



THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY

# The *linkLine* Judgment—A European Perspective

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### I. INTRODUCTION

The United States Supreme Court (“the Supreme Court”) has recently ruled, by unanimity, that absent an antitrust duty to deal or predatory pricing, the fact that a vertically integrated dominant firm/monopolist leaves no margin between the price it charges to competitors for wholesale services and the price it charges to downstream customers does not fall foul of the antitrust laws.<sup>1</sup> The Supreme Court has thus held that absent an antitrust duty to deal or predatory pricing, a “margin squeeze” cannot constitute a valid antitrust claim on its own.

The *linkLine* judgment contrasts with the increased attention that the European Commission (“the Commission”)<sup>2</sup> and national regulatory authorities<sup>3</sup> have given to margin-squeeze claims, even in cases where the company accused of this practice would not be subject to an antitrust duty to deal under the *Oscar Bronner*<sup>4</sup> criteria.

In the United States, the debate about margin squeeze has been linked to the more general debate about whether the antitrust laws should protect competition (no margin squeeze as an independent claim) or competitors (margin squeeze as an

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<sup>1</sup> Supreme Court of the United States, NO. 07-512, *Pacific Bell Telephone Company, AT&T California et al., petitioners v. linkLine Communications inc. et al.*, 25 February 2009. (“*linkLine*”)

<sup>2</sup> See e.g. Decision 2003/707/EC of 21 May (Case COMP/C-1/37.451, 37.578, 37.579 – Deutsche Telekom AG), OJ 2003 L 263, p. 9 and Commission Decision Case COMP/38.784 – Wanadoo España v. Telefónica, July 4, 2007 (“Telefónica decision”)

<sup>3</sup> See e.g. in the United Kingdom, *BSkyB*, CA98/20/2002, December 2002, *British Telecom*, Case CW/00613/04/03, November 2003, *Vodafone/02/Orange/T-Mobile*, Case CW/0061 5/05/03, May 2004, *Genzyme* [2004] CAT 4, 11 March 2004 or *Dwr Cymru Cyfyngedig v Albion water Limited* [2008] EWCA Civ 536; in France, *France Telecom/ SFR Cegetel/ Bouygues*, Decision no 04-0-48, October 2004; in Italy, *Telecom Italia*, A 351, provvedimento no. 13752, November 2004; in Denmark, *Song Networks A/S ITDC/SDNOFON*, April 2004; or Sweden, *TeliaSonera*, dnr 1135/2004, December 2004.

<sup>4</sup> Judgment of the Court of Justice of the European Communities (“ECJ”) of 26 November 1998, *Oscar Bronner GmbH & Co. KG c. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG y Mediaprint Anzeigengesellschaft mbH & Co. KG.* case C-7/97, E.C.R. [1998] (“*Oscar Bronner*”), p. I-7791, paragraphs 43-46. In that case, the ECJ held that for the owner of an infrastructure to have a duty to deal under Article 82 EC, access to this infrastructure must be (i) indispensable (*i.e.* that no viable alternative exists); and (ii) the denial of access thereto should lead to the elimination of all competition on the downstream market.

independent claim). According to some authors “more than ever before, the United States and Europe appear to be at a fork in the road over whether the law of monopolization exists to protect consumers or to ensure that a specified number of firms will profitably populate a market.”<sup>5</sup>

This article briefly assesses whether margin squeeze claims do/should constitute an independent abuse *ex Article 82 EC* absent an antitrust duty deal within the meaning of the *Oscar Bronner* case-law or abusing pricing in the upstream or downstream products.

## II. MARGIN SQUEEZE UNDER ARTICLE 82 C

### A. Margin Squeeze and Duty to Deal

The question whether Article 82 EC can apply to a margin squeeze absent an antitrust duty to deal within the meaning of the *Oscar Bronner* case-law has been clearly raised, for the first time, in the recent *Telefónica* case.<sup>6</sup>

In this decision, the Commission concluded that the margin between Telefonica’s wholesale broadband access charges and its retail broadband prices was insufficient for competitors to remain viable. As a result, the Commission imposed an unprecedented fine on Telefónica for, allegedly, having implemented a margin squeeze.<sup>7</sup>

During the administrative proceedings prior to the adoption of the decision, Telefónica argued, *inter alia*, that the investigated pricing practice amounted to a constructive refusal to deal, and that the Commission should have applied the criteria laid down by the ECJ in the *Oscar Bronner* judgment. Telefónica submitted, in substance, that if there is no antitrust duty to deal *ex Article 82 EC*, there cannot logically, economically, and legally be a duty to deal in certain terms under the same provision. In other words, that:

(...) it is illogical, and legally wrong, to maintain that its pricing policy concerning its national and regional wholesale products is nonetheless subject to Article 82 EC, simply because these wholesale products have been offered to competitors as

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<sup>5</sup> Supreme Court of the United States, NO. 07-512, *Pacific Bell Telephone Company, AT&T California et al., petitioners v. linkLine Communications inc. et al*, 25 February 2009. Brief of Amici Curiae professors and scholars in law and economics in support of the petitioners, page 5.

