SQUEEZING PRICE SQUEEZE UNDER EC ANTI TRUST LAW

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1. Introduction

Price squeeze abuses lie at the crossroad between different forms of potentially anticompetitive conduct, as well as between antitrust law and regulation. A price squeeze may occur when a vertically integrated monopolist sells an upstream input to firms that compete with the monopolist itself in the production of a downstream product sold to end users. The vertically integrated monopolist can reduce the margin between the input price charged to competing firms and the price charged in the downstream market for the end product incorporating that particular input. Competition concerns arise when the margin is negative or too small to enable downstream competitors to achieve a sufficient profit level, so as to make entry difficult or to encourage exit.

Price squeeze has been the subject of some of the most controversial and debated antitrust cases decided in the last few years in the US and the EU, as well as of intensive enforcement activity by competition and regulatory authorities in several EU Member States. The law of price squeeze has undergone important developments both in the US and the EU, following the judgments of the US Supreme Court in linkLine and of the Court of First Instance (CFI) in Deutsche Telekom. Furthermore, the Commission decision in the Telefónica case and the Guidance on Article 82 EC (Guidance) have provided additional clarifications on the Commission’s approach to price squeeze abuses.
Section 2 of the paper discusses the basic issue of the nature of price squeeze abuses. In light of the conclusions drawn in Section 2 and the recent developments in US and EU antitrust practice, the following sections analyze some of the most controversial issues in the treatment of price squeeze, namely: (i) the admissibility and utility of an analytical framework for the assessment of price squeeze under antitrust law (Section 3); (ii) the need for a duty to deal based on antitrust rules and, possibly, other sets of rules (Section 4); and (iii) the structure of the cost-based test (Section 5). In addition, Section 6 provides some additional remarks on the role of efficiencies in price squeeze cases, taking into account the indications provided by the Guidance. Section 7 contains conclusions.

2. The Nature of Price Squeeze Abuses

In the last few years, it has been widely debated as to whether price squeeze should be considered a separate antitrust infringement. A price squeeze strategy could be implemented through upstream and downstream pricing policies that may be independently unlawful under competition rules. The upstream price may be excessive or discriminatory, and it may amount to a constructive refusal to deal. The downstream price may be predatory. Given this alternative, the question that has arisen in the academic debate and actual practice is whether a combination of a lawful wholesale price and a non-predatory retail price can be characterized as exclusionary conduct based on the analysis of the margin between the two prices.

2.1. A Taxonomy

Actually, a price squeeze can exclude an equally efficient rival if the upstream-downstream price differential is lower than the incumbent’s own downstream costs. The margin may be squeezed by raising wholesale prices, lowering retail prices, or both. However, this kind of essential taxonomy obfuscates the fact that the ability to manipulate a rival’s margin may hinge on different situations, which can be distinguished by looking at the price that is paid, or should be paid, by the downstream division of a vertically integrated firm for the supply of the relevant input.

If the downstream division of the vertically integrated firm is a separate legal entity, the price paid for the input is normally specified by intra-group supply contracts. Conversely, if the upstream and downstream activities are carried out by the same company, there is no visible price. In some instances, sector-specific regulations impose on vertically integrated firms an obligation to specify the internal transfer charges (i.e., the prices that should be paid by the downstream division for the supply of certain inputs), by means of specific service contracts and separate accounts.

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4 Some companies may spontaneously decide to prepare separate accounts with a view to having a more accurate picture of internal activities and results achieved by different divisions.
Needless to say, intra-group prices and internal transfer charges, where existent and identifiable, represent a useful analytical tool for the assessment of price squeeze policies. Suppose that internal prices or transfer charges exist and can be identified. If the dominant firm charges an internal price or transfer charge lower than the external price, the costs of its downstream division will be lower than those borne by downstream competitors. As a consequence, the downstream division will be able to set a final price that equally efficient rivals will not be able to match. In this case, a price squeeze would arise from a classic form of price discrimination aimed at privileging the downstream operations of the vertically integrated firm.\(^5\)

On the contrary, assuming that the internal price or transfer charge is equal to the external price charged to rivals, the dominant firm could exclude equally efficient competitors only by offering downstream prices lower than the costs borne by the downstream division (downstream predation). Note, however, that the downstream predation could be subsidized by the exploitative level of the input price. The exclusionary strategy would not give rise to a loss for the dominant firm, but only an internal redistribution of profits. Equally efficient rivals would not be able to compete, although the analysis of the overall costs of the dominant firm would exclude predation.\(^6\)

On some occasions, a price squeeze may arise even though the dominant firm does not discriminate or engage in downstream predation. If the cost of supplying an input to rivals is higher than the cost of providing the same input to an internal downstream division, a price squeeze may be the result of the cost savings resulting from the vertical integration of the dominant firm.\(^7\) In this case, equally efficient competitors may be excluded, even though there is nothing inherently negative in the pricing policy of the dominant firm.

2.2. ... and its By-Products

Assuming that the costs of supplying an input to rivals and to internal downstream divisions do not differ, a price squeeze may arise only from a form of internal-external discrimination, which puts rivals at a competitive disadvantage by raising their costs (discriminatory price squeeze), or from a downstream predation (i.e.,

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\(^5\) The discrimination would be particularly harmful, as the competitive disadvantage would be so significant that equally efficient downstream rivals would be unable to compete.

\(^6\) We assume that the price of the end product is not predatory. If this were not the case, the practice could be simply analyzed on the basis of standard principles on predatory pricing.

\(^7\) Suppose that a vertically integrated dominant firm produces the input A and the end product B. The production cost of A is equal to 10 and the additional downstream costs borne to produce B amount to 5. Supplying A to third parties imposes on the dominant firm an additional cost of 2 (for instance, due to the need to interconnect the network of the dominant firm with those of competitors). The dominant firm sells A at a price equal to its cost to both its downstream division and rivals (i.e., 10 for the downstream division and 12 for third parties). At the same time, the vertically integrated firm charges a price equal to 16 for B. An equally efficient downstream rival would not be able to compete, as the margin between the external price of A and the price of B is lower than the downstream costs. However, the conduct is neither discriminatory nor predatory. It is not discriminatory, because the difference between the internal transfer charge and the external price of A is justified by different production costs. It is not predatory, because the price of product B is sufficient to cover all the downstream costs of the dominant firms.
downstream prices lower than the costs of the downstream division of the dominant firm), normally financed by a cross-subsidization (predatory price squeeze).8

Were it possible to identify the internal prices or transfer charges in all cases, price squeeze abuses could be simply analyzed on the basis of general principles on exploitation, price discrimination and predatory pricing. If the downstream price is predatory, in that it does not cover the costs of the downstream operations (including the cost of procuring the input), standard principles on predatory pricing apply.9 If there is actual discrimination by the dominant firm in favor of its own downstream operations, there may be a violation of Article 82, lett. c), EC. Possibly, the upstream external price could amount to a constructive refusal to deal (i.e., an extreme form of discrimination). If there is neither downstream predation nor upstream discrimination, there is no risk of exclusion of equally efficient competitors. But then we are left with the possibility that the upstream price to non-integrated rivals is excessive under Article 82, lett. a), EC, which would be true whether or not there were a separate abuse of margin squeeze. In sum, there is no need for a price squeeze theory under antitrust rules.

However, when the downstream division of the dominant firm is not a separate legal entity, distinguishing discriminatory and predatory price squeezes may turn out to be impossible, as internal transfer charges are absent in many concrete settings of vertical integration. In this case, the only observable factual element is the squeeze of competitors’ margins, which the dominant firms can realize by raising the upstream external price, lowering the downstream price, or doing both. The fact that the difference between upstream and downstream prices is lower than the downstream costs of the dominant firm indicates that the latter must have engaged in (at least) one of the two practices: either the internal transfer charge is lower than the external price, or the downstream price does not cover the costs of the dominant firm’s downstream operations.

Under this point of view, a price squeeze does not represent a separate antitrust infringement, but rather the external manifestation of practices that would be autonomously relevant under antitrust rules. Nonetheless, a price squeeze analysis, leading to a coherent framework, can be useful if intended as a tool to detect conduct that would be unlawful on the basis of other traditional theories of antitrust liability but is not directly observable from the outside, due to the vertical integration of the dominant firm and the lack of internal prices or transfer charges.

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8 Obviously, the two hypotheses are not mutually exclusive, as a dominant firm can engage simultaneously in upstream discrimination and downstream predation.

