Margin Squeeze: Theory, Practice, Policy

Niamh Dunne[1]

Prepared for EUSA Conference, 3-5 March 2011[2]

ABSTRACT: Margin squeeze occurs where the margin between the price charged by a vertically integrated firm for a wholesale input, and its own retail price for the end product incorporating the input, is so low as to foreclose one or more affected markets. The extent to which margin squeeze should constitute a discrete competition law offence, distinct from predation or refusal to deal, is a disputed question. A jurisprudential chasm between the approaches to margin squeeze under European Union competition law and United States antitrust has emerged, following the Court of Justice of the European Union's judgments in *Deutsche Telekom* and *TeliaSonera* and the US Supreme Court's decision in *LinkLine*. The EU recognises a broad concept of margin squeeze, applicable in any sector; the US does not recognise margin squeeze as a standalone abuse, and moreover, the presence of sector-specific regulation excludes the application of antitrust to the price levels that comprise the squeeze. This paper explores the margin squeeze concept, with particular attention to both areas of contention.

Protection of competition not competitors is the accepted wisdom behind the competition rules. To what extent, however, may a vertically integrated dominant firm be liable for failure to protect its competitors' profit margins, where this in turn harms competition? That is, in effect, the problem posed by margin squeeze. This paper examines the margin squeeze concept and its relationship to sector-specific economic regulation in three dimensions: theory, practice and policy implications.

The paper is structured as follows. Part II sets out the basic theory of margin squeeze; explains how such a practice may raise problems from a competition perspective; and describes how the abuse has been accommodated under the competition rules. Part III examines the case law on margin squeeze within the European Union (EU), from its first mention in the *Napier Brown* Commission decision, to the recent Court of Justice judgments in the *Deutsche Telekom* appeal and the *TeliaSonera* reference case. Given the apparently opposite answers of United States courts when faced with broadly similar questions, the US jurisprudence on the issue of margin squeeze is also considered. Part IV of the paper considers the impact of sector-specific regulation on margin squeeze as a principle of competition law, considering in particular the policy issues that arise from the concurrency approach adopted under current EU law. Part V of the paper concludes.

---

[1] PhD candidate in law, University of Cambridge, nd266@cam.ac.uk.

[2] This is a *WORK IN PROGRESS* and any comments would be most gratefully received. Please do not cite or circulate without permission.

II: The Theory of Margin Squeeze

Margin squeeze is a problem that can arise where a firm is organised with a degree of vertical integration, meaning that it operates at two or more levels of the supply chain. Microeconomic theory posits that economic operators vertically integrate in circumstances where this is the most efficient manner in which to organise their businesses, with the result that consumer welfare as a whole is maximised. Thus, vertical integration is not an *a priori* problem, and indeed generally brings beneficial efficiencies of scale and scope to the firm's operations.[3]

Where, however, the vertically integrated firm sells part of its wholesale level production to a non-integrated firm that competes with it at the downstream level, the integrated firm gains a measure of control over its competitor' costs—which can be significant, particularly where there is no alternative source of supply for the input available to the downstream competitor, for example where there is a "bottleneck monopoly" at the wholesale level. Moreover, where the integrated firm also holds a dominant market position downstream, its ability to influence prices in that market means that it can also exert control over its competitor's revenues. Thus, the integrated firm may have the ability to manipulate, or "squeeze", the relationship between the competitor's costs and revenues in order to reduce its profit margin to such a low (or negative) level as to force the competitor from the market.[4] Figure 1 below illustrates this vertical price relationship in graphical form.

[3] The classic exposition of this theory is found in R.H. Coase, "The Nature of the Firm" (1937) 4(16) *Economica* 386-405. From a competition law perspective, a key benefit that is claimed about vertical integration is that it prevents double marginalisation, that is, the integrated firm can earn monopoly profit at only one level of the supply chain. By contrast, where there is a vertically separated market structure, monopoly profits can be made at each level of the supply chain, and consumer welfare as a whole is diminished. For a relatively neutral discussion of the double marginalisation issue, see W.K. Viscusi, J.E. Harrington & J.M. Vernon (2005), *Economics of Regulation and Antitrust* 4th ed., MIT Press, Cambridge, Massachusetts, USA, in particular Chapter 8: "Vertical Mergers and Vertical Restraints". While the "one monopoly profit" theory—a lynchpin of the Chicago School approach to competition law—has come in for criticism in more recent years, nonetheless there is considerable evidence that vertical integration can result in significant welfare benefits: see F. Lafontaine & M Slade, "Vertical Integration and Firm Boundaries: The Evidence" (2007) 45(3) *Journal of Economic Literature* 629-685 for a wide-ranging review of studies on the impact of vertical integration, concluding that under most circumstances, profit-maximising vertical integration decisions are efficient, from the perspective of both firms *and* consumers.

[4] This explanation, based on the textbook example of margin squeeze, is presented in a simplified form and is intended to illustrate the legal problem under consideration rather than providing an authoritative statement of the economic issues concerned. See OECD, *Roundtable on Margin Squeeze* DAF/COMP(2009)36, at 24, for a neat summary of the assumptions of the classic margin squeeze case, as well as a sample of differences that arise in real world scenarios. See also D. Geradin & R. O'Donoghue, "The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector" (2005) 1(2) *Journal of Competition Law & Economics* 355, at 358-360, for an outline of the basis conditions for margin squeeze.

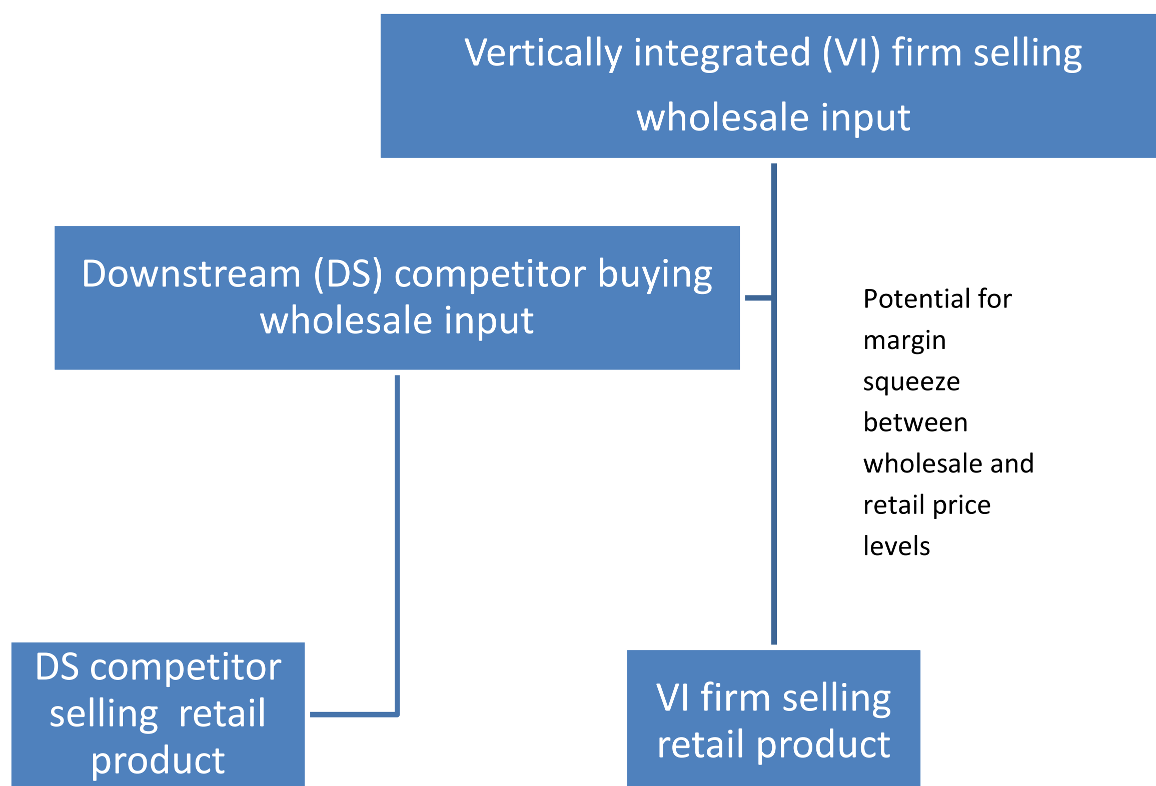

Figure 1: Vertical Margin Squeeze

Does a margin squeeze harm competition in the market, or does it merely diminish the competing firm's profits? Critics of margin squeeze attack it as being "*an antitrust rule that punishes a firm for failing to ensure its competitors' profitability*."[5] They argue that prohibiting margin squeeze simply leads to a wealth transfer from the vertically integrated firm to its downstream competitor, with no increase in consumer welfare, and moreover, can have a negative impact on the investment and competition incentives of the dominant firm. In addition, where the remedy for a squeeze is to increase retail prices to consumers, as is in fact expressly permitted under EU law, consumers lose out both directly as a result of higher prices and indirectly because of the negative impact on competition in the marketplace.

Moreover, there are those who argue that a margin squeeze will never (or at least rarely) be a rational strategy for an integrated firm: even though the firm would gain by acquiring more customers at the retail level from excluding its rivals, it would still lose out because of reduced profits at the wholesale

[5] J.G. Sidak, "Abolishing the Price Squeeze as a Theory of Antitrust Liability" (2008) 4(2) *Journal of Competition Law & Economics* 279, at 294.

level, where it has lost the customers of its wholesale product. This argument is tied to the notion that there is but "one monopoly profit" for the vertically integrated firm.[6]

Nonetheless, a plausible theory of competition harm (and corresponding benefit for the integrated firm) resulting from margin squeeze can be constructed. Firstly, exclusion of the rival from the downstream market reduces competition at that level, thus reducing the level of competitive pressure on the integrated firm to maintain lower prices and/or higher product quality. For those who view the maximisation of consumer welfare as the sole objective of competition law, a diminution in competition may not be seen as a problem where it does not result in an overall diminution in welfare.[7] For those who see competition law as a tool by which to protect the competition process, however, loss of competitors can greatly impair the proper functioning of the market mechanism.[8]

Secondly, even if the rival does not exit the downstream market, the squeeze may prevent it from climbing the ladder of investment; that is, integrating upstream into the dominant firm's primary market.[9] If the rival can develop its own upstream infrastructure, the bottleneck problem disappears, negating the possibility that a margin squeeze can arise in future and probably the need for economic regulation of the market. However, the existence of the margin squeeze prevents the rival from having sufficient revenues to fund and/or sufficient downstream market share to justify such investment.