<sup>6</sup> Commission Decision Case COMP/38.784 – *Wanadoo España v. Telefónica*, July 4, 2007.

<sup>7</sup> The Commission imposed a fine of EUR 151,875 million to Telefónica. This fine was significantly higher than those imposed to Deutsche Telekom (12.6 million) and Wanadoo (10.35 million), even though the three fines were calculated under the 1998 fining guidelines, refer to the same markets (national broadband internet services) and the conduct was similar (predatory pricing), in the Wanadoo case, or (margin squeeze) in the case of Deutsche Telekom.

a result of a regulatory obligation imposed under the Spanish telecommunications law<sup>8</sup>

The Commission rejected Telefónica's argument arguing that "in the light of the specific factual, economic and legal context of the case" the *Oscar Bronner* jurisprudence was not applicable.<sup>9</sup> In addition, the Commission argued that in previous cases, such as *Napier Brown*,<sup>10</sup> it had challenged a margin squeeze in the absence of an essential facility (one of the conditions for the existence of a duty to deal).<sup>11</sup>

The Commission also claimed that "the particular circumstances of this case fundamentally differ from those in *Oscar Bronner*." It held that since Telefónica had a regulatory duty to supply, the balancing of Telefónica's incentives to invest and/or innovate had already been carried out by the Spanish regulator.

Finally, the Commission submitted that Telefónica's *ex-ante* incentives to invest could not be altered by a margin-squeeze finding (and a fine of over 150 EUR millions) since most of Telefónica's investment on infrastructure had taken place while the Spanish company benefited from exclusive rights. Hence, so the Commission concluded, there was no need to carry out an "antitrust" duty to deal assessment in this case. The Commission thus considered, in essence, that it could apply Article 82 EC to a margin squeeze claim without having to apply the criteria laid down by the ECJ in *Oscar Bronner*.

In parallel to the Telefónica proceedings, the Commission published a series of explanatory documents in relation to Article 82. Indeed, by the time the Commission adopted the *Telefónica* decision, the Commission's Staff Discussion Paper on exclusionary abuses ex Article 82 EC, published in December 2005, had already typified "margin squeezes" as constructive refusals to supply.<sup>12</sup> More recently, in December 2008, the Commission confirmed the characterization of margin squeezes as constructive refusals to supply.

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<sup>8</sup> See Telefónica decision, paragraph 301.

<sup>9</sup> See paragraphs 302 and 309 of the Telefónica decision.

<sup>10</sup> Commission Decision of 18 July 1988 relating to a proceeding under Article 86 of the EEC Treaty (Case No IV/30.178 *Napier Brown – British Sugar*). OJ L 284, 19/10/1988, p. 0041- 0059

<sup>11</sup> See paragraph 734. However, and regardless of the merits of the Commission's interpretation of the facts in *Napier Brown*, the fact remains that this decision was adopted before the *Oscar Bronner* judgement and cannot thus be considered as a valid precedent on the law of refusals to deal.

<sup>12</sup> See DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Public consultation, Brussels, 2005 ("*Discussion Paper*"), paragraphs 62, 66, 73 and 226. It can be visited online on: <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf>

In its enforcement guidelines,<sup>13</sup> the Commission announced that it would only pursue refusal to supply cases, including margin squeeze cases, as an administrative priority when:<sup>14</sup>

- the refusal/margin squeeze relates to a product or service that is objectively necessary to be able to compete effectively on a downstream market. The Commission refers in this respect to the *Oscar Bronner* judgment;<sup>15</sup>
- the refusal is likely to lead to the elimination of effective competition on the downstream market; and
- the refusal is likely to lead to consumer harm.

However, in paragraph 82 of the guidelines, the Commission introduced an exception to the general rule. This exception would apply to “certain specific cases” and appears to be heavily inspired by the *Telefónica* decision (“the *Telefónica* exception”).