9 An example is offered by the Wanadoo case (see Commission decision of 16 July 2003, Wanadoo Interactive, available at http://ec.europa.eu/competition/antitrust/cases/decisions/38233/en.pdf). The Commission assessed the conduct at issue in that case as predatory pricing instead of price squeeze, because the wholesale and retail services were not offered by a single, vertically integrated company. The downstream operator (Wanadoo) was independent in legal terms from the upstream operator (France Télécom). Interestingly, the abuse was not brought to an end by Wanadoo through a retail price increase, but rather by France Télécom through a reduction of the wholesale tariff. However, it should be noted that, unlike standard cases of predatory pricing, in predatory margin squeeze cases recoupment could be simultaneous, as downstream losses could be financed by cross-subsidies.
3. The Limits of a Price Squeeze Analysis under Antitrust Rules

The above analysis helps to clarify the limits of a price squeeze analysis under antitrust rules. The question is whether a price squeeze analysis is admissible and useful under antitrust rules and, if so, what are the limits of antitrust intervention in price squeeze cases. As often happens in the field of unilateral conduct, there is a remarkable distance between the approaches adopted in the US and the EU.

3.1. The US Experience

In the US, price squeezes were recognized as a form of antitrust liability by the 1945 judgment of the Court of Appeals for the Second Circuit in Alcoa. In this well-known opinion, Judge Learned Hand stated that a price squeeze infringes Section 2 of the Sherman Act when: (i) the vertically integrated firm holds a monopoly power in the upstream market; (ii) the upstream price is higher than a “fair price”; and (iii) the downstream price is so low that its competitors cannot match the price and still make a “living profit”.

Judge Hand’s opinion was based on the questionable assumption that the Sherman Act aims at preserving, “for its own sake and in spite of possible cost, an organization of industry in small units”. Some decades later, most courts and commentators endorsed the view that the main goal of antitrust rules should be the protection of consumer welfare. Judge Hand’s view on the aim of the Sherman Act became obsolete and was severely criticized. The concepts of “fair price” and “living profit” were difficult to reconcile with the increasing focus on consumer welfare. Nonetheless, the opinion of Judge Hand in Alcoa continued to represent a fundamental reference point for lower courts and other Courts of Appeals for several years. In 2004, the judgment of the Supreme Court in Trinko opened the way for a critical review of the foundations of the price squeeze theory. The Supreme Court warned against the use of antitrust rules to impose duties to deal on dominant firms. Under Trinko, if an antitrust duty to deal exists, it is an extraordinarily narrow one. The

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10 United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945).
11 Id., at 437-448.
12 Id., at 429.
14 See, for instance, City of Kirkwood v. Union Elec. Co., 671 F.2d 1173 (8th Cir. 1982); City of Groton v. Connecticut Light & Power Co., 662 F.2d 921 (2d Cir. 1981); City of Mishawaka v. American Elec. Power Co., 616 F.2d 976 (7th Cir. 1980). However, in Town of Concord v. Boston Edison Co., Judge Breyer criticized the concepts of “fair price” and “living profits”, on the grounds that they were too vague and obliged courts to behave as regulatory authorities. Furthermore, Judge Breyer held that a price squeeze does not infringe Section 2 of the Sherman Act when both upstream and downstream prices are regulated. See Town of Concord v. Boston Edison Co., 915 F.2d 17, 25 (1st Cir. 1990). Contra, see City of Anaheim v. Southern California Edison Co., 955 F.2d 1373, 1377 (9th Cir. 1992).
15 The Supreme Court warned: “compelling … firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law”. Furthermore, “no court should impose a duty to deal that it cannot explain or adequately and reasonably supervise”. See Verizon Communications Inc., Petitioner v. Law Offices of Curtis V. Trinko, LLP., 540 U.S. 398, ___ (2004).
Supreme Court suggested that, based on *Aspen Skiing*, an exception to the principle of contractual freedom may exist when there is a previous course of dealing and the dominant firm changes the terms of the relationship in a way that disadvantages its rival.\(^\text{16}\) Furthermore, the Supreme Court stated that, if a dominant firm is not subject to a duty to deal under antitrust rules, it is not obliged to guarantee a minimum level of assistance in the provision of service to rivals.\(^\text{17}\) The extension of the same logic to price conditions would have precluded price squeeze claims, but for the exceptional cases in which an antitrust duty to deal existed.

Immediately before and after *Trinko*, the US Courts of Appeals analyzed a series of price squeeze cases in the telecommunications sector. Despite the strong similarities between the fact patterns of different cases,\(^\text{18}\) the Courts of Appeals reached conflicting conclusions as to the admissibility of price squeeze claims in the absence of an antitrust duty to deal.\(^\text{19}\)

The *linkLine* case gave the Supreme Court the opportunity to clarify the law of price squeezes. The facts of the case were similar to those of the other price squeeze cases in the telecommunications sector. Four ISPs brought suit against AT&T, alleging *inter alia* that the incumbent engaged in a price squeeze aimed at monopolizing the DSL market in California, by setting a high wholesale price for DSL transport and a low retail price for DSL Internet service. The Supreme Court analyzed separately the prices of the incumbent at the two levels. With regard to the upstream market, the Supreme Court stated that, under *Trinko*, a vertically integrated monopolist with no antitrust duty to deal in the wholesale market has no obligation to deal under terms and

\(^{16}\) Id., at 410; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608-611 (1985). While *Aspen* was not overruled, the Supreme Court characterized that decision as residing “at or near the outer boundary of § 2 liability”. See *Verizon Communications Inc., Petitioner v. Law Offices of Curtis V. Trinko, LLP.*, 540 U.S. 398, 399 (2004). Recently, in *Christy Sports, LLC v. Deer Valley Resort Co., Ltd.*, 555 F. 3d 1188 (2009), which like *Aspen Skiing* involved alleged monopolization by a ski resort that terminated a prior course of dealing with a rival, the Tenth Circuit’s decision affirming dismissal of the complaint distinguished *Aspen Skiing* on the ground that the defendant had a valid business reason for the termination whereas the defendant in *Aspen Skiing* was willing to forgo short-term profits to achieve an anticompetitive goal.


\(^{18}\) In the cases concerned, the plaintiffs were Internet service providers (ISPs), which sold digital subscriber lines (DSL) service to retail consumers, or competitive local exchange carriers (CLECs), which provided ISPs with DSL lines rented from incumbent local exchange carriers (ILECs). The ILECs were vertically integrated operators, which owned and operated local wireline telephone networks and, at the same time, sold retail DSL services. Competitors in the downstream markets needed access to some of the facilities that were part of the ILEC wireline network. Although cable facilities could also be used to provide high-speed Internet access, the ILECs were, with few exceptions, the only operators providing wholesale access services to the ISPs, as a result of asymmetric regulation. In this scenario, some competitors claimed that the margins between the wholesale and retail tariffs were so low that they could not profitably compete on the downstream markets.

\(^{19}\) See *Covad Communications Company v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004); *linkLine Commc’ns, Inc. v. Cal., Inc.*, 503 F.3d 876, 882-883 (9th Cir. 2007) (price squeeze may infringe Section 2 of the Sherman Act even when a vertically integrated monopolist has no antitrust duty to deal). *Contrariwise, see Covad Communications Company v. Bell Atlantic Corp.*, 398 F.3d 666 (D.C. Cir. 2005), citing P.E. Areeda-H. Hovenkamp, *Antitrust Law*, IIIA, second edition, New York, Aspen Publisher, 2002, 767c5 (“it makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal”). The Court of Appeals for the Fourth Circuit reached similar conclusions in *Cavalier Telephone, LLC v. Verizon Virginia, Inc.*, 330 F.3d 176, 190 (4th Cir. 2003), which predates *Trinko*. 
conditions favorable to its competitors.\textsuperscript{20} With reference to the downstream market, the Supreme Court recalled that, under \textit{Brooke Group}, the price charged by a vertically integrated monopolist for the end product is unlawful only when: (i) the price is below an appropriate cost measure; and (ii) there is a dangerous probability that the defendant will be able to recoup the losses caused by below-cost pricing.

The Supreme Court concluded that “if both the wholesale price and the retail price are independently lawful, there is no basis for imposing antitrust liability simply because a vertically integrated firm’s wholesale price happens to be greater than or equal to its retail prices”.\textsuperscript{21} The plaintiffs’ price squeeze claim was “nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level”. If there is no antitrust duty to deal at the wholesale level and no predatory pricing at the retail level, a vertically integrated firm “is certainly not required to price \textit{both} of these services in a manner that preserves its rivals’ profit margins”.\textsuperscript{22}

3.2. \textit{Price Squeeze Abuses in the EU}

Under EC competition law, a price squeeze strategy implemented by a vertically integrated firm may constitute an abuse of dominant position.\textsuperscript{23} However, for many years, the paucity of precedents and the uncertainties on the legal basis of the prohibition of price squeeze abuses led some commentators to wonder whether the practice constitutes an autonomous antitrust infringement, or simply an aspect of other anticompetitive behaviors, such as excessive prices, cross-subsidies and predatory prices.

