



## Margin squeeze – The Frankenstein of Article 102

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# What is margin squeeze?

DG COMP has offered a definition linked to the creation of an unsustainable profit downstream

*Draft Article 102 paper (recital 121)*

- *“Margin squeeze refers to a situation where an undertaking that is active in an upstream input market and an associated downstream market sets its upstream or downstream prices at a level that prevents downstream competitors relying on that input from operating profitably on a lasting basis.”*

See also Case E-12/20 – *Telenor*, para 198 and *TeliaSonera*, paras 32-33



## What is margin squeeze?

This suggests that

An abusive margin squeeze requires the following:

- ✓ Vertically integrated undertaking (active upstream and downstream), supplying a downstream dependent competitor (or sourcing upstream)
- ✓ Dominant (usually upstream, c.f. the definition, but no legal requirement)
- ✓ Uses wholesale/retail prices to create an unfair margin between these
- ✓ Foreclosing a downstream competitor, suggesting a product of some strategic significance

And it serves to entrench the dominant position, rather than to extend it, thereby giving abusive margin squeeze a defensive character

# What is margin squeeze?

Getting to this point has neither been straight nor simple



## What is margin squeeze?

Margin squeeze might not make sense commercially

Vertical foreclosure is not an inherently obvious commercial strategy, as both ability and the incentive must be present

- Unless super-dominant/monopoly, *ability* may be absent, as a vertical foreclosure will undermine the dominant position when the customers try to counter, e.g., by establishing their own supply sources
- Foreclosing a customer may reduce sales, making it necessary to assess the overall impact on profitability (see *Non-Horizontal Merger Guidelines*, recitals 40–44), why the *incentive* may be absent
  - Fun fact: the *Draft Merger Guidelines* makes no reference to incentives and ability and singles out entrenchment as a non-horizontal theory of harm, suggesting a U-turn on some matters

## What is margin squeeze?

Potentially explaining the ambiguity on the availability of Article 102

And for many years, it was unclear if margin squeeze was a stand-alone infringement of Article 102

- *The Guidance Paper* (2008) does not suggest seeing margin squeeze as a separate infringement of Article 102, but rather a form of refusal to supply, limiting abuse to scenarios where *Bronner* is met
  - Fun fact: DG COMP identified an abusive margin squeeze in *Deutsche Telekom* (2003) and in its *Access Notice* (1998), suggesting some unexplained internal ambiguity

## What is margin squeeze?

The ambiguity makes no sense, but suggests a conflict between the chief economist's offices and the legal teams

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  - Fun fact: DG COMP identified an abusive margin squeeze in *Deutsche Telekom* (2003) and in its *Access Notice* (1998), suggesting some unexplained internal ambiguity
  - In its defense, it should be observed that the General Courts' ruling in *IPS (2000)* does not render support to margin squeeze as a separate infringement of Article 102
  - The same emerges from vintage cases such as *National Carbonising Company* (1975) and *British Sugar/Napier Brown* (1988)

## What is margin squeeze?

But still strange that a paper published in 2008 contradicts what was argued before the Court of Justice at the same time

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# What is margin squeeze?

This suggests a need for segmenting case law

Early practice (pre-2003)	Mature practice (2003-2012)	Modern practice (post-2012)
<ul style="list-style-type: none"> <li>• <i>National Carbonising Company</i></li> <li>• <i>British Sugar/Napier Brown</i></li> <li>• <i>IPS</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Deutsche Telekom</i></li> <li>• <i>TeliaSonera</i></li> <li>• <i>Telefónica</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Slovak Telekom</i></li> <li>• <i>Fjarskipti</i></li> <li>• <i>Telenor</i></li> <li>• <i>Lukoil II (margin squeeze)</i></li> </ul>

And some cases, where no abusive margin squeeze were identified

- *Deutsche Bahn I/II* (closed against commitments)
- *Wanadoo* (advanced as a predatory pricing due to lack of a vertically integrated operator)
- *MCI/Mobile Termination Rates* (initially a case about excessive pricing)

# What is margin squeeze?

Early practice does not suggest margin squeeze as a separate category of abuse

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# What is margin squeeze?