In essence, the Commission considers that the criteria laid down in *Oscar Bronner* would not apply where:

- there is a regulatory obligation to supply as, in this type of situations, the Commission will assume that a balancing of incentives to invest/innovate has already been carried out; and/or
- the upstream market position has been achieved through state resources or special or exclusive rights.

In either of these two scenarios, the Commission would, as it did in the *Telefónica* decision, apply Article 82 to an alleged margin squeeze even if the *Oscar Bronner* conditions are not met, i.e. even where competitors can either replicate/obtain the facility/input in question and/or use alternative facilities/inputs to provide the downstream service or where the pricing practice in question would not lead to the elimination of effective competition downstream or to harm to consumers.

There thus appears to be a tension, at least as far as this set of cases is concerned, not only with the *linkLine* and *Trinko* Supreme Court rulings, but also, it is submitted, with the judgment of the ECJ in *Oscar Bronner*. In particular, the Commission’s “case by case” approach does not appear to be grounded in the case law of the European Court of Justice, and particularly in the *Oscar Bronner* judgment as this ruling does not require the carrying out of an *ad hoc*, case-by-case, analysis of incentives every time a given company is confronted with an access request.

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<sup>13</sup> Communication from the Commission, *Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, (“enforcement priorities paper”) Brussels, 9.2.2009, C(2009) 864 final. It can be visited online on: [http://ec.europa.eu/competition/antitrust/art82/guidance\\_en.pdf](http://ec.europa.eu/competition/antitrust/art82/guidance_en.pdf)

<sup>14</sup> See enforcement priorities paper, paragraph 81.

<sup>15</sup> See enforcement priorities paper, paragraph 83.

This *ad hoc* incentives analysis approach has not been applied in the past, let alone carried out by reference to that of a regulatory authority. In particular, it has not been applied to cases involving refusals to deal relating to companies benefiting from legal monopolies such as patents and other International Property (“IP”) rights. For instance, in the recent *Microsoft* decision the Commission did not analyze the impact of Microsoft’s decision to disclose certain aspects of its interoperability information to third parties on its incentives to invest prior to applying the *Oscar Bronner* criteria.<sup>16</sup>

The Commission’s approach appears to make the prosecution of a conduct dependent not on the conduct itself (“objective criteria”), but on the characteristics of the infringing undertaking and/or its history (“subjective criteria”).

The Commission’s approach makes the application of Article 82 EC contingent on the intervention of a regulatory authority which, other than potentially constituting a breach of, *inter alia*, the principles of legal certainty and no discrimination, does not take account of the fact that the objectives of regulation and competition law may not be the same. In particular, the Commission seems to disregard the fundamental and obvious fact that regulatory authorities often impose access obligations in situations where competition law cannot.

Regulators and competition authorities have different aims. Given these different aims, it cannot be assumed that, when balancing incentives, regulators will come to the same conclusion as a competition authority would. Regulators may impose access where a competition authority would not, and the price set by a regulator may be different to that set under competition law criteria. Regulation and competition policy do not necessarily carry out the same balancing of incentives.<sup>17</sup>

Indeed, when considering whether to impose obligations for access, National Regulatory Authorities (“NRAs”) ought to take into account factors that go beyond the protection of competition in the relevant markets.<sup>18</sup> For instance they are not required to consider whether or not access is indispensable for companies to compete downstream,

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<sup>16</sup> Commission Decision of 24 May 2004 relating to a proceeding pursuant to Article 82 of the EC Treaty and Article 54 of the EEA Agreement against Microsoft Corporation, OJ L 32, 6.2.2007, p. 23–28.

<sup>17</sup> When deciding whether to require access, the aim of a regulator is to encourage the emergence of competition in a market, whereas, the aim of European competition laws is to prevent restrictions on existing or potential competition. In this vein, the Access Directive (Directive (2002/19/EC) on access and interconnection in setting out guidelines for regulators imposing access terms on operators with significant market power state that a National Regulatory Authority (“NRA”) may “impose obligations to meet reasonable requests for access to, and use of, specific network elements and associated facilities, *inter alia* in situations where the NRA considers that denial of access or unreasonable terms and conditions having a similar effect would hinder the emergence of a sustainable competitive market at the retail level [...]”(article 12)

<sup>18</sup> See Access directive 2002/19/EC, Article 12: “(i) the technical and economic viability of using or installing competing facilities, in the light of the rate of market development, taking into account the nature and type of interconnection and access involved; (ii) the feasibility of providing the access proposed, in relation to the capacity available; (iii) the initial investment by the facility owner, bearing in mind the risks involved in making the assessment; (iv) the need to safeguard competition in the long term; (v) where appropriate, any relevant intellectual property rights; and (vi) the provision of pan-European services.”

or whether the refusal to provide access is likely to lead to the elimination of effective competition downstream. But in setting access prices they may take into account the need not to discourage investment in alternative infrastructures.