Thirdly, the margin squeeze may also limit the rival's incentive to innovate within the downstream market, insofar as any cost saving the rival makes as a result of greater efficiency will be captured by the dominant firm via the squeeze. This results in consumer harm because it prevents the emergence of a more efficient downstream market.[10]

The *Telefónica* decision provides a good example of the related ways in which foreclosure via margin squeeze can be a rational, profitable strategy for a dominant firm. In this case, the Commission found that cross-subsidies from the high retail prices that Telefónica could maintain through foreclosure of the downstream market surpassed by far the foregone profits at the retail level; Telefónica was able to

---

[6] D.W. Carlton, "Should "Price Squeeze" be a Recognized Form of Anticompetitive Conduct?" (2008) 4(2) *Journal of Competition Law & Economics* 271, at 275. Geradin & O'Donoghue (2005), at 364, argue that while the reduced incentive for the firm to engage in margin squeeze does not render such behaviour irrational as a matter of course, it means that competition enforcers should consider carefully whether foreclosure is plausible in the circumstances.
[7] OECD (2009) at 27.
[8] See, for example, E.M. Fox, "The Modernization of Antitrust: A New Equilibrium" (1981) 66 *Cornell Law Review* 1140 at 1191.
[9] See E.N. Hovenkamp & H. Hovenkamp, "The Viability of Antitrust Price Squeeze Claims" (2009) 51 *Arizona Law Review* 273, at 287.
[10] Hovenkamp & Hovenkamp (2009), at 289.

protect its dominant position in adjacent retail markets; and it was perfectly position to also pre-empt emerging retail markets in new technologies.[11] At the same time, the lack of competition in the downstream market meant that Spain had among the highest average prices for retail broadband in the EU, and below-average broadband penetration rates. Thus, Telefónica maintained its dominance and consumers suffered due to few users and higher prices.

Margin Squeeze and Competition Law

The principal focus of this paper is an analysis of the treatment of margin squeeze cases under current competition jurisprudence, firstly in the EU, with a comparative assessment of the approach under US antitrust law. Particular consideration is given to the question of the application of the margin squeeze concept, as a principle of competition law, in sectors already subject to sector-specific regulation. Before we consider the specifics of the approaches in the two jurisdictions under examination, however, it is worthwhile giving some thought, more generally, to how price squeezing behaviour fits within the established competition law framework.

Although a vertically integrated firm may, legally, comprise a number of separate companies, the group of companies as a whole typically constitutes a single economic unit. Therefore, the competition rules on unilateral conduct are the appropriate starting point for our assessment. In the EU, Article 102 of the Treaty on the Functioning of the European Union (TFEU)[12] prohibits the "abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it", insofar as this affects trade between Member States. In the US, §2 of the Sherman Act prohibits monopolisation, attempts to monopolise and conspiracies to monopolise trade. While the market share threshold for the application of Article 102 TFEU is significantly lower than that required for the application of §2 of the Sherman Act, the latter provision covers the anticompetitive acquisition as well as maintenance of a monopoly, whereas at least according to the letter of the law Article 102 TFEU covers only the abuse of an existing position of dominance. For the purposes of this paper, however, we shall assume that the core of each provision is broadly equivalent: prohibiting anticompetitive behaviour by firms holding substantial market power.

How might a margin squeeze be construed as a unilateral conduct abuse? Firstly, there are those that would exclude circumstances leading to a margin squeeze from the purview of competition law

[11] Commission Decision of 4 July 2007 relating to a proceeding under Article 83 of the EC Treaty (Case COMP/38.784 – *Wanadoo España v Telefónica*), at paragraphs 611-613.

[12] Prior to the entry into force of the Lisbon Treaty on 1 December 2009, Article 102 TFEU was known as Article 82 EC, and prior to that Article 86 of the EC Treaty. For the sake of simplicity, the term "Article 102 TFEU" is used throughout this paper to refer to the provision, which remains completely unchanged in substance.

entirely. Rather, the argument is that such behaviour is more appropriately dealt with under the economic principles on access pricing. Thus, the wholesale level price (and possibility also the downstream price) should be set by a regulator at a level that maximises consumer welfare, the assumption being that in the market concerned the operation of the market mechanism will not result in a socially optimal pricing scheme.[13] A key consideration for those favouring the regulatory approach is the presumed superiority of regulators in addressing competition issues within their area of special expertise, when compared to generalist competition law enforcers.[14] On the other hand, sector-specific regulation and competition law seek to achieve different objectives with respect to competition—broadly, promoting versus policing competition, respectively—a distinction that may justify a different economic treatment of margin squeeze under each approach,[15] and which therefore suggests that subsuming antitrust considerations within access pricing is not the optimum solution.

Secondly, even where it is admitted that margin squeeze behaviour may be examined under the competition rules, opinion is divided as to whether a margin squeeze should constitute a standalone cause of action, or whether it should instead be fitted into existing competition law standards. The latter position is supported by the argument that competition law should treat economically-equivalent actions in an identical manner, and that many if not all forms of conduct by which a margin squeeze can arise are already captured by existing competition law prohibitions.[16]

Thus, some commentators treat margin squeeze as a form of refusal to deal,[17] an approach that focuses principally on the wholesale prices charged by the vertically integrated firm. Under this view, the dominant firm's practice of charging a wholesale prices that does not allow the downstream competing firms to make sufficient profit (however one defines sufficiency) in view of the existing retail price amounts to a constructive refusal to deal, or a refusal to deal on commercially acceptable terms. As an competition law abuse, however, refusal to deal is construed very narrowly—the default assumption being that even dominant firms are free to decide who they want to transact with and on what terms—so that an approach to margin squeeze that examines the behaviour solely through the lens of the refusal to deal principle is in practice a very restricted one.

[13] For example, see Sidak (2008); also OECD (2009), cited fn. 4 above, at 27-29, for a summary of access pricing principles.
[14] See Sidak (2008), at 287 & 294 and Hovenkamp & Hovenkamp (2009) at 297-298.
[15] See Oxera, "No Margin for Error: The Challenges of Assessing Margin Squeeze in Practice" *Oxera Agenda,* November 2009.
[16] OECD (2009) at 21.
[17] For example, S.C. Salop, "Refusals to Deal and Price Squeezes by an Unregulated, Vertically Integrated Monopolist" (2010) 76(3) *Antitrust Law Journal* 709 and E. Meriwether, "Putting the "Squeeze" on Refusal to Deal Cases: Lessons from *Trinko* and *LinkLine*" (2010) 24 *Antitrust* 65.

Alternatively, margin squeeze may be characterised as a form of predation, that is, below cost pricing, sustained by the dominant firm for long enough to drive the competitor from the market.[18] Colley & Burnside favour this approach on the basis that, under both predation and margin squeeze, the dominant firm incurs incremental losses (in the latter case, at least in the form of profits forgone).[19] As the *Telefónica* case demonstrates, however, margin squeeze cases can just as easily involve high wholesale and retail prices as low wholesale and retail levels. Moreover, the test for predatory pricing test, which assumes that predation is an inherently unsustainable policy insofar as no firm can lose money forever, may not capture fully the vertical element of margin squeeze. Vertical integration and cross-subsidisation means that margin squeeze contains a built-in mechanism by which the integrated firm can sustain the otherwise unsustainable.[20]

It is this vertical aspect of margin squeeze that prompts other commentators to argue that it should constitute a standalone abuse, on the basis that examination of each price level separately for evidence of a discrete abuse fails to take account of the dominant firm's ability to engage in vertical leveraging.[21] The issue then becomes one of determining what level of a squeeze between wholesale and retail prices should be prohibited—how "unfair", "inadequate", "inappropriate" or "disproportionate" the relationship between these prices must be,[22] and more importantly, how this is to be measured, objectively and efficiently.[23]

Some would go beyond even an economics-based standalone test for margin squeeze. Lopatka, who was in fact sceptical of the logic of a quantitative margin squeeze test in the presence of price regulation, argued that dominant firms should instead be liable for deliberate abusive conduct in the regulatory price-setting process. Conversely, a margin squeeze that arises as a result of regulatory inconsistency would not be actionable.[24] On the other hand, Dogan & Lemley, who have argued that

[18] For example, Carlton (2008); S.L. Dogan & M.A. Lemley, "Antitrust Law and Regulatory Gaming" (2009) 87 *Texas Law Review* 685, at 725; and L Colley & S. Burnside, "Margin Squeeze Abuse" (2006) 2 *European Competition Journal* 185, at 186-188. Sidak (2008), although favouring a access pricing approach, argues that where the retail price is unregulated its legality should be considered under the predatory pricing rules.

[19] Colley & Burnside (2006) at 186.

[20] Hovenkamp & Hovenkamp (2009), at 291.

[21] N. Economides, "Vertical Leverage and the Sacrifice Principle: Why the Supreme Court got *Trinko* Wrong" (2005) 61 *NYU Annual Survey of American Law* 379.

[22] To use the language of the *TeliaSonera*, *LinkLine*, *Deutsche Telekom* (CJEU) judgments and the *Telefónica* decision, all discussed in Part III below, respectively.

[23] Two options are the as-efficient competitor test, which uses the costs of the dominant firm, and the reasonably efficient competitor test, which uses the costs of a hypothetical reasonably efficient competitor of the dominant firm.

[24] J.E. Lopatka, "The Electric Utility Price Squeeze as an Antitrust Cause of Action" (1984) 31 *UCLA Law Review* 563. Note, however, that Lopatka was considering circumstances where the wholesale and retail prices were set by separate regulatory agencies. Where both price-setting functions reside in a single agency, he suggested that participation in the regulatory process would probably be immunised by the *Noerr-Pennington* doctrine of US antitrust law, which excludes lobbying and other attempts to influence the legislative function from antitrust enforcement (at 634). The case theory behind the prosecution of Rambus by both the European

competition law should be used to address other forms of regulatory gaming such as patent hopping, see margin squeeze as the limit to this approach: where there is detailed regulation already in place, the costs of antitrust intervention begin to outweigh its benefits.[25]

This latter point leads to an additional question: even where we recognise margin squeeze as a competition law abuse (either as a standalone offence or where the component prices constitute discrete examples of other established offences such as predation or refusal to deal), to what extent does the existence of *ex ante* sector-specific economic regulation in the market impact upon, or even prevent, the *ex post* application of competition law to the price squeeze behaviour? This question is linked to broader policy considerations regarding the intersection between competition law and economic regulation more generally, but it has a particular significance in the margin squeeze context. As noted, many margin squeeze cases arise in sectors where there is a bottleneck monopoly at the wholesale level—and it is the presence of such a monopoly that is, frequently, the impetus behind the implementation of economic regulation in the first place. Thus, arguably, margin squeeze cases are in practice *most likely* to arise in sectors where there is existing regulation, meaning that the relationship between margin squeeze as a competition law and regulatory abuse merits special consideration.

Bouckaert & Verboven, for example, argue that the presence, and degree, of economic regulation *should* impact on the treatment of margin squeeze on the basis that the regulatory environment determines the nature of the offence.[26] Where there is full regulation at both the wholesale and retail levels, they argue that a squeeze is simply "*an artefact of the regulatory system*",[27] and therefore can only be addressed through the regulation in place. Where there is price regulation at the wholesale but not the retail level, competition law can be applied to the unregulated retail price in the form of the test for predatory pricing, but not to the margin as such. It is only where there is no regulation at either level that foreclosure via the margin itself becomes a problem—but even in such circumstances, competition law enforcement may not be the optimal tool to resolve the problem. Rather, it may be better addressed through alternative solutions such as (re)regulation, facilities-based competition (although this is not always economically feasible) or structural separation of the vertically integrated firm.[28] While this approach is merely one among many to the regulation/competition law interface in

---

Commission and the US Federal Trade Commission, concerning anticompetitive participation in a standard-setting process, might provide some support for this approach, but unfortunately neither proceeding has resulted in a formal finding of breach: the EU proceedings were closed without a finding of abuse on receipt of behavioural commitments from the firm; the initial finding of breach by the FTC was annulled on appeal.

