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Price Squeeze Abuse in the EU Telecommunications Sector: A Reasonably or Equally Efficient Test?

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In the apparent eradication of the stand-alone price squeeze test from U.S. antitrust law, the U.S. Supreme Court recently unanimously ruled in *Pacific Bell v. linkLine*[1] that a price squeeze claim may not be brought under Section 2 of the U.S. Sherman Act in the absence of an antitrust duty to deal. On the EU side, competition policy took a completely different turn last year in *Deutsche Telekom*,[2] where the EC Court of First Instance ("CFI") recognized the validity of a price squeeze claim as a stand-alone abuse of dominant position under Article 82 EC Treaty. This CFI ruling had been preceded by several cases at the national level and in the Commission's administrative practice, but *Deutsche Telekom* was the first time that a European Court had been called upon to confirm that a price squeeze constituted a qualified abuse under Article 82. This ground-breaking development in EU antitrust policy nevertheless left the U.S. Supreme Court visibly unswayed. Rarely have policy-makers stood so far apart on a topic in recent history, and particularly given an overall trend towards convergence.

Despite this rather startling polarity, the present article does not aim to focus on transatlantic splits or the superiority of either approach. Instead, this brief paper remains within the ambit of the now established Article 82 price squeeze test, and focuses on one aspect of its implementation—the application of the reasonably-efficient operator test, as opposed to the equally-efficient operator test. We believe that established case law of the EU Courts strongly suggests the appropriateness of applying a reasonably-efficient competitor test in recently liberalized network industries such as the telecommunications industry.

The equally-efficient operator test assesses whether the difference between the upstream input price and the downstream retail price covers the costs of the dominant undertaking. By contrast, the reasonably-efficient competitor test examines whether the margin covers the costs of a reasonably-efficient competitor. The Commission's recent

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[1] Pac. Bell Tel. Co., dba AT&T California, et al. v. linkLine Communs., Inc., et al., 172 L. Ed. 2d 836; 2009 U.S. LEXIS 1635, 25 February 2009.

[2] C.F.I., 10 April 2008, Deutsche Telecom, Case T-271/03, not yet published.

Article 82 Guidelines confirm the Commission's general approach in applying an equally-efficient competitor approach. However, the Commission's *Communication on the Application of Competition Law to Access Agreements in the Telecommunications Sector* expressly provides for both tests. There is, indeed, no inherent contradiction between the two. Although the equally efficient competitor test seems to provide a reasonable approach in the general enforcement of Article 82 abuses, certain sectors warrant a more pro-active approach.

In the recently liberalized telecommunications sector, competition law has been crucial to shaping the Commission's liberalization policy. In this regard, the Commission has issued guidelines on the application of competition law in the sector, conducted sector inquiries, and issued several Article 82 decisions, mainly in relation to predatory pricing and price squeeze cases[3].

Recently liberalized network industries warrant the application of a reasonably-efficient competitor test, both from a policy and a competition law perspective. The test, in fact, appears indispensable in recently liberalized markets as a means to ensure an "equality of opportunity" for all market players. In this regard, alternative operators must be in a position to enter the market by offering tariffs that are competitive with those of the monopoly operator.

Under established case-law, competition law must guarantee "equality of opportunity" to ensure new entry into the market. The European Court of Justice ("ECJ") has consistently affirmed the importance of this principle, and has recognized the clear effects of adhering to this principle in recently liberalized network industries such as the telecommunications sector.

In its *Connect Austria* judgment, the ECJ recalled that "The Court has consistently ruled that a system of undistorted competition, as laid down in the Treaty, can be guaranteed only if equality of opportunity is secured as between the various economic operators."[4] In this case, the ECJ had been called upon to rule on the validity of granting free additional mobile frequencies to the historic Austrian operator, Mobilkom. Both Mobilkom and other operators had previously been subject to a fee for the allocation of an initial set of frequencies. Austria Connect considered that the granting of free additional frequencies constituted a state measure contrary to Article 82 EC Treaty.

The ECJ sought to verify whether, in economic terms, the fees imposed on competitors were equivalent to the fees imposed on Mobilkom and the subsequent attribution of supplementary frequencies without additional payment.

[3] *See* Alexandre Verheyden and Yvan Desmedt, *Article 82 Guidelines—Missed Opportunities In the Telecoms Sector,* 2(1) GCP MAGAZINE (February, 2009).

[4] E.C.J., 22 May 2003, Connect Austria, Case C-462/99, Rec., 2003, p. I-5197, ¶ 83.

Only in such case of economic equivalence would the contested measure "be deemed to ensure equality of opportunity for different economic operators and therefore guarantee undistorted competition."[5] If not, such grant of frequencies would constitute "a State measure which creates a situation where equality of opportunity for the various economic operators concerned cannot be ensured, it may amount to a breach of Article 86(1) EC in conjunction with Article 82."[6]

However, the ECJ specified that in evaluating this economic equivalence or equality of opportunity, account must be taken of the actual situation of the new entrant—the structural disadvantages related to its position as new entrant and the structural advantages benefiting the historic operators, including special and exclusive rights and significant economies of scale. The ECJ observed that:

> In the course of its examination, the national court must also determine the economic value of the licences concerned, taking account *inter alia* of the size of the different frequency clusters allocated, the time when each of the operators concerned entered the market and the importance of being able to present a full range of mobile telecommunications systems.[7]

This case-law, and more particularly its application in the recently liberalized telecommunications sector, has been consistently repeated by the European courts. In *O2*, the CFI annulled the Commission's decision to place a time-limit on the exemption granted to the "national roaming agreement" between O2 and the incumbent's mobile operator, T-Mobile[8]. The Commission had found that the agreement violated, in principle, Article 81 of the Treaty. The CFI found that the Commission, when assessing the agreement's (non) conformity to competition law, had been insufficiently precise in taking account of O2's disadvantaged position as a new entrant:

> It is apparent from that presentation that T-Mobile is a major operator on the German mobile telecommunications market, both as regards wholesale and retail markets and 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, as the Decision indicates, its modest market share and its situation as the last entrant place it objectively in a less favourable position.[9]

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[5] *Id*. ¶ 90.

