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Regulating the Regulated: *Deutsche Telekom v. European Commission*

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I. INTRODUCTION

Depending on your perspective, the European Court of First Instance's (CFI) dismissal of Deutsche Telekom's appeal of the European Commission's 2001 decision imposing a EUR 12.6 million fine for margin (or price) squeeze abuses either continues dominant firms' depressing run of defeats before the EC courts or is a positive development in the use of abuse of dominance laws against lazy or "captured" national sectoral regulators.[1]

The truth, as often, is more nuanced. To a large extent, the case seems surrounded more by policy and politics than law. There would almost certainly have been no violation had Germany complied with its legislative duty to fully rebalance the wholesale and retail tariffs in question (more on this later in the paper) and had the national regulatory authority (NRA), the RegTP, considered its duties under Article 10 EC to ensure that its regulatory action did not encourage or require margin squeeze abuses under competition law. In these circumstances, it seems unfair that Deutsche Telekom

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[1] *See* Case T-271/03, Deutsche Telekom AG v. Commission (not yet reported) (judgment of Apr. 10, 2008) [hereinafter CFI Judgment]; and Commission Decision of 23 April 2003, COMP/C-1/37.451, 37.578, 37.579 — Deutsche Telekom AG, 2003 O.J. (L 263) 9 [hereinafter Commission's Decision].

(DT) should have borne the brunt of the Commission's failure to take Germany to court for not complying with its EU obligations. The case therefore represents the outcome of a political compromise that undoubtedly also involved matters other than those directly forming the subject of the decision against DT.

That said, it is reasonably clear following *Deutsche Telekom* that the EC courts are comfortable with applying competition law in regulated telecommunications markets. In the United States, the *Trinko* judgment effectively found that there is no scope for applying a duty to deal under Section 2 of the Sherman Act where such issues have already been considered under the applicable regulatory framework.[2] Whether that should also extend to margin squeeze conduct of the kind at issue in *Deutsche Telekom* forms part of a fascinating appeal pending before the U.S. Supreme Court. An influential body of opinion has submitted that the outcome should be the same as in *Trinko* (i.e., complex issues like margin squeeze are best left to the regulators, not competition authorities or courts).[3] In broad terms, *Deutsche Telekom* shows that the EC courts do not share a similar aversion to parallel application of competition law and regulation in the area of telecommunications. In doing so, the CFI has greatly increased the burden on regulated firms and, although perhaps unintended, may also have reduced the overall effectiveness of regulation.

On a narrow technical level, the CFI's ruling also clarifies, to some extent, a number of issues surrounding the law on margin squeeze, including the nature of the

[2] *See* Verizon Comm'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004) [hereinafter *Trinko*].

[3] *See* Brief of Amici Curiae Professors and Scholars in Law and Economics in Support of Petitioners, Pacific Bell Tel. Co. v. linkLine Comm'ns (No. 07-512).

abuse, the basic test for identifying it, the relationship with other legal principles such as refusal to deal, and the extent to which material adverse competition effects on the affected downstream are required. These clarifications are, for the most part, not particularly helpful for competition policy in this area.

II. THE SALIENT FACTS

The facts of the case are reasonably detailed, but the essential points are as follows:

- The case concerned access to DT's local loop in Germany. DT supplied access to the local loop at a wholesale level, which was used, among other things, to provide narrowband and broadband Internet services and telephone call services at a retail level, where DT was also itself active.
- DT's wholesale charges were approved in advance by the RegTP while its retail charges were subject to a price cap—effectively a maximum price. Retail prices were not regulated separately for each service, according to the individual cost of that service, but were regulated for a block of services at a time, with different services being grouped together in "baskets." The baskets initially comprised residential and business services, and each basket included both access revenues and telephone calls.
- During the period covered by the Commission's decision, the RegTP required DT to reduce its retail prices in the designated baskets. It was found that under the relevant German legislation DT could modify the charges of individual retail services, provided the overall price cap was respected. The RegTP could, however, refuse a modification if they did not comply with the relevant German regulatory legislation or "other legal provisions."
- Between 1998 and the end of 2001, DT reduced the retail prices more than by the mandatory price cap reductions, mainly for call charges. In 2002, a new system

was introduced by the RegTP that increased the number of granular baskets for end-user lines, local calls, domestic long-distance calls, and international calls. DT applied to increase its wholesale prices in 2002, which the RegTP allowed, but a further application to increase its retail charges was refused.

