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# Margin Squeeze in Regulated Industries: The CFI Judgment in the *Deutsche Telekom Case*

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**Margin Squeeze in Regulated Industries:  
The CFI Judgment in the *Deutsche Telekom* Case**

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In its long-awaited ruling of April 10, 2008, the Court of First Instance (“CFI”) upheld the decision of the European Commission imposing on the German incumbent operator Deutsche Telekom a fine of EUR 12.6 million for abuse of a dominant position on the market for local access to its fixed network.<sup>1</sup> The Commission found that the German incumbent operator had charged, between 1998 and 2003, a higher price to its competitors for the provision of wholesale access to subscriber lines than what it had claimed from its own retail customers for the subscription to the fixed telephony network. Deutsche Telekom’s market behavior was thus tantamount to an abusive margin squeeze.

The judgment is noteworthy in three points:

1. it constitutes the first clear legal confirmation that the margin squeeze represents a stand-alone type of abuse;
2. it defines the scope of application of the competition rules in sectors subject to ex-ante regulation; and

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<sup>1</sup> Case T-271/03, *Deutsche Telekom AG v. Commission* (not yet reported) (judgment of Apr. 10, 2008) [hereinafter CFI judgment].

3. the judgment sheds some light on the extent to which an effects-based analysis is required in order to establish that a certain practice is contrary to Article 82 EC.

## **I. MARGIN SQUEEZE: A “NEW” FORM OF ABUSE**

In the *Deutsche Telekom* case, the CFI explicitly recognized for the first time that the margin squeeze is tantamount to a distinct form of abuse and, by confirming the approach taken by the Commission in its decision, provided for a general definition of such abusive practice, clarifying its constitutive elements and the methodology to be applied for its assessment.

The CFI has fully endorsed the definition of margin squeeze provided by the Commission in its decision. Accordingly, a margin squeeze can be found if:

the difference between the retail prices charged by a dominant undertaking and the wholesale prices it charges its competitors for comparable services is negative, or insufficient to cover the product-specific costs to the dominant operator of providing its own retail services on the downstream market.<sup>2</sup>

This definition casts light on the essential elements of an abusive margin squeeze. The first main condition for a margin squeeze to take place is vertical integration. Deutsche Telekom, as most of the incumbent fixed line operators, offers local loop access at two different levels. Besides the retail subscriptions to end customers, it also offers unbundled local loop access to competitors, which allows them to gain direct access to end users. Deutsche Telekom is thus active on the upstream market for wholesale local loop access to competitors and on the downstream market for retail access services to end customers.

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<sup>2</sup> Commission Decision of 21 May 2003, COMP/C-1/37.451, 37.578, 37.579 — *Deutsche Telekom AG*, 2003 O.J. (L 263) 9 [hereinafter Commission’s decision], at para. 107.

The central feature of the abuse is the competitive inconsistency between upstream and downstream prices, without it being required that the prices are in themselves abusive. According to some commentators, this represents a shift in the case law on margin squeeze.<sup>3</sup> Yet, already in its *Napier Brown* decision, the Commission had stated that in a margin squeeze case “the analysis of pricing must be centred upon the difference between the selling price of the dominant company’s raw material and its downstream product prices,”<sup>4</sup> without being necessary, thus, for the individual prices to be abusive.

It was only in *Industrie des poudres sphériques* (“IPS”) that the CFI was afforded the opportunity to clarify whether or not a margin squeeze can take place only in the presence of excessive wholesale prices or predatory retail prices. IPS had accused its vertically integrated supplier (PEM) of having charged excessive prices for the raw material and predatory prices for the derived product. In addition, it had alleged the existence of an insufficient spread between those prices. The CFI stated that:

In the absence of abusive prices being charged by PEM for the raw material [...], or of predatory pricing for the derived product [...], the fact that the applicant cannot, seemingly because its higher processing costs, remain competitive in the sale of the derived product cannot justify characterising PEM’s pricing policy as abusive.<sup>5</sup>

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<sup>3</sup> See B. Amory & A. Verheyden, *Comments on the CFI’s recent ruling in Deutsche Telekom v. Commission*, GCP MAGAZINE 1 (May 2008), at 4.

<sup>4</sup> Commission Decision of 18 July 1988, Case No. IV/30.178 — *Napier Brown/British Sugar*, 1988 O.J. (L 284) 41, at para. 25.

<sup>5</sup> Case T-5/97, *Industrie des poudres sphériques SA v. Commission*, 2000 E.C.R. II-3755 [hereinafter *IPS*], at para. 179.