In the first price squeeze cases, the Commission suggested that the practice could be a separate infringement of Article 82 EC.\textsuperscript{24} In 1998, the Commission confirmed that price squeeze may constitute an abuse of dominance in the Notice on the application of the competition rules to access agreements in the telecommunications

\textsuperscript{20} The Supreme Court held that there was no meaningful distinction between the “insufficient assistance” claims rejected in \textit{Trinko} and the price squeeze claims in the \textit{linkLine} case. According to the Court, “for antitrust purposes, there is no reason to distinguish between price and nonprice components”. See \textit{Pacific Bell Telephone Co., dba AT&T California, et al. v. linkLine Communications, Inc., et al.}, 555 U.S. ___ (2009).

\textsuperscript{21} \textit{Id.}, __.

\textsuperscript{22} \textit{Id.}, __.

\textsuperscript{23} On the European cases, see D. \textsc{Geradin-R. O'Donoghue}, \textit{The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector}, 1 Journal of Competition Law & Economics 355 (2005).

\textsuperscript{24} The practice was analyzed by the Commission for the first time in \textit{National Carbonising}. In an interim decision, the Commission stated that the supplier of an essential input may have “an obligation to arrange its prices so as to allow a reasonably efficient manufacturer of the derivative a margin sufficient to enable it to survive in the long-term”. See Commission decision of 29 October 1975, \textit{National Coal Board, National Smokeless Fuels Limited and National Carbonising Company Limited}, O.J. L 35/6 (1976).

Some years later, in \textit{British Sugar/Napier Brown}, the Commission affirmed: “[t]he 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 [prices of the two products], 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”. Commission decision of 18 July 1988, Case IV/30.178, \textit{Napier Brown/British Sugar}, O.J. L 284/41 (1988), § 66.
sector.\textsuperscript{25} However, the judgment delivered in 2000 by the CFI in \textit{Industrie des Poudres Sphériques} seemed to cast doubts on the admissibility of a separate price squeeze abuse, as the CFI suggested that the pricing policy of a vertically integrated firm is not unlawful if the upstream price is not abusive and the downstream price is not predatory.\textsuperscript{26}

In the subsequent years, the Community institutions clarified that price squeeze abuses constitute a recognized form of antitrust liability under EC law, in two cases concerning the telecommunications sector. In 2003, in \textit{Deutsche Telekom}, the Commission fined the German incumbent for having implemented a prolonged price squeeze policy, aimed at excluding rivals from the retail markets for broadband and narrowband Internet access services.\textsuperscript{27} The Commission stated that a price squeeze may infringe Article 82 EC when the margin between downstream and upstream prices is negative or, in any case, insufficient to cover the costs borne by the vertically integrated firm to supply its own services in the downstream market.\textsuperscript{28}

In 2007, in \textit{Telefónica}, the Commission fined a similar commercial policy implemented by the Spanish incumbent. The Commission held that, based on previous decision practice and case law, a price squeeze strategy may constitute “a clear-cut abuse”.\textsuperscript{29} The Commission specified that the rationale for the prohibition of price squeezes lies in the “disproportion between an upstream and a downstream price”. As a consequence, “there is no need to demonstrate that either the wholesale price is excessive in itself or that the retail price is predatory in itself”.\textsuperscript{30}

Finally, in April 2008, the \textit{Deutsche Telekom} judgment of the CFI confirmed that price squeeze is a separate infringement of Article 82 EC. The Court explicitly rejected the argument that, if the upstream tariffs are regulated, the unlawfulness of a price squeeze may result only from the predatory nature of downstream tariffs. According to the Court, the anticompetitive nature of the conduct was linked to the “unfairness of the spread” between upstream and downstream prices, regardless of whether those prices were abusive as such.\textsuperscript{31}

Some months later, the Guidance on Article 82 EC explicitly included price squeeze abuses among the priorities of the Commission enforcement. Price squeeze

\textsuperscript{25} Notice on the application of the competition rules to access agreements in the telecommunications sector, O.J. C 265/2 (1998), in particular §§ 117-118.

\textsuperscript{26} See CFI, Case T-5/97 \textit{BPB Industrie des Poudres Sphériques SA v. Commission} [2000] ECR II-3755, §§ 169-186. According to the CFI, “[i]n the absence of abusive prices being charged by [a dominant firm] for the raw material … or of predatory pricing for the derived product …, the fact that the applicant cannot, seemingly because of its higher processing costs, remain competitive in the sale of the derived product cannot justify characterising [the dominant firm’s] pricing policy as abusive”. \textit{Id.}, § 179. However, the CFI held, in addition, that the applicant had not demonstrated a price squeeze capable of excluding an equally efficient competitor from the downstream market. \textit{Id.}, §§ 180-182.


\textsuperscript{28} \textit{Id.}, §§ 102, 107, 140.

\textsuperscript{29} Commission decision of 4 July 2007, Case COMP/38.784, \textit{Wanadoo España/Telefónica}, \textit{___}, §§ 731-736 and 740.

\textsuperscript{30} \textit{Id.}, § 283.

\textsuperscript{31} CFI, Case T-271/03 \textit{Deutsche Telekom AG v. Commission} [2008] ECR II-477, §§ 166-168. However, according to some commentators, the \textit{Deutsche Telekom} judgment could also be read as implying that, when downstream prices are not predatory, a price squeeze would be unlawful only in case of excessive prices in the upstream market. See F.E. GONZÁLEZ DÍAZ-J. PADILLA, \textit{The linkLine Judgment – A European Perspective}, in GCP, APR-09 (1).
strategies were analogized to constructive refusal to deal and subject to principles and criteria consistent with those applicable to other cases of refusal to deal.  

3.3. The Scope for a Price Squeeze Analysis under Antitrust Law: Some Critical Remarks

There is a remarkable divergence between the US and the EU in the assessment of price squeeze cases under antitrust law. The Supreme Court judgment in *linkLine* does not preclude any possibility of intervention in price squeeze cases. Although the Supreme Court held that price squeeze is not a stand-alone antitrust offence, an upstream price that is too high relative to the downstream price could still be considered a constructive refusal to deal infringing Section 2 of the Sherman Act. However, the application of the principles on refusal to deal established by *Trinko* left extremely limited scope for antitrust intervention in price squeeze cases. Conversely, in the EU price squeeze constitutes an established form of antitrust liability and one of the priorities of the enforcement policies of the Commission and national competition authorities.

Some commentators have questioned the admissibility and the utility of a price squeeze theory under antitrust rules. It has been noted that, if upstream and downstream prices are not independently incompatible with competition rules, the fact that a margin squeeze makes it difficult for rivals to compete in a downstream market could not give rise to an antitrust infringement. The insufficiency of downstream margins could only justify a possible intervention of regulatory agencies through procompetitive measures specifically aimed at facilitating the entry and expansion of minor competitors. The prevention of price squeeze strategies would be a regulatory issue, which should be addressed through price regulation in industries characterized by the imposition of a duty to deal. Courts and antitrust authorities should not second-guess the assessment of regulatory agencies. An intervention based on antitrust rules would interfere with regulatory measures in force and could frustrate their effects. Furthermore, the economic and factual complexity of determining whether efficient competitors can earn some level of profit deemed to be sufficient would counsel against the application of antitrust rules in price squeeze cases.

It has also been noted that an antitrust rule based on the idea that a vertically integrated dominant company should guarantee rivals’ profit margins would protect the welfare of competitors instead of that of consumers, on the discredited assumption that

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32 See *COMMISSION, Guidance, supra note __*, § 80.
33 According to some commentators, if an antitrust duty to deal exists, both a price squeeze claim and a *de facto* refusal to deal claim would be viable. However, the distinction would have limited practical importance, as the same set of facts likely would, in many cases, support both claims. See T. BARRETT-S. GASKINS-J. GRAUBERT, *Price Squeeze Claims Succumb to Need for “Clear Rules”*, in *GCP, APR-09* (1).
34 “As a practical matter, *linkLine* represents the end of the price squeeze as an independent antitrust claim”: S. MARTIN, *The linkLine decision: Section 2 Gets Squeezed Further*, in *GCP, APR-09* (1).
35 In the EU, this approach would be consistent with the Community principle of subsidiarity. See F.E. GONZÁLEZ DÍAZ-J. PADILLA, *supra note __*.
37 See J.G. SIDAK, *supra note __*.
38 W.J. BAUMOL ET AL., *supra note __*.
antitrust rules should ensure the presence of a minimum number of independent firms in the market.\(^{39}\)

In addition, antitrust intervention could deter procompetitive and efficient conduct and hinder an effective price competition in the downstream market. The threat of a price squeeze claim could be read as an invitation to abstain from reducing downstream prices and to maintain a price umbrella for minor rivals. Thus, a ban on price squeeze strategies could have perverse effects, since it could favor a flow of sensitive information and could give firms an effective tool to elude the per se ban on collusion and to promote price stability and coordination.\(^{40}\)

A further potential perverse effect of antitrust intervention in price squeeze cases is represented by the incentives to stop supplying the input to other operators or to exit the downstream market. If there is no duty to deal in the upstream market, a ban on price squeeze could led the vertically integrated firm not to supply the input concerned to competitors, in order to avoid the exposure to price squeeze claims. This could harm consumers, especially when one or more downstream competitors would have used the input supplied by the vertically integrated monopolist to commercialize products different from those of the dominant firm. On the other hand, if there is a duty to deal, a ban on price squeeze could induce the vertically integrated monopolist to raise the price of its end product or cease production in the downstream market, in order to avoid any risk of violating antitrust rules. Even in this case, consumers may be harmed, if downstream competitors are less efficient than the vertically integrated firm.\(^{41}\)

The above-mentioned criticisms highlight the necessity to shape an analytical framework for the assessment of price squeeze within limits consistent with the aims and guiding principles of competition law. A price squeeze theory based on the idea that non-integrated rivals should be granted a reasonable or fair profit margin should have no place in competition law. Protection of minor rivals and active promotion of effective competition are objectives that could be pursued by a regulatory authority in the initial phase of the development of a market. For the purposes of antitrust rules, what matters is the risk of exclusion of equally efficient competitors through conduct inconsistent with the paradigm of competition on the merits.

