



Court upholds Deutsche Telekom margin squeeze fine

In May 2003 the European Commission fined Deutsche Telekom €12.6m for abusive pricing of access to its local fixed telecommunications network and required the infringement to be brought to an end immediately. The European Court of First Instance has now upheld the Commission's decision in full. The Court's judgment clarifies the relationship between sector regulation and competition law.

In May 2003 the European Commission fined Deutsche Telekom €12.6m for charging its competitors and end-user customers unfair prices for access to its local telecommunications network, resulting in an anti-competitive 'margin squeeze', and required the infringement to be brought to an end immediately. The European Court of First Instance (CFI) has now upheld the Commission's decision in full. This judgment confirms the Commission's traditional approach to the application of article 82 of the EC Treaty on pricing abuses and serves as a reminder that EU competition rules can be an important tool even in markets subject to detailed sector-specific state regulation.

Commission decision

The Commission identified the relevant markets as wholesale, retail narrowband and retail broadband access to the fixed telecommunications network (local loops) in Germany. Since 1998 both EU and German law have required Deutsche Telekom to provide competitors with local access to its network. Although wholesale access can in principle be provided by other means such as fibre-optic networks, wireless local loops, satellites, power lines and cable TV networks, the Commission considered that these were not yet sufficiently developed to provide a substitute for Deutsche Telekom's local loop network and so did not include them in its market definition.

In 2003 Deutsche Telekom still had a share of 100 per cent for wholesale local network access and over 95 per cent in narrowband and broadband retail markets

for local access to fixed telecommunications networks, making it dominant in all these markets.

The Commission found that during the four-year period from 1998 to 2001 Deutsche Telekom charged its competitors higher fees for wholesale access to the local loop than the fees it charged individual subscribers for fixed-line access. From 2002 the charge for wholesale access was lower than that for retail, but the difference was not sufficient to cover Deutsche Telekom's own costs for the supply of end-user access. The Commission held that these margin squeezes hindered new market entry and reduced choice of service suppliers and price competition to the detriment of consumers. It imposed a €12.6m fine and Deutsche Telekom appealed to the CFI.

The CFI's judgment

Relevance of price regulation

Deutsche Telekom argued that its wholesale and retail charges were subject to sector-specific regulation but the Court agreed with the Commission that Deutsche Telekom retained sufficient commercial discretion over how it structured its tariffs to be able to have reduced or put an end to the margin squeeze. Specifically, wholesale prices were fixed by the regulator but retail prices were not and during the four years from 1998 to 2001 Deutsche Telekom had sufficient freedom of action to end the price squeeze entirely. It could have done this by raising its retail prices – although such rises would have required prior authorisation by the regulator. The CFI also upheld the finding that from 2002 onwards

there was scope to reduce the squeeze by raising the retail charges for broadband access. The competition rules – and in particular article 82 of the EC Treaty, which prohibits abuse of a dominant market position – therefore applied.

Method of establishing pricing abuse

To establish the abuse the Commission had assessed whether there was a margin squeeze: this involved considering whether the difference between the retail and wholesale prices was either negative or insufficient to cover the product-specific costs to Deutsche Telekom of providing its own retail services. Deutsche Telekom argued that wholesale prices could not be taken into account in establishing an abuse because they were set by the regulator and that in these circumstances the Commission was entitled to consider only whether retail prices were so low as to be predatory. The CFI rejected this argument.

Deutsche Telekom also argued that access charges should not be considered separately from call charges, that the Commission wrongly inflated wholesale charges by including in them access discontinuance charges and that it should not be assumed that Deutsche Telekom's competitors would want to replicate its customer pattern. The CFI rejected all these arguments. On the last point it emphasised that the abusive nature of pricing practices must be determined on the basis of the dominant company's situation and not on that of its competitors.

Effect on the market

As far as effect on the market is concerned, the CFI stated that, given that access to Deutsche Telekom's network is indispensable to a competitor wanting to compete with Deutsche Telekom in providing retail access, a margin squeeze between wholesale and retail charges 'will in principle hinder the growth of competition in the downstream markets... a potential competitor who is just as efficient as [Deutsche Telekom] would not be able to enter the retail access services market without suffering losses'. It considered actual market evidence briefly and concluded that the small market shares acquired by competitors support this view.

Role of German regulator

Finally the CFI held that, even if it were the case that the German regulator's failure to act against the margin

squeeze was a breach of Community law, Deutsche Telekom had had scope to reduce or eliminate the squeeze and so article 82 could apply to its conduct without the Commission's trespassing on the regulator's area of competence.

Future enforcement of article 82

With considerable uncertainty still surrounding the nature and content of any guidance that may eventually result from the Commission's article 82 review, any European court judgment providing further clarification on the application of article 82 is welcome. This one, like a number of other recent judgments, fully backs the Commission's traditional approach to establishing abuse. However, like those judgments, it in no way closes the door to an approach based more on economic effect.

As far as the law on margin squeeze abuses is concerned, it is noteworthy that in July 2007 the Commission imposed a fine on the Spanish incumbent telecoms operator Telefónica for a similar margin squeeze, which lasted just over five years. This case concerned regional and national wholesale access to the local loop for provision of broadband services rather than local loop unbundling and the fine was much larger: €151,875,000. Appeals before the CFI are pending.

A comparison of the two cases is interesting, not least because the Commission's decision in one was taken before its review of article 82 enforcement and the other came after that review. A striking difference, apart from the level of the fine, is the treatment of the issue of effect on the market. Only eight paragraphs of the Deutsche Telekom decision are devoted to 'effect on the market' and on appeal the CFI dealt with the question in a similarly summary way. The Telefónica decision has 76 paragraphs on 'impact on competition' and includes detailed consideration of much empirical evidence.

The judgments in the Telefónica appeals will provide the next chapter in the story and perhaps bring further clarification of the law on pricing abuses in general and margin squeezes in particular.

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