Some authors have interpreted this statement in the sense that a margin squeeze does not constitute a separate ground for abuse.<sup>6</sup> However, the opposite interpretation has been confirmed by the European Court of Justice (“ECJ”). In order to prove that the pricing practice of a dominant undertaking is abusive before the ECJ, it is sufficient to prove that the spread between wholesale and retail prices does not leave enough scope for competition. This is demonstrated by the fact that the CFI, after having found that the prices charged by PEM at the wholesale and retail level were not abusive if taken individually, assessed whether the difference between those prices was such as to “eliminate an efficient competitor from the [...] market [for the retail product].”<sup>7</sup>

Despite the existence of these precedents, it is only in its *Deutsche Telekom* judgment that the CFI clearly and explicitly stated that for an abusive margin squeeze to occur, wholesale and retail prices charged by the incumbent do not necessarily have to be abusive when taken individually. Deutsche Telekom had argued that its conduct would have been in breach of Article 82 EC only if it was demonstrated that its retail tariffs were predatory. The Commission and the CFI disagreed with the applicant’s view and stated that:

[T]he abusive nature of [Deutsche Telekom’s] conduct [was] connected with the unfairness of the spread between its prices for wholesale access and its retail prices [...]. Therefore, [...] the Commission was not required to demonstrate in [its] decision that [Deutsche Telekom’s] retail prices were, as such, abusive.<sup>8</sup>

The definition of margin squeeze provided for in the CFI judgment also clarifies the method that should be followed in the assessment of a margin squeeze abuse, both in

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<sup>6</sup> See Amory & Verheyden (2008), *supra* note 3, at 4.

<sup>7</sup> *IPS*, *supra* note 5, at para. 180.

<sup>8</sup> CFI judgment, *supra* note 1, at para. 167.

terms of the competing services to take into consideration and of the cost structure relevant to the assessment.

### **A. The Methodological Approach**

The calculation of the margin squeeze in the Commission's decision, confirmed by the CFI, clarifies three fundamental methodological issues, namely the definition of the relevant market, the definition of the customer pattern of the new entrant, and the definition of a reasonably efficient entrant.

First, the Commission based its margin squeeze calculation on a comparison of Deutsche Telekom's wholesale access tariff with retail access tariffs and did not take into account the revenues from calls. According to Deutsche Telekom, the Commission should have taken into consideration not only revenues from the provision of access to telephone lines to end users, but also revenues from call services. The approach of the Commission was clearly based on the EU directives since for the purposes of cost-oriented pricing, access to local network lines and the offer of different call categories are clearly regarded as separate services. The CFI agreed with the Commission's view and stated that:

[I]n order to assess whether [Deutsche Telekom's] pricing practices distort competition, it was necessary to consider the existence of a margin squeeze in relation to access services alone, and thus without including telephone call charges in its calculation.<sup>9</sup>

Second, the methodology used by the Commission was based on the approach that competitors would have to be enabled to replicate the incumbent's customer pattern. A margin squeeze exists if Deutsche Telekom charges its competitor prices for wholesale

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<sup>9</sup> *Id.* at para. 200.

access to the local loop higher than its own prices for retail services. In order to establish the existence of a margin squeeze, the wholesale and retail services need to be comparable in the sense that they allow the provision of similar services. According to Deutsche Telekom, on the contrary, new entrants have no interest in reproducing the customer pattern of the incumbents and focus on the highest value markets where there is no margin squeeze. The Court underlined that:

Equality of opportunity is secured only if the incumbent operator sets its retail prices at a level which enables competitors—presumed to be just efficient as the incumbent operator—to reflect all the wholesale costs in their retail prices.<sup>10</sup>

Therefore,

[t]he assessment of the abusive nature of [Deutsche Telekom's] pricing practices cannot therefore be influenced by any preferences which [Deutsche Telekom's] competitors may have for one or other market.<sup>11</sup>

Third, the Commission considered the practice of the incumbent abusive if it has the effect of removing from the market an operator just as efficient as the incumbent. Deutsche Telekom argued that the Commission should have based its assessment on the particular situation of its actual and potential competitors, rather than on the cost of a hypothetical competitor as efficient as the dominant operator. The CFI rejected this argument on the grounds that only the approach followed by the Commission provides the required level of legal certainty. A dominant company cannot be required to make its commercial decisions on the basis of data that it does not know and that it cannot be expected to know, as would normally be the case with regards to the cost structure of its competitors. For the CFI, the abusive nature of a dominant undertaking's pricing

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<sup>10</sup> *Id.* at para. 199.