Nonetheless, an analytical framework for the assessment of price squeeze strategies, consistent with the aims and fundamental principles of competition law, can be a useful enforcement tool. As noted above, a price squeeze may arise from internal-external discrimination (discriminatory price squeeze) or downstream predation (predatory price squeeze).\(^{42}\) If the upstream and downstream activities are carried out by separate legal entities, or internal transfer charges are clearly specified and observable, it is possible to distinguish the two hypotheses, which could be analyzed on the basis of general principles on price discrimination and predatory pricing. However,

\(^{39}\) See J.G. SIDAK, supra note __.

\(^{40}\) “[A]ny suggestion by the downstream competitor that the monopolist raise its retail price to eliminate the price squeeze is equivalent to solicitation of price fixing. The vertically integrated monopolist must navigate between the Scylla of monopolization liability and the Charybdis of price-fixing liability”: J.G. SIDAK, supra note __. See also H.J. HOVENKAMP-E.N. HOVENKAMP, supra note __, according to whom a rule entitling minor competitors to a minimum profit margin “would virtually require price fixing ... This fact alone counsels strongly against an expansive price squeeze rule”.

\(^{41}\) See D.W. CARLTON, supra note __.

\(^{42}\) See supra, § __.
if the downstream division of the vertically integrated firm is not a separate legal entity and there are no internal transfer charges, the only observable factual element would be the price squeeze. In this case, a properly defined analytical framework for the assessment of price squeeze allows for detection of potentially anticompetitive conduct of a discriminatory or predatory nature, that is not directly observable due to the vertical integration of the dominant firm and the lack of internal prices or transfer charges. Refraining from intervening in price squeeze cases would give rise to a disparity of treatment between companies operating directly at different stages of the production chain and vertically integrated firms structured in separate legal entities. The application of antitrust rules should be based on the economic impact of the contested practice, rather than formalistic considerations. Moreover, the disparity of treatment between the two cases would distort the incentives of vertically integrated firms in the definition of their internal organization.

Furthermore, to the extent that a refusal to deal by a dominant firm is considered unlawful under antitrust rules, it should be possible to intervene to control price squeezes, in order to prevent an elusion of the duty to supply. A dominant firm could easily circumvent a duty to supply by reducing the margin between upstream and downstream prices to a level that does not allow equally efficient rivals to compete. Even linkLine recognizes the possibility of intervening when the vertically integrated monopolist has an antitrust duty to deal. In the US, the extremely limited scope for antitrust intervention in price squeeze cases reflects the strict limits within which an antitrust duty to deal may exist under Trinko. In the EU, the need for an analytical framework for the assessment of price squeeze is stronger than in the US, as the range of antitrust duties to deal that may be imposed on dominant firms is much broader.

In conclusion, although price squeeze does not represent a separate antitrust infringement, an analytical framework for the assessment of price squeeze cases can be useful, provided that it is intended as a tool to detect anticompetitive conduct of a discriminatory or predatory nature. Any antitrust analytical framework for the assessment of price squeeze should be construed in accordance with basic aims and principles of competition rules. The application of EC competition rules to the most relevant European margin squeeze cases – i.e., the Deutsche Telekom and Telefónica cases – has been largely influenced by regulatory criteria and considerations, which affected the resolution of some critical issues raised by the assessment of the practice. This approach could lead to inconsistencies within the antitrust system. While regulatory agencies may enjoy a certain degree of discretion in the definition of measures aimed at promoting the entry and growth of minor competitors, antitrust intervention in price squeeze cases should be subject to limits and criteria consistent with the other doctrines of antitrust liability.

A discussion of all the facets of the analysis of price squeeze cases under competition rules is beyond the scope of this paper. The following paragraphs focus on two widely debated issues, which are particularly relevant: (i) the application of principles on refusal to deal to price squeeze cases; and (ii) the structure of the cost-based test applied to identify potentially anticompetitive foreclosure.

4. The Need for an Antitrust Duty to Deal

There is a strong link between price squeeze and refusal to deal. As noted above, an analytical framework for the assessment of price squeeze is a necessary complement to an antitrust duty to deal. Intervention in price squeeze cases may be necessary to avoid the elusion of an antitrust duty to deal. At the same time, a ban on price squeeze translates into the imposition of a duty to supply under terms and conditions allowing equally efficient rivals to compete in a downstream market.

In antitrust practice and literature, the question has arisen as to whether a finding of infringement in price squeeze and refusal to deal cases should be subject to the same requirements. If there is no duty to deal under antitrust rules, it could appear illogical to punish a dominant firm for having supplied the input concerned under conditions that did not allow rivals to operate profitably in a downstream market.44

In the US, linkLine clarified that a price squeeze is not incompatible with Section 2 of the Sherman Act if there is no antitrust duty to deal in the upstream market. In the EU, it is not clear whether the input supplied by the vertically integrated firm must be an “essential facility” within the meaning of EC case law, and whether the application of Article 82 EC to price squeeze abuses is subject to the same strict requirements provided for by case law on refusal to deal.45

The issue was not explicitly addressed by the CFI in Deutsche Telekom, although the Court took into account the fact that there was no other infrastructure that would have provided rivals with viable entry into the downstream market.46 The Commission decision practice does not provide conclusive indications as to whether the relevant input must be essential.47 However, in no case did the Commission base its

44 See, inter alia, P.E. AREEDA-H. HOVENKAMP, Antitrust Law, IIIA, second edition, New York: Aspen Publisher (2002), 767c5 (“It makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal”). See also R. O’DONOGHUE-A.J. PADILLA, The Law and Economics of Article 82 EC, Oxford: Hart Publishing (2006), 326-327, according to whom, in the assessment of price squeeze cases, it would be necessary at least to take into account the potential negative effects arising from the imposition of a duty to supply.
46 CFI, Case T-271/03 Deutsche Telekom AG v. Commission [2008] ECR II-477, § 236-237. The question should be answered in a pending Article 234 reference before the Court of Justice: Case C-52/09, Konkurrensverket/TeliaSonera AB (pending). The appeal currently pending before the CFI in the Telefónica case is also expected to address the issue: Case T-336/07, Telefónica and Telefónica de España v. Commission (pending).
47 In British Sugar/Napier Brown, the dominant firm (a producer of beet sugar) held only 58% of the market for granulated sugar and there were alternative supply sources, such as imports from abroad and supplies of can sugar by a competitor holding a 37% market share. See Commission decision of 18 July 1988, Case IV/30.178, Napier Brown/British Sugar, O.J. L 284/41 (1988), §§ 51-54. On the contrary, in National Carbonising, the National Coal Board held an almost monopolistic position in the supply of coal, which represented the main raw materials used in the production of industrial and domestic hard coal. See Commission decision of 29 October 1975, National Coal Board, National Smokeless Fuels Limited and National Carbonising Company Limited, O.J. L 35/6 (1976). In Deutsche Telekom and Telefónica, the Commission held that there were no valid alternatives to the wireline networks of the incumbents for the supply of retail access services, since infrastructures based on other technologies – such as optical fiber, wireless, satellites, electric grid and cable – were not sufficiently developed. See Commission decision of 21 May 2003, Cases COMP/C-1/37.451, 37.578, 37.579, Deutsche Telekom AG, O.J. L 263/9 (2003), § 547 (“ADSL competitors in the retail market could not substitute away from