- DT's charges for high-speed broadband (ADSL) were not subject to ex ante regulation, but the RegTP launched a retrospective investigation in 2001 to assess whether ADSL prices were below cost, and found that there were not.
- The Commission found that there was a negative spread between DT's wholesale and retail prices between 1998 and 2001 and, while the spread was positive in 2002, it was still insufficient to cover DT's product-specific costs linked to the provision of retail services. Importantly, the Commission took account only of charges for local network access and excluded telephone call charges. Both price periods were found to give rise to an abusive margin squeeze. These findings were upheld in full by the CFI.

III. ANALYSIS

A. Policy and Politics: A Lack of Tariff Rebalancing

Deutsche Telekom reflects the Commission's decision to use competition law to correct the adverse effects of the regulatory failure by Germany to rebalance tariffs fully. As a general principle, local loop access is required under the EU new regulatory framework (NRF) for telecommunications to be cost-oriented. But former State monopoly telecoms providers such as DT have historically made losses on certain classes of calls and services and subsidized those losses with profits from other categories of services. This obviously benefited consumers in some respects. The problem, however, is

readily apparent: If retail services are in some cases below cost, then even wholesale prices that are cost-oriented will not avoid a margin squeeze.

This lack of tariff rebalancing has led the Commission to bring a number of infringement actions against Member States.[4] In principle tariffs should have been fully rebalanced by January 1, 1998. Germany had rebalanced some of the tariffs at issue in *Deutsche Telekom*, but the Commission's action suggests that it was neither sufficient nor fast enough. But if this was the case, the correct course of action, as a matter of EU administrative law, was surely for the Commission to take Germany to court under the Article 226 EC procedure (which also allows for fines for non-compliance under Article 228 EC). There were suggestions in the background to the case that the Commission had intended to do precisely this, but the action was dropped for political reasons. In these circumstances, it seems not only unfair, but also as a matter of administrative law wrong, for DT to be the only firm penalized as a result of Germany's and the Commission's failures to take action.

B. Parallel Application of Regulation and Competition Law

A second issue concerns the actions and inactions of the RegTP in its role as supervisor of the wholesale and retail tariffs at issue. As noted, DT's wholesale charges were set ex ante by the RegTP, so any margin squeeze created as a result of the wholesale charges was the direct result of State action and could not have been attributed to DT. The situation regarding retail prices was more complicated since, at least prior to 2002, they were subject to maximum price caps according to baskets of services. But the caps

[4] *See, e.g.*, Case C-500/01, Commission v. Spain, 2004 E.C.R. I-583.

and designation and definition of the price caps were still subject to approval by the RegTP, and could also be varied.

Not surprisingly therefore, DT argued that its prices were effectively set by the RegTP and that any margin squeeze that resulted should be attributed to the German state and pursued through infringement actions under Article 226 EC. DT said it was doing no more than abiding by the regulatory framework and regulatory decisions.

The CFI disagreed, for essentially two reasons. Its first reason was that DT's retail prices were subject to a maximum price cap, and so could be adjusted if necessary by DT (i.e., it had some discretion to avoid infringing Article 82 EC). Moreover, that cap applied to service baskets so the price of an individual service could be adjusted upwards or downwards so as to eliminate any margin squeeze, provided the overall price cap was respected.

