‘Margin squeezes’ and the regulation of dominant companies

BY THOMAS HEIDE
senior associate, Berwin Leighton Paisner LLP


Dominant companies, and anyone trading with such companies, can take the following important points away from the CFI’s judgment:

- squeezing your competitors’ margins can amount to a separate and independent abuse under competition law; and
- complying with sector-specific regulations will not in itself guarantee immunity from competition law.

‘MARGIN SQUEEZES’ AND DEUTSCHE TELEKOM

A vertically integrated company (such as a major telecoms company) which competes in a downstream market (like broadband retailing) may also provide a key input to its competitors in that market (eg access to a market or a wholesale broadband, or a licence of a patent-protected pharmaceutical ingredient). A ‘margin squeeze’ results where the company prices the key input in such a way that the competitors it supplies cannot make a sufficient profit margin.

In 2003, the Commission issued its decision objecting to Deutsche Telekom’s pricing practices. It found that Deutsche Telekom held a dominant market position on the markets for direct access to its fixed telephone network, both on the wholesale local loop access market and the retail access market. According to the Commission, Deutsche Telekom had approximately a 95% market share and still held this strong position ‘even after five years of competition’. It abused its dominant position by charging new entrants higher fees for access to the wholesale local loop than it charged its own subscribers for their connections at the retail level. Deutsche Telekom was fined €12.6m as a result, but the Commission accepted:

‘... mitigating circumstances due to the fact that under the German sector-specific regulation there was some degree of legal uncertainty about the tariffs under scrutiny’.

In particular, Deutsche Telekom was required to comply with price-caps both at the wholesale and retail level. Its pricing tariffs had also been approved by the German telecoms regulator.

PROVING MARGIN SQUEEZING AS AN INDEPENDENT ABUSE

Pricing abuses under competition law have primarily focused on whether a price is in itself excessive or predatory (ie, a company engaging in below cost pricing). The CFI’s judgment confirms that margin squeezing can amount to a separate and independent abuse under competition law. In other words, it is not necessary to look to whether a price is abusive in itself in order to prove an abusive margin squeeze.

The CFI also confirmed that it will be necessary to look at a dominant company’s charges and costs, rather than those of its actual or potential competitors, in order to establish the abusive nature of a dominant company’s pricing practices. In the margin-squeeze context, abusive conduct will exist where the spread between the wholesale and retail prices is insufficient, to the extent that it would prevent an ‘equally efficient competitor’ from covering the product-specific costs of supplying its similar retail service.

NO IMMUNITY FROM COMPETITION LAW

Deutsche Telekom argued that because it had complied with German telecoms legislation, the competition rules preventing dominant companies from abusing their market position should not apply to its conduct. In this respect, it relied on the fact that its pricing tariffs had been approved by the German telecoms regulator.

The CFI dismissed this argument in its entirety and underscored the point that sector-specific regulation and approval by a national regulator does not provide an exemption from competition law in the EU. This is the polar opposite to the situation in US, where sector-specific regulation will prevent the antitrust rules from applying (see VERIZON COMMUNICATIONS INC v LAW OFFICES OF CURTIS V TRINKO LLP [2004]).

IMPLICATIONS FOR DOMINANT AND NON-DOMINANT COMPANIES

The judgment underscores the need for continuing vigilance by any vertically integrated dominant company when determining its pricing on the different markets on which it is active. The judgment also reinforces the point that any non-dominant company should regularly assess the competitive landscape in which it does business in order to decide whether the conduct of a dominant company affects its ability to compete.

WHAT WILL HAPPEN NEXT?

It seems likely that, irrespective of whether Deutsche Telekom decides to appeal, the CFI’s judgment is
bound to have a significant impact in the short term. There is a pending appeal concerning a margin squeeze arising from the Commission fining Telefónica €152m in 2007 for charging rivals excessively high rates for wholesale access to its broadband network (Telefónica and Telefónica de España v Commission [2007]).

By Thomas Heide, senior associate, Berwin Leighton Paisner LLP.

---

**OFT accuses 112 construction companies of cover pricing**

ON 17 APRIL 2008, THE OFFICE OF FAIR TRADING (OFT) published a press release confirming that it had issued a Statement of Objections (SO) against 112 construction companies. The contracts involved in the investigation include projects for schools, hospitals and other public- and private-sector buildings, the majority of which are located in the Midlands, Yorkshire and Humberside. This is the OFT’s largest ever Competition Act investigation. Construction has been one of the OFT’s priority areas for several years.

The OFT alleges that the companies breached Chapter I of the Competition Act 1998 by engaging in bid-rigging and cover pricing. Cover pricing is described by the OFT as:

‘... a situation where one or more bidders collude with a competitor during a tender process to obtain a price or prices which are intended to be too high to win the contract’.

The OFT also alleges that in some cases (involving nine of the companies, according to press reports) compensation was paid to unsuccessful tenderers.

The OFT claims it found evidence that cover pricing was a ‘widespread and endemic practice in the construction industry as a whole’. Although the OFT claims to have received evidence of cover pricing implicating many more companies on thousands of tenders, it has not pursued every firm against which it received allegations. Due to limited resources, the OFT focused its investigation on about 240 alleged infringements, which it set out in the SO.

Some construction companies have claimed that cover pricing was only done to save face with customers, or to stay on their shortlists. Yet it is clear from OFT decisions and case law that cover pricing infringes UK competition law (see, for example, Apex Asphalt and Paving Co Ltd v Office of Fair Trading [2005]).

The accused construction companies can now respond to the OFT’s findings. The OFT’s final decision on whether they have infringed competition law is expected next year.

---

**OFT leniency policy**

In order to encourage businesses to come forward with information about cartels, the most serious infringements of competition law, the OFT operates a ‘leniency policy’. The policy enables businesses that co-operate with the OFT to benefit from immunity from, or a significant reduction in, the fine the OFT may impose for the infringement. In this investigation, 37 of the 112 construction companies accused applied for leniency.

In March 2007, the OFT announced that it would not accept any more leniency applications in relation to this investigation, but would offer a reduction in fines to companies implicated who had not yet applied for leniency, but were prepared to admit to infringing the law. Forty companies accepted that offer, despite not knowing the detailed case against them or the level of the ultimate fine. Some may withdraw their acceptance now they have received the SO.

**Penalties**

Firms found to have infringed competition law could be fined up to 10% of their annual turnover. It is difficult to predict the level of fines in this case, but given the scale and length of the OFT investigation, the OFT is likely to want headline-grabbing figures – perhaps over £100m in total.

**Information note to local authorities and other procuring entities**

The OFT has also published an information note to local authorities and other procuring entities on the implications of the SO. The OFT emphasises that it is for individual procurers to consider what action, if any, they should take in their own particular circumstances, having taken appropriate legal advice as required.

The OFT also refers to a guidance note that it has published, with the Office of Government Commerce, on public-sector construction procurement. This includes guidance on how to mitigate the risk of anti-competitive behaviour.

**Possible damages actions**

Those who suffer loss as a result of competition law infringements can bring claims for damages against