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Bernard Amory and Alexandre Verheyden

Jones Day

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This brief paper discusses the implications on the test for price squeeze arising from the *Deutsche Telekom* ruling of the European Court of First Instance (CFI) of April 10, 2008.¹ Price squeeze is a relatively novel form of abuse. In many respects, it is a concept that is still evolving, and various issues remain open, such as the need for a finding of dual dominance both at the retail and wholesale level, and the scope of the service or the size of the market affected.

The CFI ruling provides some clarity on the issues of (i) price squeeze as a stand-alone ground for abuse and (ii) the relevance of the two tests (hypothetical competitor and reasonably efficient competitor) proposed by the Commission in support of a price squeeze allegation. Our comments will focus on these two points. However, we submit that this judgment raises a number of new questions.

* The authors are partners in Jones Day's Brussels office. This paper is intended to remain concise and does not constitute an exhaustive review of price squeeze. For a complete discussion on price squeeze, see D. GERADIN & R. O'DONOGHUE, THE CURRENT APPLICATION OF COMPETITION LAW AND REGULATION: THE CASE OF MARGIN SQUEEZE ABUSES IN THE TELECOMMUNICATIONS SECTOR (GCLC Working Paper, No. 04/05, 2005) and Milena Stoyanova, *Regulatory and competition law approaches to price squeeze access pricing in the telecommunications sector*, EUR. COMPETITION J. 347 (Oct. 2005).

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

I. PRICE SQUEEZE AS A STAND-ALONE GROUND FOR ABUSE

It now seems accepted that price squeeze constitutes a separate and distinct form of abuse, as advocated by the Commission in its Access Notice.² The Commission, in particular, argued for the application of two price squeeze tests:

1. the hypothetical competitor test, where the regulator examines whether “the dominant company’s downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company,”³ and
2. the reasonably efficient competitor test, where the regulator determines whether “the margin between the price charged to competitors on the downstream market [...] for access and the price which the network operator charges in the downstream market is insufficient to allow a reasonably efficient service provider to obtain a normal profit.”⁴

Thus far, however, there is no case law from the EC Courts formally confirming that price squeeze could constitute a separate form of abuse. The CFI refers in *Deutsche Telekom* to the European Court of Justice’s (ECJ) ruling in *Akzo v. Commission*⁵ as a precedent whereby the Court sought to compare the intermediate costs of a vertically integrated dominant company with its retail prices. While it is true that the facts of *Akzo* could have prompted a price squeeze argument, the ECJ in *Akzo* never actually focused on the issue of margin reduction. Rather, it conducted an independent assessment of the abusive nature of the retail (predatory pricing) and wholesale (discriminatory pricing)

² European Commission, Notice on the application of the competition rules to access agreements in the telecommunications sector, 1998 O.J. (C 265) 2 [hereinafter “Access Notice”].

³ Access Notice, *id.* at para. 117.

⁴ *Id.* at para. 118.

⁵ Case C-62/86, AKZO Chemie BV v. European Commission, 1991 E.C.R. I-3359 [hereinafter *Akzo*].

prices charged by Akzo. It is noteworthy, in this regard, that the CFI does not cite *Akzo* as a formal price squeeze precedent, but only refers to it in discussing the price squeeze calculation methodology to show that the ECJ based its assessment on Akzo's retail and wholesale prices.⁶

In *Industrie des Poudres Sphériques*, also referred to by the CFI in *Deutsche Telekom*, the CFI was in fact rather explicit about contesting the existence of a price squeeze as a separate ground for abuse:

[I]n 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 characterizing PEM's pricing policy as abusive.⁷

Again, the CFI, in *Deutsche Telekom* did not refer to its preceding ruling in *Industrie des Poudres Sphériques* as a precedent confirming the existence of price squeeze, but only to justify a reference to the costs of the vertically integrated dominant undertaking.

These two cases show, in spite of being cited as relevant precedents in the CFI's *Deutsche Telekom* judgment, that the EC Courts have not formally accepted price squeeze as a separate form of abuse. In this regard, the *Deutsche Telekom* ruling constitutes the first clear legal enunciation from a Community court to the effect that price squeeze constitutes a stand-alone form of abuse.