The problem for the Commission (and the CFI in upholding its decision) was that, in circumstances where the wholesale price was fixed at a maximum level by the RegTP, only an increase in retail access prices would have eliminated the margin squeeze. (Note that if the objection was that the wholesale price was too high, then it was clearly the result of direct action by the RegTP, not DT.) In this regard, the CFI noted that DT had decreased the price of telephone calls between 1998 and 2001,[5] which, the CFI said, would have allowed it to increase retail access charges and so avoid a margin squeeze, provided the overall price cap was respected.[6]

[5] CFI Judgment, *supra* note 1, at para. 100.

[6] *Id.* at para. 101.

In theory this may have been true, but as a matter of competition policy it sounds odd to say that retail prices to consumers should be raised so as to protect competitors' ability to compete. In its 2007 decision in *Telefónica*, in which the Commission fined the telecoms provider for margin squeeze abuses in Spain, the Commission focused only on wholesale price reductions, not retail price increases.[7] In recent years, retail access and call charges in the European Union have generally *decreased*, often substantially. Saying that DT should have *increased* access charges sounds odd.

The CFI's second reason for disagreeing was more interesting from a legal and policy point of view. DT argued that it should have a defense in any event because the RegTP approved its retail prices and as such the fact that DT had some discretion in setting them was not the end of the matter.

This argument was also rejected by the CFI. In response, the CFI first recalled case law to the effect that State action only provides a defense to what would otherwise be anticompetitive conduct where that conduct originates solely in State action (e.g., legislation); in other words, it removes any scope for autonomous action by the firms in question.[8] As noted, the CFI had already concluded that DT had residual pricing discretion to raise retail access prices up to the price cap level.

But the CFI went further. The RegTP examined the issue of margin squeeze in at least five separate decisions, and concluded that rivals could remain competitive by

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

[8] CFI Judgment, *supra* note 1, at para. 107.

selling access at a low price and recouping additional amounts through call charges.[9] The CFI held that this was irrelevant and that either the RegTP did not apply Article 82 EC or did not do so properly.[10]

The CFI followed this up with a series of statements. It first said that the Commission was not bound by a decision taken by a national authority under Article 82 EC.[11] This is trite law. Nonetheless, there must be good reasons to suspect that the NRA's decision is wrong in a material respect. On their face, the RegTP's conclusions on margin squeeze provided a good basis for saying that a price squeeze in relation to access pricing did not matter because all firms had incentives to offer low prices for access in the hope that this would lead to follow-on revenues from calls.

Next, the CFI said that the German regulatory legislation did not preclude the RegTP from authorizing charges that were contrary to Article 82.[12] This may have been literally true, but it is settled law under Article 10 EC that a Member State cannot approve or even encourage measures that are contrary to Article 82 EC.[13] This is true whether or not national legislation says anything to the contrary and an NRA or national court has a duty not to apply legislation that would result in Article 82 EC violations—whether or not it formally has such a power under national law (i.e., Article 10 EC also

[9] *Id.* at para. 115.

[10] *Id.* at para. 119.

[11] *Id.* at para. 120.

[12] *Id.* at para. 123.

[13] Case 66/86, Ahmed Saeed Flugreisen & Others v. Zentrale zur Bekampfung unlauteren Wettbewerbs, 1989 E.C.R. 803.

grants legal powers).[14] Indeed, the CFI seemed earlier to have accepted this when it noted that the RegTP was obliged to comply with the provisions of the EC Treaty.[15] The CFI reasoned, however, that the RegTP was a telecoms regulator, not a competition authority, and that its objectives were different from those under competition law.[16] That may well be true, but the RegTP is still not allowed to approve tariffs that are contrary to Article 82 EC, and its decisions to do so should have resulted in action against the German state, of which it is an emanation, not DT. Indeed, the CFI seemed to accept that Germany had probably infringed EU law and that infringement proceedings may have been appropriate.[17]

C. Are We Heading in an Incoherent Policy Direction?

The above points are to some extent legal technicalities that mask what is arguably a more important policy point. The policy question is: When is it appropriate for the Commission to act under its competition law powers in a market that is regulated under secondary EU utility liberalization legislation?