[25] Dogan & Lemley (2009) at 723.

[26] J. Bouckaert & F. Verboven, "Price Squeezes in a Regulatory Environment" (2004) 26(3) *Journal of Regulatory Economics* 321.

[27] Bouckaert & Verboven (2004), at 334.

[28] Structural separation of vertically integrated firms can provide a more enduring remedy to margin squeeze problems by separating the upstream and downstream activities of the firm, effectively disintegrating the integrated firm. It is an interesting (and controversial) topic beyond the remit of this paper. Detailed discussion

the margin squeeze context, it does illustrate the significant impact that regulation may have on both the policy and economics-focused issues. This aspect will be discussed in detail in Part IV of the paper.

III. Margin Squeeze: The Case Law

Having considered the theory of margin squeeze, we shall now examine the development of the EU competition law jurisprudence on the issue, as well as outlining the current position. The EU approach is compared to and contrasted with the far more restrictive US approach, a divergence that is particularly interesting in view of the close factual similarities between the cases that have arisen in both jurisdictions. In particular, we shall examine two issues: (i) the extent to which margin squeeze constitutes a standalone competition law offence; and (ii) the impact of sector-specific regulation on margin squeeze as a competition law concept. In both jurisdictions, as noted above, we are considering the position of the vertically integrated form under the rules relating to unilateral conduct, that is Article 102 TFEU and §2 of the Sherman Act.

Margin Squeeze in the European Union

The concept of margin squeeze as an abuse of dominance was first applied by the Commission in 1988 in its *Napier Brown – British Sugar* decision.[29] The case concerned a series of abusive practices carried out by the sole sugar beet producer in the UK, British Sugar. This firm was active, *inter alia*, on the markets for the sale of granulated sugar in bulk quantities and individually packaged for retail sale in the UK, and was found by the Commission to hold a dominant position on both markets. When the UK's largest sugar merchant, Napier Brown, attempted to enter the retail packet sugar market, by buying sugar in bulk from British Sugar and packaging itself, British Sugar retaliated with a series of sales practices designed to prevent Napier Brown from gaining a foothold in the downstream market, including refusals to supply, tying and fidelity rebates. Among the alleged anticompetitive practices was the fact that British Sugar had cut its prices for retail packet sugar, thereby squeezing the margin between the wholesale cost of sugar in bulk and retail packet sugar prices. The Commission took the view that a margin squeeze of this nature could amount to an abuse of dominance, in the circumstances:

---

of the policy considerations involved can be found in OECD, *Restructuring Public Utilities for Competition* (2001). A useful description of the degrees of separation that may be imposed is available in M. Cave, "Six Degrees of Separation: Operation Separation as a Remedy in European Telecommunications Regulation" 64 *Communications and Strategies* (4th quarter 2006), p.1-15. For an example of recent economic thinking on structural separation, see B. Moselle & D. Black, "Vertical Separation as an Appropriate Remedy" (2011) 2(1) *Journal of Competition Law & Practice* 84.

[29] Commission Decision 88/518/EEC of 18 July 1988 relating to a proceeding under Article 86 of the EEC Treaty (Case No IV/30.178 *Napier Brown – British Sugar*) (OJ L 284/41, 19.10.1988).

> The maintaining, by a dominant company, which is dominant in the markets for both a raw material and a corresponding derived product, of a margin between the price which it charges for a raw material to the companies which compete with the dominant company in the production of the derived product and the price which it charges for the derived product, which is insufficient to reflect that dominant company's own costs of transformation…[]…with the result that competition in the derived product is restricted, is an abuse of dominant position.[30]

Thus, the Commission established that the relevant measure of costs is an objective one: the as-efficient competitor test, that is, British Sugar's *own* costs, rather than those of its downstream competitors. The standard by which those costs were to be assessed, however, was a rather nebulous one: the sufficiency of the margin in reflecting the cost of transformation between the wholesale and retail products. On the facts, taking into account the evidence of intention to foreclose the retail sugar market, and coupled with the other abuses that British Sugar has committed, the Commission held that the margin squeeze constituted an abuse of dominance.[31]

The possibility that a margin squeeze can amount to an abuse of dominance was later recognised by the then Court of First Instance (now General Court) in the *Industries des Poudres Sphériques* judgment,[32] albeit no abuse was found on the circumstances. Industries des Poudres Sphériques (IPS) was a French firm that manufactured that manufactured broken calcium metal from primary calcium metal. It purchased the latter raw material from another French firm, Péchiney Électrométallurgie (PEM), which was also active in the broken calcium metal market. IPS complained to the Commission, *inter alia*, that PEM's pricing practices with respect to its primary calcium metal and broken calcium metal products, respectively, constituted an abuse of PEM's alleged dominant position on the upstream market. The Commission rejected the complaint against PEM in its entirety, and IPS appealed the rejection decision to the General Court. In assessing the initial complaint submitted by IPS, the General Court described the potential abuse of margin squeeze in the following terms:

> Price squeezing may be said to take place when an undertaking which is in a dominant position on the market for an unprocessed product and itself uses part of its production for the manufacture of a more processed product, while at the same time selling off surplus unprocessed product on the market, sets the price at which it sells the unprocessed product at such a level that those who purchase it do not have a sufficient profit margin on the processing to remain competitive on the market for the processed product.[33]

---

[30] *Napier Brown* at paragraph 66, relying on the earlier Court of Justice decision in Case 6/72 *Continental Can v Commission* [1973] ECR 215.

[31] The other abuses challenged in the decision contributed to the margin squeeze found on the facts. British Sugar refused to supply bulk sugar apart from on an *ex* factory pricing basis, which included a charge for the delivery of the sugar from British Sugar's factory to the customer's premises. Not only did this practice have the effect of reserving to British Sugar the separate but ancillary activity of delivery of the sugar, it also raised the wholesale cost of the sugar for any firm intending to transform the bulk sugar into packet sugar.

[32] Case T-5/97*Industries des Poudres Sphériques v Commission* [2000[ECR II-3755.

[33] *Industries des Poudres Sphériques* at paragraph 178.

Thus, the Genera; Court followed the Commission's approach in *Napier Brown* in adopting the sufficiency of the margin as the central concern. Moreover, by focusing on the costs and revenues of the downstream competitor, rather than the dominant firm, the formulation in *Industries des Poudres Sphériques* appears, at first glance, to be more favourable to downstream competitors than the as-efficient competitor test, insofar as it protects inefficient competitors in addition to as-efficient ones. Nonetheless, when it came to applying this formulation to the facts at hand, the CFI adopted a far more restrictive approach. It held that, in the absence of abusive prices at the wholesale level (which would constitute a constructive refusal to deal) or predatory prices at the retail level, IPS had failed to raise facts that could constitute a breach of the competition rules. In particular, the fact that IPS incurred higher processing costs did not justify characterising PEM's pricing policy as abusive—because a producer, even in a dominant position, is not obliged to sell its product below its manufacturing costs.[34]

Another case of relevance in this context, albeit one that does not consider the issue of vertical margin squeeze directly, is the *Deutsche Post* decision of 2001.[35] In this case, the Commission held that Deutsche Post, the incumbent postal operator in Germany, had abused its dominant position in the liberalised market for mail order parcel services in Germany, by setting predatory prices for those services that did not cover the incremental cost of their provision. While the Commission applied the orthodox predatory pricing standards established in *AKZO*,[36] the predation strategy was financed via cross-subsidies from the profitable letter-post market, where Deutsche Post held a legal monopoly of service. While the case thus concerned horizontal rather than vertical related markets, it provides support for the proposition that a firm's ability to cross-subsidise between profitable and losing-making businesses can make a foreclosure strategy rational in the longer term.[37]

Nonetheless, until recently the parameters of the margin squeeze concept as a unilateral conduct offence were somewhat unsettled within EU competition law: firstly, as to whether it can constitute a standalone competition abuse, in the absence of predation or refusal to deal; and secondly, as to the calculation of whether a margin is abusive on the facts. These questions have been substantially clarified in two recent judgments of the Court of Justice of the European Union dealing expressly and

[34] *Industries des Poudres Sphériques* at paragraph 179. Note that, while IPS had higher processing costs than PEM, it ended up with a higher value final product, insofar as the broken calcium metal sold by IPS commanded a 25% premium on the prices charged for competing products; see *Industries des Poudres Sphériques* at paragraph 185.

[35] Commission Decision 2001/354/EC of 20 March 2001 relating to a proceeding under Article 82 of the EC Treaty (Case Comp/35.141 – *Deutsche Post AG*) (OJ L 125/27, 5.5.2001).

[36] Case C-62/86 *AKZO v Commission* [1991] ECR I-3359.

[37] See G.R. Faulhaber, "Cross-Subsidization: Pricing in Public Enterprises" (1975) 65(5) *American Economic Review* 966-977 for a discussion on cross-subsidisation by integrated firms, in particular the impact on consumer welfare and the possibility of competitive entry.

at length with the issue of margin squeeze, namely *Deutsche Telekom* and *TeliaSonera*. In these cases, the Court has recognised a very broad concept of margin squeeze as a standalone abuse, and moreover on that can arise in any circumstances, whether in a regulated sector, in the presence of an essential facility or in an otherwise competitive market.

The Deutsche Telekom *Judgment*

The *Deutsche Telekom* case emerged from the EU's efforts to introduce competition at the retail level for telecommunications services in the EU, via mandatory unbundling requirements imposed on incumbent telecommunications operators in the Member States. Deutsche Telekom (DT) is the formerly State-owned incumbent operator in Germany, which retains ownership of the fixed telephone network. The German markets in the provision of infrastructure and telephone services have been liberalised since 1996, in line with EU law requirements, and DT has been subject to mandatory access requirements under national law since that date. DT now provides, *inter alia*, retail telecommunications services to end users, as well as wholesale access to infrastructure services to non-integrated firms that compete with it in the downstream markets. During the time period in question, in addition to the mandatory access requirements, DT was subject to price regulation at both the wholesale and retail levels. The case against DT proceeded on the basis that, at the wholesale level, access charges were set by the national telecommunications regulator, while at the retail level, DT was subject to a price cap for "baskets" of services.[38] The latter regulatory structure required that the aggregate price for each basket was not permitted to exceed a certain level, but gave DT discretion as to the pricing of individual component services within the basket, although any adjustment of these charges required authorisation from the regulator.

By a decision of 2003, the Commission held that the spread between the wholesale and retail prices charged by DT for fully unbundled access to its local loops amounted to an abusive margin squeeze, contrary to what is now Article 102 TFEU.[39] DT was considered to hold a dominant position in both the wholesale and retail access markets. Once again, the as-efficient competitor standard was applied to determine the existence of an anticompetitive squeeze.[40] This test established that the spread

[38] At the time in question, two "baskets" were established, one for services to residential customers and the other for services to business customers.

