# Judgment of the European Court of First Instance in T-271/03 Deutsche *Telekom v. Commission*

## 1. The Commission Decision 2003

In 2003 the European Commission adopted a decision in which it fined Deutsche Telekom ('DT') 12.6 million for ab using its dominant position in the German telecommunications market over a period of more than 5 years.

More specifically, DT was found dominant both in the market of wholesale access to the fixed telecommunications network (local loops), which allowed competitors of DT to further provide their end customers with various access services[1], and in the market of retail access to the local loops, with a market share of 95%. DT abused its dominance in the market for direct access to its fixed network by charging unfair prices to competitors in the form of a margin squeeze; i.e. the charges paid by competitors for wholesale access (which are regulated by the Regulatory Authority in Germany – Reg TP) were higher than the charges paid by DT end customers on a retail level for fixed line subscriptions. This resulted in reduced price competition[2], which further deprived consumers of the benefit of choice.

The Commission adopted the following method to find the margin squeeze: It is sufficient to show a disproportion between the wholesale and retail prices charged, together with a commercial discretion to reduce or end the margin squeeze on the part of the dominant undertaking, in order to find a restriction of competition (paragraph 105).

As regards this test, the Commission stated that an abusive margin squeeze exists if the difference between the retail prices charged by a dominant operator and the wholesale prices it charges to competitors is negative or insufficient to cover the product-specific costs incurred by the dominant operator in providing its own retail services in the downstream market (paragraph 107). Furthermore, given that Reg TP applies single charges for wholesale services, yet the downstream services provided vary in nature (analogue, ISDN and ADSL lines), the retail price against which the comparison is made should be the average retail access prices for all three services.

The Commission, indeed, found that for the period 1998 – 2001 there was a negative spread between the wholesale and retail prices charged by DT, which DT was in a position to end entirely by increasing its retail charges for narrowband connections since there was scope within the sector-specific regulation measures.[3]

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[1]The retail access services include narrowband services (analogue and digital (ISDN) connections) and broadband services (ADSL connection).

[2]If access on a wholesale level is costlier than retail access, competitors are necessarily faced with the option of either exiting the market or incurring losses.

[3]Although call services and access services are distinct, and the former were not taken into account when calculating the margin squeeze, they were cumulatively subject to the same price ceiling until 2002; this meant that by reducing call charges, there was scope for increasing access charges. The Commission depicted that DT lowered its call charges substantially, without redirecting the amount released from such reductions towards an increase of retail access charges.

Moreover, for the period 2002 until the adoption of the decision, the spread was positive but insufficient to cover DT's product-specific costs linked to the provision of retail services and DT could have reduced the margin squeeze by increasing the ADSL retail access charges, as it is a retail service exempt from regulation and there was no scope during that period for increasing retail narrowband prices.[4]

The Commission noted in its decision that, in respect of the effects on the market, none of DT's competitors had acquired a significant market share throughout the duration of the infringement. As regards the alternative technical infrastructure available to competitors in order to offer their customers access services on a retail level (among others, satellites, power lines and upgraded cable TV networks), they was not sufficiently developed during the period of the infringement and thus, not equivalent to the DT network and the latter was impossible to replicate.

## 2. The Court of First Instance (CFI) judgment

DT challenged the Commission decision before the CFI advancing four pleas in law; only the first, comprising of four parts, will be explored below as it refers to the infringement of the Article 82 EC.

### (A) DT claimed that there was no abuse of dominance, since there was no sufficient scope to avoid the margin squeeze

DT's main arguments were, firstly, that the retail prices were charged following examination and authorisation by RegTP, which in itself means that the conduct is not abusive (paragraph. 76) and, in any case, RegTP has the responsibility to take into account competition law considerations (allegedly proved by relevant regulatory and court decisions) - thus, RegTP should have rejected the application concerning retail access charges.

Nonetheless, DT concluded that, even if it were responsible for compliance with competition law, there was no scope to end the margin squeeze for the period 1998 – 2001 due to the price ceiling for retail prices. As for the alleged margin squeeze in respect of the period 2002 – 2003, DT contested that any such abuse could not be ascribed to it because it did not have unlimited leeway in increasing ADSL retail prices.

DT also pointed out that the Commission failed to show how the alleged margin squeeze for the period 2002-2003 would have been avoided by increasing retail prices for ADSL connection. They went on to challenge the wholesale market definition as a unified market, arguing that ADSL and other access services can be marketed separately due to line sharing.