The existence of regulation necessarily implies that a market has certain problems that limit effective competition and that intervention in the form of access obligations and price controls are necessary to iron those out, leading to a transition to full competition. Regulation also necessarily presumes that regulators have and need more extensive and

[14] *See, e.g.*, Case C-81/05, Anacleto Cordero Alonso v. Fondo de Garantía Salarial (Fogasa), 2006 E.C.R. I-7569, at para. 46 ("In such a situation, a national court must set aside any [unlawful] provision of national law, without having to request or await its prior removal by the legislature. […] That obligation persists regardless of whether or not the national court has been granted competence under national law to do so.").

[15] CFI Judgment, *supra* note 1, at para. 113.

[16] *Id.* at para. 113.

[17] *Id.* at paras. 265 & 271.

detailed powers than competition authorities for these purposes. NRAs will also be closer to the market facts in the country in question and so will be able to look at the costs and benefits of different types of interventions in a more balanced manner than a single intervention by the Commission in a competition proceeding. Regulation therefore represents a delicate balance between ensuring that the necessary incentives are in place to, say, promote capital investment in new infrastructure development, while at the same time ensuring that effective competition can flourish in parallel.

In *Deutsche Telekom*, the RegTP seems to have considered these issues in some detail and concluded, in its various decisions between 1998 and 2001, that a policy favoring low retail access charges was appropriate to stimulate the uptake of Internet services among consumers and did not unduly harm competitors since they could recoup extra money from follow-on call charges; in other words, consumers looked at services in terms of clusters of services, not individual services. The RegTP clearly had sector-specific remedies to protect a competitive market structure, and seemed willing to apply them in a manner that took into account competing considerations of regulation and competition.

To the extent the Commission disagreed with these objectives, it should have taken the German state to the European Court of Justice (ECJ) (and, apparently, this was the intention until a political compromise was reached). In these circumstances, the need for Commission intervention was unclear. The situation arguably should be different only if there is a “lazy” or “captured” regulator. The RegTP did not seem to have been either

in this case: It just seemed to have a different view of optimal market development. This view should have counted for something, since the regulator inevitably will be much closer to the full market facts than the Commission.

Certainly, *Deutsche Telekom* was not at all comparable to the case relied on by the CFI in support of the Commission's intervention: *Doganali*.[18] In that case, the Italian association of custom agents was required by national legislation to adopt a tariff for the services of custom agents. However, the legislation did not impose detailed price levels. Because the association enjoyed a margin of discretion in this regard, the ECJ held that the association infringed EC competition law by adopting a minimum price that exceeded the prices then in force by 400 percent.

By contrast, in *Deutsche Telekom*, there were maximum price caps and the RegTP had intervened on several occasions to *reduce* them, as well as confirming that no material margin squeeze issues arose on at least five separate occasions. In these circumstances, the suggestion that DT was acting abusively by not seeking to materially *increase* its retail access prices seems very different. Indeed, it might even be questioned whether the EC courts' case law concerning autonomous national price control legislation (*Doganali*) is relevant in the context of a regulated firm's duty to take action that runs counter to the NRA's policy initiatives and directions under EU liberalization legislation (*Deutsche Telekom*).

The major difficulty, however, with the *Deutsche Telekom* case is that it assumes, implicitly but clearly, that in a regulated environment, competition law considerations

[18] Case T-513/93, Consiglio Nazionale degli Spedizionieri Doganali v. Commission, 2000 E.C.R. II-1807.

must still always be paramount. This seems questionable, since it would question the basic need for legitimacy and efficacy of telecommunications regulation to begin with. For example, NRAs sometimes (deliberately) impose margin squeezes through a combination of wholesale and retail price measures, but then are compensated by efficiencies such as encouraging investment in new infrastructure or increasing the overall size of the retail market. *Deutsche Telekom* suggests, however, that only the competition considerations ultimately matter, and moreover matter for essentially doctrinal reasons rather than serious economic or competition policy reasons.

