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Policy Approaches to Margin Squeeze in the Telecommunications Sector in South Africa

Ryan Hawthorne
Kate Morris



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By: Ryan Hawthorne and Kate Morris¹

¹ Ryan Hawthorne is a Senior Analyst in the Policy & Research Division, Competition Commission South Africa, and Kate Morris is an Analyst in the Policy & Research Division, Competition Commission South Africa. Please note that the views reflected are those of the authors and do not necessarily reflect those of the Competition Commission South Africa.

1. Introduction

Telkom has been the target of a range of complaints in respect of value-added network services, including the provision of internet access. In some of the complaints, the complainants allege that Telkom has engaged in a 'margin squeeze'. This is where an upstream owner of a bottleneck good, in this case telecommunications infrastructure, provides its own downstream subsidiary with a lower price for the bottleneck good than it charges its downstream competitors, such as the members of the internet service providers association (ISPA), such that downstream competitors are unable to compete with the incumbent.

Here we examine the economics literature and economic aspects of jurisprudence on margin squeeze as a theory of harm in the USA and EU, and briefly explain their relevance to margin squeeze cases in the telecommunications sector in South Africa.

2. One monopoly profit theory and price squeeze cases in the US

2.1 The one monopoly profit theory and price squeezes in regulated industries: *Town of Concord*

Antitrust scholars in the United States are somewhat sceptical about margin squeezes in sectors that are regulated, such as the telecommunications sector. This emanates from the US's scepticism about refusal to deal cases.² Essentially, upstream monopolists that do not have an *antitrust* duty to deal (supply downstream rivals), though they may be forced to do so due to other sector specific regulations, are not required to provide a margin to downstream competitors by leaving a sufficient gap between their wholesale and retail prices under antitrust law. One important decision in which this approach was taken is *Town of Concord*, in which an upstream monopolist electricity supplier was accused of monopolising local distribution of electricity. The circuit court held in that case that price squeezes where the monopolist is regulated upstream is not a theory of monopolisation under section 2 of the Sherman Act³. The court rejected price squeeze as a theory of harm in that case for a

² In *Trinko*, the US Supreme Court held that *Aspen Skiing*, a landmark refusal to deal case, was at the 'ragged edge' of what the court would consider as a monopolization case by refusal to deal.

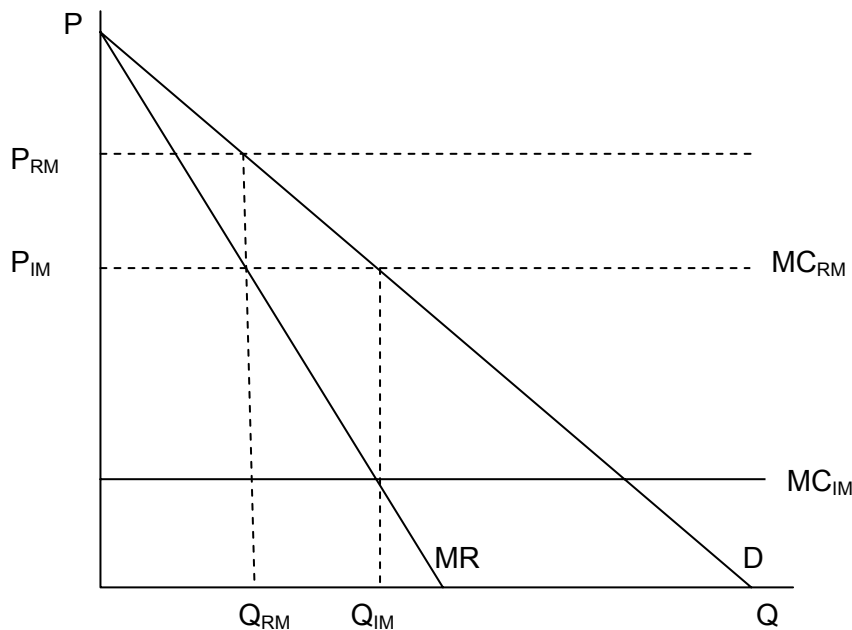
³ The Sherman Antitrust Act (Sherman Act) July 2, 1890, ch. 647, 26 Stat. 209, 15 U.S.C. § 1–7, states in section 2 that "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among

number of reasons, including the fact that the firm engaging in the price squeeze did not have market power. We focus here on the price squeeze aspects of the case and the court's reasons for rejecting this.