⁶ CFI Judgment, *supra* note 1, at para. 189.

⁷ Case T-5/97, *Industrie des Poudres Sphériques SA v. European Commission*, 2000 E.C.R. II-3755, at para. 179.

II. HYPOTHETICAL VERSUS REASONABLY EFFICIENT COMPETITOR TESTS

The Court has been less explicit in relation to the definition of a methodology to be used for the purpose of assessing the existence of a squeeze. In *Deutsche Telekom*, the CFI ruled that a possible method for assessing price squeeze was to appraise the margin reduction on the basis of the charges and costs of a vertically integrated dominant undertaking. The CFI did so by referring the EC Courts' earlier rulings in *Akzo* and *Industrie des Poudres Sphériques* (quoted in section I of this paper). The CFI further stated that taking account of the costs of new entrants "could be contrary to the general principle of legal certainty."⁸

There is no doubt that certain commentators will infer from the present ruling that the CFI sought to limit the price squeeze test to that of the hypothetical competitor, to the exclusion of the reasonably efficient competitor test. In our view, however, an analysis of the judgment and of its overall context suggest otherwise. As to the premise to our analysis, it must be recalled that the Commission itself applied the hypothetical competitor test, which was therefore the primary focus of the CFI and which explains the absence of significant emphasis on the reasonably efficient competitor test.

A. Difficulties in Application of the Reasonably Efficient Competitor Test: Recent Market Entry Is Not a Factor of Inefficiency

The primary obstacle to applying the reasonably efficient competitor test lies in the acceptability of basing a finding of abuse on the costs of a new entrant, insofar as

⁸ CFI Judgment, *supra* note 1, at para. 192.

such new entrant could be less efficient than a dominant enterprise, due to a possible lack of experience or lower economies of scale.

We submit that low market share is not necessarily evidence of inefficiency. This is particularly the case in industries, such as the field of electronic communications, where market entry is the sine qua non condition for the emergence of competition and where incumbents have enjoyed special or exclusive rights in the past. There is extensive case law, both at the EC and national levels, which confirm that late entry (and a corresponding lower market share) is not a factor of inefficiency.

This case law is explicitly set out in *O2 Germany v. Commission*, where the CFI determined that:

O2, which was the last operator to enter the German market, appears to be in the weakest competitive position. Even if O2 does have some infrastructure, [...] its modest market share and its situation as the last entrant place it objectively in a less favourable position. [...] The dependence [...] thus stems from de facto inequality that the agreement specifically seeks to rebalance by placing O2 in a more favourable competitive position.⁹

Similarly, in *Mobistar v. Commune de Fléron*, the ECJ ruled that:

[I]n the context of its examination the national court will have to assess the effects of the taxes bearing in mind, in particular, the point at which each of the operators concerned entered the market. It may become apparent that operators which have or have had exclusive or special rights were able to enjoy, before other operators, a position allowing them to redeem their costs of establishing networks. The fact that operators entering the market are subject to public service obligations, including those concerning territorial cover, is likely to put them, in terms of controlling their costs, in an unfavourable position by comparison with traditional operators.¹⁰

⁹ Case T-328/03, *O2 (Germany) GmbH & Co OHG v. European Commission*, 2006 E.C.R. II-1231 [hereinafter *O2 Germany*], at para. 107.

¹⁰ Joined Cases C-544/03 & C-545/03, *Mobistar SA v. Commune de Fléron*, 2005 E.C.R. I-7723 [hereinafter *Mobistar*], at para. 49.