Mature, and to some extent, modern practice is tainted by emerging in a regulated environment

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## What is margin squeeze?

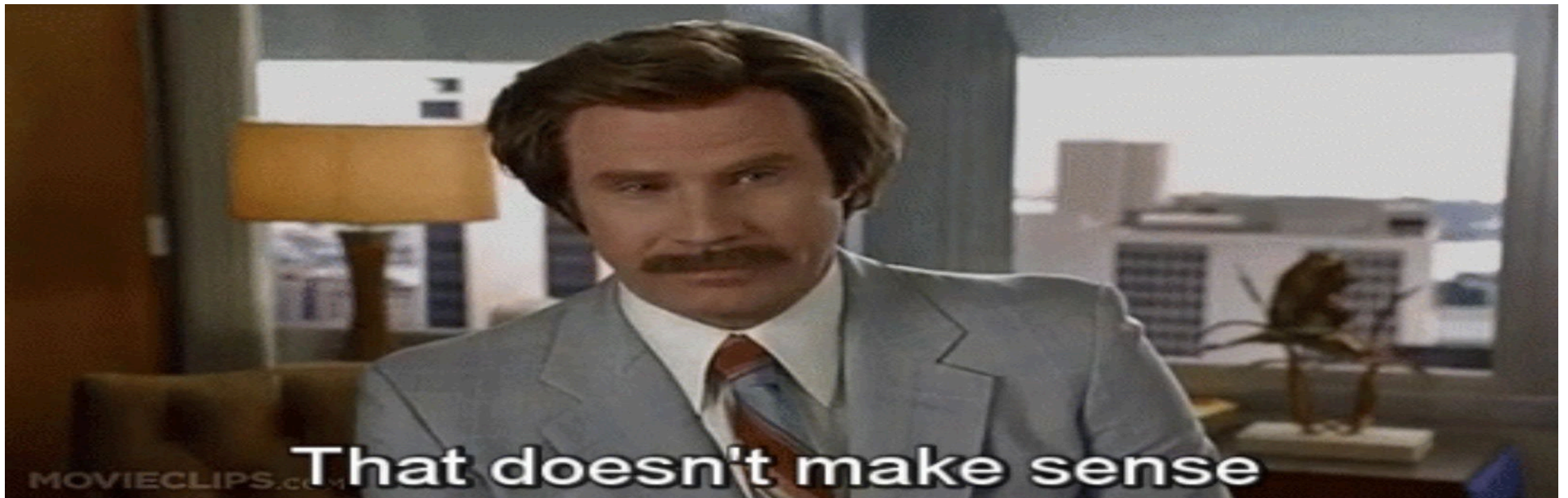
The regulatory environment has implications

- 1) No use of *Bronner*, c.f. *Slovak Telekom*, para 50. Usually, incentives and the need for a fair rate of return on the deployed capital are secured in the adopted ex ante regulation, making *Bronner* irrelevant
- 2) No need to identify an indispensable product, as *Bronner* doesn't apply. But does this make sense?
- 3) Case law has provided for two ways to establish an abusive margin squeeze, but neither are simple to deploy
- 4) What if ex ante regulation allows for a bespoke business strategy (e.g., full or shared local loop access), where some are inferior? Accepting this defies the AEC principle and *IPS*
- 5) What if the dominant costs are unavailable or somehow unrelated to realities?

