertaking most likely has had to invest in its maintenance and further improvement, making differentiation as to where the property came from problematic. Lowering the competition standard on these grounds is not compatible with competition law objectives and would be better suited as a regulatory tool.

As it stands, the case-law of the ECJ and the Guidance Paper contradict each other when it comes to assessing an abusive margin squeeze when a vertically-integrated undertaking has voluntarily dealt with its competitors. The Guidance Paper creates legitimate expectation for dominant undertakings on the market, but those expectations will turn into legal uncertainty when the guidance differs in a substantial way from the EU judicature´s interpretation. If this is the road to follow in the future then it is necessary that the Commission withdraws its guidance concerning the application of margin squeeze to eliminate uncertainty and preferably give further guidance on, for example, how the Commission will determine indispensability so that vertically-integrated undertaking may better understand how margin squeeze might apply to their particular circumstances as well as for the national competition authorities to implement EU competition rules.

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