In *KPN Denda*, Advocate General Poiares Maduro went even further, suggesting that basic competition law principles should take into account the fact that in the telecommunications sector, new entrants are competing with operators who enjoyed past special or exclusive rights:

[W]here the supplier has an advantage in the secondary market which it was able to acquire because it was previously shielded from competition, the potentially deterrent effect on investment and innovation resulting from the imposition of a duty to supply is minimal and is likely to be outweighed by the interest in promoting competition.¹¹

At the national level, in a recent judgment of April 4, 2008, the Court of Appeal of Brussels ruled that “a small market share does not necessarily indicate that the weaker operator is inefficient.”¹²

It stems from these examples in the case law that new entrants should not necessarily be seen as sources of inefficiencies. What remains to be determined is whether this conclusion is prompted by competition law considerations, as applied in the specific context of electronic communications sector specific regulations, or whether the conclusion also lies at the core of competition law. Certain commentaries on price squeeze have suggested that price squeeze should be interpreted restrictively as a form of exclusionary abuse, thereby bound to have a much narrower scope than sector specific regulation which aims at fostering competition regardless of an actual abuse.

A simple answer to this question of the breadth of competition law at issue is that some of the cases given as examples are pure competition law cases (i.e., *O2 Germany*

¹¹ Opinion of Advocate General Poiares Maduro in Case C-109/03, *KPN Telecom BV v. OPTA*, 2004 E.C.R. I-11273 [hereinafter *KPN Denda*], at para. 41.

¹² Court of Appeal of Brussels, *BASE v. BIPT* (judgment of Apr. 4, 2008), R.G. 2007/AR/3394 (not yet published), at para. 21.

and *KPN Denda*).

The CFI ruling in *Deutsche Telekom* takes a more conclusive stand, shedding light on the interaction between pure competition law and competition policy applied in the context of sector specific regulation. Indeed, in order to conclude to the validity of the Commission's decision in *Deutsche Telekom*, the CFI conducted a detailed assessment of the sector-specific regulatory framework. It did so by making a clear reference to the key objectives of the electronic communications regulatory framework. The CFI explicitly states that:

[A] system of undistorted competition between the applicant and its competitors can be guaranteed only if equality of opportunity is secured as between the various economic operators¹³

In this regard, the CFI further elaborated:

[E]quality of opportunity as between the incumbent operator and owner of the fixed network, such as the applicant, on the one hand, and its competitors, on the other, therefore means that prices for access services must be set at a level which places competitors on an equal footing with the incumbent operator as regards the provision of call services. Equality of opportunity is secured only if the incumbent operator sets its retail prices at a level which enables competitors—presumed to be just as efficient as the incumbent operator—to reflect all the wholesale costs in their retail prices. However, if the incumbent operator does not adhere to that principle, new entrants can only offer access services to their end-users at a loss. They would then be obliged to offset losses incurred in relation to local network access by higher call charges, which would also distort competition in telecommunications markets.¹⁴

Therefore, the CFI confirmed unambiguously the overlap between competition policies promoted by sector specific regulations in the field of electronic communications

¹³ CFI Judgment, *supra* note 1, at para. 198 (citing Case C-462/99, *Connect Austria*, 2003 E.C.R. I-5197, at para. 83; and Joined Cases C-327/03 & C-328/03, *ISIS Multimedia and Firma O2*, 2005 E.C.R. I-8877, at para. 39).

¹⁴ CFI Judgment, *supra* note 1, at para. 199.

and the parameters to be taken into account for the purpose applying Article 82 EC.

Another testimony to this conclusion lies in the CFI's conclusions in paragraph 235 of the judgment, where it concludes in relation to the appraisal of the effect of the abuse that such an effect can be presumed because of the fact that the incumbent used to enjoy exclusive rights:

[G]iven that, until the entry of a first competitor on the market for retail access services, in 1998, the applicant had a monopoly on that retail market, the anti-competitive effect which the Commission is required to demonstrate relates to the possible barriers which the applicant's pricing practices could have created for the growth of competition in that market.¹⁵

In sectors characterized by the presence of former monopolies, we conclude that the application of competition law cannot be restricted to avoiding pure exclusionary abuses, but must also foresee the necessity of ensuring competition in the marketplace and, in particular, that new entrants are given as equal an opportunity to succeed as dominant enterprises.

In this regard, although the CFI in *Deutsche Telekom* did not engage in a lengthy discussion on the desirability of defining a price squeeze test that would enable effective market entry, it nevertheless recognized the relevance of the reasonably efficient competitor test. We conclude, therefore, that the CFI's ruling does not aim at excluding the reasonably efficient competitor test as a matter of principle. To the contrary, undistorted competition presupposes the equality of opportunity between the various economic operators.