Regulated companies are thereby placed in something of a quandary: They must comply with any non-competition objectives sought by the NRA under ex ante regulation and at the same time respect the primacy of ex post competition law objectives, even in circumstances where the two regimes clearly overlap and pursue similar objectives. This is true even in instances where the NRA sets the wholesale price, regulates the maximum retail price, and specifically reviews the spread between the two prices and concludes that it raises no material issues. In addition, the costs to regulated companies of getting this wrong and being forced to second-guess the NRA are obviously enormous (consider, for example, the EUR 152 million fine imposed in *Telefónica*). The situation regulated companies find themselves in seems unfair.

The CFI judgment shows a certain lack of coherent direction of EU regulatory and competition policies in the telecommunications areas. While it is true that judges decide cases and not policy, it is regrettable that the CFI looked at the issue purely in

terms of legal technicalities, and offered no real appreciation of the overall policy and quasi-constitutional issues at stake. This is not at all to say that competition law should never apply where there is a regulatory regime and a competent regulator, but simply to note that the matter is much more complicated and nuanced than the CFI seems to pretend. In short, the Commission's decision and the CFI judgment show a lack of coordinated thinking with respect to the interaction between regulation and competition law and, as a result, have placed regulated firms in an invidious position.

Whether one agrees with it or not, at least the U.S. Supreme Court has a clear policy in this area, and one that strongly pleads against competition law intervention where there is a competent regulator with the legal powers and willingness to take effective action. U.S. law, for example, has effectively concluded that competition law issues such as refusal to deal and margin squeeze are best left to sectoral regulators because they require enormous industry knowledge, data, and supervision that only specialist regulators can provide.[19] In *Telefónica*, the Commission notably took no remedial action (other than issuing fines), because the NRA has already secured wholesale price reductions that eliminated a margin squeeze.[20]

[19] *See Trinko*, *supra* note 2 and LinkLine Comm'ns, Inc. v. SBC Cal., Inc., 503 F.3d 876 (9th Cir. 2007), *cert. granted* 76 U.S.L.W. 3226 (U.S. Oct. 17, 2007) (No. 07-512).

[20] *See supra* note 7.

D. Identifying a Margin Squeeze

On a technical level, the CFI judgment offers some interesting insights into the law on margin squeeze abuses, and Article 82 EC policy more generally.

1. The basic test

A first issue concerns the relevant costs and prices to be taken into account in a margin squeeze assessment. In principle, one could look at the dominant firm's own costs or charges, those of its rivals, those of a "reasonably efficient provider," or some combination of all three. The CFI acknowledged that the EC courts had not expressly ruled on this point,[21] but concluded that it was reasonably clear from the case law and other considerations that only the dominant firm's own costs or charges were relevant. The main reason was pragmatic in nature: that the dominant firm will only know its own costs so any rule that depended on third-party costs would be contrary to legal certainty.[22] This conclusion is unsurprising and was already reasonably clear from the existing case law.[23]

2. Comparing relevant costs and revenues

A second, more controversial issue concerns the CFI's upholding of the Commission's decision to assess the margin squeeze solely by reference to DT's (and competitors') access charges and to exclude revenues from calls. DT argued that the relevant end-user revenues should both access revenues and revenue from

[21] CFI Judgment, *supra* note 1, at para. 188.

[22] *Id.* at para. 192.