<sup>11</sup> *Id.* at para. 204.

practices can be determined on the basis of its own situation, and therefore on the basis of its own charges and costs, rather than on the basis of the situation of actual or potential competitors. The cost of a reasonably efficient entrant is its downstream cost which should be equal to the incumbent's downstream retail cost net its extra costs for providing interconnectivity to an entrant. This definition is based on the assumption that rivals are "just as efficient as" the dominant firm. However, the fact that the CFI decided not to apply a test based on the cost-structure of an hypothetical "reasonably efficient competitor" in *Deutsche Telekom* does not undermine the validity of such test, which could thus be applied in other margin squeeze cases.<sup>12</sup>

A margin squeeze test based on the cost structure of the dominant firm's competitors could lead to prohibiting conduct that is merely the result of the dominant firm's greater efficiency. The CFI explicitly dealt with this issue in the *IPS* case. As mentioned above, the CFI in this case compared PEM's wholesale and retail prices and concluded that the spread between them did not force an equally efficient competitor out of the market. Therefore, the CFI stated:

The reason for which IPS's customers are not prepared to bear the additional price to which IPS's higher processing costs give rise is either because its product is equivalent to that of its competitors but is too expensive for the market and therefore its production is not sufficiently efficient in order to survive on the market, or its product is better than that of its competitors and efficiently manufactured but is not sufficiently appreciated by its customers in order to justify its offer on the market.<sup>13</sup>

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<sup>12</sup> Amory & Verheyden (2008), *supra* note 3, at 14.

<sup>13</sup> *IPS*, *supra* note 5, at para. 185.



The margin squeeze doctrine cannot be construed in such a way as to oblige dominant undertakings to subsidize their competitors.<sup>14</sup>

### **B. Comparison of the *Deutsche Telekom* Case with the *Wanadoo* Case**

It is interesting to compare the *Deutsche Telekom* case with the *Wanadoo* case.<sup>15</sup> The main difference between the two cases lies in the forms of the abusive behavior. In the case against *Wanadoo*, the abuse was based on an isolated view of the retail customer prices, while in the *Deutsche Telekom* case, the relative spread between the wholesale and retail tariffs was considered abusive. With regards to the economic effects, however, there are large similarities between both cases. *Wanadoo*'s retail tariffs were abusive because they were too low in relation to the underlying cost. The relevant cost was in return based mainly on wholesale tariffs for the necessary input product to be paid by *Wanadoo* to France Télécom. This shows that an abusive relationship between the retail and the wholesale tariffs could be observed in the *Wanadoo* case as well. This is also highlighted by the fact that the abuse was not brought to an end by *Wanadoo* through a retail price increase, but rather by France Télécom through a reduction of the wholesale tariff, just like in the *Deutsche Telekom* case.

The Commission nevertheless did not assess the *Wanadoo* case as a margin squeeze, because the wholesale and retail services were not offered by a single, vertically integrated company as in the *Deutsche Telekom* case. *Wanadoo* was independent in legal terms from France Télécom, and the margin squeeze test would have required the additional proof that France Télécom exercised such a determining influence on the

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<sup>14</sup> *Id.* at para. 179.

<sup>15</sup> Case T-340/03, *France Télécom SA v. Commission*, 2007 E.C.R. II-107 [hereinafter *Wanadoo*].

pricing strategy of its subsidiary that Wanadoo did not set its final customer prices autonomously, which appeared not to be the case.

In its judgment on the appeal against the Commission's decision brought by Wanadoo, the CFI confirmed the validity of the Commission's approach and upheld the decision. An appeal before the ECJ is still pending.

## **II. COMPETITION VERSUS REGULATION**

An important clarification of the *Deutsche Telekom* judgment is the relationship between sector-specific regulation and competition law. Deutsche Telekom had argued in its appeal that due to regulatory restraints on the level of its charges at wholesale and retail level, it did not have sufficient scope to avoid the margin squeeze. The alleged abusive practice was thus triggered by the regulatory measures adopted by the German Regulator ("RegTP"). As a consequence, Deutsche Telekom had submitted that if the Commission considered the prices to be in breach of Community law, it should have initiated proceedings against Germany, instead of adopting an Article 82 decision against Deutsche Telekom.

Recall that margin squeeze refers to a situation in which the incumbent uses its dominant position in the wholesale market to exclude or prevent its competitor from making profits on the downstream market in which the incumbent is competing with them. The incumbent can implement this exclusionary strategy through its wholesale or retail prices. Even if the wholesale or retail markets are regulated, there may still be a

certain degree of freedom for the incumbent to avoid the margin squeeze. In that case the incumbent is responsible for any abusive behavior.