This justifies, in our view, the relevance of the reasonably efficient competitor

¹⁵ *Id.* at para. 235.

test. In fact, this test has already been applied at the Member State level. In *Albion Water*, the U.K. Competition Appeal Tribunal confirmed the validity of the reasonably efficient competitor test, ruling that its application may require a notional cost analysis without necessarily leading the competition authority to favor inefficient market entry.¹⁶ In a recent judgment of December 18, 2007 involving *Tele 2*, the Court of Appeal of Brussels also affirmed the applicability of the reasonably efficient competitor test.¹⁷

B. Legal Certainty as an Obstacle to the Application of the Reasonably Efficient Competitor Test

It is true that the CFI in *Deutsche Telekom* added a cautionary note with regard to the reasonably efficient competitor test:

[A]ny other approach [including the reasonably efficient competitor test] could be contrary to the general principle of legal certainty. If the lawfulness of the pricing practices of a dominant undertaking depended on the particular situation of competing undertakings, particularly their cost structure—information which is generally not known to the dominant undertaking—the latter would not be in a position to assess the lawfulness of its own activities.¹⁸

However, we do not believe that such obiter dicta supports any conclusion that the CFI sought to exclude the application of the reasonably efficient competitor test because it would imply the use of or reference to the costs of new entrants, which would be opaque to an incumbent.

The CFI's position is much more nuanced insofar as it only indicated that the reasonably efficient competitor test "could be contrary to the general principles of legal

¹⁶ U.K. Competition Appeal Tribunal, *Albion Water Limited e.a. v. Water Services Regulation Authority* (judgment of Oct. 6, 2006), at paras. 896-918.

¹⁷ Court of Appeal of Brussels, *TELE2 v. Belgacom* (judgment of Dec. 18, 2007), R.G. 2006/MR/3 (not yet published).

¹⁸ CFI Judgment, *supra* note 1, at para. 192.

certainty.” In this regard, it must be recalled that the *Deutsche Telekom* case involved the fixed local access market. The size and scope of the activities of the incumbent significantly differed from those of new entrants. This was probably an important factual element considered by the CFI when referring to the principle of legal certainty.

From a practical standpoint, however, we have trouble understanding how the principle of legal certainty could really stand in the way of applying the reasonably efficient competitor test.

As a matter of principle, we take the premise that competition law must be applied in a manner that permits market entry and allows equality of opportunity between operators. Under such terms, it would be difficult to understand how a dominant enterprise could claim that it was not in a position to assess the ability of a new entrant to compete on the basis of the dominant enterprise’s retail tariffs.

Reconstruction of a new entrant’s cost base is hardly insurmountable for a dominant undertaking. Dominant enterprises, by virtue of their long-standing market positions, tend to have an unparalleled knowledge of the market.

Various models exist, which can be used to that end. For example, certain national regulatory agencies have developed price squeeze methodologies to assess and compare the margins resulting from each type of access, precisely in order to allow new entrants to effectively compete. Similarly, ARCEP (the French regulatory agency) rejected the assumption that a new entrant was less efficient than an incumbent operator in its Decision No. 05-1103 of December 15, 2005.¹⁹ ARCEP, in particular, assessed France

¹⁹ See, e.g., ARCEP Recommendation No. 05-0089 of Feb. 8, 2005; ARCEP Recommendation No. 05-0397 of May 12, 2005; and ARCEP Decision No. 05-1103 of Dec. 15, 2005.

Telecom's tariffs for its bitstream offer (the offer *DSL Entreprise*) on the basis of a price squeeze test by adding to the local loop unbundling costs the various other costs for the provision of DSL bitstream of an efficient operator. Such analysis has also been conducted by the U.K. Office of Communications in the context of its analysis of the competitive margin between British Telecom's ATM interconnect access offer (corresponding to wholesale bitstream access) and IP stream access offer (corresponding to the wholesale resale product).²⁰ Interestingly, in its *Telefónica* decision, the Commission stated that "all national regulatory authorities agree that the process of climbing of the ladder of investment can only be effective if there is a margin between all the steps of the ladder,"²¹ which confirms the similarity of focus of the application of sector specific regulation and the application of Article 82 of the EC Treaty. Consequently, there are ways for incumbents of ensuring that each of their access products does not prevent market entry.