[23] *See, e.g.*, Napier Brown/British Sugar, 1988 O.J. (L 284) 41, at para. 65 ("insufficient margin for a packager and seller of retail sugar, **as efficient as BS itself** in its packaging and selling operations, to survive in the long-term" (emphasis added)); and Case T-5/97, Industrie des Poudres Sphériques SA v. Commission, 2000 E.C.R. II-3755, at paras. 178-82.

telecommunications services, in particular telephone calls. This was based on the consideration that:

> [T]he wholesale costs for the local loop are overheads both for the provision of retail access and for telephone calls, so that any attempt to allocate costs to individual services in order to investigate the possibility of below cost selling makes no sense and is consequently arbitrary.[24]

The CFI rejected this argument. It first noted that the relevant regulatory framework for tariff rebalancing provided for separate consideration of access and call charges.[25] It is surprising that the CFI would prefer principles of regulatory law over basic competition economics in a competition law case. It would have been economically much more meaningful to include total aggregate revenues from access and calls, since this more accurately captures the economic reality of how competitors use access to the local loop (i.e., their full incremental revenue opportunities). Telecommunications service providers generally compete on bundles of access and individual call services, which is why other jurisdictions also include other revenue in a local loop margin squeeze analysis.[26] In addition, market developments in the period since the Commission's decision provide a strong basis for saying that this is the only sensible way of looking at the retail markets. Virtually all Internet service providers now bundle calls too.

It is also interesting to note how the CFI relies on regulatory principles in some parts of the judgment for support (e.g., relevant costs and revenues), while saying they are irrelevant in others (e.g., the NRA's conclusions on margin squeeze). This is inconsistent. Indeed, it seems reasonably clear that the Commission and CFI were

[24] Commission's Decision, *supra* note 1, at para. 117.

[25] CFI Judgment, *supra* note 1, at para. 197.

[26] *See, e.g.*, Verizon New Hampshire & Delaware Order 2002, 17 F.C.C. Rcd 18660 (Rz 148).

ultimately more concerned with regulatory objectives than competition law. The Commission originally stated that the "primary consideration … is the effect on market entry by competitors, and not the question whether the end-user regards access services and calls as a single bundle of products."[27] The decision thus seemed more rooted in creating favorable entry conditions for rivals than whether DT's pricing arrangements harmed equally efficient competitors. For example, the Commission did not consider:

1. whether DT's competitors could duplicate DT's mixture of access and call revenues;
2. what the effects of DT's pricing were on those that had in fact done so; or
3. why, under Article 82 EC, ability to duplicate is even a relevant test (competitors will usually just cherry-pick the most profitable market segments).

The CFI did not demur on this point.

In doing so, the CFI missed an important opportunity to lend greater economic rigor to the abuse of margin squeeze. Margin squeeze cases always involve two markets and it is therefore important to "compare apples to apples" and to look in detail at the effects on competitors and competition in the retail market, in particular because there does not appear to be a formal requirement under Article 82 EC margin squeeze cases that the dominant firm must also have a dominant position in the retail market.

[27] Commission's Decision, *supra* note 1, at para. 127.

The basic theory of margin squeeze relies on the twin assumptions that

(a) there is a simple, linear vertical chain of production (i.e., a single, clearly identifiable upstream product and a single, clearly defined downstream product in which the upstream product is a high fixed proportion of total costs); and

(b) rivals have no opportunity for additional revenues on the retail market. This will often not be true in practice, and, on its face, seems to have been untrue in *Deutsche Telekom*.

Given these assumptions, it seems questionable for the CFI to have excluded *any* assessment of rivals' opportunities to achieve downstream call revenues with local loop access. While it is clearly correct that a margin squeeze should be assessed on the basis of the dominant firm's own costs and revenues (if only for pragmatic reasons), it does not follow that rivals' downstream costs and revenues are irrelevant to the assessment. In particular, if rivals have other sources of revenue, or use access prices to bait consumers into making more calls and generating other follow-on revenue, simply looking at access pricing does not tell the whole story. At the very least, asking these basic questions runs very close to saying that protecting competitors' profitability is a legitimate competition law objective, which EC competition law has been at pains to emphasize is not the case. Interestingly, the CFI's truncated assessment in this regard is inconsistent with the detailed principles on input foreclosure principles and the requirement for good evidence of anticompetitive effects set out by the Commission in its 2007 *Non-Horizontal Merger Guidelines*.[28] This could have the paradoxical effect of encouraging forward integration

[28] Commission Notice, Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (Nov. 28, 2007), *at*

by dominant firms by merger or acquisition, which would most likely be judged under less strict principles than unilateral conduct with the same effects.