### **A. Regulatory Measures Imposed on Deutsche Telekom**

Deutsche Telekom held a quasi-monopoly position on the wholesale market for fixed telephony infrastructure (more than 95 percent of the local access market throughout Germany) and this position resulted from previous monopoly rights. As the wholesale access to the local loop might be used for different types of retail access, RegTP controlled each wholesale price individually.

Since 1998, Deutsche Telekom had offered unbundled access to the local loop to competitors, following a ministerial order taken at national level. Under the German telecom law, charges for access to the local loop must be cost oriented and must be authorized in advance by the German regulator. Accordingly, Deutsche Telekom filed a tariff application with RegTP based on its own internal cost accounting system. RegTP based its authorization on a system of analytical cost, which sets out to identify the long-run incremental cost of local loop unbundling in a more rigorous way. RegTP fixed the monthly rental fee Deutsche Telekom could charge its competitors, first in 1999, and then reduced the monthly rental fee in its March 2001 decision.

At the same time, in Germany, retail tariffs for local access were subject to a price cap defined as a tariff regulation tool for a basket of services which contains the basic retail subscription as well as the different categories of calls. The price cap only imposed an overall ceiling on the combined price for all services. Tariffs for retail subscriptions

(i.e., analogue, ISDN) and calls (e.g., local, regional, long distance, international) were not regulated individually, but jointly within a basket. This basket of services had to be cost-oriented and the overall price for the basket had to be reduced by a certain percentage for the period under consideration in the case. From the economic point of view, this imposed overall tariff reduction was meant to reflect efficiency gains. Within this overall ceiling, Deutsche Telekom was absolutely free to modify its tariffs for individual components of the basket. Deutsche Telekom had the freedom to increase the tariff for one of several components of the basket and decrease the tariff for other components of the basket, provided that the overall ceiling was not exceeded. Moreover, the price cap did not prevent an overall tariff reduction so that Deutsche Telekom was free to reduce its overall tariff level below the imposed reduction rate.

Since then, Deutsche Telekom has maintained the retail subscription fee at the historical below-cost level, dating from the monopoly before 1998, and has implemented a very substantial reduction of call charges. It would have been possible for Deutsche Telekom to increase its retail access tariffs towards the cost level under the price cap system, with higher subscription fees and lower call charges. Before liberalization started, cross-subsidies between different activities were frequent, but the liberalization directives required that tariffs charged for different services reflect the underlying cost (i.e., tariff rebalancing).

The CFI confirmed that, according to well-established case law, Articles 81 and 82 EC are not applicable to the anticompetitive activities of undertakings if the restrictive

effects on competition are completely due to the national law regulating those activities.<sup>16</sup>

Moreover, the fact that Deutsche Telekom's tariffs at retail level had been approved by RegTP did not absolve it from responsibility under Article 82 EC for two reasons:

1. Deutsche Telekom had the possibility to influence the level of those charges, through applications to RegTP; and
2. The regulator had imposed only a price ceiling for a basket of retail services, thereby leaving the incumbent operator a certain room for maneuver in establishing the price of each of those services. Deutsche Telekom did not use that discretion to avoid and, subsequently, put an end to the margin squeeze.

## **B. Opportunity to Apply Competition Law in Regulated Sectors**

Commentators have observed that “the CFI confirmed unambiguously the overlap between competition policies promoted by sector specific regulation in the field of electronic communications.”<sup>17</sup> Others have adopted a much more critical approach towards the enforcement of the competition rules in sectors where ex ante regulation applies. In particular, it has been argued that:

[I]t is reasonably clear following *Deutsche Telekom* that the EC courts are comfortable with applying competition law in regulated telecommunications markets. [...] In doing so, the CFI has greatly increased the burden on regulated firms and, although perhaps unintended, may also have reduced the overall effectiveness of regulation.<sup>18</sup>

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<sup>16</sup> Joined Cases C-359/95 & C-379/95 P, *Commission and France v. Ladbroke Racing*, 1997 E.C.R. I-6225, at para. 34.

<sup>17</sup> Amory & Verheyden (2008), *supra* note 3.

<sup>18</sup> R. O'Donoghue, *Regulating the Regulated: Deutsche Telekom v. European Commission*, GCP MAGAZINE 1 (May 2008), at 3.

Moreover, the CFI has been severely criticized for not taking into account fundamental principles of Community law (such as subsidiarity, proportionality, legal certainty, legitimate expectations, and sound administration) when drawing the boundaries between ex ante regulation and general competition law rules.<sup>19</sup>

Some of the criticism raised by the CFI's dismissal of Deutsche Telekom's appeal of the Commission's decision is based on the U.S. approach chosen by the U.S. Supreme Court in the *Trinko* case<sup>20</sup> regarding the interaction between regulation and competition law. The Supreme Court has a clear policy against competition law intervention if there is a regulator with the legal powers to take effective action. The question is whether the approach by the Supreme Court in *Trinko* is preferable to the approach followed by the CFI in *Deutsche Telekom*. There are at least three main reasons that support the CFI approach.