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decision on the principles and criteria set out by EC case law on refusal to deal. On the contrary, in Telefónica the Commission held that it was not necessary to demonstrate that the conditions set out by Oscar Bronner were met,\(^{48}\) in light of the specific circumstances of the case. Firstly, Spanish regulation compatible with the EC telecommunications framework imposed on the dominant firm an obligation to provide wholesale broadband access, on the basis of a balancing test made by the Spanish authorities between the incentives to invest and innovate and the need to promote downstream competition in the long term. Secondly, it was not necessary to protect the \textit{ex ante} incentives of the incumbent, as its infrastructure was to a large extent the fruit of investments undertaken well before the advent of broadband services in Spain and in a context where the dominant firm was benefiting from special or exclusive rights that shielded it from competition.\(^{49}\) In addition, the Commission noted that, in the previous price squeeze cases, the contested conduct was deemed incompatible with Article 82 EC regardless of the existence of an essential facility under EC case law on refusal to deal.\(^{50}\)

In the Guidance, the Commission seems to have modified its approach. The Guidance assimilates price squeeze to a constructive refusal to deal. According to the Guidance, the intervention of the Commission in price squeeze and refusal to deal cases should be based on the same requirements, which echo those set out by EC case law on access to essential facilities.\(^{51}\) In particular, refusal to deal and price squeeze cases would represent a priority in the Commission enforcement when: (i) the relevant product or service is objectively necessary to be able to compete effectively on a downstream market; (ii) the practice is likely to lead to the elimination of effective competition on the downstream market; and (iii) the practice is likely to lead to consumer harm, because the probable negative consequences of the practice outweigh over time the negative consequences of imposing an obligation to supply.\(^{52}\)

On the other hand, the Guidance alleviates the burden of proof imposed on the Commission by Oscar Bronner, Magill and IMS Health.\(^{53}\) In line with the approach adopted in Telefónica, the Guidance states that the Commission does not have to prove the specific conditions required for the prohibition of refusal to deal when it is clear that the imposition of a duty to supply does not negatively affect the incentives of the dominant firm and other operators. This could be the case, in particular, when: (i) regulation compatible with Community law already imposes an obligation to supply on the dominant undertaking and it is clear, from the considerations underlying such regulation, that the necessary balancing of incentives has already been made by the regulatory authority; or (ii) the upstream market position of the dominant undertaking has been developed under the protection of special or exclusive rights or has been the regional and national wholesale inputs provided by Telefónica by turning to an alternative viable (in terms of price, geographical coverage and capacity) wholesale input”); see also §§ 687-688.


\(^{50}\) See Commission decision of 4 July 2007, Case COMP/38.784, Wanadoo España/Telefónica, ____, §§

\(^{51}\) See, in particular, Case C-7/97 Oscar Bronner [1998] ECR I-7791.

\(^{52}\) See COMMISSION, \textit{Guidance, supra note ____}, § 81.

financed by state resources.\textsuperscript{54} In these cases, the Commission would analyze refusals to deal and price squeeze cases on the basis of general principles applicable to unilateral exclusionary conduct.\textsuperscript{55}

Thus, both in the US and the EU, price squeeze cases have been analogized to constructive refusal to deal. However, the same interpretative choice has led to remarkably different results in the two legal systems. In the US, the application of general principles on refusal to deal to price squeeze cases resulted in a drastic limitation of the scope for antitrust intervention in price squeeze cases. In the EU, competition policy in the field of refusal to deal has traditionally been much more interventionist. In addition, the Guidance seems to have further widened the scope for the imposition of duties to deal on dominant firms.

The extension of general principles on refusal to deal to price squeeze cases seems to be a reasonable policy choice. There are valid reasons to believe that refusal to deal and price squeeze represent two sides of the same coin and should be treated consistently. If a refusal to deal infringes competition rules, antitrust authorities and courts should be able to intervene in the case of price squeeze, in order to prevent elusion of the duty to supply. On the other hand, if a refusal to deal is lawful, it does not make sense to prohibit price squeeze, since the dominant firm could achieve the same result simply by refusing to supply the input to rivals.

Absent an antitrust duty to deal, it is not easy to identify a rationale for prohibiting price squeeze strategies under competition rules. In some cases, a supplier may engage in opportunistic and unfair behavior that may harm minor competitors. The supplier may induce a downstream competitor to invest in a specific technology that is unique to the vertically integrated firm. Then the supplier may increase the price of the input, in order to exclude minor rivals or appropriate their fixed cost investment.\textsuperscript{56} In this case, some kind of intervention may be appropriate. However, it is doubtful that antitrust rules are a suitable tool for punishing such opportunistic behavior. Assuming that the refusal to deal was legal to begin with, price squeeze would not cause any incremental consumer harm.\textsuperscript{57} The opportunistic behavior of the supplier should be analyzed on the basis of other sets of rules, such as those on abuse of economic dependency and unfair competition.

Some basis for liability may exist where a dominant firm discovers that a rival with an established dealing relationship with the defendant is bent on integrating vertically into the monopolized input market, and the dominant firm responds with a price squeeze aimed at denying the rival the resources necessary for the vertical expansion.\textsuperscript{58} In this case, the practice may harm consumers in the long run. However,
absent a duty to deal in the upstream market, the application of competition rules could have perverse effects, as the threat of future antitrust claims could undermine the incentives of the dominant firm to supply the input to competitors in the first place. Furthermore, if capital markets work properly, a rival should be able to raise the funds necessary to implement its vertical integration project, if it is sustainable and profitable.

While the extension of principles on refusal to deal to price squeeze cases seems to be a positive development (assuming that the European Courts will actually endorse the Guidance approach), the expansion of the range of duties to supply that may be imposed on dominant firms is much less convincing. The Guidance seems to go beyond the strict limits identified by the European Court of Justice (ECJ) in Oscar Bronner, Magill and IMS Health. In these cases, the ECJ tried to balance the need to safeguard the incentives to invest and the collective interest in the protection of competition. In order to safeguard the incentives to invest and innovate, the ECJ recognized the possibility of interfering with the contractual freedom of dominant firms only in exceptional circumstances. In the Guidance, the Commission reserves the possibility of departing from the strict requirements set out by EC case law when it is clear that it is not necessary to protect ex ante incentives. Such an approach cannot be easily reconciled with the above-mentioned rulings of the ECJ, which did not intend to allow antitrust authorities and courts to carry out a case-by-case assessment of the trade-off between preservation of incentives to invest and protection of competition.

In any case, the two hypotheses explicitly provided for by the Guidance – i.e., the existence of a regulatory obligation to supply and the achievement of the dominant position under the protection of special or exclusive rights or through state resources – seem to open the way for a remarkable intrusion into the commercial freedom of dominant firms, which could negatively affect their incentives to invest and innovate.

The first hypothesis makes the application of Article 82 EC contingent on the intervention of a regulatory authority, on the assumption that the latter has already carried out the balancing between preservation of incentives and protection of competition. Compared to US antitrust law, the Guidance reflects a different philosophy of the relationship between antitrust and regulation. In the US, Trinko limited the application of antitrust rules in regulated sectors, on the ground that the “slight benefits of antitrust intervention” would likely be outweighed by costs and risks inherent in judicial enforcement of “detailed sharing obligations”.

In Credit Suisse, the Supreme Court stressed also the risk that the concurrent application of antitrust and sector-specific rules would produce “conflicting guidance, requirements, duties, privileges or standards of conduct”. In the EU, antitrust and regulation have traditionally been seen as complementary tools. Regulation does not normally prevent the application of antitrust rules. Furthermore, the Commission and national antitrust

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61 According to established case law, the application of competition rules is possible as long as national rules do not deprive firms of any discretion to avoid the contested conduct. The infringement itself must originate from regulation for a firm to be immune from liability. See, inter alia, CFI, Case T-271/03 Deutsche Telekom AG v. Commission [2008] ECR II-477, §§ 86-87. Furthermore, once a national competition authority has issued a decision finding an infringement of EC competition rules and disapplying the anti-competitive national law, the firms concerned are no longer immune from antitrust law. See ECJ, Case C-198/01 CIF [2003] ECR I-8055, § 55.
authorities have often been willing to use competition rules to support liberalization processes and secure the achievement of procompetitive aims of other sets of rules.  

However, the Guidance seems to go even further, as it implies that regulatory measures can orient the interpretation and application of antitrust rules in regulated sectors. Once a national regulation has imposed on a dominant firm an obligation to supply, the fulfillment of this obligation and the pricing can be examined under competition law, provided that the regulatory authority has carried out the necessary balancing between incentives and competition. This approach may result in significant deviations from competition law principles. The balancing carried out by a regulatory authority does not necessarily coincide with the same assessment made by an administrative or judiciary authority in charge of applying antitrust rules. Regulatory authorities may impose obligations to supply beyond the limits set by competition law. Indeed, they may adopt measures aimed at actively promoting the development of an effective competition, and may take into account factors that go beyond the protection of competition.