[39] Commission Decision 2003/707/EC of 21 May 2003 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-1/37.451, 37.578, 37.579 – *Deutsche Telekom AG*) (OJ C 263/9, 14.10.2003).

[40] See the *Deutsche Telekom* decision at paragraphs 107-108:

> "…there is an abusive margin squeeze 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…[]...An insufficient spread between a vertically integrated dominant operator's wholesale and retail charges constitutes anticompetitive conduct especially where

between DT's average retail access price and its wholesale access price was always negative from the time when local loop unbundling became a legal obligation in Germany in 1998 up to the end of 2001. Given that DT had sufficient "commercial discretion" to avoid the squeeze by adjusting the retail prices within its price-capped baskets and in the absence of any objective justification the margin squeeze amounted to an abuse of dominance by DT. A fine of €12.6 million was imposed for the violation, which included a lower basic amount to account for the relative novelty of the margin squeeze calculation and subsequent efforts by DT to reduce the squeeze, plus a 10% reduction to take account of the regulatory regime as a mitigating circumstance.

DT appealed the 2003 decision to the CFI, where the Commission's approach was largely affirmed.[41] DT further appealed that judgment to the Court of Justice, which in 14 October 2010 dismissed DT's action in its entirety.[42] Since the Court of Justice judgment essentially confirms the approach of the CFI, we shall focus on the more recent higher court judgment in determining the principles on margin squeeze emerging from the case.

Firstly, the Court of Justice accepted that margin squeeze can, *in itself*, constitute an abuse of dominance contrary to Article 102 TFEU. The abuse of margin squeeze is concerned with the unfairness of the spread between two vertically related prices. Therefore, it is not necessary to establish, in addition, that either the wholesale or retail price is, independently of the claimed squeeze, excessive (thereby amounting to a constructive refusal to deal) or predatory.[43] Moreover, the unfairness of a margin squeeze stems from its very existence rather than its precise spread. The absolute values of the wholesale and retail prices are therefore irrelevant: margin squeeze relates instead to the relationship between these absolute values.[44]

Secondly, the Court of Justice approved the use of the as-efficient competitor test in order to determine whether such a pricing spread breaches the competition rules, relying solely upon the dominant undertaking's charges and costs, rather than the situation of its actual or potential competitors. The Court took the view that, not only is such an approach consistent with general welfare considerations, insofar as it protects competition (in the form of as- or more efficient competitors) as opposed to less efficient competitors, it is moreover consistent with the general

---

other providers are excluded from competition on the downstream market even if they are at least as efficient as the established operator."

[41] Case T-271/03 *Deutsche Telekom AG v Commission of the European Communities* [2008] ECR II-477.

[42] Case C-280.08 P *Deutsche Telekom Ag v European Commission*, Judgment of 14 October 2010 (not yet reported).

[43] *Deutsche Telekom* (CJEU) at paragraph 182.

[44] *Deutsche Telekom* (CJEU) at paragraphs 167-168.

principle of legal certainty, insofar as a dominant firm will know its own costs but not those of its competitors.[45]

Thirdly, the Court acknowledged that, in certain circumstances including those of the *Deutsche Telekom* case itself, the only mechanism available to the dominant firm by which to remedy an abusive margin squeeze may be to raise retail prices for end-users. Nonetheless, the Court appears to have taken a "lesser-of-two-evils" approach, whereby increased retail prices are acceptable in the immediate term in order to protect the existence of competition in the market, on the assumption in the longer term the presence of competition would place downward pressure on retail prices once again.[46] This position is in complete opposition to the approach of the Supreme Court in *LinkLine*, discussed below, where the fear that dominant firms might raise retail prices to avoid a price squeeze seems to have been a key factor behind the Court's highly restrictive approach.

Fourthly, the Court followed the approach of the General Court in *Deutsche Telekom* in holding that, contrary to the arguments of the Commission, it is not sufficient to merely demonstrate the existence of a *prima facie* margin squeeze of as-efficient competitors in order to establish a violation of Article 102 TFEU. Additionally, anticompetitive effect must be established, relating to the possible barriers which the appellant's pricing practices could have created for the growth of products on the retail market, and therefore, on the degree of competition on the downstream market. However, the fact that a margin squeeze, once implemented, ultimately fails to drive the competitors from the market does not alter its categorisation as abusive, where the market penetration of those competitors has been made more difficult.[47]

Finally, the Court considered the impact that sector-specific regulation has on the application of EU competition law, and in particular, on the margin squeeze concept. As noted, the case against DT had proceeded on the assumption that did not have any discretion as to the wholesale access prices to be charged, which were set by the national regulator, but that it could alter its retail prices provided that these remained within the total price cap and that the changes were granted regulatory approval. In assessing the impact of the sectoral regulation, the Court drew a distinction between situations where the restriction of competition is wholly attributable to the regulatory regime, and situations where it is

---

[45] *Deutsche Telekom* (CJEU) at paragraphs 196-202.

[46] *Deutsche Telekom* (CJEU) at paragraphs 181-182. The Court did not, however, address the dilemma of the firm that is dominant but subject to price regulation at the wholesale level, and which faces downward competitive prices at the retail level—in particular, the question as to whether such a firm can cut prices to meet competition, even if this leads once again to a margin squeeze. Following the highly restrictive approach adopted in the *Telefónica* decision, it seems unlikely that a dominant firm can invoke the "meeting competition" defence to excuse a conscious margin squeeze, even though, in a somewhat circular fashion, it is the existence of the prohibition on margin squeeze which, coupled with the wholesale price regulation, has allowed the development of competition which drives the reduction in retail prices (*Telefónica* at paragraphs 637-640).

[47] *Deutsche Telekom* (CJEU) at paragraphs 250-254.

merely encouraged or facilitated by the regulatory regime, also allowing some scope for autonomous conduct by the firm concerned. Under the former scenario, the competition rules are not applicable, because they apply directly only to the conduct of undertakings—essentially a State or regulatory compulsion defence. In the latter case, however, *any* scope for autonomous behaviour by the relevant firm can be examined to determine whether it is in conformity with the competition rules.[48] A very high threshold for operation of the State compulsion defence in these circumstances was therefore established by the Court. The existence of sector-specific regulation—even relatively intrusive regulation, like the mandatory access requirements and dual-level price regulation in place in the *Deutsche Telekom* situation—does not immunise the relevant market from the application of the competition rules, unless it has "eliminated any possibility of competitive activity" by the dominant firm.[49] As DT had the ability to avoid the margin squeeze by raising its price for retail access, its failure to do so violated the competition rules. The existence of sectoral regulation is, however, relevant to the determination of the competitive conditions in the market concerned, a factor that impacts on the application of the competition rules to the conduct of firms operating in that market.[50] It may also lead to a reduction in fine for the firm, where it is found to be a contributing factor to the breach. The relationship between the margin squeeze concept and sector-specific regulation is considered further below in Part IV of this paper.

The TeliaSonera *Judgment*

The principles established in *Deutsche Telekom* case have been confirmed and somewhat developed in the recent *TeliaSonera* judgment of the Court of Justice.[51] A reference case from Sweden, it concerned the application of Article 102 TFEU and the margin squeeze abuse by the Swedish national competition authority. In the absence of a detailed finding of facts, the referring court asked, in essence, a series of questions clarifying the parameters of the margin squeeze concept.

The Court of Justice confirmed that margin squeeze constitutes a standalone abuse under Article 102 TFEU, where the spread between wholesale and retail prices is "*negative or insufficient…so that that spread does not allow a competitor which is as efficient as [the dominant] undertaking to compete for the supply of [retail] services to end users*."[52] In such circumstances, an as-efficient competitor of the dominant firm would be forced to operate at a loss or "*artificially reduced levels of profitability*."[53] Generally, only the costs and revenues of the dominant firm are relevant to this assessment—an

[48] *Deutsche Telekom* (CJEU) at paragraphs 80-85.
[49] *Deutsche Telekom* (CFI) at paragraph 90.
[50] *Deutsche Telekom* (CJEU) at paragraph 224.
[51] Case C-52/09 *Konkurrensverket v TeliaSonera Sverige AB*, judgment of 17 February 2011, not yet reported.
[52] *TeliaSonera* at paragraphs 31-32.
[53] *TeliaSonera* at paragraph 33.

objective standard—although in exceptional circumstances, the costs and prices of its competitors might be relevant, for example where it is not possible to identify the cost structure of the dominant firm.[54] Proof of recoupment of any losses incurred as a result of the margin squeeze is not required,[55] nor is dominance in the downstream market, wholesale dominance being sufficient.[56]

The Court clarified that the margin squeeze concept can be applied to any pricing practices by dominant firms, even in the absence of a regulatory or antitrust duty to deal at the wholesale level. Here, the Court diverged from the advice of Advocate General Mazák, who had argued that unless the firm has a duty to deal in the first place—either imposed by sectoral regulation or because the relatively restrictive *Oscar Bronner* requirements for the imposition of antitrust forced sharing are satisfied[57]—it cannot be under a distinct duty to deal on particular terms.[58] Instead, the Court was of the view that where a dominant firm voluntarily chooses to deal with downstream competitors, it might be found to abuse its dominant position where the terms of dealing are "*disadvantageous*" to the latter.[59] Indispensability of the wholesale input is not, therefore, required for liability.[60]

On the other hand, the Court followed the approach in *Deutsche Telekom* by requiring anticompetitive effect to be demonstrated in order to establish an abusive margin squeeze. The Court appears to have established a two-part presumption as regards the effects of a squeeze, based on the level of the margin between wholesale and resale prices. Where the margin is negative, an effect which is at least potentially exclusionary is probable. Where the margin remains positive, it has to be demonstrated that the application of the pricing practice was (for example, by reason of reduced profitability) likely

---

[54] *TeliaSonera* at paragraphs 41-46.
[55] *TeliaSonera* at paragraphs 96-103.
[56] *TeliaSonera* at paragraphs 84-89.
[57] Under the criteria set out by the Court of Justice in *Oscar Bronner*, three conditions must be satisfied before a refusal to grant access to an input by a dominant firm can be considered abusive: (i) the refusal must be likely to eliminate all competition in the secondary market on the part of the person requesting the access; (ii) there is no objective justification for the refusal; and (iii) the service in itself is indispensible to carrying on that person's business, inasmuch as there is no actual or potential substitute in existence; see Case C-7/97 *Oscar Bronner GmbH & co.KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co.KG* [1998] ECR I-7791 at paragraph 41. Note that the Court in *TeliaSonera*, in a rather curious dicta, seems to suggest that even though the conduct at issue in *Oscar Bronner* was considered highly unlikely, on the facts, to amount to an anticompetitive refusal to deal, it may have constituted another form of abuse, such as illegal tying (see *TeliaSonera* at paragraph 57).
[58] Opinion of Advocate General Mazák in Case C-52/09 *Konkurrensverket v TeliaSonera AB*, delivered on 2 September, at paragraphs 11-30. Advocate General Mazák argued, persuasively in my view, that absent a regulatory duty to deal, there is "*no independent competitive harm caused by the margin squeeze above and beyond the harm which would result from a duty-to-deal violation at the wholesale level*" (paragraph 16). Moreover, he highlighted the potential dangers of a rule to the contrary, including detrimental impact on a dominant firm's incentives to invest, as well as the danger that it would most likely remedy a price squeeze simply by raising retail prices (paragraph 21). See also Hovenkamp & Hovenkamp, cited fn. 9 above, at 278.
[59] *TeliaSonera* at paragraph 55.
[60] Although raised by the Advocate General in his Opinion, the impact of such a rule on the willingness of firms to deal with their competitors without regulatory compulsion was not considered by the Court.

to make market penetration of competitors more difficult.[61] Similarly, while indispensability is not required for liability, it is relevant to the assessment of the likely effects of the squeeze. Thus, where the wholesale product is indispensable, potential anticompetitive effects are probable.[62] Nonetheless, the Court expressly confirmed that the objective justification defence is available, even where a *prima facie* margin squeeze with anticompetitive effects has been established. The dominant firm has the burden of demonstrating that its pricing practice is economically justified in line with the defence.[63]

The facts of the *TeliaSonera* reference did not require the Court to consider the application of the margin squeeze principle in a regulated sector, and so *Deutsche Telekom* remains the guiding authority on this point. Yet, the Court in *TeliaSonera* construed the "special responsibility" of dominant firms with respect to margin squeeze so broadly—relating to "*the conduct, by **commission or omission**, which that undertaking decides on its own initiative to adopt*"[64]—that in regulated sectors it may develop in practice into a variety of "Bad Samaritan" liability. This point is considered further in Part IV below.