In any case, even if a NRA and an antitrust authority were to pursue the same aims, that would still not provide grounds for the Commission to pursue a margin squeeze case simply because a regulator has mandated access to a specific upstream product, in particular, where that access has been mandated under terms and conditions that would not be the same as those mandated by competition law if the *Oscar Bronner* conditions were met. Indeed, regulators and competition authorities may disagree about the price of access. Regulators may set higher access prices than a competition authority would require in a margin squeeze case in order, for example, to encourage competition and/or investment.<sup>19</sup> This is yet another reason why competition authorities cannot use the existence of access regulation as a valid ground for pursuing a margin squeeze case. Indeed, if a competition authority relies on the judgment of a regulator that requiring access will not harm investment incentives, it should also accept that regulator's judgment about the price at which access has no harmful effects.

As to the second exception, contrary to what the Commission seems to claim, even when a company's market position has been achieved through state financing or exclusive rights, granting access or challenging a pricing policy on margin squeeze grounds could still undermine the profitability of the investments the company made at the time, or of investments made subsequently. Indeed, the investment incentives of a company that gained its monopoly through state financing would be harmed if there had been less investment in the assets in question had investors known *ex ante* that a margin squeeze case was going to be brought *ex post*, *i.e.*, it is wrong to think that where the investor is a government it will spend money without taking account of the impact this will have on its finances in the future.

In any case, some of the assets in question may have been paid for by market investors after privatization, even if the company originally gained its dominant position through state financing. Similarly, some of the investment in the relevant assets may have been made after a company stopped benefiting from exclusive rights. Also, the fact that a company benefited from exclusive rights for a period does not guarantee that it earned a return on any investments it made during that period (e.g. it may have been providing universal services wholly or partly a loss).

Finally, the distinction between companies that have, in the past, been granted special or exclusive rights and all the others for Article 82 EC purposes appears to be at

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<sup>19</sup> See in this regard, J. Bouckaert and F. Verboven, *Price Squeezes in a Regulatory Environment*. J. REGULATORY ECON. 2004 26(3): 321-351.

odds with the principles of impartiality vis-à-vis the type of property ownership and the principle of equality between public and private companies laid down by the Treaty.<sup>20</sup>

### **B. Margin Squeeze and Abusing Pricing**

Regarding the existence of a margin squeeze claim absent predatory pricing downstream, the European Commission appears to take the view that there is no need to demonstrate that either the wholesale price is excessive in itself or that the retail price is predatory in itself, “the margin squeeze being merely a disproportion between an upstream and a downstream price.”<sup>21</sup>

The Commission’s theory of harm is that, even in the absence of abusive prices, a very low or even negative margin may harm competitors (by delaying entry and growth) in a way that is likely to hinder competition. This view seems to contrast with the position the CFI took in the first litigated case on margin squeeze, *IPS*, where it held that:

In the absence of **abusive prices** being charged by PEM for the raw material, namely low-oxygen primary calcium metal, 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. In that regard, it must be pointed out that a producer, even in a dominant position, is not obliged to sell its products below its manufacturing costs. [Emphasis added]<sup>22</sup>

The Court’s reasoning seems to be in line with the Supreme Court in *linkLine* in that in order to have anticompetitive effects, the prices charged by the dominant company must be either (i) abusive in themselves upstream or (ii) predatory downstream. Otherwise, the alleged insufficient margin between the two prices cannot give rise to an abuse where none existed otherwise.

More recently, in the *Deutsche Telekom* case, the CFI concluded that:

(...) the abusive nature of the applicant’s conduct is connected with the unfairness of the spread between its prices for wholesale access and its retail prices, which takes the form of a margin squeeze. Therefore, **in view of the abuse found in the contested decision**, the Commission was not required to

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<sup>20</sup> See Article 295 EC and, *inter alia*, the Commission Decision of 16 December 2003 on the State aid granted by France to EDF and the electricity and gas industries, OJ L 049, 22/02/2005 P. 0009 - 0029, paragraph 97.