In the US, Trinko clarified that a regulatory obligation to supply does not trigger an antitrust duty to deal. The Supreme Court made it clear that antitrust courts should not be entrusted with the enforcement of regulatory duties to deal, as affirmative regulatory duties often go well beyond the generally negative duties imposed under

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62 Actually, one of the main drivers of the Deutsche Telekom and Telefónica decisions seems to be the dissatisfaction of the Commission with the speed of liberalization of the telecommunications sector under national regulations. See P. Palmigiano, Margin Squeeze in the United States and in Europe: Stand Alone Abuse or Refusal to Deal, in GCP, APR-09 (1); R. O’Donoghue, Regulating the Regulated: Deutsche Telekom v. European Commission, in GCP, MAY-08 (1). On the relationship between antitrust and sector-specific regulation, see also, inter alia, A. Pera, supra note __; D. Géradin-R. O’Donoghue, supra note __; S. Genevaz, Margin Squeeze after Deutsche Telekom, in GCP, MAY-08 (1).

63 See F.E. González Díaz-J. Padilla, supra note __.

64 See CFI, Case T-271/03 Deutsche Telekom AG v. Commission [2008] ECR II-477, § 113 (sector-specific regulations “have objectives that differ from those of Community competition policy”), and European Regulators Group, Report on the discussion on the application of margin squeeze tests to bundles, March 2009, available at http://erg.ec.europa.eu/doc/publications/2009/erg_09_07_report_on_the_discussion_of_the_application_of_margin_squeeze_tests_to_bundles.pdf (“[w]hile competition law is intended to prevent margin squeeze as an exclusionary abuse, ex ante regulation seeks the more ambitious goal of promoting competition by facilitating entry”). In addition, sector-specific regulation may oblige dominant firms to grant access at prices different from those that could be set under competition law criteria. A regulatory authority may set high access tariffs in order to stimulate investments and promote a facility-based competition. It could appear contradictory that the Commission relies on the judgment of a regulator that requiring access will not harm investment incentives, but it departs from the decision of the same regulatory authority as to the prices at which access has no harmful effects. See F.E. González Díaz-J. Padilla, supra note __. Obviously, the Commission would inter even only when a dominant firm has sufficient discretion to avoid the infringement by setting its upstream or downstream prices. Nonetheless, the Commission would second-guess the decision of a regulatory authority not to intervene, or to leave a margin of discretion to the firm concerned at the upstream or downstream level. Ultimately, the Commission would remedy the inaction of the regulatory authority or the inadequacy of its intervention.

antitrust rules. The Supreme Court treated the existence of regulation as a reason to scale back on antitrust liability, not to expand it.

The second hypothesis provided for by the Guidance is based on the assumption that there is no need to safeguard investment incentives when a firm has achieved its dominant position under the protection of special or exclusive rights or through state financing. Even this assumption is questionable. Firstly, even firms that benefit from special or exclusive rights or state financing may have fewer incentives to invest and innovate, if they are aware \textit{ex ante} of the \textit{ex post} exposure to antitrust liability for refusal to deal or margin squeeze. Secondly, some investments in the relevant assets may have been realized after the termination of the advantages granted by public authorities. Thirdly, the fact that a firm benefited from special or exclusive rights for a given period does not necessarily imply that it earned a return on any investments it made during that period, especially when it was obliged to provide universal service at a loss.

5. The Structure of the Cost-Based Test

In order to ascertain whether a price squeeze strategy would unlawfully exclude downstream competitors, a number of alternative cost-based tests have been proposed in antitrust practice and literature, namely: (i) whether the downstream divisions of a vertically integrated firm could trade profitably on the basis of the wholesale price charged to rivals for the relevant input (equally efficient competitor test); (ii) whether a hypothetical competitor, which is not as efficient as the dominant firm, but is capable of achieving reasonable efficiency levels, could compete in the downstream market on the basis of the wholesale price charged by the dominant firm (reasonably efficient competitor test); (iii) whether downstream rivals could trade profitably on the basis of the wholesale price charged by the dominant firm (actual competitors test); or (iv) a combination of the above tests.

5.1. Equally or Reasonably Efficient Competitor Test

The Commission has traditionally tried to preserve a certain degree of flexibility in the choice of the cost-based test applicable to price squeeze cases. In the Notice on the application of the competition rules to access agreements in the telecommunications sector, the Commission stated that a finding of abusive price squeeze may be based on both the equally efficient competitor test and the reasonably efficient competitor test.

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66 Id., at 415-416 (distinguishing between the regulatory goal of “eliminate[ing] … monopolies” and the antitrust objective of “prevent[ing] unlawful monopolization”).
67 See A.M. PANNEK, \textit{Are Price Squeezes Anticompetitive?}, in GCP, APR-09 (1).
68 See F.E. GONZÁLEZ DÍAZ-J. PADILLA, \textit{supra} note .
70 Notice on the application of the competition rules to access agreements in the telecommunications sector, \textit{supra} note , §§ 117-118. According to the Notice, “[a] price squeeze could be demonstrated by showing that the dominant company’s own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant
In its decision practice, the Commission has not excluded, in principle, the application of the reasonably efficient competitor test. However, in all cases, the Commission has actually favored the equally efficient competitor test. In *National Carbonising*, the Commission suggested that the price charged by the supplier of an essential input should guarantee the survival of a reasonably efficient downstream competitor, but it actually applied a test based on the costs of the vertically integrated firm. In *British Sugar/Napier Brown*, the Commission explicitly adopted an equally efficient competitor test. Similarly, in *Deutsche Telekom*, the Commission stated that “a margin squeeze occurs if the spread between [the dominant firm’s] retail and wholesale prices is either negative or at least insufficient to cover [the dominant firm’s] own downstream costs”. Finally, in *Telefónica*, the Commission reiterated the view that a finding of abuse may be based on both the equally efficient competitor test and the reasonably efficient competitor test. However, it held that, in the case under investigation, the applicable test was the equally efficient competitor test, without providing additional clarification.

The limited case law of the CFI seems to favor the equally efficient competitor test. In *Industrie des Poudres Sphériques*, the CFI stated that a price squeeze cannot be characterized as abusive if a rival’s inability to compete is due to its higher processing costs. In *Deutsche Telekom*, the CFI explicitly endorsed the equally efficient competitor test adopted by the Commission. In light of the *Akzo* ruling, as well as of the precedents on price squeeze, the Court stated that “the abusive nature of a dominant undertaking’s pricing practices is determined in principle on the basis of its own situation, and therefore on the basis of its own charges and costs, rather than on the basis of the situation of actual or potential competitors.” The CFI also considered that

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71 See Commission decision of 29 October 1975, *National Coal Board, National Smokeless Fuels Limited and National Carbonising Company Limited*, O.J. L 35/6 (1976) (the supplier of an essential input may have “an obligation to arrange its prices so as to allow a reasonably efficient manufacturer of the derivative a margin sufficient to enable it to survive in the long-term”).

72 See Commission decision of 18 July 1988, *Napier Brown/British Sugar*, O.J. L 284/41 (1988), § 65-66 (holding that the contested pricing policy was abusive because the margin between the dominant firm’s upstream and downstream prices was “insufficient to reflect that dominant company’s own costs of transformation”).


75 The Commission noted only that the equally efficient competitor test was more favorable to the dominant firm than the reasonably efficient competitor test, because a competitor that shared the same cost structure as the dominant firm’s own downstream businesses, but that did not enjoy the same economies of scale and scope, inevitably had higher unit network costs. Commission decision of 4 July 2007, Case COMP/38.784, *Wanadoo España/Telefónica*, ____, § 314.


“any other approach could be contrary to the general principle of legal certainty”, as accurate information on the cost structure of competitors is generally not known to the dominant undertaking, which would not be in a position to assess \textit{ex ante} the lawfulness of its own activities.\textsuperscript{79}

Notwithstanding the clear preference of the CFI for the equally efficient competitor concept, the state of the law is still uncertain. In the Discussion Paper and the subsequent Guidance, the Commission stated that, as a general rule, it intends to make reference to the equally efficient competitor benchmark in the assessment of dominant firms’ pricing policies.\textsuperscript{80} However, the Commission reserved the right to depart from the equally efficient competitor test in particular cases. In particular, this could happen when, in the absence of the contested practice, a competitor may benefit from demand-related advantages, such as network and learning effects, which will tend to enhance its efficiency.\textsuperscript{81}

Some commentators have maintained that the \textit{Deutsche Telekom} ruling does not prevent the application of the reasonably efficient competitor test. According to this reading, the CFI approved the choice of the equally efficient competitor test made by the Commission in that specific case, but it did not rule out the possibility of adopting a different test, based on the cost of a reasonably efficient competitor, when this is appropriate in light of market circumstances.\textsuperscript{82} In recently liberalized network industries, new entrants can be at a competitive disadvantage \textit{vis-à-vis} the incumbent, in terms of low market shares, limited availability of infrastructures and lower capacity for realizing scale or scope economies. In these cases, a reasonably efficient competitor test would be necessary to ensure equality of opportunities between the vertically integrated incumbent and minor competitors.\textsuperscript{83}

The reasonably efficient competitor benchmark is often used in regulatory settings,\textsuperscript{84} but its extension to the antitrust field raises a series of delicate issues. Protection of less efficient rivals may represent a coherent policy option for regulatory measures, whose goal is to promote competition by influencing the structural conditions of the markets concerned. The same kind of intervention is much less convincing under antitrust law, which aims at preventing artificial distortions of competition by dominant firms through conduct incompatible with the paradigm of competition on the merits.