## What is margin squeeze?

How can it be abusive if not indispensable? Viable alternatives must be unavailable

- No need to identify an indispensable product, as *Bronner* doesn't apply. But how can insignificant products facilitate a foreclosure?
  - *Non-Horizontal Merger Guidelines*, recital 34, and *Draft Article 102 Guidelines*, recital 127, acknowledged that only important input can facilitate a vertical foreclosure. Moreover, the foreclosure risk must be real, c.f. *Deutsche Telekom*, para 250



# What is margin squeeze?

Case law has provided for two ways to establish an abusive margin squeeze

- Margin squeeze can be established if: **a)** the margin is negative, or **b)** the margin is insufficient to cover the dominant undertaking's downstream costs, including the wholesale input, c.f. *TeliaSonera*, paras 73-74
- If the margins are negative (test **a**), the calculations are, in principle, simple, but we need to decide what to include in the retail revenue
  - In *Telefónica*, two methods (period-by-period and DCF/NPV) were employed to estimate customer-generated revenue, but DCF/NPV had been rebutted in *Wanadoo*
  - *Slovak Telekom* and *Telenor* relied on an aggregated approach to revenue (across the portfolio of broadband offerings), but *Telenor* reserved the right to dispense with the aggregated approach in favor of a product-by-product approach
  - In *Telenor*, revenues from international roaming, business mobile broadband, and data services such as SMS were excluded, and in *Slovak Telekom*, testing was done with and without additional services (voice telephony and internet TV)

## What is margin squeeze?

This gives rise to what is described as muddle margins, where the aggregated portfolio is profitable, unlike the individual services, "penalizing" an operator that has specialized in one

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## What is margin squeeze?

Under test B, it must be determined if the dominant undertaking could have operated profitably if compelled to pay its own wholesale prices

- Margin squeeze can be established if: **a)** the margin is negative, or **b)** the margin is insufficient to cover the dominant undertaking's downstream costs, including the wholesale input, c.f. *TeliaSonera*, paras 73-74
- If the margins are insufficient (test **b**), the calculations become more complicated by necessitating discussions on costs
  - *Draft Article 102 Guidelines*, recital 121-136 suggest relying on **i)** the wholesale price **ii)** plus downstream operating costs calculated as LRAIC, including **iii)** capital costs
  - In *Telefónica* and *Telenor*, this involved the regulated wholesale prices. However, cheaper alternatives were available, and the regulated wholesale prices were, in principle, set artificially high and therefore not relied upon internally, making the deployed tests more akin to a Reasonable Efficient Competitor (REC) test
  - Replacement costs are included in costs. In *Telefónica*, DG COMP relied on the Modern Equivalent Asset (MEA) Approach, but this was rejected in *Slovak Telekom*

## What is margin squeeze?

How does this comport with the AEC principle?

- What if ex ante regulation allows for a bespoke business strategy (e.g., full or shared local loop access or niche offerings), where some are inferior?
  - Margin squeeze requires two vertically linked products, and these are identified using a bottom-up approach, contemplating which wholesale offerings allow access to supplying the downstream retail product
  - In *Telefónica* and *Slovak Telekom*, both pertaining to broadband internet, three and two distinct wholesale products were identified. Some allowed for less advanced retail products and were not used by the dominant undertaking
  - In *Telefónica* and *Telenor*, cheaper access alternatives were (potentially) available
  - Going forward, we might see a discussion about alternatives, e.g., (cheap) raw-copper vs (more expensive) fibers as access products in the telecom sector
- Allowing third parties to design a bespoke business strategy sits uncomfortably with the AEC principle and *IPS*

# What is margin squeeze?

Should we protect less efficient competitors?

- What if the dominant costs are unavailable or somehow unrelated to realities?
  - In *TeliaSonera*, paras 45, the Court accepted relying on the costs of a Reasonable Efficient Competitor (REC), if the dominant undertaking's own costs were unavailable. Combined with *Post Danmark II*, cautioning against overreliance on the AEC, and the approach in *Telefónica* and *Telenor*, in some scenarios, the foreclosure of an REC competitor could be abusive
  - In *Slovak Telekom*, some of the necessary data for the LRAIC calculation were unavailable and had to be estimated using proxies. While DG COMP enjoys a discretion in using such approximations, it had (in my opinion) not fully accounted for why and how this affected the final assessment
  - *Slovak Telekom* and *Telenor* revenues are calculated on an aggregated level, including all forms of broadband but not additional services (voice telephony and internet TV). *Telenor* reserved the right to dispense with the aggregated approach in favor of a product-by-product approach

## What is margin squeeze?

Do we want legal zombies?