3. Margin squeeze and refusal to deal

A third issue concerns the relationship between margin squeeze and refusal to deal abuses. It is sometimes argued that, if there is no general duty to deal under competition law, then a dominant firm should not be criticized for dealing on exclusionary terms (i.e., terms that would render non-integrated rivals unprofitable on a downstream market).[29] The phrases "a firm has refused to deal" and "a firm will only deal on unattractive terms" are said to be undistinguishable.

This argument certainly has logical force, but has not been expressly taken up by either the Commission or the CFI to date. The CFI did, however, observe in its judgment that DT's wholesale services were "indispensable" for rivals and that a margin squeeze would hinder the growth of competition in the retail market,[30] which comes close to the language used in duty-to-deal cases.

If intended, this comment is broadly welcome, since at the very least it is important that margin squeeze cases should try to avoid the well-known potential pitfalls of applying a duty to deal. It cannot be right, in general, to say that protecting competitors' profitability is a legitimate competition law objective, even if a firm is the

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http://ec.europa.eu/comm/competition/mergers/legislation/nonhorizontalguidelines.pdf (last visited May 1, 2008).

[29] *See, e.g.*, P. AREEDA & H. HOVENKAMP, ANTITRUST LAW § III.A (2nd ed. 2002), at para. 767c5 ("It makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal.") (*quoted with approval in* Covad Comm'ns Co. v. Bell Atlantic Corp., 398 F.3d. 666, 673 (D.C. Cir. 2005), at 78).

[30] CFI Judgment, *supra* note 1, at para. 237.

dominant supplier of an important input. To take an obvious example, adding more competitors does not improve competition if all that happens is that two or more firms share the previous single monopoly profit. Any duty to deal, and a fortiori a duty to deal at a particular price, should encourage more competition than it discourages (i.e., the ex post benefits of a duty to deal to consumers must outweigh any harm to firms' ex ante incentives to develop products). (This trade-off is easier said than done, but nonetheless vital to bear in mind as a guiding principle.) Finally, vertical foreclosure may have strong efficiency benefits, as the *Non-Horizontal Merger Guidelines* recognize. Thus, as a pragmatic matter, there is something to be said for limiting margin squeeze cases to situations akin to essential facilities. Otherwise, the risks of falsely imputing a margin squeeze where none exists, or where it would be inefficient to find one, are relatively high.

4. Anticompetitive effects

The comments in the preceding sections lead to the issue of anticompetitive effects in margin squeeze cases, and Article 82 EC abuses more generally, where something of a chasm has developed between recent policy statements of the Commission and the case law of the EC courts. The Commission's recent policy reforms in its Discussion Paper on Article 82[31] and its *Non-Horizontal Merger Guidelines* emphasize the need for an examination of actual or likely anticompetitive effects, which at the very least require a series of sound market facts that support a case of likely harm to consumer welfare. This is said to be particularly important in cases involving

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

anticompetitive leveraging conduct from a dominant market to a second market because such conduct is often good for consumer welfare even if it is bad for producers.

By contrast, in a series of recent judgments (*Michelin II*[32], *BA/Virgin*[33], and now *Deutsche Telekom*), the EC courts have eschewed any effects-based analysis, and effectively presumed that certain *forms* of dominant firm conduct are necessarily bad for competition (and worse, that adverse effects on competitors always equal similar adverse effects for consumers, or, worse still, that an absence of discernible adverse effects on rivals means that it can be presumed that rivals would have fared even better but for the abusive conduct). For example, in *Deutsche Telekom*, the CFI stated that once a margin squeeze is demonstrated, this will "in principle" hinder the growth of competition[34] and that evidence of competitors' ability to offset the effects of them is largely irrelevant.[35]

These statements go too far, particularly for a margin squeeze abuse where the effects of input foreclosure may be quite complex in practice. Even if EC competition law does not support a recoupment test in pure predatory pricing cases,[36] it is surely relevant to at least examine actual or likely market effects in the case of a margin squeeze abuse.