### ***1. Market opening of network industries and sector-specific regulators***

The market opening of the different network industries as telecommunications, electricity, gas, transport, and postal services has influenced the evolution of their economic structure. A legal and regulatory framework was designed to allow these network industries to operate more efficiently and was the rationale behind the liberalization process being to improve their performance and to generate wide-ranging macroeconomic benefits. While prior to liberalization network industries were generally organized as vertically integrated state-owned monopolies, adequate sector-specific

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<sup>19</sup> P. Alexiadis, *Informative and Interesting- The CFI Rules in Deutsche Telekom v. European Commission*, GCP MAGAZINE 1 (May 2008), at 10.

<sup>20</sup> Verizon Comm'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

regulation is needed to promote competition in a liberalized market. Sector-specific regulators play a key role in particular in relation with the implementation of EU directives which are designed to open these markets to competition. With the process of opening network industries, markets become contestable by allowing new entrants to compete with the former monopolists. Market structures will change as reforms are progressively implemented in different sectors open to competition. However, despite a growing number of competitors, incumbent operators' market shares still remain very high in a large number of EU Member States, especially in access markets.

Given the EU situation (which differs from the situation in the United States), the U.S. approach, which encourages competition authorities and courts not to intervene when acting in regulated network industries, would be a clear mistake in Europe. This would imply that the network industries, which account for around 7.5 percent of the EU-15's total value added,<sup>21</sup> would only be overseen by sector-specific authorities and exempt from general competition law. That sector-specific regulators are important is undisputed, but their roles are quite different from competition authorities. To clarify the debate about how to oversee the process of liberalization of network industries, it is useful to stress several differences between competition and regulation.

## ***2. Distinction and relationship between competition law and sector-specific regulation***

Technological innovations and liberalization change the market structure of regulated industries and highlight the definition of public intervention and the main differences between competition and regulation.

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<sup>21</sup> EUROPEAN COMMISSION, EVALUATION OF THE PERFORMANCE OF NETWORK INDUSTRIES PROVIDING SERVICES OF GENERAL ECONOMIC INTEREST (2005), *available at* [http://ec.europa.eu/economy\\_finance/publications/publication10917\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication10917_en.pdf).

a) Ex ante versus ex post approaches

Regulation relies on ex ante detailed prescription of business conducts while competition law approach usually operates ex post on the basis of a consumer harm-based approach.

b) Information required

Regulation requires more information than the competition law approach. National regulatory agencies (“NRA”) need general detailed information about the industry, as they are supposed to control a certain number of decisions of industry managers. The ex post competition policy approach can assess the business conduct on the basis of an alleged abuse and competition authorities need only the information on this specific abuse.

c) Remedies

Competition remedies address specific forms of abuse and generally do not require extensive monitoring of the conduct of the undertaking. On the contrary, regulatory remedies are often detailed remedies such as wholesale prices or conditions mandating the provision of certain services.

d) Temporary nature of regulation

As competition becomes effective in new markets, regulation of markets susceptible to ex ante regulation will be replaced by the application of general competition law. Regulation should only be imposed where there are market failures.



Therefore, market regulation should be temporary except for specific markets where bottlenecks remain in place.

Figure 1 summarizes the differences between the competition law approach and sector-specific regulation and shows how in practice both are working together. The concurrent application of regulation and competition is not a problem in itself. It is in the nature of partly regulated industries to be subject at the same time to competition law and regulation, both of which complement each other.

**Figure 1.**

**Differences between Competition Law Approach and Sector-Specific Regulation**

	<b>COMPETITION</b>	<b>REGULATION</b>
a) General approach	Ex post, harm-based approach	Ex ante prescriptive conduct
b) Information needed	Only information on the abuse	General and detailed information
c) Remedies	Structural remedies addressed to specific conduct	Detailed conduct remedies requiring extensive monitoring
d) Nature of public intervention	Permanent based on competition law principal	Part of sector-specific regulation replaced by competition law as competition is more effective

Source: P.-A. Buigues, *Regulation and Competition Law*, in ISSUES IN COMPETITION LAW AND POLICY (W. Collins ed., forthcoming 2008).

The speed and degree of liberalization are quite different between the network industries. The telecommunication industry is perhaps the best example of a formerly

monopolistic industry that is moving towards liberalization, in which the role of competition law principles is growing within the regulatory framework itself.