- Margin squeeze can be established if: **a)** the margin is negative, or **b)** the margin is insufficient to cover the dominant undertaking's downstream costs, including the wholesale input, c.f. *TeliaSonera*, paras 73-74
- The Court referred to the dominant undertaking's margins, suggesting that it could be abusive, even if the competitors' margins were positive due to being more efficient
- This has been referred to as "positive margins theory" or a "legal zombie theory."



# What is margin squeeze?

Strong arguments can be presented against advancing margin squeeze cases

- 1) Cases tend to emerge in regulated environments, and where sector regulators have failed in performing their duties
- 2) In *TeliaSonera*, access had been granted freely, yet *Bronner* remained unavailable. Do we really want to penalize the good company?
- 3) Is a margin squeeze really possible unless super-dominant upstream?
- 4) Should we protect less efficient competitors, and when?
- 5) Enforcers enjoys substantial discretion in selecting the standards applied in cases, but how much discretion should we accept?
- 6) An analysis entails numerous methodological decisions, increasing the risk of mistakes
- 7) What constitutes a sufficient margin when it is not negative (Test b)?
- 8) Should we test the margin across a portfolio of services or selectively?

# Cited cases

Court cases	Commissions Decisions
<p>Case C-260/24 – <i>Lukoil II (margin squeeze)</i>,            Case C-245/24 - <i>Lukoil I</i>            Case E-12/20 – <i>Telenor</i>            Case C-165/19P - <i>Slovak Telekom</i>            Case E-6/17 – <i>Fjarskipti</i>,            Case C-52/09 – <i>Konkurrensverket v TeliaSonera Sverige AB</i>            Case C-280/08P – <i>Deutsche Telekom</i>            Case T-336/07 – <i>Telefónica, SA</i>            Case C-7/97 - <i>Bronner</i>            Case T-5/97 – <i>Industrie des poudres sphériques SA</i></p>	<p>AT39.678/AT.39731 – <i>Deutsche Bahn I/II</i>,            COMP/38233 – <i>Wanadoo Interactive</i>            COMP/37704 – <i>MCI/Mobile Termination Rates</i>            COMP/37451 – <i>Deutsche Telekom AG</i>            IV/30178 – <i>Napier Brown - British Sugar</i>, O.J. 1988L 284/41            Case C-76/185/ECSC – <i>National Coal Board, National Smokeless Fuels Limited and the National Carbonizing Company Limited</i>, O.J. 1976L 35/6.</p>

# Cited notices

- *Guidelines on the assessment of mergers under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (draft)*
- *Guidelines on the application of Article 102 of the Treaty on the Functioning of the European Union to abusive exclusionary conduct by dominant undertakings (draft)*
- *Communication from the Commission: Guidance on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*
- *Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings*
- *Notice on the application of the competition rules to access agreements in the telecommunications sector - framework, relevant markets and principles*

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## Abusive Margin Squeeze: The Frankenstein Monster of Article 102 TFEU?

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### Abstract

While the content of margin squeeze has been largely provided by the case-law of European courts detailing how the foreclosure of competitors occurs as a direct result of its usage, some key conceptual issues have remained unresolved. These issues are not confined to how to identify abusive margin squeezes, but if it is prudent for a competition authority to pursue these abuses in enforcement action. The many embedded choices in an investigation by a competition authority (e.g. on costs and revenue standards) inflate the risk of mistakes and blur the lines related to other forms of abuse. This perhaps runs the risk of “regulatory shopping”, where other forms of abuse are masked as margin squeezes, lowering the threshold for market intervention. Restraint in pursuing margin squeeze cases can therefore often be the prudent position. In this paper, we review the case law and make some practical observations on enforcement action.

**Keywords:** abuse; Article 102; margin squeeze, enforcement; DG COMP

**JEL Classification:** K21, K23, L12, L13, L22, L40, L41, L43, L44, L96

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# Questions?



Otherwise, feel free to reach out on [cbe@drbergqvist.dk](mailto:cbe@drbergqvist.dk)