International Competition Network

UNILATERAL CONDUCT WORKING GROUP
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Case Study - Margin Squeeze

The Market Players

1. AlphaTelecoms is the incumbent provider of electronic communications services in Highlands, a country of 65 million inhabitants. Until 2004 it enjoyed exclusive rights (due to a government-sanctioned monopoly) in the provision of electronic communications services, which were liberalised on 1.1.2005. It is still the only owner of a nationwide fixed electronic communications network in Highlands and there are no regional networks in Highlands. AlphaTelecoms had a retail market share of 90% in the provision of fixed voice call services, which has been steadily falling after a successful liberalisation to 50%.

2. AlphaTelecoms has also invested in up-grading its network so that the latter enables the provision of broadband services (based on xDSL), and has a market share of 67% in the national market for the provision of retail broadband services. AlphaTelecoms applies the same retail broadband tariffs in the whole territory of Highlands.

3. Its main competitors in the national market for the provision of retail broadband services are:

1) e-Entrant and Innovator whose market shares have been increasing to reach respectively 12% and 6%. The retail broadband services offered by these firms are based on access to AlphaTelecoms' network.

2) a handful of cable operators operating their own network in certain cities of the country and whose aggregated market share (that is, for the whole country) has been steadily around 15%. The cable operators' prices have been aligned or slightly above those applied by AlphaTelecoms.

Below are the national market shares for all broadband operators:

Retail broadband market share				
	2007	2008	2009	2010
Alpha	71%	69%	68%	67%
E-entrant	10%	11%	11%	12%
Innovator	4%	5%	6%	6%
Cable*	15%	15%	15%	15%

* Aggregated market share for 7 local cable operators.

Regulation

4. Since 1.1.2005, TelReg, has overseen the transition of the electronic communications sector of Highlands from a monopoly to a liberalised market. It has imposed a series of obligations on AlphaTelecoms (access, interconnection, non-discrimination …),

5. TelReg imposed on AlphaTelecoms **an obligation valid from 1 January 2009 onwards to provide unbundled access** to the local loop so that its competitors could develop their own broadband services, differentiated from those offered by AlphaTelecoms. TelReg set a cap on the price of this wholesale access product, based on estimations provided by AlphaTelecoms as to the evolution of the broadband market in the coming years and the resulting costs of service provision.

6. **From 2007 until the end of 2008 AlphaTelecoms had already been providing unbundled access to the local loop <u>on a voluntary basis (i.e. without TelReg having imposed an obligation to do so)</u>. However, there was only limited demand for this product**.

7. No access obligation has been imposed on the cable operators and the cable operators do not provide access to their infrastructure on a voluntary basis.

<u>The Complaint</u>

8. On 1.1.2010 the competition authority of Highlands, Highcomp, received a complaint from e-Entrant, claiming that AlphaTelecoms had abused its dominant position by engaging, from 2007 until today, in a margin squeeze, thus inflicting continuous losses on its competitors.

<u>Investigation</u>

9. Following an inspection of the premises of AlphaTelecoms, Highcomp ascertained that from 2007 until the end of 2008 the spread between the wholesale and retail prices of AlphaTelecoms' broadband offerings was negative and that in the period from 2009 until today that spread was insufficient to cover the product-specific costs of AlphaTelecoms for providing its own retail broadband services (i.e., AlphaTelecoms could not itself profitably sell the retail product at the price offered during the period).

10. It also found that the product specific costs for the provision of broadband services at the retail market of e-Entrant and Innovator were 20% higher than those of AlphaTelecoms, mainly due to differences in economies of scale and scope as well as higher customer acquisition cost.

11. In the inspection, an e-mail was found in which the key account manager for wholesale products of AlphaTelecoms stated that the regulated wholesale rate was too high due to a flawed cost accounting methodology applied by TelReg. The author suggested to keep AlphaTelecom's wholesale price at the previous lower level. In a later e-mail the CEO of AlphaTelecom was informed that the director's committee had decided to use the upper price cap set by TelReg.

12. Finally, Highcomp found that two consecutive promotional offers by e-Entrant and Innovator and the cable operators before Christmas 2008 and 2009 did not have any noticeable impact on AlphaTelecom's retail market share or price setting policy even though its retail prices are normally aligned to those of its competitors.

Arguments put forward by AlphaTelecoms as to the results of the investigation

13. As Highcomp engaged in discussions with AlphaTelecoms on its prices, AlphaTelecoms claimed that it cannot be held liable for an abuse because until the end of 2008 it had no duty to provide unbundled access to the local loop. It also claimed that from 2009 on it had provided access to this product under a regulatory obligation to supply, but not under an antitrust obligation to supply, and in any event it had set its wholesale price for access to the local loop in compliance with the price regulation put in place by TelReg.

14. AlphaTelecoms refuted the existence of an abusive margin squeeze on two main grounds: firstly, it disagreed with the way Highcomp had allocated to broadband services costs that are common to the provision of various electronic communications services. Secondly, it argued that it is normal for its downstream division to have incurred losses because broadband is a new market in which investments will only yield profits after a certain time.

15. AlphaTelecoms argued that the identified margin squeeze had produced no effect on the market since it has been losing market share to e-Entrant and Innovator, and because the cable operators do not need access to its unbundled loops to provide retail broadband services. AlphaTelecoms also argued that retail prices for broadband access had actually decreased during the period of alleged abuse.

Justification and efficiency defences put forward by AlphaTelecoms

16. Finally, AlphaTelelecoms argued that even if Highcomp had established a margin squeeze (quid non), in any event (i) it was legally allowed to charge the wholesale price set by TelReg, (ii) was forced to align its retail prices on those used by its downstream competitors ("meeting competition defence "), and (iii) that its retail pricing conduct contributed to its competitors having to enhance their efficiency to the benefit of consumers