Other Recent Commission Activity

Deutsche Telekom and *TeliaSonera* must now be regarding as providing the most authoritative statement of the status of margin squeeze under EU competition law. However, a number of other Commission decisions, plus the approach taken in its Communication of 2009 setting out its enforcement priorities with regard to Article 102 TFEU, are worthy of note.

The Commission's margin squeeze decision against Telefónica,[65] the incumbent telecommunications operator in Spain, addressed circumstances similar to those of the *Deutsche Telekom* case. Telefónica was held to have committed an abusive margin squeeze between its retail and wholesale prices for high speed internet,[66] which were broadly subject to price regulation by a national authority. The Commission expressly declined to apply the *Oscar Bronner* test of indispensability[67] with respect to Telefónica's wholesale products, arguing that this was unnecessary on the facts: there was already in place a regulatory duty to supply, and Telefónica's status as a former State monopoly provider meant

[61] *TeliaSonera* at paragraphs 73-74.s
[62] *TeliaSonera* at paragraphs 69-71.
[63] *TeliaSonera* at paragraphs 75-76.
[64] *TeliaSonera* at paragraph 53.
[65] Commission Decision of 4 July 2007 relating to a proceeding under Article 83 of the EC Treaty (Case COMP/38.784 – *Wanadoo España v Telefónica*).
[66] Under the market definitions used in the decision, access for high-speed internet services at the wholesale level was divided into regional access, national access and local loop unbundling, which differed as regards the levels of investment required by downstream competitors. The decision itself only concerned regional and national access. Cable internet access, which had coverage in about 40% of Spain at the time covered by the decision, was entirely excluded from the market definition at the wholesale level.
[67] See fn. 56 above.

that its *ex ante* incentives to invest in infrastructure were not at stake.[68] While this position has been criticised,[69] it is in essence confirmed by *TeliaSonera*'s view that a regulatory or antitrust duty to supply is not required for margin squeeze liability. A fine of €151.875 million was imposed on Telefónica for the breach, which included a reduction of 10% to take account of the impact of the regulatory regime on its behaviour.[70]

In the *RWE Gas Foreclosure* commitment decision,[71] the Commission voiced concerns that RWE, the vertically integrated German gas company, had maintained an anticompetitive margin squeeze between its gas transmission tariffs and its downstream gas supply tariffs. In addition to the high level of the network tariffs charged by RWE, important elements of the network tariffs applied only to third part users, creating an asymmetric effect on network access costs. The case was closed without a finding of breach, on the basis of a binding commitment from RWE to divest its existing German gas transmission business. Note that, similarly to *Deutsche Telekom*, RWE's obligation to provide third party access to its gas transmission network had its origins in the EU gas market liberalisation directives. Given the abridged nature of the commitments procedure, the impact of the regulatory framework was not considered in the published decision, but it does provide an example of a margin squeeze occurring in a regulated area other than the telecommunications sector.

Mention should also be made of the guidance issued by the Commission in 2009 on the topic of its enforcement priorities with respect to the enforcement of Article 102 TFEU.[72] In this document, the Commission itself adopts a noticeably more restrictive approach to margin squeeze that that evinced in the case law. Margin squeeze is classified as a variety of refusal to deal, and thus is considered abusive only where: (i) access to the wholesale product is objectively necessary to compete effectively on a downstream market; (ii) refusal to supply is likely to lead to the elimination of effective competition on the downstream market; and (iii) the refusal is likely to lead to consumer harm.[73] The extent to which this policy statement will limit the margin squeeze concept in EU competition law is, however, somewhat doubtful. Firstly, regardless of the Commission's prior views, the far more expansive margin squeeze principles outlined by the Court of Justice in its recent cases must be considered as the authoritative statement of the current EU position. Secondly, the Commission itself takes the view that, where there is a regulatory duty supply already in place—

[68] *Telefónica* at paragraphs 302-309.
[69] See D. Geradin, "Refusal to Supply and Margin Squeeze: A Discussion of Why the "*Telefónica* exceptions" are Wrong", available online at ssrn.com/abstract=1750226.
[70] *Telefónica* at paragraphs 765-766.
[71] Commission Decision of 18 March 2009 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39.402 – *RWE Gas Foreclosure*).
[72] Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (OJ C 45/7, 24.2.2009).
[73] Guidance on enforcement priorities at paragraphs 80-81.

meaning, in essence, that any damage to investment incentives has already been done—the higher refusal to deal standard does not apply. Rather, what must be shown is simply likelihood of anticompetitive foreclosure.[74] Given the frequency with which margin squeeze issues have arisen in regulated sectors, this may well be the exception that in fact forms the rule.

Margin Squeeze under US Antitrust Law

Although margin squeeze as a standalone antitrust abuse has, arguably, been recognised in US law for more than half a century since the seminal decision of the Second Circuit in *Alcoa*,[75] the recent decision of the Supreme Court in *LinkLine* appears to have eliminated the possibility of maintaining a independent price squeeze action. In the following section of the paper, we shall consider the *Alcoa* and *LinkLine* jurisprudence, in an effort to determine the scope (if any) for margin squeeze actions under US antitrust law today.

The Alcoa *case*

The facts of *Alcoa* display certain similarities to both the *Napier-Brown* and *Industries des Poudres Sphériques* cases discussed above, and likewise occurred in an unregulated market. Alcoa held a monopoly in a production of virgin aluminium ingot in the US, which it sold to sheet aluminium manufacturers, and it also itself produced sheet aluminium. Among a series of monopolisation offences with which Alcoa was charged was the claim that it "*consistently sold ingot at so high a price that the "sheet rollers", who were forced to buy from it, could not pay the expenses of "rolling" the "sheet" and make a living profit out of the price at which Alcoa itself sold "sheet".*"[76] Judge Learned Hand held that, when Alcoa was made aware of the effects of the price squeeze and failed to remedy it, it became unlawful under §2 of the Sherman Act. Where there was evidence of intent, a price squeeze in itself could constitute a monopolisation offence:

> That it was unlawful to set the price of "sheet" so low and hold the price of ingot so high, seems to us unquestionable, provided…that on this record the price of ingot must be regarded as higher than a "fair price".[77]

The *Alcoa* judgment has attracted significant academic and judicial criticism. This is due, in large part, to its references to "*fair price*" and "*living profit*" for competitors, which are considered to be inconsistent with the more economic approach to antitrust law adopted by the courts in the decades

[74] Guidance on enforcement priorities at paragraph 82.
[75] *United States v Aluminium Company of America et al.* 148 F.2d 416, 65 U.S.P.Q. 6 (1945), commonly known as "*Alcoa*". The Court of Appeals for the Second Circuit sat as a court of last instance in this case, as the recusal of a number of Supreme Court justices meant that it was unable to reach the necessary quorum to hear the case, and the principles established in *Alcoa* have historically be granted the same status as Supreme Court precedent.
[76] *Alcoa* at 437.
[77] *Alcoa* at 438.

following the decision. Bork criticised the judgment on the basis that it sought "*to trade off consumer welfare for unarticulated social values*."[78] *LinkLink* relegates *Alcoa* to a footnote, taking that view that the more recent (and far more restrictive) precedents in *Trinko* and *Brooke Group* were "*more pertinent*" in light of "*developments in economic theory and antitrust jurisprudence since* Alcoa"—even though neither of those cases, on the facts, dealt with price squeeze issues.[79]

A key criticism in *LinkLine* of the *Alcoa* price squeeze principle is the alleged difficulty of determining whether a margin is fair or adequate on the facts of a case. However, the test articulated by Judge Hand in *Alcoa* in fact amounts to a simplified form of the as-efficient competitor test found in EU law, also referred to as the "transfer price test" in US case law.[80] The administrability of the as-efficient competitor test in practice may be debatable, particularly in view of the difficulties of apportioning the costs of a vertically integrated firm;[81] nonetheless, there is a clear precedent within US antitrust for its use. As *LinkLine* demonstrates, this precedent has not been followed and its status as good law must be regarded as questionable in the circumstances.

The LinkLine *Judgment*

The facts of the *LinkLine* case are remarkably similar to those of *Deutsche Telekom* and *Telefonica*, relating to local loop unbundling under the Telecommunications Act of 1996.[82] LinkLine purchased wholesale DSL transport services from AT&T, the owner of the local fixed telecommunications network throughout much of California, and both LinkLink and AT&T provided downstream retail DSL services to end users on the network. AT&T had a regulatory duty to deal with LinkLine, enforced by the sectoral regulator, the Federal Communications Commission; it does not appear to have been subject to price regulation at either the wholesale or retail levels. In 2003, LinkLine brought an antitrust suit against AT&T, alleging *inter alia* an anticompetitive price squeeze in violation of §2 of the Sherman Act. AT&T's motion to dismiss the price squeeze claim was denied by both the district court and Ninth Circuit of Appeals, and so the case made it to the Supreme Court in 2009. The principal issue to be decided was whether a price squeeze could constitute a standalone

[78] R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (1973) Free Press, New York, USA, p.52.
[79] Hovenkamp & Hovenkamp (2009), argue that it is difficult to read *LinkLine* as anything other than an implicit overruling of *Alcoa*.
[80] See *Brief of the American Antitrust Institute as* Amicus Curiae *in Support of Dismissal of the Writ or Affirmance* in *Pacific Bell Telephone Company v LinkLine Communications*, at pp.9-10, citing Hovenkamp & Hovenkamp (2009) at 274-275. Note, however, that the Chief Justice Roberts' majority opinion in *LinkLine* expressly rejected the "transfer price test" as a means of assessing margin squeeze, on the basis that "*it lacks any grounding in our antitrust jurisprudence*"—even though, in substance, it is the same as the test approved by Judge Hand.
[81] OECD (2009), cited fn. 4 above.
[82] For a highly critical assessment of the performance of the 1996 Act, see Economides (2005).

unilateral conduct antitrust offence;[83] Chief Justice Roberts, in the majority opinion, held that it could not.