The relative share of a new entrant's own internal costs, as compared to its total costs, is also an element that must be taken into account for the purpose of applying the principle of legal certainty. It could be argued that a dominant operator could not be deemed to have abused its dominant position on the basis of a methodology in relation to which it would have no ability whatsoever to understand the new entrant's entire cost base. However, such a defense would show its limitations in instances where a significant portion of a new entrant's costs are publicly known.

²⁰ U.K. OFFICE OF COMMUNICATIONS, DIRECTION SETTING THE MARGIN BETWEEN IPSTREAM AND ATM INTERCONNECTION PRICES (Aug. 28, 2004).

²¹ Commission Decision of 4 July 2007, Case COMP/38.784 — Wanadoo España v. Telefónica, 2008 O.J. (C 83) 5 [hereinafter *Telefónica*], at para. 393.

The relative similarity of costs incurred by the various players is another key element to take into account. Minimum common sets of public service specifications applicable to all operators tend to drive the costs of competing operators at a similar level. This is, for instance, the case of mobile services where mobile operators tend to be subject to relatively high minimum coverage and quality requirements on a nationwide basis. The ECJ confirmed this in its *Mobistar v. Commune de Fleuron* judgment, where it ruled:

[T]he fact that operators entering the market are subject to public service obligations, including those concerning territorial cover, is likely to put them, in terms of controlling their costs, in an unfavourable position by comparison with traditional operators.²²

In this context, it would be hard for an operator to claim that it had no knowledge of new entrants' costs, as the key differentiating factor would not be the overall cost base, but the difference in scale (i.e., fundamentally, the market share), which an incumbent operator can easily factor into its pricing policies.

Finally, it is not determinative even if the CFI in *Deutsche Telekom* is understood to have excluded the application of the reasonably efficient competitor test because the incumbent operator did not have sufficient visibility on the new entrant's cost base. It cannot be excluded that, for the purpose of private litigation cases, domestic rules would treat a model based on the reasonably efficient operator test as constituting a presumption of abuse, which would have the effect of shifting the burden of proof of absence of abuse on the incumbent operator. In such case, it would fall on the incumbent to rebut the presumption on the basis of the "as efficient" competitor test, using its own costs as a

²² *Mobistar*, *supra* note 10, at para. 49.

basis for the rebuttal.

The structure of the market, and the fact of lagging emergence of competition, is another set of evidence that can hardly be denied as to appraising a new entrant's ability to compete in the market, and in particular in increasingly mature markets. The CFI ruled in *Deutsche Telekom* that the nature of the telecommunications sector is such that the anticompetitive effects of the abuse can be presumed from the lack of competition on the market. Specifically, it found that:

[T]he small market shares acquired by the applicant's competitors in the retail access market since the market was liberalised by the entry into force of the TKG on 1 August 1996 are evidence of the restrictions which the applicant's pricing practices have imposed on the growth of competition in those markets.²³

III. CONCLUSION

In conclusion, we submit that the CFI in *Deutsche Telekom* innovates insofar as it confirms that price squeeze constitutes a stand-alone form of abuse, as a result of which a reduction of the margin between the incumbent's retail tariffs and its internal costs could be abusive. However, the CFI's reference to the inherent limitation of the use of other methodologies integrating the costs of new entrants, because of the principle of legal certainty, could have been clearer. We believe that the CFI did not mean to exclude, as a matter of principle, the reasonably efficient competitor test. Indeed, the *Deutsche Telekom* judgment confirms the very large overlap between competition law and the goal of fostering competition in a field which is characterized by the presence of former monopolies. Consequently, if one accepts the premise that competition law must be applied to ensure equality of chances and opportunities between operators, such a

²³ CFI Judgment, *supra* note 1, at para. 239.

premise becomes irreconcilable with an alleged ruling by the CFI to exclude the reasonably efficient competitor as a matter of principle.