[4]The narrowband retail prices, unlike the wholesale prices which were fixed due to national regulation, were subject to a price cap system, which, however, did not apply for the broadband (ADSL) retail prices. Given that the price cap system changed from 2002 and separated call and access charges, and given that the price ceiling for narrowband was almost exhausted by DT at that time, the only legal means to reduce the margin squeeze was increasing ADSL prices.

The CFI upheld the Commission's findings for both abuses and rejected all arguments advanced by DT. In its preliminary observations the CFI clarified that in order for the national legal framework to have the effect of rendering antitrust law inapplicable to anticompetitive activities, the restrictive effects of competition must originate solely in the national legislation (paragraph 87).[5]

For both infringement periods the CFI held that DT could increase the retail narrowband services while respecting the overall price ceilings through its application to RegTP; the fact that DT must request approval by RegTP for its charges does not absolve it from responsibility to comply with EC Competition law because the very fact that it has the ability to influence its charges by way of application proves that any restrictive effect on competition does not originate solely from national legislation (paragraph 105).

As to the responsibility of the RegTP to comply with EC competition law, the CFI underlined that such a fact did not derive from national legislation and the evidence provided by DT (RegTP decisions) proved the exact opposite; i.e. that the regulatory authority did not consider the Article 82 EC. Nevertheless, even if RegTP was obliged to consider whether retail charges proposed by DT complied with EC competition law, the Commission could not be bound by a decision taken by a national body pursuant to the Article 82 (paragraph 120).[6]

The CFI concluded that DT had the scope to increase its retail charges because it could influence those by way of its applications submitted to RegTP and therefore, it had a special responsibility, as incumbent, to apply for an adjustment of its charges at a time when those charges had the effect of impairing genuine undistorted competition on the common market (paragraph 122).[7] The fact that it did not use its discretion to that direction (no applications were made for increasing both analogue and ISDN line access charges) fully justifies the findings of the Commission.

Finally, the Commission's argument concerning the margin squeeze since January 2002 was upheld. The CFI concluded that there was scope for a limited increase of the ADSL charges, which would have indeed increased the average retail prices and, thus, reduced the margin squeeze for the contested period; answering the DT allegation that ADSL and narrowband retail markets are different, the CFI crucially noted that ADSL can not be offered to end-users on its own because, for technical reasons, it always involves an upgrading of narrowband connections. The DT challenge of the market definition was disregarded by the CFI.

### (B) DT challenged the method used by the Commission to find abuse as unlawful

The main arguments of DT were firstly that the retail prices taken into account for the calculation of the margin squeeze should include revenues not only from the provision of telephone lines (access services), but also from other services as well

[5]See T-513/93 *Consiglio nazionale degli spedizionieri doganali v Commission* [2000] ECR II - 1807 paragraph 61
[6]See C-344/98 *MasterfoodsandHB* [2000] ECR I – 11369 paragraph 48
[7]See C-322/81 *Michelin v. Commission* [2003] ECR II -4071 paragraph 97

(e.g. call services). As to the method itself, DT asserted that it is erroneous to rely exclusively on DT's charges and costs instead of taking into account the situation of DT's actual and potential competitors. Finally, DT complained that the wholesale prices were inflated because discontinuance charges should not have been included in the calculation as they were not payable on a retail level.

The CFI affirmed that the Commission was correct to examine a vertically integrated undertaking such as DT on the basis of the proposition of whether an economic operator that is just as efficient would be able to offer its retail services without incurring a loss, as this method is in line with case-law on the abusive nature of a dominant undertaking's pricing practices (paragraphs. 187 - 193). Furthermore, taking into account the particular situation of competing undertakings would be contrary to the general principle of legal certainty (paragraph. 192).

The CFI also succinctly showed that calculating access services revenues in isolation was required, firstly, for the purposes of compliance with EU law (tariff rebalancing) and secondly, because it was the only way to examine, on the basis of equality of opportunity, whether competition was really distorted or not (paragraphs. 198 – 203)[8].

Finally, the CFI upheld the Commission's reasoning that, when calculating wholesale charges paid to DT, which comprise of one-off and monthly charges, discontinuance charges must be taken into account, since, together with access charges, they amount to the one-off charges received by DT.

### (C) DT spotted an error in the calculation of the margin squeeze made by the Commission

DT found an error in the product specific costs which altered the amount of the spread and they contended that the margin squeeze should be reduced by such an amount. The Commission admitted the calculation error before the CFI, but stated that the lawfulness of the contested decision was not affected.