The judgment is noteworthy in a number of respects. Firstly, the notion of an anticompetitive spread between wholesale and retail prices, embraced so emphatically by the EU courts, was dismissed absolutely in *LinkLine*. The primary reason for rejecting the pricing spread concept appears to be administrative concerns:

> Recognizing price-squeeze claims would require courts simultaneously to police both the wholesale and retail prices to ensure that rival firms are not being squeezed. And courts would be aiming at a moving target, since it is the *interaction* between these two prices that may result in a squeeze.[84]

Thus, a price squeeze may violate the antitrust rules only if there is a refusal to deal at the wholesale level (which could encompass a constructive refusal to deal consisting of excessively high rates or unduly restrictive or burdensome terms) or predatory pricing at the retail level. An unfair or inadequate margin in itself is not illegal.

Secondly, the restrictive nature of this holding is reinforced by the highly restrictive precedents relied upon by the Court to determine the refusal to deal and predatory pricing questions. After *Trinko*, refusal to deal by a monopolist will be found to violate the antitrust laws only in the most exceptional circumstances.[85] Similarly, following *Brooke Group*, a predatory pricing strategy can be impugned only where it is shown that (i) the prices charged by the monopolist are below an appropriate measure of its costs, and (ii) there is a dangerous probability that the monopolist will be able to recoup its "investment" in below-cost prices.[86] Moreover, the Supreme Court does not appear to have modified in any way the test for predation to take account of the cross-subsidisation aspect of margin squeeze, whereby losses at the retail level can be supported with profits at the wholesale level. As a result, it is impossible for a margin in itself to breach the antitrust rules, and highly unlikely that either of the constituent prices will breach these rules either.

---

[83] The rather complicated procedural posture of the case meant that it could in fact have been resolved without reaching any decision as to the viability of price squeeze claims under antitrust law, an approach urged by the American Antitrust Institute in its *Amicus Curiae* brief in the case on the basis that the absence of a factual record made the case a poor vehicle to establish antitrust policy (at p.5). While Chief Justice Roberts, speaking for the majority of the Court, considered it both possible and necessary to rule on the margin squeeze question, Justice Breyer, delivering a concurring opinion in which Justices Stevens, Souter and Ginsburg joined, limited their holding solely to the regulated firm exception—thus, arguably, suggesting that outside the regulatory context a standalone margin squeeze claim may still be viable; see Hovenkamp & Hovenkamp (2009) at 282.

[84] *LinkLine*, emphasis in original.

[85] "*[U]ltimately the issue is whether there is a valid business justification for the refusal to deal ot whether the facts demonstrate a willingness to forgo short-term profits in favour of reducing competition over the long run by harming a rival*"; see Meriwether (2010) at 70.

[86] *Brooke Group Ltd v Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) at 222-224.

Finally, *LinkLine* confirmed the approach in *Trinko* with respect to the effects of sector-specific regulation on the application of the antitrust rules, and indeed may have strengthened the *de facto* antitrust immunity for regulatory activity resulting from that judgment. The Supreme Court in *Trinko* took the view that the existence of a regulatory duty to deal removed any scope for imposing an antitrust duty to deal in the market concerned. *Trinko*, like *LinkLine*, concerned the mandatory access provisions of the Telecommunications Act of 1996, which the *Trinko* Court described as "*a good candidate for implication of antitrust immunity, to avoid the real possibility of judgments conflicting with the agency's regulatory scheme*". Nonetheless, the 1996 Act contains an *explicit* antitrust saving clause, which preserves those "*claims that satisfy established antitrust standards*". Thus, in *Trinko*, the Court had to consider whether an antitrust duty to deal could exist in the circumstances: it took the view that the extensive provision for access under the 1996 Act made it unnecessary to impose a judicial doctrine of forced access under the antitrust rules. In *LinkLine*, by contrast, the Court interpreted the *Trinko* precedent as creating a "*straightforward*" rule, barring any antitrust obligations arising in the presence of sectoral regulation. Notably, both *LinkLine* and *Trinko* relied upon a judgment of Justice Breyer, given when he was Chief Justice of the First Circuit, in the case of *Concord v Boston Edison*.[87] That earlier case concerned an alleged price squeeze by a vertically integrated electricity company, which was subject to price regulation at both the wholesale and retail levels. In the judgment, Breyer J considered at length the relationship between competition law and regulation, arguing that "*where regulatory and antitrust regimes coexist…antitrust analysis must sensitively "recognize and reflect the distinctive economic and legal setting" of the regulated industry to which it applies*."[88] On the question of the alleged price squeeze, Breyer J took the view that:

> …a price squeeze of the sort at issue here does not ordinarily violate Sherman Act, §2, where the defendant's prices are regulated at both the primary and secondary levels. In so holding, we are not saying either that the antitrust laws do not apply in this regulatory context, or that they somehow apply less stringently here than elsewhere. Rather, we are saying that, in light of the regulatory rules, constraints, and practices, the price squeeze at issue here is not ordinarily exclusionary, and, for that reason, it does not violate the Sherman Act.[89]

Note how the approach of the court in *Town of Concord* to the question of the antitrust/regulation interface differs markedly from the approach in *Linkline*, even though the Supreme Court in the latter decision quoted at length from the earlier decision. In *Town of Concord*, antitrust is applied within the regulated sector, but the existence of the regulation so impacts upon the relevant market that the conduct at issue does not breach the antitrust rules. By contrast, in *LinkLine* this ultimate result is presumed, so that a *per se* rule of legality under the antitrust rules is imposed, albeit this is conceived

[87] *Town of Concord, Massachusetts, et al. v Boston Edison Company* 915 F.2d 17 (1990).
[88] *Town of Concord* at paragraph 20, quoting Watson & Brunner, "Monopolization by Regulated "Monopolies": The Search for Substantive Standards" (1977) 22 Antitrust Bulletin 559, at 565.
[89] *Town of Concord* at paragraph 21. See also paragraph 35: "*Full price regulation dramatically alters the calculus of antitrust harms and benefits*."

both in *Trinko* and *LinkLine* as more of an immunity than a safe harbour. Nonetheless, the ultimate result in *Town of Concord*, *Trinko* and *LinkLine* is the same: the presence of economic regulation precludes any finding of breach of the antitrust laws. This result stands in clear contrast to the position in EU law, as confirmed in *Deutsche Telekom* and *TeliaSonera*, and it is this question—the application of the margin squeeze concept in regulated sectors—that comprises Part IV of this paper.

Before addressing that issue, however, it is worth summarising the differing approaches to margin squeeze to be found under current EU and US jurisprudence.

- In the **EU**, a margin squeeze can constitute a standalone violation of Article 102 TFEU where the spread between wholesale and retail prices charged by a vertically integrated firm is negative or insufficient to cover the costs incurred by that firm (or its as-efficient competitor) in producing the retail product. There must be dominance at the wholesale but not the retail level and, barring exceptional circumstances, the only costs and revenues to focus on are those of the dominant firm itself. It is necessary to demonstrate that the existence of the squeeze makes market penetration more difficult for competitors, although where the wholesale product is indispensable and/or the spread is negative, anticompetitive effects are considered to be probable.

- In the **US**, margin squeeze does not constitute a standalone violation of §2 of the Sherman Act. Price squeezing behaviour must instead be assessed as a constructive refusal to deal or an instance of predatory pricing—with no modification of the existing (and highly restrictive) legal tests for these offences to take account of the vertical relationship and possibility of cross-subsidies.

- In the **EU**, the presence of sector-specific regulation—even intrusive regulation that mandates entry and sets prices—does not prevent the application of competition law and the margin squeeze concept, provided the vertically integrated firm retained some scope to avoid the squeeze, even if it can only do so by raising retail prices. By contrast, in the **US**, the *ex ante* economic regulation of a sector appears to remove it from the purview of antitrust, so that only regulatory duties can arise and regulatory remedies be imposed.

IV. Margin Squeeze and Economic Regulation

We now consider in greater detail the relationship between the margin squeeze concept and sector-specific economic regulation. Both competition law and economic regulation are concerned, broadly, with the effective functioning of markets. However, important differences remain—for example, the

mode and temporal aspect of enforcement, as well as the objectives that may be pursued[90]—so that one regime cannot be subsumed within the other without reaching a very high level of generalisation. Economic regulation can take a multitude of forms,[91] but general, the three key decision variables controlled are price, quantity and industry entry or exit.[92] Moreover, regulation of one aspect of a firm's operations frequently impacts on the other variables.[93] For example, mandatory access requirements almost inevitably lead to some form of price regulation for the industry concerned, because a right of access or supply will be worthless in practice if the infrastructure owner or supplier is permitted to charge an unreasonably high rate that amounts to a constructive refusal to deal with competitors. Similarly, production quotas typically act as a barrier to entry, since potential entrants may be prevented from bringing their product onto the market. In the margin squeeze context, the problem is frequently created by a mandatory access requirement at the wholesale level—and complicated by price regulation at one or both levels of the price squeeze.

Three preliminary observations are appropriate. There is, firstly, an asymmetry of liability regarding margin squeezes that occur in a regulated sector. In such circumstances, the margin squeeze cannot be caused entirely by the conduct of the vertically regulated firm. By contrast, the squeeze can be caused entirely by the regulator.[94] Secondly, regulated markets are typically very far from the archetype of atomistic perfect competition that is the model informing the competition rules. Indeed, a margin squeeze in a regulated sector may in fact be evidence of *increased* competition in the market (due to intermodal competition), which in fact may imply that deregulation is appropriate.[95] Thirdly, and in view of the rather critical approach that this paper takes with respect to the regulated margin squeeze as a competition law offence, it should be noted that the concurrent application of competition law and regulation is not without its strong defenders.[96] Indeed, it has been argued that the presence of regulation *increases* rather than reduces the need for competition law enforcement,

[90] See Geradin & O'Donoghue (2005) at 360-364, for an outline of the basic differences between regulatory and competition law powers in relation to margin squeeze.
[91] See Viscusi et al. (2005), Part II, for a comprehensive analysis of the wide variety of forms of economic regulation that may be implementation and the particular features of each.
[92] Viscusi et al., (2005), at p.358.
[93] For example, if the regulator imposes a quota restricting the permitted output of a particular product, in the absence of price regulation the artificial scarcity is likely to result in a rise in prices for that product. Moreover, if the quota restricts output per firm but not total industry output, the rise in prices is likely to encourage new entry. Conversely, if the quota caps total industry output, it will act as a barrier to entry as potential new entrants have to The EU's Common Agricultural Policy provides an (in)famous example of how regulation can impact on every aspect of a sector.
[94] Lopatka (1984) at 597.
[95] W. Briglauer, G. Götz & A. Schwarz, "Can a Margin Squeeze Indicate the Need for Deregulation? The Case of Fixed Network Voice Telephony Markets" (2010) 34 *Telecommunications Policy* 551. See also Sidak (2008) at 300, who argues that a *prima facie* margin squeeze may reflect merely the efficient workings of the market and the effective response to consumer demand.
[96] See, for example, Dogan & Lemley (2009); also A. Heimler, "Is Margin Squeeze an Antitrust or a Regulatory Violation" (2010) 6(4) *Journal of Competition Law & Economics* 879.

insofar as it creates incentives for the regulated (and usually, former monopoly) firm to avoid the regulation and seek monopoly rents in new markets.[97]

The US Approach to the Regulated Margin Squeeze

Under US jurisprudence, the existence of regulation at one or both levels appears to remove that element of the squeeze from the purview of competition law. While the extent to which *Trinko* in fact removes regulated conduct from the purview of competition law is disputed,[98] *LinkLine* articulates a clear principle that regulation prevents the relevant prices from being examined even individually under the discrete tests for refusal to deal or predation.