The equally efficient competitor test ensures that dominant firms can pass efficiency gains derived from vertical integration on to consumers. In some cases, the application of antitrust rules to protect not yet equally efficient competitors may benefit consumers, but it may also produce serious collateral effects. An antitrust intervention aimed at preventing the exclusion of potential equally efficient competitors would at

\textsuperscript{79} Id., § 192.
\textsuperscript{80} See \textit{COMMISSION, Guidance, supra note __}, § 23.
\textsuperscript{81} Id., § 24. With regard to price squeeze cases, the Guidance specifies that the Commission will generally rely on the cost of the downstream division of the dominant undertaking to determine the cost of an equally efficient competitor benchmark. However, it adds that the costs of a non-integrated competitor might be used as the benchmark, for example when it is not possible to clearly allocate the dominant undertaking’s costs to downstream and upstream operations. Id., § 80.
\textsuperscript{82} See S. CLERCKX-L. DE MUYTER, \textit{Price Squeeze Abuse in the EU Telecommunications Sector: A Reasonably or Equally Efficient Test?}, in GCP, APR-09 (1); B. AMORY-A. VERHEYDEN, Comments on the CFI’s Recent Ruling in Deutsche Telekom v. European Commission, in GCP, MAY-08 (1).
\textsuperscript{83} See S. CLERCKX-L. DE MUYTER, supra note __; B. AMORY-A. VERHEYDEN, supra note __.
\textsuperscript{84} See, for instance, \textit{EUROPEAN REGULATORS GROUP, supra note __}. 
the same time protect inefficient companies and discourage competitive initiatives, thus favoring high price levels, collusive equilibria and productive efficiency losses. The potential consumer benefits may not be worth the risks. Furthermore, if capital markets work properly, a potential equally efficient competitor should be able, in theory, to procure resources necessary to finance a start-up period of below-cost sales. The need to protect newcomers and minor competitors may be more intense and durable in recently liberalized markets. However, in these markets the issue could be resolved more effectively through ad hoc regulatory measures, thus avoiding the creation of precedents that might influence the application of competition rules in other sectors.

In addition, it may be extremely difficult, if not arbitrary, to determine the cost level of a reasonably efficient entrant. Reference to actual competitors’ cost level would not be adequate, as it could protect inefficient firms. It would also be unclear how to determine which rival should be used as the benchmark. In any case, the dominant company may not be aware of rivals’ costs. Legal certainty could be seriously harmed, as dominant firms may not be able to assess ex ante the lawfulness of their own commercial policy.85 Furthermore, the application of the reasonably efficient competitor test would likely induce dominant firms to try to collect information on rivals’ costs and revenues, thus favoring information flows that could be incompatible with antitrust rules.

5.2. The Application of the Equally Efficient Competitor Test in the Case of Different Costs or Differentiated Products

It has been noted that, in certain instances, a test based only on the dominant firm’s costs and prices may result in wrongly imputing a price squeeze. The fact that the margin is lower than the production costs of the dominant firm’s downstream division does not necessarily imply that the practice is exclusionary. Rivals may be more efficient than the dominant firm and, possibly, may have a different cost structure.86 In these cases, a test based on the cost of the dominant firm could offer a misleading picture of the impact of the practice on rivals’ competitive capacity and profitability. According to some commentators, it would be necessary to verify not only whether a hypothetical equally efficient rival would be able to compete, but also whether the margin is actually lower than downstream rivals’ costs.87 In other words, a price squeeze should be considered abusive only when it fails both the equally efficient competitor test and the actual competitors test.

Furthermore, in case of differentiated products, downstream competitors’ margins may be significantly higher than the margins of the dominant firm. As a consequence, rivals could be able to make an adequate profit, even though the

86 The equally efficient competitor test relies on a simple, linear vertical chain of production, within which the relevant input represents a high fixed proportion of total costs. In some markets, competitors may use a range of different intermediate inputs in combination, whereas technical, regulatory or legacy constraints may prevent the dominant firm from using some or all of the same inputs. Id., 331.
contested policy fails the equally efficient competitor test. In this case, in order to ascertain whether a pricing policy can actually exclude the supplier of a differentiated product, it may be necessary to look also at its margins.

However, the application of a cost-based test based on the situation of actual competitors may lead to unsatisfactory results. Suppose that the margin between upstream and downstream prices is lower than the incremental costs of production of the dominant firm’s downstream division, but it is higher than rivals’ costs. Competitors’ lower costs do not necessarily reflect a higher efficiency level. They may simply reflect an inferior quality level of rivals’ products, specifically conceived to satisfy the needs of more price-sensitive consumers. A dominant firm could exclude competitors or limit their growth by offering high quality products at a price that does not cover its own costs of production at the downstream level, but is higher than the costs borne by rivals to produce lower quality products. In this case, the commercial policy of the dominant firm would pass a test based on actual competitors’ costs, but it would have effects similar to those of the sale of homogeneous products at a price lower than competitors’ costs. In both cases, the dominant firm would offer a price-quality combination that could not be matched by equally efficient competitors. The equally efficient competitor test allows for the neutralization of the impact of product differentiation.

Suppose instead that rivals are more efficient than the dominant firm or commercialize differentiated products that allow them to earn higher margins. The application of a test based on the situation of actual competitors would allow the dominant firm to adjust its upstream and downstream prices so as to appropriate systematically the possible cost savings realized by rivals, as well as the value created by competitors through the commercialization of higher quality products. This would reduce the incentives of the vertically integrated monopolist and its rivals to invest and innovate to reduce their costs and improve their products.

Finally, in most cases, rivals’ costs and margins are not exactly known to dominant firms. A test based on the situation of actual competitors would give rise to legal certainty issues similar to those raised by the reasonably efficient competitor test.

In conclusion, it seems preferable to postpone consideration of the situation of actual competitors. The costs of the dominant firm’s downstream division represent the most reliable benchmark for the application of a cost-based test establishing a presumption of legality at a first stage of analysis. Nonetheless, competition authorities and courts should take into account factors such as product differentiation and differences in cost structures in the subsequent phase of the comprehensive assessment of the competitive impact of the practice. In some instances, a price squeeze policy may not be able to produce significant exclusionary effects if rivals’ margins are higher or their costs are lower than those of the dominant firm.

89 H.J. HOVENKAMP-E.N. HOVENKAMP, supra note __, notice that the appropriation of a rival’s efficiency gains would not necessarily prevent prices from falling. By appropriating the smaller firm’s efficiency gains the integrated firm will very likely be prompted to lower its own retail prices. Eventually, prices may fall by the same amount. However, the authors recognize that consumer injury may result from the reduced incentive that smaller firms have to create efficiencies whose value will immediately be appropriated by the dominant firm.
90 See supra, § __.
5.3. The Application of the Equally Efficient Competitor Test when the Supply of an Input to Competitors Entails Additional Costs

As noted above, in some instances, a price squeeze may be neither discriminatory nor predatory. A squeeze of competitors’ margins may result from the fact that supplying an input to rivals entails additional costs. For instance, a dominant firm may incur additional costs to interconnect its own infrastructures to a rival’s network or to make its input compatible with the technology and production process of another operator. If the cost of supplying an input to rivals is higher than the cost of providing the same input to an internal downstream division, price squeeze may simply be the result of the diseconomies of vertical disintegration.  

The standard version of the equally efficient competitor test asks whether the margin between upstream and downstream prices covers the incremental costs of a hypothetical equally efficient competitor in the downstream market. This test is expressed by the following formula:

$$p - a \geq c_d$$  \[1\]

where $p$ is the price of the end product, $a$ is the access price and $c_d$ is the cost of the downstream operations of the vertically integrated firm (without the cost of procuring the input).

If the additional costs of supplying the input to rivals are not negligible, the dominant firm may have to set an external price higher than the internal price or transfer charge. In turn, this could give rise to a squeeze of competitors’ margins. In this case, the application of the standard version of the equally efficient competitor test could lead to the prohibition of a price squeeze that would be neither discriminatory nor predatory, as it would simply reflect the cost savings arising from vertical integration. In order to allow the dominant firm to pass these cost savings on to consumers, it is necessary to modify the cost-based test by deducting the additional costs borne to supply the input to rivals from the overall costs that should be covered by the margin between upstream and downstream prices.

The modified test is expressed by the following formula:

$$p - a \geq c_d - c_i$$  \[2\]

where $c_i$ is the additional cost borne by the vertically integrated monopolist to supply the input to rivals.