### ***3. The competition law approach and the telecommunication regulatory framework***

As is the case with other network industries, telecommunications markets require regulation because of their particular characteristics, the existence of essential infrastructures (networks) and of high and non-transitory entry barriers. This industry is characterized by structural barriers to entry since the technology and the cost structures are such that they create asymmetric conditions between incumbents and new entrants.

However, it is interesting to underline that under the regulatory framework for electronic communications, ex ante regulation is warranted only in those markets for which competition law remedies are insufficient to effectively redress possible market failures. Already the first Commission recommendation on relevant products and service markets susceptible to ex ante regulation<sup>22</sup> has underlined that:

[T]he decision to identify a market as justifying possible ex ante regulation should also depend on an assessment of the sufficiency of competition law in reducing or removing such barriers or in restoring effective competition.<sup>23</sup>

The guiding principle of the regulatory framework is to avoid over-regulation. It is therefore clearly appropriate for the Commission to intervene under its competition law powers in the telecommunications industry (which is only partly regulated for a limited number of relevant markets where NRA provide sufficient economic reasoning to justify the imposition of ex ante regulatory obligations).

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<sup>22</sup> European Commission, Commission Recommendation 2003/311/EC on relevant product and services markets within the electronic communication sector, 2003 O.J. (L 114) 45.

<sup>23</sup> *Id.* at para. 15.

The new Commission recommendation on relevant markets susceptible to ex ante regulation<sup>24</sup> further limits the number of markets in which ex ante regulatory obligations are imposed from 18 to seven and “thereby contribute to the aim of the regulatory framework to reduce ex ante sector-specific rules progressively as competition in the markets develop.”<sup>25</sup>

The design of the regulatory framework is such that the Commission should intervene even when there is a sector-specific regime designed to protect a competitive market structure. It would not be in the spirit of the regulatory framework to transfer a case to an NRA to allow it to take a decision on the basis of the sector-specific legislation.<sup>26</sup> One of the arguments supporting this view is that the concurrent application of regulation and competition can create situations in which conflicts arise between the consumer welfare standards in competition law and the objective of regulation. These situations may be the case if the objective of regulation is “the need to maintain equality of opportunity for firms who depend on incumbents essential inputs,”<sup>27</sup> which could be contrary to the consumer welfare approach in competition law. As we emphasized earlier in this paper, the objective of the regulatory framework is not protecting competitors, but rather to regulate only in these markets in which competition law remedies are clearly insufficient to effectively redress possible market failures.

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<sup>24</sup> European Commission, Commission Recommendation 2007/879/EC on relevant product and service markets within the electronic communications sector, 2007 O.J. (L 344) 65.

<sup>25</sup> *Id.* at para. 14.

<sup>26</sup> See D. Geradin & R. O’Donoghue, *The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector*, 1(2) J. COMPETITION L. & ECON. 355-425 (2005).

<sup>27</sup> See *id.*

The lawfulness of the Commission's decision, thus, cannot be called into question on the grounds that the regulatory measures enacted by the RegTP are in breach of Community law. This is clear from the judgment. The Court was well aware that the German telecoms rules were probably in breach of Community law:

[I]t is not inconceivable that the German authorities also infringed Community law—particularly the provisions of Directive 90/338, as amended by Directive 96/19—by opting for a gradual rebalancing of connection and call charges...<sup>28</sup>

Notwithstanding the above, the CFI confirmed the validity of the Commission's decision to take action against *Deutsche Telekom* under Article 82.

Furthermore, the Community Courts have repeatedly held that the Commission enjoys a wide discretion in deciding whether to initiate proceedings against a Member State under Article 86 or 226 EC. In the same way, once the Commission has started such proceedings, it is under no obligation to bring the Member State concerned before the ECJ. Consequently, when it opened the case against *Deutsche Telekom*, the Commission did not have to start with parallel proceedings against Germany for failure to fulfill obligations.

### **III. EFFECT OF THE MARGIN SQUEEZE ON THE MARKET**

A highly debated issue, not only in relation to abusive margin squeeze, but to abusive behavior in general, is whether a certain conduct can be considered per se contrary to Article 82 EC or whether for a breach of Article 82 EC to take place it is also necessary to demonstrate the actual negative effects on competition caused by that conduct.

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<sup>28</sup> CFI judgment, *supra* note 1, at para. 265.