[32] Case T-203/01, Manufacture Française des Pneumatiques Michelin v. Commission, 2003 E.C.R. II-4071.

[33] Case C-95/04 P, British Airways v. Commission (not yet reported) (judgment of Mar. 15. 2007).

[34] CFI Judgment, *supra* note 1, at para. 237.

[35] *Id.* at para. 238.

[36] Case T-340/03, France Télécom SA v. Commission, 2007 E.C.R. II-107.

IV. CONCLUSION

Deutsche Telekom appears to be a case simultaneously concerned with excessively broad policy issues and unduly narrow technical issues, both of which led the CFI to overlook important points.

On a broader policy level, the CFI appears to have very much endorsed the Commission's right to intervene under competition law where it feels that an NRA in a regulated sector is not applying regulatory or competition law principles in the way that the Commission would like. While it is correct that the Commission should have the right to intervene in exceptional circumstances, a test based on whether the regulated firm had some discretion to arrange its prices in a different manner seems unrealistic and unfair. This applies in particular where, as in *Deutsche Telekom*, it would require the regulated firm to act in a manner that:

1. is completely at odds with all regulatory intervention to date (e.g., to increase retail prices where the regulatory decisions only required price reductions); and
2. seems contrary to consumers' interests (i.e., price rises as a result).

As a matter of EU administrative law, it was always intended that the principal obligations in this regard should fall on the Member States and NRAs and that the infringement procedure under Article 226 EC is the correct remedy if EU law infringements arise. The CFI's conclusions could lead to less effective, and more complicated, regulation, since the burden may shift to the regulated firms to effectively challenge or second-guess the NRAs where the NRAs take regulatory action that could

lead to competition law violations. This might even lead to an odd dialectic where the regulated firm would be forced to argue that the NRA needs to act in a manner more adverse to the regulated firm. This seems impractical and unfair, and to be a misunderstanding of how effective regulatory dialogue works in practice.

Reading the Commission's decision and the CFI judgment gives one the sense that the agency and court anticipate bigger battles ahead, in particular the serious market failures and abuses that are rife in the energy sector in Europe.[37] While one can empathize with this position as a policy matter, it did not exclude the fact that the CFI could have set out a more nuanced position on certain points in the case at hand.

The narrow technical legal findings made by the CFI seem for the most part unhelpful in terms of sensible competition policy. Margin squeeze abuses are very complex in practice, and yet the CFI seems to think that once a prima facie case of an insufficient price spread between wholesale input costs and retail prices is shown, an abuse necessarily follows. Much more needs to be said by way of legal principles that allows a court, competition authority, or regulator to reach robust, fact-based outcomes, and in particular the need to capture the total economic opportunities open to rivals on the downstream market, the relevance of input prices in this context, and the effects of rival foreclosure on consumer welfare in the retail market.

While the CFI was doubtless influenced by DT's very high wholesale and retail shares at the relevant time, and the Commission's policy perspective that the retail market needed a "kick start," there will also be more marginal cases where more rigorous

[37] For the main Commission documents in its on-going sectoral inquiry and follow-on cases, *see* European Commission, Energy: Sector Inquiry, *at* http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html (last visited May 1, 2008).

analysis is required. The EC courts need to better understand that in the European Union, which presently comprises 27 individual countries, most enforcement will occur at the local or national level, and often by non-specialist courts or newly created competition authorities. Over-simplification of matters may ultimately lead to the well-known paradox and EU competition law being "at war with itself."[38]

[38] R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978).