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91 See supra, § __.
92 See M. POLO, supra note __; P. CROCIONI-C. VELIANOVSKI, supra note __.
93 A similar approach was adopted by the Italian Competition Authority (ICA) in the Telecom Italia case. The ICA analyzed the replicability of a tender offer submitted by the Italian telecommunications incumbent in a procurement for the provision of telecom services to the Italian Public Administration. In order to ascertain whether the incumbent had implemented an abusive price squeeze strategy, the ICA applied a cost-based test that took into account the diseconomies from vertical disintegration. These diseconomies consisted of the cost of a second interconnection kit needed when the lower portion of the incumbent’s network was interconnected to the backbone network of a competitor. The same interconnection kit was not needed in the case of an integrated architecture. See Decision of the Italian
Compared to the basic version of the equally efficient competitor test, the modified version imposes on competitors additional efficiency constraints. Rivals can enter or stay in a market only if: (i) they are more efficient than the dominant firm; and (ii) their higher efficiency level is sufficient to compensate the additional costs borne by the dominant firm to supply the input to rivals. As a consequence, downstream rivals can be excluded even though they are as efficient as the dominant firm.

The modified cost-based test is based on the assumption that entry in a downstream market should be encouraged only when the end-to-end costs of a vertically disintegrated competitor are not larger than the costs of providing the product in an integrated architecture. 94 If the cost-based test did not take into account the additional costs borne to supply the input to rivals, the dominant firm would have to behave as though it were less efficient. Its final prices would have to cover costs that the dominant firm does not actually incur, to the detriment of consumers. In some cases, it might be appropriate to ensure higher margins for alternative operators in order to promote the development of effective competition, but such an assessment should be referred to regulators rather than antitrust authorities and courts.

6. The Role of Efficiencies in the Assessment of Price Squeeze Abuses under EC Competition Law: Waiting for Godot

Given the increasing focus of European institutions on the prevention of price squeeze strategies, a clear framework for the analysis of efficiencies would be crucial to limit the risk of deterring procompetitive and efficient conduct. Unfortunately, under EC competition law, the role of efficiencies in the assessment of price squeeze strategies and, in general, abuse of dominance is extremely limited. In Telefónica, the Commission analyzed the possible objective justifications and efficiency gains related to the contested conduct, but eventually it dismissed all the defenses. 95 The Guidance states that the Commission intends to take into account possible efficiency gains related to price squeeze strategies. However, the Guidance does not seem to have strengthened the role of efficiencies in the assessment of price squeeze strategies, as the standard of proof on dominant firms is extremely high. Furthermore, the limited indications provided by the Guidance are unclear and contradictory.

According to the Guidance, the Commission will consider claims that a refusal to supply or a margin squeeze is necessary to allow the dominant undertaking to realize an adequate return on its investments and to safeguard its incentives to invest and innovate. 96 However, the evaluation standard applicable to refusals to deal and price squeeze cases is already based on a balancing between preservation of incentives and protection of competition. A finding of abuse would be justified only when the likely negative consequences of the practice outweigh over time the negative consequences of

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94 See M. POLO, supra note __; P. CROCIONI-C. VELJANOVSKI, supra note __. This approach resembles the logic of the efficient component pricing rule proposed by some commentators to price access. See W. BAUMOL-G. SIDAK, The Pricing of Inputs Sold to Competitors, 11 Yale Journal of Regulation 171 (1994).


96 See COMMISSION, Guidance, supra note __, § 89.
imposing an obligation to supply. As a consequence, it seems unlikely that similar considerations will lead to a different conclusion in the subsequent phase of the assessment of possible justifications.

Furthermore, according to the Guidance, to invoke an efficiency defense, dominant firms would have to demonstrate the fulfillment of strict conditions, which basically resemble those required for benefiting from an exemption under Article 81.3 EC. In particular, dominant firms have to prove that the contested conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition. In addition, dominant firms have to demonstrate that the likely efficiencies brought about by the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets. In Telefónica, the Commission underlined that the incentive of the dominant firm to pass cost efficiencies on to consumers is related to the existence of competitive pressure from the remaining firms in the market and from potential entry.

It follows that, according to the Commission Guidance and decision practice, the protection of the competitive process is a fundamental value, which prevents the application of the efficiency defense in case of risk of elimination of effective competition. At the same time, the Guidance states that the elimination of effective competition on a downstream market is one of the specific requirements for a finding of infringement in refusal to deal and price squeeze cases. As a consequence, there seems to be extremely limited scope for efficiency defenses in refusal to supply and margin squeeze cases. In principle, if the specific requirements for a finding of infringement are satisfied, there is no valid efficiency defense.

It could be argued that the availability of the efficiency defense would, in fact, be limited to cases in which the Commission considers that it is not necessary to prove the specific circumstances referred to in paragraph 81 of the Guidance. According to the Guidance, this would be the case, in particular, when a regulation compatible with Community law already imposes an obligation to supply on the dominant firm on the basis of a balancing of incentives made by a regulatory authority, or the upstream dominant position has been developed under the protection of special or exclusive rights or has been financed by state resources. However, in Telefónica the Commission held that, in these cases, a price squeeze strategy cannot be considered necessary to protect innovation and investments, as there would not be a real need to safeguard the ex ante incentives of the dominant firm.

97 Id., § 86.
98 Id., §§ 30, 89-90.
99 Id., § 30.
101 "Ultimately, the protection of rivalry and the competitive process is given priority over possible short-term efficiency gains". Id., § 657.
102 See COMMISSION, Guidance, supra note __, § 81.
103 Id., § 82.
104 Id., § 82.
In addition, the Guidance suggests that the application of the efficiency defense is more unlikely when the dominant firm has previously supplied the input in question,\textsuperscript{106} as normally happens in margin squeeze cases.

In conclusion, under EC competition law, proving the existence of the conditions required for the application of the efficiency defense seems to be almost impossible. The inconsistencies arising from the approach adopted by the Guidance reflect the fact that the conditions set out by Article 81.3 EC cannot be easily extended to abuse cases. Under the general approach to exclusionary conduct set out by the Guidance, a finding of “anticompetitive foreclosure” requires not only exclusionary effects, but also likely consumer harm.\textsuperscript{107} According to the Guidance, there should be no abuse if a practice produces efficiencies such that on balance consumer welfare improves. The distinction between the finding of anticompetitive foreclosure, within the meaning of the Guidance, and the subsequent assessment of possible efficiencies is artificial. A case could be made that the consideration of counterbalancing efficiencies should be part of the overall assessment of abuse, rather than postponed to the last stage of the analysis, as a defense subject to strict requirements.

7. Conclusion

Several other facets and implications of the price squeeze story would deserve attention. But it is time to conclude an already long paper.

Its main teaching is that there is no room for an autonomous abuse of price squeezing. According to the conventional view of the problem, a virtual Big Brother, \textit{i.e.} a vertically integrated firm, controlling an input that a downstream operator needs to deploy in its production, may manipulate the prices emerging in the involved markets with the precise goal of suffocating the rival. The perspective is made particularly suggestive by the connection established between two distinct, though related markets. But the assumed complexity is only apparent. In fact, the integrated firm may squeeze its downstream competitor by imposing a discriminatory wholesale price, which practically destroys any opportunity for the rival in the final market; or it may engage in downstream predatory pricing, possibly supporting this strategy by fixing an exorbitant price in the upper market. This being the overall picture, the margin compression is dealt with by the traditional doctrines; invoking a new one would be simply redundant. From a conceptual point of view, this should be the end of the query. The question whether a combination of a lawful wholesale price and a non-predatory retail price can be characterized as exclusionary conduct based on the analysis of the margin between the two prices is to be given a negative answer. As a corollary, one should consider that the tightness of the vertical integration, which may by-pass internal transfer charges and the like (despite their indisputable relevance), is irrelevant, since such an undisclosed price implicitly exists, at least in a theoretical vein, and enables the standard analysis.

The praxis, however, is mostly plagued with an intractable problem. Whenever the internal transfer charges within the divisions of an integrated firm are not observable, the above clear-cut approach collapses, since it is no longer possible to detect discriminatory pricing and downstream predation. The only available data are

\textsuperscript{106} See COMMISSION, \textit{Guidance, supra} note \textsuperscript{__}, § 90.

\textsuperscript{107} \textit{Id.}, § 19.
the external price of the input and the price of the end product. And this is why we need (no separate theory of antitrust liability, but) an analytical approach, that is an operational tool, aiming to approximate the outcome of a full-fledged scrutiny.

Instead of mimicking regulatory tools and criteria, the analytical framework for the assessment of price squeeze cases should be construed in accordance with basic principles of competition law and traditional doctrines of antitrust liability. This strongly supports the application of principles on refusal to deal to price squeeze cases and the use of the equally efficient competitor test to ascertain whether a given pricing policy is anticompetitive.