The plaintiffs (complainants) in that case alleged that Boston Edison had increased its wholesale rates for electricity but not its retail rates and had thus made electricity distribution in Concord less profitable. A key fact in that case was that both the wholesale and retail prices of the product in question were regulated. The judge pointed out in that case that when an upstream monopoly drives out downstream rivals, this does not necessarily result in a firm gaining an additional means of raising prices. This is because, in some cases, there is *one monopoly profit* to be earned. Furthermore, vertical integration may reduce double mark-ups where there is a lack of competition at both levels of the supply chain. Take, for example, the extreme case of successive monopolists (see Figure 1 below): there is a single demand curve for the final product (D); an input monopolist (IM) selling the final product would set a price P_{IM} and a quantity Q_{IM} , as the monopolist treats the true marginal cost (MC_{IM}) as its marginal cost. A retail monopolist (RM) sees the same demand curve and the same marginal revenue curve as the input monopolist but treats the price it would pay for the input, set at the monopoly wholesale price, as its marginal cost (MC_{RM}), which it sets equal to marginal revenue. Thus price is higher under successive monopoly and quantity is lower.

the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.”

Figure 1: Double marginalisation arising from market power at both levels of the market



Source: *Town of Concord v. Boston Edison*, appendix B. That case contains a useful numerical example linked to the graph.

In *Town of Concord* Judge Breyer explained that two arguments have been raised against this ‘One Monopoly Profit Theory’: the first is that monopolising both levels of the value chain raises barriers to new entry at either level, since a new entrant would need to enter at both levels simultaneously. Other arguments are that greater competition at the second level introduces non-price competition, such as quality competition, which might eventually provide it with the ability to enter the primary market. However, there are two circumstances in which price squeezes lead to efficiencies: the first is where the downstream competitor is also a monopolist (for the reasons discussed above) and where the upstream firm is more efficient than downstream rivals.

Judge Breyer criticised the difficulty of administering US Supreme Court’s decision in *Alcoa*, in which Judge Learned Hand said that an upstream monopolist must charge a “fair price” for the wholesale input and must allow its downstream competitors to make a “living profit”. This is because courts would have to become price regulators to establish a ‘fair price’ and would be hard pressed to distinguish efficient rivals from inefficient ones in administering the “living profit” test. Furthermore, this test protects *competitors* rather than *competition*.

In view of the ‘fine balance’ between pro-competitive and anti-competitive effects that a price squeeze can have, Judge Breyer declined to apply the *Alcoa* test as the industry in question was fully regulated, which eliminated the theories of harm discussed above. He noted that the ‘barrier to entry’ theory of harm was unlikely since regulators are often able to prevent incumbents from excluding rivals by, for example, refusal to deal. Furthermore, local electricity distribution (the downstream product in that case) is a natural monopoly and it is unlikely that the entire town would move to alternative town due to high electricity prices. Regulators also set prices according to costs. To the extent that the downstream rival could not survive on the margin reflecting downstream costs, it is likely that the downstream rival was inefficient. It was argued that the incumbent might file tariffs in which a higher margin on wholesale sales is sought than retail sales; however, a price squeeze finding may not reduce wholesale prices but instead might increase retail prices. The complainants in the case suggested that a reasonable profit be earned at both levels; however, this would create administration difficulties for courts for the reasons discussed above. In particular, allocating investments between retail and wholesale activities is difficult. Finally, the complainant had access to an administrative remedy; it could approach the regulator (the Federal Energy Regulatory Commission, “FERC”) if it was being discriminated against, for example.

Judge Breyer did nonetheless note that:

“We recognise that a special problem is posed by a monopolist, regulated at only one level, who seeks to dominate a second, unregulated level, in order to earn at that second level the very profits that regulation forbids at the first”.

Judge Breyer therefore does not dismiss the notion that margin squeezes could be a contravention of the Sherman Act where the vertically integrated firm is not regulated at both wholesale and retail levels, and did not decide that the price squeeze theory should be dismissed as a theory of exclusion.