The CFI concluded that, as regards the negative spread of the infringement period 1998 – 2001, there was no need to examine further the product-specific costs, and as for the period from 2002 onwards, the test would still result into a margin squeeze had the correct amount been taken into consideration; the CFI underlined that the abuse under scrutiny was the nature of pricing practices and not the precise spread thereof (paragraph 223).

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[8]Despite the fact that call and access services constitute a 'cluster' from the subscribers' standpoint, DT's competitors needed access to the local loops in order to offer such services; for finding an abuse for the access services market, call charges had to be set aside (paragraph 200).

(D) DT CONTENDED THAT THERE WAS NO ACTUAL EFFECT ON THE MARKET.

DT argued that the pricing practice *per se* did not constitute an abuse[9] and that in line with European Court of Justice (ECJ) case-law and the Commission's decisional practice, evidence is required that the conduct in question constitutes either a barrier to entry or helps remove competitors from the market. According to DT, there were opportunities for entering the market since competitors can cross-subsidize each other in order to make up for any deficits in their connection costs; in addition, examples of significant market shares that have been acquired by competitors in urban areas were mentioned by DT and also supported the claim that competition has developed, as a whole, better in Germany than in other Member States.

The CFI established that the Commission was correct in finding that due to the existence of the margin squeeze alone competition in the market for retail access services was restricted; the Commission did not need to further demonstrate anti-competitive effects. Nevertheless, it emphasised that the fixed telephone network served as the only infrastructure through which DT's competitors could have made a viable entry onto the downstream market and was thus indispensable; this meant that a margin squeeze between the wholesale and retail access prices would in principle hinder the growth of competition.

With respect to the cross-subsidization practices, the CFI concluded that the very fact that the incumbent did not have to follow the same practice in order to offset losses in the retail access market translated into a distortion of competition not only in the said market, but in the telephone calls market as well[10].

The CFI underlined that the market shares of DTs competitors remained very small since the liberalisation of the market, and in line with all the above, served as proof of the restrictions imposed in the growth of competition. The market shares of competitors in urban areas did not suffice as an argument to affect the previous finding, since they were still very small when examining the German market in its entirety.

## 3. COMMENT

This judgment is delivered in affirmation of the 2007 Commission decision against Telefonica[11] and in anticipation of the decision on the appeals lodged, despite some crucial differences between the two cases (e.g. Telefonica had even greater discretion in price setting). The CFI essentially confirmed that incumbents can not rely on the national regulatory framework as an objective justification for conducts otherwise illegal,

[9]DT contended that in a margin squeeze case the relevant case-law criteria would be those of AKZO; the Commission failed, in the opinion of DT, to prove that after excluding competitors from the market DT would be able to offset the losses incurred as a result of its low-price policy, as such thing did not happen in the present case.
[10]See note 5. Needless to say, the prices at which the DT competitors could offer retail call services would have to be lower than the respective DT retail charges, thus, necessarily loss making.
[11]Case COMP/38.784 - *Wanadoo España v. Telefónica*

contributing further to the growing discussion on the interrelationship of sector-specific regulation and the Article 82 EC applications[12]. The crucial point was whether the incumbent had the discretion to satisfy both the price ceiling set out in national legislation and the EC competition rules, and whether it used its discretion to that direction. Article 82 EC was infringed precisely because of DT's failure to exercise its discretion to increase retail access prices. Moreover, a point substantially illustrated in the judgment, even when a regulatory authority is obliged to consider compliance with the EC competition law, it cannot bind the Commission in not finding an infringement of the EC competition law.

The CFI additionally upheld the method for finding a margin squeeze proposed by the Commission, despite the fact that *'the Community judicature has not yet explicitly ruled on the method to be applied in determining the existence of a margin squeeze…'* (paragraph 188).[13] In essence, it endorsed the Commission's view in its previous judgments on margin squeeze following the "as efficient competitor test" (2003 Commission decision, Telefonica), in alignment with the guidance set out in the Commission's Discussion Paper (2005 D.P., paragraph 220). Accordingly, it rejected a *per se* assessment of whether retail prices are themselves abusive (i.e. predatory) and underlined that in margin squeeze cases, it is the specific difference of prices and not the specific price level that matters.

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[12]Case COMP/ 37.507 – *Generics/ Astra Zeneca*, 15.06.2005, Case C-53/03 *Syfait & Others v. Glaxosmithkline*, opinion of Advocate General Jacobs 28 October 2004 and judgment of the ECJ of 31 May 2005 ('Syfait I'), Cases C-468-478 Sot. Lelos kai Sia EE & Others v GlaxoSmithKline, OJ [2007] C-20/03-13 ('Syfait II').
[13]Emphasis added.
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