In its July 2005 report, *An Economic Approach to Article 82*, the Economic Advisory Group on Competition Policy (“EAGCP”) underlined the need to focus on the effects of company behavior rather than on the form that these actions may take. Effects-based analysis takes into consideration the different effects of these actions in different circumstances (e.g., prevention of behavior that harms consumers in some cases or promotion of increased productivity and efficiency in others) and focuses on the competitive harm that arises from exclusionary strategies.

In its decision, the Commission found that the price practices enacted by Deutsche Telekom restricted competition on the market for retail services. This was illustrated by the slow development of competition. The total number of local loops rented to competitors was increasing, but the rate of quarterly growth remained unchanged since the beginning of 2001. There was no discernible improvement in the situation with respect to competition. However, no in-depth economic analysis was presented concerning the competitive harm from Deutsche Telekom’s exclusionary margin squeeze strategy. It is worth emphasizing that the EAGCP report explicitly stated, in the case of an effects-based approach, that “possible exceptions concern some natural monopoly industries which may require ongoing supervision of access prices and conditions.”<sup>29</sup>

It is noteworthy that after the adoption of the *Deutsche Telekom* decision, the Commission decided to follow a more economic methodology. In its *Discussion Paper on the Application of Article 82 EC*, the Commission claimed that in the assessment of

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<sup>29</sup> EAGCP, *An economic approach to Article 82* (on file with the Commission) (Jul. 2005), at 3, available at [http://ec.europa.eu/comm/competition/publications/studies/eagcp\\_july\\_21\\_05.pdf](http://ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf).

alleged abuses of dominant position, account should be taken of the economic effects of the conduct of dominant undertakings on the market. According to the Commission:

[T]he conduct in question must in the first place have the capability, by its nature, to foreclose competitors from the market. To establish such capability it is in general sufficient to investigate the form and nature of the conduct in question. It secondly implies that, in the specific market context, a likely market distorting foreclosure effect must be established.<sup>30</sup>

More recently, in the *Telefónica* decision, the Commission embarked on a detailed analysis not only of the capability of the margin squeeze practice enacted by Telefónica of restricting competition in the retail market for access services, but also of the actual impact of the margin squeeze on the competitive structure of the relevant market and of the detrimental effects for end users.<sup>31</sup>

The *Deutsche Telekom* judgment shows that, despite the change in the Commission's practice, the CFI can be, for the time being, viewed as sticking to previous case law in this regard. The CFI established that a margin squeeze has the capability, by its nature, to impair competition on the market. Accordingly, the CFI stated:

If [Deutsche Telekom's] retail prices are lower than its wholesale charges, or if the spread between [Deutsche Telekom's] wholesale and retail charges is insufficient to enable an equally efficient operator to cover its product-specific costs of supplying retail access services, a potential competitor who is just as efficient as [Deutsche Telekom] would not be able to enter the retail access services market without suffering losses.<sup>32</sup>

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<sup>30</sup> EUROPEAN COMMISSION, DG COMPETITION DISCUSSION PAPER ON THE APPLICATION OF ARTICLE 82 OF THE TREATY TO EXCLUSIONARY ABUSES (Dec. 2005) [hereinafter Discussion Paper], at para. 58, available at <http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf>.

<sup>31</sup> See Commission Decision of 4 July 2007, Case COMP/38.784 — Wanadoo España v. Telefónica, 2008 O.J. (C 83) 5 [hereinafter *Telefónica*], at paras. 543-618; and Belt and Braces: Analysing Margin Squeeze Abuses under Article 82 (unpublished article, Frontier Economics) (Jun. 2008).

<sup>32</sup> CFI judgment, *supra* note 1, at para. 237.

The Court went on to examine the specific features of the relevant market. It observed that, until 1998, Deutsche Telekom held a monopoly on the retail access market and that, at the time when the Commission's decision was adopted, it still owned the fixed line telephone network. Furthermore, no alternative viable infrastructures were available to rival telecom operators to enter the retail market on access services. Therefore, the CFI based its finding of dominance both on the nature of the conduct in question and on the specific structure of the relevant market. Yet, the CFI did not require the demonstration of actual harm suffered by Deutsche Telekom's competitors. Quite the opposite, it rejected Deutsche Telekom's claim that its pricing practice did not affect the market structure since its competitors would normally resort to cross-subsidization to make up for the losses suffered on the retail access market. Moreover, the CFI considered in its analysis that Deutsche Telekom's market shares had increased to the detriment of its competitors, but did not request proof of the causal link between the margin squeeze and the low uptake of competition by the new entrants.