2.1 Is price squeeze a plausible theory of harm in the US? Linkline vs. Pacific Bell Telephone Company

In *Linkline*, Pacific Bell, a vertically integrated supplier of telecommunications services and internet access, is accused of charging too high a price for its wholesale ‘bottleneck’ input, the copper ‘access’ line serving the customer’s premises, relative to the retail price it charges for both the ‘access’ line and the internet access components of the final product. Pacific Bell is compelled by regulation to supply its Digital Subscriber Line (DSL). The

upstream wholesale price for 'access' to the customers' premises is regulated, while the downstream retail market for internet access services is not regulated. The case is due to be heard by the US Supreme Court later this year, and has generated a large literature in the form of *amicus* briefs and academic articles.

Opponents in principal of price squeezes as a theory of antitrust harm such as Gregory Sidak (2008) argue that anti-price squeeze rules would deter investment, deter upstream suppliers from voluntarily supplying inputs to efficient competitors, and would reduce retail price competition. He argues, along with several other antitrust scholars in an *amicus* brief in *LinkLine*, as well as the US Department of Justice, that unless a complainant can make out a predatory pricing or refusal to deal case, a price-squeeze case has no merit (see *amicus* briefs in *Linkline*). In order to make out a predatory pricing case in the US, the standards set up in *Brooke Group* require that a monopoly set prices below some measure of cost (that the monopolist 'sacrifices' some profits) and that there is a dangerous probability of recoupment of those profits. However, the complainant in this case did not allege predatory pricing. In any event Sidak (2008: 7) argues that it will be too difficult for a jury to arrive at an appropriate measure of costs for a vertically integrated firm where fixed investments will need to be allocated between wholesale and retail activities.

Sidak (2008) argues that price squeezes are really a regulatory problem and are not readily handled by the courts, not least because margins would need to be monitored by the courts constantly, as demand and supply factors change over time. A price squeeze case therefore imposes a substantially greater factual burden on courts than a straightforward refusal to supply case, in which a monopolist providing an input previously ceases to do so; in a price squeeze case, prices and margins must be determined, and must be monitored over time. The exception to this is where the wholesale price is greater than the retail price, though even in these circumstances the monopolist may have an incentive not related to exclusion to engage in this conduct (discussed below). The correct regulatory procedure for pricing access to a bottleneck input is well-understood; Baumol and Sidak (1995) argue that the optimal pricing rule for access is the 'Efficient Component Pricing Rule' or 'imputation rule' discussed below. Price squeezes may also allow firms to circumvent *per se* prohibitions of price fixing, in that if wholesale prices increased, for example, downstream rivals could successfully demand that the vertically integrated firm's retail prices would increase too. Competitors will be in a position to limit price competition (indeed, they would be forced to do so) without contravening the antitrust laws. Sidak (2008) explains that even a refusal to supply case (without a price squeeze theory) that would force courts to regulate the quality, quantity and price at which a monopolist is forced to supply products would be unlikely to be

a contravention of the Sherman Act, as a result of the US Supreme Court's decision in *Trinko*, which eschews granting courts the power to act as 'Central Planners'.

Sidak (2008) points out that there are good reasons for firms to charge retail prices that are below their wholesale prices. For multi-product firms, owning the customer is very important due to cross-selling of potentially higher margin products with the product in question (such as voice services with the DSL line and internet access)⁴; thus the opportunity cost of losing a retail customer may well be more than the incremental cost of providing the retail service to that customer. A related question is whether it makes sense to examine margin squeeze on only one of the products in a multi-product offering.

Furthermore, supplying the product jointly may entail substantial production cost savings for the integrated firm. These are known as economies of scope. Hovenkamp & Hovenkamp (2008) provide the following example: imagine a tour operator buys an airline ticket from a monopoly airline at R400 per ticket, which is the cost of an airliner divided by the total number of tickets, and the airline itself has a tour operator business, and the incremental cost of offering the tour is R10. Assume further that one of the airlines planes is not full, and the incremental cost of offering one seat on that plane is R40. If the airline sold the seat at R50, it would not be charging below its incremental cost, though the average cost to the non-integrated tour operator would be higher than the airline's retail price for the tour. Therefore, where there are economies of scope in the upstream monopoly providing the final downstream service, using average total costs as the margin squeeze test would not allow the economy to benefit from these economies of scope.