[6] *Id*. ¶ 87.

[7] *Id*. ¶93.

[8] This agreement allowed O2, a new entrant, to pay to use the network of T-Mobile, the historic operator.

[9] E.C.J., 2 May 2006, O2 (Germany) / Commission, Case T-328/03, Rec., 2006,p.II-1231, ¶ 107.

Although in the regulatory context, the ECJ similarly ruled in *Mobistar v. Commune de Fléron*. In assessing the effect of a disputed GSM antenna tax, which was indistinctly imposed on all operators including the historic operator and new entrants, the ECJ determined that account must be taken of the advantages that benefited historic operators for decades and, more particularly, special and exclusive rights.[10] In *ISIS Multimedia*, the ECJ recalled that a system of undistorted competition could only be guaranteed by assuring equality of opportunity, and found that the advantages that benefited historic operators must be taken into consideration. Without such assessment, "It follows that new operators are not placed on an equal footing with the undertaking in a dominant position in respect of obtaining telephone numbers and that competition on the local network voice telephony services market is therefore distorted."[11]

The CFI and ECJ have unequivocally established that respect of this principle of equality of opportunity requires taking account of the new entrant's structural disadvantages in terms of market share, network infrastructure at the time of market entry, and as a corollary, the advantageous structural position of the historic operator, who benefited from special and exclusive rights.

The application of the price squeeze test on the basis of the historic operator's costs can never assure either an equality of opportunity or market access for new operators. Even if new entrants are reasonably efficient, they have a disadvantageous cost structure due to the lack of economies of scope and scale. Such economies of scale and scope did not even arise from a self-achieved dominant position by the incumbent, but from laws that shielded it from competition on the market. Taking account of the incumbent's lower costs would not shield new entrants from market eviction. New players could be eliminated from the market by pricing practices that would escape a finding of abuse. Such pricing practices would serve to perpetuate the competitive advantage of historic operators, as the application of an equally efficient operator test would benefit historic operators by taking account of their lower costs, but which are solely due to their position as ex-monopolists.

Of course, dominant firms should not subsidize new entry, and innovation should not be dampened. However, sector-specific regulation generally sets access fees to ensure that incumbents get a fair return on investment. In any event, due to the special and exclusive rights that benefited incumbents, network investments have typically been written off long ago and have been well-compensated by monopoly profits over several decades.

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[10] E.C.J., 8 September 2005, Mobistar and Belgacom Mobile, Case. C-544/03, Rec., 2005, p.I-7723, ¶ 49.

[11] C.F.I, 20 October 2005, ISIS Multimedia Net GmbH und Co. KG c O2 GmbH und Co. OHG, Joint Case C-328/03 and C-327/03, Rec.2005, p.I-08877, ¶ 44.

In *KPN/Denda*, Advocate General P. Maduro acknowledged the principle that dominant undertakings must be able to generate a reasonable rate of return on investments and innovation, but highlights that this principle should be balanced with an interest in fostering competition on the market. He noted that in recently liberalized markets, where incumbents have benefited from special and exclusive rights, the deterrent effect on innovation is marginal and outweighed by the benefits to competition:

> Under those conditions, where 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.[12]

Similarly, the Commission's new Article 82 guidelines acknowledge that a more rigid application of Article 82 is warranted when undertakings have benefited from special and exclusive rights.

Despite the above, some will argue that the CFI excluded the application of a reasonably efficient competitor test in its recent *Deutsche Telekom* ruling. We disagree, as the CFI did not rule on a set price squeeze test, but merely concluded that the Commission was correct to condemn an abusive price squeeze practice by reference to the costs of the dominant operator, Deutsche Telekom. In the presence of a price squeeze based only on the historic operator's costs, there is *a fortiori* a price squeeze practice based on the new entrants' higher costs. As a result, there is no reason to conduct an assessment based on new entrant costs, as this will *a fortiori* lead to the same conclusion, since new entrants have even higher costs. The CFI also noted that a reasonably-efficient operator approach could breach the principle of legal certainty to the extent that the incumbent would not know the new entrants' costs and therefore would be unable to assess the legality of its pricing policy. However, the CFI only expresses this as a possibility. A potential breach of the principle of legal certainty must be assessed on a case-by-case basis. And in any event, long-experienced incumbents are often very well placed to accurately appraise new entrants' costs or, at least, the costs of a "reasonably efficient" new entrant.

The merits of the equally efficient competitor test, as a general enforcement rule, are certainly acknowledged. Nevertheless, a more rigorous examination under the reasonably efficient test is demonstrably essential in certain sectors. Effective competition policy, indeed, must allow for distinct applications without endangering legal certainty. Structural sector characteristics should be considered, such as the importance of economies of scale and scope in network industries and recent

[12] *Id*. ¶ 55.

liberalization of an industry. With respect to the telecommunications sector, we therefore submit that only a reasonably-efficient competitor test will effectively allow for new entry, to the long-term benefit of competition and consumers.