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Working Party No. 2 on Competition and Regulation

MARGIN SQUEEZE

-- Lithuania --

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The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 19 October 2009.

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1. A "margin squeeze" or "price squeeze" is not a separate, stand-alone form of abuse of dominance reflected in the Lithuanian legal acts. I.e. it is not specifically mentioned in legislation. However, it is recognized by courts as inappropriate behaviour by dominant firms, a form of abuse. Notably, in two recent cases involving price squeeze, one case (involving telecoms operator TEO) was decided (2006) to have violated Article 9(1) of the Lithuanian Competition Act (imposition of unfair prices), whereas another one (involving post services provider *Lietuvos Pastas* (LP)) was decided (2007) to have infringed the general part of Article 9, which prohibits a dominant firm from all activities restricting competition and constraining the other firms' possibilities to operate in the market.

2. The latter case with LP was essentially a margin squeeze case. However, the case was judged not as such, but as some other form of abuse, some restricting-competition behaviour. I.e. a dominant post-services provider, having a monopoly over delivery of letters up to a certain established weight (a monopoly over "reserved postal services"), being an upstream provider of an essential input (delivery of letters by post), was also competing on downstream markets, e.g. in providing a complex service of delivery of electricity bills to customers, which included not only the delivery itself, but also other delivery-related services (i.e. printing out of electricity bills, putting them into envelopes, writing addresses of the clients, posting the envelopes). The key issue at stake was the downstream price (of a complex service) relative to the price for the essential input (delivery of letters). No other firm operating in the market for complex delivery services was capable of delivering letters, because this was reserved by law to LP, all of them actually had to subcontract LP and use their delivery services[1].

3. However, this case was treated neither as a "margin squeeze" case, nor as other traditional form of abuse, such as refusal to deal, predatory pricing, price discrimination or excessive pricing. The reason for that probably was that, firstly, this was not a telecommunications case (most common area of margin squeeze abuses), secondly, the Lithuanian Competition Act allows to catch all kinds of possible abusive behaviour restricting competition. Consequently, the case was judged as the latter abusive behaviour.

4. The first case involving an incumbent telecoms operator TEO (telephone fixed line monopoly) was decided as a price squeeze case. No other consideration has been given to characterising this case as another form of abuse, this case was considered as fitting into price-squeeze framework right from the beginning of the investigation.

5. In the TEO case, TEO is vertically integrated undertaking and provided broadband internet ADSL services both in wholesale and in retail markets. The essential input provided by the integrated firm to the downstream rivals was broadband internet connection via ADSL technology (wholesale services). This input was the same as the input that TEO provided to itself (TEO also acted in the retail market for broadband internet connection). The downstream products sold by the downstream rivals and by the integrated company TEO were substitutes – basically in both cases they were retail broadband internet connection services. Both the downstream rivals and the integrated firm targeted the same two broad groups of retail customers – business clients and home users. The downstream services were not sold as part of a bundle of products but rather as separate products ensuring a particular level of speed of data flow (download / upload). The integrated firm did not engage in volume discounts or other forms of price discrimination to its own customers.

6. Analysis was made of retail broadband internet ADSL connection and of expenditures incurred by companies acting in retail services using data mainly from TEO. For the internet consumers, there were 18 different plans (differing from one another mainly in the speed of the internet, and in some other

[1] Delivering of letters by others, than LP, was not prohibited *de jure*, though. It was legally allowed to deliver letters by other companies as well, but they were obliged to apply prices 3 times higher than LP's prices, which made impossible for them to compete with LP.

characteristics) by TEO for retail customers (end-users) to choose from. For each separate plan, the Competition Council made calculations, using the cost data presented by TEO, of the retail price that should have been set by TEO. It appeared that the wholesale costs for DSL access, wholesale DSL flow costs, and wholesale international DSL flow costs in sum exceeded the retail price of the given plan. That is, irrespective of the other retail-related costs (as installation costs, indirect costs, etc.), the retail price of the plan by TEO was lower than the wholesale price (for DSL access, flow costs).

7. The same was true for most of the plans by TEO, i.e. most of the offers (plans) of TEO (oriented towards households) in the retail markets were sold at a lower price than the price it set for buyers of wholesale ADSL services. The retail rivals buying the wholesale ADSL services from TEO for creating the retail broadband connection internet access services to end-user, were incurring larger expenses than TEO's retail prices. If these rivals had provided retail services, reflecting wholesale prices of TEO, their services would have been loss-making and they would not have been able to operate in the retail markets in the longer run. And because of that there was little competition, if any, in the market for households.

8. The retail ADSL services of TEO could not be profitable when they were provided on the basis of the wholesale ADSL prices set in the wholesale market. Since the income TEO earned from services provided in the retail market did not cover the expenses of providing such services, the conduct of TEO was treated as an abuse of a dominant position through the use of a *price squeeze*.

9. During the time of application of the price squeeze schemes by TEO, there was an increase in the number of customers signed up with TEO for the services which was an indication of retail competitors being pushed out of the market.

10. In the TEO case, there was no pre-existing duty-to-deal based on other, than competition, laws (i.e. there were no regulatory requirement to deal). Only competition law could be used to force the incumbent to deal. However, there were no considerations about imposing a duty to deal because the incumbent did not refuse to deal completely, it only offered inappropriate terms and conditions for retail rivals.

11. TEO was found to have abused a dominant position in the wholesale ADSL market using a price squeeze. TEO applied such prices for wholesale and (or) retail services that reasonable efficient TEO competitors, operating in the retail markets, could not obtain a normal profit. Because of that these competitors were being forced out from retail markets. TEO didn't offer any justifications for the alleged abuse and recognized that its conduct was an abuse of a dominant position. TEO paid the fine imposed and did not challenge the decision of the Competition Council in court.

12. The Competition Council in its decision did not specify the exact remedy, it only pointed out the violation of the law and obliged the company to remove the violation. It was then up to the company to choose whether to change the upstream price for the essential input or to change the downstream price. There were no regulatory obligations, such as a requirement to provide the essential input (wholesale broadband internet connection) at a specified price, so there could not be any conflict between the competition law obligations and regulatory obligations. Also because of no regulation on this, the integrated TEO could not rely on regulation as a form of defence against being found liable for an anticompetitive margin squeeze.

13. Lithuanian competition law is rather young and we have not had much experience with margin squeeze cases. The two cases on margin squeeze by the Competition Council mentioned earlier were brought in 2006-2007. One case was not challenged in court, another one was brought to court, but on market definition grounds (eventually the company lost the case). At the moment we do not foresee any changes in this area. Standard of proof, in our experience, is different in various forms of abuse. For

instance, a predatory pricing case may require showing of a loss-recoupment theory (which is not present in margin squeeze cases); refusal to deal cases may mean outright refusals (whereas in margin squeeze there is no refusal as such); an excessive pricing case requires showing price in no connection with the "value of the product" (whereas in margin squeeze cases there is no such requirement). However, a margin squeeze case in some circumstances may be considered as a price discrimination case if price-discriminated are all the clients of the dominant firm, and price-favoured is the dominant firm (i.e. when all the clients have to pay the wholesale price, and the dominant firm does not "pay" an appropriate wholesale price). On the other hand, it is not clear what aim can be achieved by incorporating margin squeeze cases into one of the traditional abuses (predatory pricing, price discrimination, excessive pricing, refusal to deal) and by eliminating margin squeeze cases completely from the map of abuses.