Thus, the *Deutsche Telekom* ruling, together with other Article 82 judgments recently delivered by the ECJ<sup>33</sup> show that in order to prove that a certain market conduct is tantamount to an abusive of dominant position, the Commission is not required to carry out as meticulous an economic analysis as the one it performed in the *Telefónica* decision. As the CFI held:

[T]he [only] anti-competitive effect which the Commission is required to demonstrate relates to the possible barriers which [Deutsche Telekom's] pricing practices could have created for the growth of competition in that market.<sup>34</sup>

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<sup>33</sup> See, e.g., Cases C-95/04, *British Airways v. Commission*, 2007 E.C.R. I-2331, at para. 123; and *Wanadoo*, *supra* note 15, at paras. 253-67.

<sup>34</sup> CFI judgment, *supra* note 1, at para. 235.

#### IV. OUTLOOK

The *Deutsche Telekom* ruling certainly contains a number of important clarifications on the application of the margin squeeze test in regulated industries. Already the Commission's decision has served as a model for a number of similar cases at the EC and national levels, the most prominent example being the Commission's decision against Telefónica in July 2007. It cannot be overlooked that the margin squeeze test also gains in importance in other network industries characterized by the presence of vertically integrated operators. In France, the Conseil de la concurrence recently adopted a decision against an electricity provider based on the margin squeeze test.

However, it has to be recalled that the CFI, while fully endorsing the line taken by the Commission, has not necessarily set out a standard assessment for any such cases within the European Union. For example, the CFI statement that in this particular case it was legal for the Commission to rely on the "hypothetical competitor test" does not imply that the "as efficient competitor test" may not be applied in other cases whenever appropriate. Similarly, the CFI's conclusion that the demonstration of anticompetitive effects carried out by the Commission in this case was sufficient does not mean that in other cases a deeper economic analysis may be warranted. Therefore, some of the criticisms seem to be overstated when they assume that the *Deutsche Telekom* judgment (unduly) narrows the assessment of margin squeeze cases.

The company now appears to have lodged an appeal before the ECJ against the CFI judgment,<sup>35</sup> possibly along the lines of its earlier defense. This appeal by Deutsche

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<sup>35</sup> Case C-280/08, *Deutsche Telekom v. Commission* (appeal to the CPI of Case T-271/03, *Deutsche Telekom*).



Telekom may have been driven to some extent by the pending damage claims before the national civil courts, like in the *Telefónica* case. While it does not seem very likely at this stage that the appeal will be successful, the final assessment of the issues discussed will only be known years from now.

## APPENDIX: RECOMMENDED ADDITIONAL READING

- Alexiadis P., “The rules in *Deutsche Telekom v. European Commission*,” *GCP Magazine*, Release 1, May 2008.
- Amory B. & A. Verheyden, “Comments on the CFI’s Recent Ruling in *Deutsche Telekom v. European Commission*,” *GCP Magazine*, Release 1, May 2008.
- Bouckaert J. & F. Verboven, “Price Squeezes in a Regulatory Environment,” *Journal of Regulatory Environment*, Vol. 26, No. 3, Nov. 2004.
- Buigues P.-A., “The Competition Policy Approach,” in *The Economics of Antitrust and Regulation in Telecommunication* (P.-A. Buigues & P. Rey eds., 2004).
- Carlton D., “Should Price Squeeze Be a Recognized Form of Anticompetitive Conduct?,” *Journal of Competition Law and Economics*, Vol. 4, Issue 2, 2008.
- European Commission, DG Competition, “Discussion Paper on the Application of Article 82 of the Treaty of Exclusionary Abuses,” 2005.
- Frontier Economics, “Belt and braces. Analysing Margin Squeeze Abuses under Article 82,” June 2008.
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- Geradin D., “Limiting the Scope of Article 82 of the EC Treaty: What can the EU Learn from the US Supreme Court’s Judgment in *Trinko* in the wake of *Microsoft*, *IMS*, and *Deutsche Telekom*,” *Common Market Law Review*, Dec. 2005.
- Klotz R., “Applicability of the European Competition Law to Special Areas,” in *Competition Law: European Community Practice and Procedure* (G. Hirsch et al. eds., 2008).
- Geradin D. & R. O’Donoghue, “The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector,” *Journal of Competition Law and Economics*, Vol. 1, No. 2, 2005.

- Motta M. & A. de Stree, “Exploitation and Exclusionary Excessive Prices in EU Law,” in *What Is an Abuse of a Dominant Position?* (C.-D. Ehlermann & I. Atanasiu eds., 2004).
- O’Donoghue R., “Regulating the Regulated: *Deutsche Telekom v. European Commission*,” *GCP Magazine*, Release 1, May 2008.
- Polo M., “Price Squeeze: Lessons from the Telecom Italia Case,” *Journal of Competition Law and Economics*, Vol. 3, No. 3, 2007.