The question of whether margin squeeze behaviour should be exempt from the application of the competition rules where it is also subject to sector-specific regulation is linked to the broader issue of the intersection between competition law and regulation. The regulatory immunity approach adopted in *LinkLine* has the benefit of clear, *ex ante* certainty of application for firms and for national authorities (regulators and competition agencies). Moreover, a key assumption of this approach is that the competition problem is not irremediable absolutely, insofar as a regulatory remedy generally exists—it is simply irremediable via antitrust. In both *Trinko* and *LinkLine*, a regulatory remedy was available to address the competition problem, and indeed in *Trinko*, the incumbent's behaviour had already been investigated and corrected by the sectoral regulator, the FCC. The availability of regulatory remedies appears to have been a significant factor confirming the Supreme Court decision in both cases.

Of course, where the regulatory regime does not have the means by which to remedy the margin squeeze, excluding the application of competition law in order to remedy the problem creates a lacuna in the legal framework. The question then becomes whether it is appropriate to address regulatory problems via competition law mechanisms. Is the application of the competition rules really a suitable vehicle by which to tackle the problem of regulatory capture, for example, to say nothing of adverse effects on legal certainty that may result? A key policy question is whether we accept that some competition problems are beyond the reach of competition law—and much comes down to the administrability of competition law in the particular regulatory context.[99]

---

[97] T.J. Brennan, "Essential Facilities and *Trinko*: Should Antitrust and Regulation be Combined?" 61 *Federal Communications Law Journal* 133, at 141.
[98] It has been argued, for example, that while *Trinko* does not, *a priori*, remove a regulated sector from the purview of antitrust, the pre-existence of the regulatory regime means that the conduct at issue is unlikely to be considered harmful on the facts; see J.L Rubin, "The Truth About *Trinko*" (2005) 50 *Antitrust Bulletin* 725. By contrast, Meriwether (2010), at 70, argues that it leaves "*little room*" for competition enforcement unless the regulatory regime itself is inadequate to address the harm.
[99] Hovenkamp & Hovenkamp (2009) at 288.

A further question with regard to the regulatory immunity approach is whether immunity should be automatic—as was apparently the case in *LinkLine*—or reached via a deductive reasoning process that considers the impact of the regulatory regime on the firm's behaviour, and in particular, its potential to cause anticompetitive harm—as was laid out in *Town of Concord*. The former approach has the benefit of administrative simplicity, while the latter is arguably the more principled and respectful of the jurisdiction of the antitrust rules. To an extent, however, given that both approaches will arrive at the same ultimate conclusion, this is perhaps more of a theoretical question than a practical concern.

The EU Approach to the Regulated Margin Squeeze

In the EU, by contrast, the concurrent application of competition and regulation has been expressly approved by both the Commission and the EU courts, and this principle extends to the regulated margin squeeze context. The Commission is strongly of the view that competition rules and sector-specific regulation form "*a coherent regulatory framework*" of EU law,[100] capable of concurrent application and with "*mutually reinforcing*" effect.[101] In *Deutsche Telekom*, the Court of Justice agreed, describing the relationship between the EU competition rules and sector-specific regulation in the following terms:

> …the competition rules laid down by the EC Treaty [now Treaty on the Functioning of the European Union] supplement…by an *ex post* review, the legislative framework adopted by the Union legislature for *ex ante* regulation of the telecommunications markets.[102]

Advocate General Mazák, in his Opinion, in *Deutsche Telekom*, saw the sector-specific regulation at issue in that case and the EU competition law provisions as "*complementary*",[103] arguing that the former "*completes the Treaty provisions on competition and should guarantee a competitive context to an extent which [the competition rules] alone could not with the same certainty…[the competition rules] should be considered to constitute a set of minimum criteria*."[104] Competition law and regulation remain separate instruments, "*even if ultimately they both seek to promote competition*":

[100] Commission *Notice on the application of the competition rules to access agreements in the telecommunications sector* (C 265/2, 22.8.98) ("Access Notice"), at paragraph 57. While framed in terms of telecommunications markets, the principles contained in the Access Notice is considered to be of more general relevance (see paragraph 6).

[101] Access Notice at paragraph 58.

[102] *Deutsche Telekom* (CJEU) at paragraph 92. Note that the Commission in the *Telefónica* decision, discussed below, took the *ex ante/ex post* distinction further: it declined to use to the costs relied upon by the national regulator to set access prices *ex ante*, on the basis that costs assessed *ex post* are more accurate (but, self-evidently, unavailable to the regulator at the price-setting stage); see *Telefónica* at paragraphs 492-511.

[103] Opinion of Advocate General Mazák in Case C-280/08 P *Deutsche Telekom AG v European Commission*, delivered on 22 April 2010, at paragraph 19.

[104] Opinion in *Deutsche Telekom* at paragraph 15.

here, Advocate General Mazák invoked the analogy of two barriers, the distinct requirements of each having to be respected on the facts.[105]

In general terms, there is, first and foremost, a basic legal certainty and fairness problem stemming from concurrent application of regulation and competition law. O'Donoghue argues that the approach in *Deutsche Telekom* shows "*a lack of coordinated thinking with respect to the interaction between regulation and competition law and, as a result, [has] placed regulated firms in an invidious position.*"[106] Thus, the regulated firm is subject to two sets of legal duties, both imposed by the State, with respect to the same market conduct, and compliance with one set of obligations does not guarantee that its other obligations have also been satisfied, as the facts of *Deutsche Telekom* itself illustrate. At a more pragmatic level, there is a risk of duplication of work by enforcers[107]—which, incidentally, appears to be the Commission's primary concern regarding concurrent regulation/competition law enforcement.[108]

More specifically, in the margin squeeze context, the fact of regulatory price setting means that the prices under assessment have not been freely decided upon and implemented by the dominant firm. Thus, liability is imposed on the firm, not for its anticompetitive actions, but rather for the anticompetitive consequences of its inaction. It is established in EU law that a dominant firm has a "special responsibility" not to allow its conduct to impair genuine undistorted competition on the Common Market.[109] In *Deutsche Telekom*, the Court of Justice distinguished between "scope" to remedy a margin squeeze (where a dominant firm can, directly or indirectly via representations to the regulatory price-setter, alter at least one of the parameter of the vertical margin to alleviate the squeeze) and "fault" in failing to exercise such scope to remedy, for example intention to foreclose as a result. Once scope has been established, under current EU law there is no additional requirement to demonstrate that the firm was at fault in failing to exercise its ability to remedy—the mere omission to do so is sufficient to establish margin squeeze liability.[110] *TeliaSonera* now confirms that a margin squeeze can be carried out by "*commission or omission*".[111]

A basic issue here is the degree to which a firm subject to detailed regulatory requirements in reality has scope to proactively avoid the margin squeeze created by a regulated pricing structure. In *Deutsche Telekom*, for example, the Court of Justice took the view that the regulation merely

[105] Opinion in *Deutsche Telekom* at paragraph 21.
[106] R. O'Donoghue, "Regulated the Regulated: *Deutsche Telekom v European Commission*" *Global Competition Policy*, May-08 (1), at 14.
[107] Geradin & O'Donoghue (2005) at 409.
[108] Access Notice at paragraphs 28, 150.
[109] *Deutsche Telekom* (CJEU) at paragraphs 83 & 176.
[110] Applying *Deutsche Telekom* (CJEU) at paragraphs 89, 113 & 124.
[111] *TeliaSonera* at paragraph 53.

encouraged the squeeze identified. In such circumstances, the dominant firm is expected "*to take the initiative*" and to apply for variation of its regulated prices.[112] Consider, however, that the regulation at issue involved (i) a mandatory duty to deal; (ii) wholesale prices that were (according to the Commission's case theory) wholly set by the regulator; and (iii) retail prices that were subject to a price cap that was steadily decreased over the time period concerned, and in any event retail price changes required the permission of the regulator. To say that DT had genuine scope to alter its prices to avoid the scope in these circumstances sets the threshold for a finding of autonomous conduct at a nonsensically low level. At most, DT had a highly circumscribed ability to alter its retail prices, and therefore it could touch only one parameter of the anticompetitive spread, a term which on its common sense means implies the need for at least two references points. Yet, the Court refused to consider the legality of DT's retail prices in isolation.[113]

A deeper problem is that, to hold a dominant firm liable for its omission or failure to lobby for changes to the regulatory regime that will benefit solely the balance sheet of its competitors, is in effect to establish a "Bad Samaritan" rule, or duty to rescue, in EU competition law. That is, a firm may have breached the competition rules in circumstances where the anticompetitive effects felt on the market result from the actions of a third party, namely the regulatory authority that has either set or approved the prices for the products concerned, thereby dictating *in law* the prices that the dominant firm must charge. Thus, the dominant firm will be liable, not for its own conduct—that is, charging prices required by law—but rather, for its failure to intervene and prevent the regulator from adopting policies that harm the dominant firm's competitor.[114]

---

[112] *Telefónica* at paragraph 672.

[113] While on the facts, DT access retail access prices may have been priced below cost (but not its prices for retail operations viewed as a whole), there would be a strong argument for a State compulsion defence here on the facts.