<sup>21</sup> See *Telefónica* decision, paragraph 283.

<sup>22</sup> Judgment of the Court of First Instance of 30 November 2000, *Industrie des poudres sphériques SA v Commission of the European Communities*, Case T-5/97, E.C.R. [2000] Page II-03755.



demonstrate in that decision that the applicant's retail prices were, as such, abusive.<sup>23</sup> [Emphasis added]

In light of this finding, the question arises whether the CFI has ruled out the need to show predatory pricing downstream and/or abusive pricing upstream in order to find an anticompetitive margin squeeze.

However, it is submitted, the *Deutsche Telekom* judgment does not necessarily contradict the *IPS* (and *linkLine*) case-law. Indeed, in *Deutsche Telekom* the CFI limited itself to reply to the applicant's argument, *i.e.*, that for a margin squeeze to be proved the Commission had to show that the retail prices were predatory. The CFI rightly pointed out that the downstream prices do not need necessarily to be predatory to be contrary to Article 82 EC. Indeed, in EU law where, as opposed to U.S. law, excessive pricing can be held contrary to Article 82 EC, a margin squeeze could be found to breach this provision if the upstream prices are excessive.

The *IPS* (and *linkLine*) jurisprudence has also a clear economic justification, *i.e.*, a margin squeeze conduct can only be anticompetitive if downstream prices are predatory and/or upstream prices are abusive in themselves.

A margin squeeze finding in circumstances other than those just mentioned, abusive upstream prices in themselves or predatory downstream prices, would bring about undesired consequences. Indeed, a reduction of the upstream product price in order to avoid a margin squeeze, in circumstances where there is no duty to deal, could likely lead an efficient dominant company to bear losses in the provision of the upstream product. In this scenario, the dominant company would no longer have incentives to invest in upstream infrastructure which could lead to the collapse of the upstream market. By the same token, a downstream price increase in order to avoid a margin squeeze in the absence of predatory pricing would immediately increase the prices paid by customers, and, in addition, artificially raise the profitability of inefficient players in the market, thus benefiting competitors to the detriment of consumer welfare.

To sum up, both economic theory and the *IPS* judgment appear to support the view, and the *Deutsche Telekom* ruling does not seem to contradict it, that a margin squeeze practice can only be found contrary to Article 82 EC if the spread between wholesale and retail prices is negative due to the abusive character of the upstream prices or the downstream prices. Therefore, in at least one of its readings, the EC law on margin squeeze would be in line with U.S. law. This is not however the position taken by the European Commission in its *Telefónica* decision.

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<sup>23</sup> Judgment of the Court of First Instance of 10 April 2008, *Deutsche Telekom AG v Commission of the European Communities*, T-271/03, E.C.R. 2008, not yet published, paragraph, 167.

### ***C. Margin Squeeze in a Regulatory Context***

A dominant company whose infrastructure is not “essential” within the meaning of the *Oscar Bronner* case-law or whose pricing policy, while not abusive, makes it more difficult for competitors to enter the market, may, as a matter of regulatory policy, justify that national regulators foster the entry or growth of new entrants by introducing ladder-of-investment type of facilitating measures in which regulatory margin-squeeze actions could be useful. Indeed, regulators may be empowered to pursue regulatory margin-squeeze cases in regulated markets even in cases where there is no duty to deal or abusive pricing in the antitrust sense.

A regulatory solution to margin squeeze cases in those situations where the EU law on refusals to deal does not justify intervention would also be in line with the EC principle of subsidiarity. Indeed, NRAs, often created under the umbrella of European directives, are generally better placed than the European Commission to monitor the functioning of their national regulated markets, and to pursue competition and regulatory goals.

### **III. CONCLUSION**

Although the Commission seems to concur with the U.S. Supreme Court in considering that Article 82 should not be applied, in general, to margin squeeze cases when there is no duty to deal within the meaning of the *Oscar Bronner* case law, its position seems to be radically different in situations where there has been a regulatory intervention mandating access or certain forms of state intervention (the granting of exclusive rights/public funding). Fortunately, the merits and compatibility of these exceptions with Community law will likely be decided shortly by the European courts.<sup>24</sup>

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<sup>24</sup> Some of these issues have also been raised in the context of a reference for a preliminary ruling from the Tingsrätt Stockholm (Sweden) lodged on 6 February 2009, *Konkurrensverket v. TeliaSonera Sverige AB* (Case C-52/09).