There are therefore a range of objections to price squeeze as a theory of antitrust harm in principle in the US. We now turn to price squeeze standards in the EU.

3. Policy approaches in the EU: Margin squeeze and Article 82

3.1 Overview of Article 82 of the Treaty of Rome

The EU has a significantly less restrictive interpretation of harm to competition than the US, and the European Commission has imposed substantial fines on margin squeeze offenders.

⁴ Sidak (2008) links this to Ramsey prices, which is the optimal pricing solution where a company incurs substantial fixed costs in providing a number of different products; the company charges higher mark-ups for products for which demand is relatively inelastic.

The EC therefore do see margin squeeze as a viable contravention of competition law, unlike many scholars and judges in the US.

Article 82 is aimed at protecting harm to consumers both directly as well as indirectly such as through the negative impact on an effective competitive structure (*British Airways* ECJ decision: para. 106 – 107; *Continental Can*: para. 26). The burden of proving a contravention that meets these policy imperatives does not include an obligation by the antitrust authorities to specifically determine whether the actions of a dominant undertaking has caused prejudice to consumers (*British Airways* ECJ decision, para. 107). In a 2005 discussion document on the application of Article 82 of the European Treaty to exclusionary abuses, the Commission states that harm to intermediate buyers is generally presumed to create harm to final consumers, both in the short and long term (European Commission, 2005: 18).

Exclusionary conduct may discourage entry, prevent expansion or even compel disadvantaged rivals to exit an industry. The Commission therefore does not require exit of a rival as the only means of proving a reduction of competition due to exclusionary conduct (European Commission, 2005: 18). In *British Airways vs. European Commission*, the court of first instance (“CFI”) ruled that “for the purposes of establishing an infringement of Article 82 EC, it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in that respect to demonstrate that the abusive conduct of the undertaking in a dominant position tends to restrict competition, or, in other words, that the conduct is capable of having or likely to have, such an effect.” (See CFI judgement in *British Airways*, para. 293). Indeed, the mere objective of restricting competition is sufficient - “where an undertaking in a dominant position actually implements a practice whose object is to oust a competitor, the fact that the result hoped for is not achieved is not sufficient to prevent that being an abuse of a dominant position within the meaning of Article 82 EC” (*France Telecom*, para. 196; *Compagnie maritime belge*, para. para. 149; *Irish Sugar*, para. 191).

In a speech delivered at the 2008 International Antitrust Law and Policy conference, Europe's competition commissioner, Neelie Kroes, stated that the European Union's DG Competition should apply an effects-based approach to deciding whether a dominant firm's conduct would be likely to harm consumers. This entails establishing only the potential for harm in order to justify intervention by the Commission, stating that while actual evidence of harm or exit would serve to strengthen a case of exclusionary behaviour, waiting for harm to occur could permanently damage markets and inflict long-term harm on consumers.

This harsh stance is evidenced by the Commission's statement that "where certain exclusionary conduct is clearly not competition on the merits, in particular conduct which clearly creates no efficiencies and which only raises obstacles to residual competition, such conduct is presumed to be an abuse." The dominant company in question may rebut this presumption, but requires convincing evidence that the conduct does not and will not result in the exclusionary effect alleged, or that the conduct is objectively justified (European Commission, 2005: 19).

3.2 General framework for the assessment of margin squeeze cases

Geradin and O'Donoghue (2004) argue that in order for the behaviour under analysis to constitute margin squeeze, the input in question must be essential for the purposes of the product or service being sold by downstream rivals. If the input is not necessary or there are substitutes available to downstream firms, these firms are not being subjected to a squeeze. In addition, the input supplied should constitute a relatively high and fixed proportion of downstream firms' costs in order to plausibly argue that a lack of profitability is fundamentally due to the dominant upstream firm's pricing policies.

Gerardin and O'Donoghue (2004) also point out that the upstream firm must have an *incentive* to engage in the conduct; for example, if the firm in question was not in a position to collect all of the customers of foreclosed rivals, it would forego sales of its monopoly input. Another point to be established is whether the dominant firm has any reasonable justification for any downstream losses it may be suffering, other than an exclusionary intent. Possibilities include the introduction of a new product with low volumes, and expectations that these will increase over time. Importantly, an evaluation should be undertaken as to whether the dominant firm's conduct has, or is likely to have, a material impact on competition. This requires that the behaviour be relatively persistent in order to show a non-transitory impact on downstream rivals.