[114] Imposition of liability for Bad Samaritans, who fail to rescue third parties, adheres in large part to the civil/common law divide. Typically, there is a duty to rescue in civil law system, whereas there is no such duty under the common law. For discussion on the role played by the Bad Samaritan doctrine in civil law jurisdictions, see, *inter alia*, F.J.M. Feldbrugge, "Good and Bad Samaritans: A Comparative Survey of Criminal Law Provisions Concerning Failure to Rescue" (1966) 14 *American Journal of Comparative Law* 630-657; M. Vranken, "Duty to Rescue in Civil Law and Common Law: Les Extrêmes se Touchent?" (1998) 47 *International and Comparative Law Quarterly* 934-942; E.A. Tomlinson, "The French Experience with Duty to Rescue: A Dubious Case for Criminal Enforcement" (2000) 20 New York Law School Journal of International & Comparative Law 451-499; D. Schiff, "Samaritans: Good, Bad and Ugly: A Comparative Law Analysis" (2005) 11 *Roger Williams University Law Review* 77-141; J. Dopico Gómez-Aller "Criminal Omissions: A European Perspective" (2008) 11 *New Criminal Law Review* 419-451; and J-M. Sílva Sánchez, "Criminal Omissions: Some Relevant Distinctions" (2008) 11 *New Criminal Law Review* 452-469. For a discussion of the place of the Bad Samaritan doctrine in English law, see T. Elliott & D. Ormerod, "Acts and Omissions – A Distinction Without a Defence?" (2008) 39 *Cambrian Law Review* 40-59. Arguments that the common law should incorporate some form of duty to rescue can be found at E.J. Weinrib, "The Case for a Duty to Rescue" (1980) 90(2) *Yale Law Journal* 247-293, and K. Levy, "Killing, Letting Die, and the Case for Mildly Punishing Bad Samaritanism" (2010) 44(3) *Georgia Law Review* 607-695. See also J. Feinberg, "The Moral and Legal Responsibility of the Bad Samaritan" (1984) 3 *Criminal Justice Ethics* 56-69 and K. Huigens, "Virtue and Inculpation" (1995) 108 *Harvard Law Review* 1423-1480 for assessment of the Bad Samaritan doctrine from a moral/ethical perspective.

At least two arguments can be advanced against imposing Bad Samaritan liability in the context of a regulated margin squeeze. The first is that, even in civil law jurisdictions, liability of this nature is typically imposed only in circumstances where the victim is in imminent danger of serious physical harm. In the regulated margin squeeze context, the harm is diminished profitability or at worst bankruptcy for the competing firm; the harm occurs more gradually, usually over numerous or even years; and during this period, the competing firm has the opportunity to avoid or mitigate the harm by altering its business strategy or itself petitioning the regulator to impose more appropriate wholesale and/or retail prices. The duty to rescue presupposes that, without the rescuer's intervention, the harm *will* occur, whereas this crucial causal link is missing in the regulated margin squeeze context. Thus, the key normative considerations justifying imposition of liability for omission—serious physical harm, lack of alternative options for avoidance, the constrained time frame—are not satisfied with respect to a regulated margin squeeze.[115]

Secondly, the foundational premise of the market system—and thus of competition law, which protects the market system—is that individual market operators are rational self-maximisers.[116] Given that the welfare of society is merely the sum of the welfare of each individual (or firm), economics tells us that, somewhat counter-intuitively, when we act in our own best interests we actually act in the best interests of society. While it would go too far to suggest that competition law advocates selfishness, it does work from the premise that individual firms should be concerned solely with securing their own economic efficiency and success in the market. For this reason, dominant firms are prohibited from using their market power to exclude competitors by recourse to non-normal means of competition. Rather, they can ensure their continued economic success only by competing effectively in the marketplace. A rule that requires a dominant firm to consider, and pro-actively protect, the market position of its competitors goes against this fundamental distinction between competition on the merits and artificial manipulation of the market that lies at the core of competition law theory. If dominant firms are prohibited from interfering in the market to the detriment of competitors, why are they obliged to do so in order to protect their competitors? Surely, the success or otherwise of competing firms should concern the dominant firm only indirectly if at all, insofar as

---

[115] To give a rather lurid example of this distinction, under a Bad Samaritan law, a passer-by may be liable if she fails to render first aid or call the emergency services upon encountering the victim of a heart-attack, even though the passer-by had nothing to do with the initial occurrence of the heart-attack. Conversely, even where the heart-attack is a direct result of years of eating unhealthy food prepared by a loved one, the cook should not be held responsible for the resulting harm, because the victim's own actions and inactions were the key causal element.

[116] This assumption has been the basis of neo-classical economic theory since the time of Adam Smith, who used the oft-quoted metaphor of the "invisible hand" of the market process, which puts the resources of society to the best (most efficient) uses; see A. Smith, *The Wealth Of Nations* (1776) Harriman House Edition, republished 2007, Harriman House, Hampshire. For a more recent re-statement of this approach, see G.S. Becker, *The Economic Approach to Human Behaviour* (1976) University of Chicago Press, Chicago, US.

it provides a measure by which to assess the effectiveness of the dominant firm's own competition efforts. Despite suggestions to the contrary,[117] the Commission itself takes the view that in applying EU competition law, "*what really matters is protecting an effective competitive process and not simply protecting competitors*."[118] Yet, a principle to the effect that a dominant firm must ensure that third parties act in the best interest of its competitors (with the corollary that its own interests are likely to be compromised) makes the dominant firm, in effect, its competitors' keeper. Moreover, it conflicts with the principle that competition—unlike sector-specific regulation—does not impose affirmative duties even on dominant firms.[119] As for the argument that protecting competitors is one means of protecting the competitive process, Geradin & O'Donoghue argue that, while subsidising inefficient entry in the short term on the basis that the entrant will become more efficient over time may be a legitimate objective under regulatory policy, no such mandate exists under competition law.[120]

The *Deutsche Telekom* case itself highlights a further problem that can result from a conglomerate regulation/antitrust approach in the EU context. On the facts of the case, DT's own provision of retail access services was in fact loss-making; however, losses due to the below-cost access charges were subsidised by higher call charges. This pricing structure was a result of the historical pricing policy pursued by DT in its guise as the State monopoly telecommunications provider, on social policy grounds (presumably, to make access affordable, even if service usage costs were high), which DT inherited upon privatisation. That telecommunications tariffs had not yet been rebalanced to a more cost-reflective structure stemmed, in reality, from the failure of Germany to implement correctly the requirements of the EU telecommunications directives.[121] In applying the margin squeeze test, however, the Commission proceeded *as if* tariffs had already been rebalanced by refusing to take account of the cross-subsidisation effects from profitable service charges (which both DT and its competitors used to make up the access shortfall). Moreover, DT then duly failed the test, precisely

---

[117] See *Brief of* Amici Curiae *Professors and Scholars in Law and Economics in Support of the Petitioners* in *Pacific Bell Telephone Company v LinkLine Communications* at p.5:

> *The alternative to consumer-welfare maximisation is the view that antitrust law is simply one more tool of industrial policy, and thus its application may permissibly compromise consumer welfare to advance the welfare of competitors. Other nations evidently consider this normative proposition to be appropriate, if recent developments in the European Union are a valid indication. More than ever before, the United States and Europe appear to be at a fork in the road over whether the law of monopolization exists to protect consumers of to ensure that a specified number of firms will profitably populate the market.*

[118] Communication from the Commission, *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings* (OJ C 45/7, 24.2.2009), at paragraph 6.

[119] Geradin & O'Donoghue (2005) at 364.

[120] Geradin & O'Donoghue (2005) at 395.

[121] *Deutsche Telekom* (CFI) at paragraph 260.

because tariff rebalancing was not yet in place.[122] Therefore, by the Commission's choice to pursue DT under the competition rules for the margin squeeze abuse rather than Germany for failure to fulfil its EU law obligations under Article 258 TFEU (*ex* Article 226 EC), arguably the end result is a form of horizontal direct effect of the relevant directives, contrary to the established principle of EU law prohibiting such a result.[123] Note that while Geradin & O'Donoghue have highlighted the "*arguably greater scope (and need) for intervention on the basis of competition rules in the [EU] than in the US*" in the context of telecommunications law, on the basis that the latter legislative regime is far more detailed and prescriptive than the EU regulatory framework,[124] this distinction does not address the legal issue of horizontal direct effect, even though it may provide a policy reason supporting concurrent application of competition law with the regulatory provisions.

V. Conclusion

Margin squeeze as a competition law abuse addresses the anticompetitive margin between wholesale access prices and end user retail prices charged by a dominant vertically integrated firm. It is recognised as a discrete offence under EU competition law, but can be attacked under US antitrust law only by demonstrating that one or both of the price levels, individually, is anticompetitive. Margin squeezes arising in regulated sectors pose a particular problem: to what extent is the pricing behaviour attributable to the regulatory regime rather than the dominant firm's conduct, and does this disconnect shield the dominant firm from liability under the competition rules?

Formally, at least, neither EU nor US law contains a bright line rule regarding the application of the margin squeeze concept within regulated sectors. Nonetheless, after *Deutsche Telekom*, the scope for reliance upon the State compulsion defence seems minimal, while in *LinkLine* antitrust immunity was treated as *de facto* automatic in the presence of sectoral regulation.

In a sense, however, the distinction between the EU and US approaches can be overstated. Both are concerned primarily with preserving competition on the merits in a market, and conversely, avoiding conduct that inhibits such beneficial competition. Where these positions differ is the focus of their attentions. From the EU perspective, protecting competition means attracting and keeping rivals (that is, firms other than the vertically integrated firm) in the market.[125] From the US perspective, this

[122] The tariff rebalancing requirements under EU telecommunications law, and the application of these principles to the facts of *Deutsche Telekom*, are discussed in particular detail in the General Court's judgment in that case. See also Advocate General Mazák's Opinion in the case at paragraphs 54-59.

[123] *Case* 152/84 *Marshall v Southampton and South-West Hampshire Area Health Authority (Teaching)* [1986] ECR 723 is the classic authority for the vertical/horizontal direct effect distinction with respect to directives.

[124] Geradin & O'Donoghue (2005) at 417.

[125] The Commission takes the view that a diminution in competition—either because competitors have been excluded or they compete less vigorously as a result of a margin squeeze—"*inevitably leads to likely harm to*

means protecting the incentives that the vertically integrated firm itself has to compete, for example by investing in more efficient technology and cutting its retail prices. As to whether, from an economic standpoint, one approach is superior to the other, it is difficult to say with much certainty.

Given the strong industrial policy flavour that permeates the *Deutsche Telekom* and *Telefónica* decisions—the key objective of development of the information society in the EU—there is perhaps an argument that the margin squeeze concept developed in that line of case law should be confined to its facts.[126] However, the *TeliaSonera* case, even though it concerns an alleged margin squeeze in the same (telecommunications) sector, draws the parameters of the margin squeeze concept in such a broad manner, and of such general application, that it appears to limit the scope for any such restrictive interpret. For the moment, therefore, the margin squeeze concept under EU competition is far from a principle in danger of being narrowed out of existence.

As for the US approach, given contemporary policy arguments in favour of reregulation (or at least better regulation) in many sectors, the question is whether the automatic regulatory immunity afforded in *LinkLine* will be challenged going forward, given that the expansion of economic regulation will result in a correlating elimination of antitrust. In both jurisdictions, therefore, we must await further developments before the scope of the margin squeeze concept can be determined definitely.

---

consumers" (*Telefónica* at paragraph 557). See also *Telefónica* at paragraph 586: "*The establishment of foreclosure effects does not mean that rivals are forced to exit the market: it is sufficient that rivals are disadvantaged and consequently led to compete less aggressively.*"

[126] See also C. Cavaleri Rudaz, "Did *Trinko* Really Kill Antitrust Price Squeeze Claims? A Critical Approach to the *LinkLine* Decision through a Comparison of E.U. and U.S. Case Law" (2010) 43 *Vanderbilt Journal of Transnational Law* 1077, at 1119.