However, the fundamental question to be addressed in assessing margins squeeze cases is how large a positive margin is required for healthy competition. Clearly an insufficiently large margin results in squeezing out efficient rivals and deterring their entry in the first place. On the other hand, too large a required margin encourages the entry and survival of inefficient market players resulting in productive inefficiency (Vickers, 2005).

A European Commission ("EC") notice on the application of competition rules to access agreements (European Commission, 1998) sets out two tests, the "As efficient" competitor

test and the “reasonably efficient” competitor test. The “as-efficient” competitor test asks whether the vertically integrated firm could trade profitably if faced with the internal transfer price charged to competitors. If not, equally or more competitors are concluded to be unable to effectively compete in the market. The “reasonably efficient” competitor test asks whether a reasonably efficient entrant could operate profitably on the basis of the margins available between retail and access prices. The advantage of this test is where new entrants are likely to be less efficient than the incumbent vertically integrated firm, possibly due to factors such as economies of scale.

The first test focuses specifically on short-term efficiency by requiring competitors to be as, if not more, efficient than the integrated firm in order for the contravention to be considered detrimental to competition rather than merely a competitor. The second test, on the other hand, recognises that a less efficient new entrant may sacrifice short-term productive efficiency but may increase it in the long-run due to a more dynamic and competitive environment in which the incumbent is forced to remain cost-efficient.

Because the incumbent’s own costs are relatively readily available, typically the first test is used, and often even when the second test is used costs of the incumbent are used as the basis for establishing costs of a reasonably efficient entrant with some adjustments. This has led the EC to state that, in fact, both tests are tantamount to the same thing, given that the dominant firm’s costs are used as a benchmark of a *reasonably efficient service provider* (Geradin & O’Donoghue, 2004).

The Commission notes that in using the “as efficient” test, it may be necessary to examine costs and revenues in a wider context rather than focusing only on an assessment of whether price or revenue covers the costs for the products in question. In the case that the dominant firm’s conduct is negatively affecting its revenues in other markets, it may be necessary to look at incremental revenues. In the event that reliable information on the dominant firm’s costs is not available, it may be necessary to apply the as efficient competitor test using the cost data of apparently efficient competitors (European Commission, 2005: 21).

3.3 Possible defences

The European Commission (European Commission, 2005: 24 – 28) allows for a dominant firm to engage in exclusionary behaviour if it can show an objective justification, that it was

or is meeting competition or that the conduct in question results in efficiencies which outweigh the negative effect on competition.

The first defence may be met if it can be shown that the conduct is objectively necessary e.g. due to safety or health related reasons. This defence requires strict indispensability meaning that the product(s) concerned would not be able to be produced or distributed without such conduct occurring. Community courts have maintained, however, that it is not up to the dominant firm to squeeze out products it deems as dangerous or inferior to its own.

To prove that the exclusionary conduct is merely a reaction to competition within the market, the proportionality test must be met; the dominant firm must show that the chosen conduct was the most appropriate way in which to achieve the legitimate aim of competing. Furthermore, the conduct must be shown to be indispensable such that the legitimate aim could not be achieved in any less anticompetitive manner, and that the time in which the conduct occurred was limited to its minimum. This defence can generally never be applied when firms have priced below average avoidable costs.

Finally, in order to rely on the efficiency defence, firms must fulfil four conditions. The first is that efficiencies are realised or are likely to be realised as a result of the conduct concerned e.g. protecting client-specific investments. Second, the conduct concerned must be indispensable to realising these efficiencies. The dominant company is not required to take into account hypothetical or theoretical alternatives, but must demonstrate why apparently realistic and less anticompetitive alternatives are substantially less efficient. Third, the efficiencies must benefit consumers. This ultimately requires the firm to show how the conduct enables the dominant firm to sustainably deliver pro-competitive benefits to consumers that outweigh the negative effects arising from a reduction in competition. In order for these efficiencies to be considered as a counteracting factor against a reduction in competition, they must arise timeously. Lastly, it is required that competition in respect of a substantial part of the products concerned is not eliminated. This is in recognition that while short-term efficiencies may benefit the consumer in the short-term it is the presence of rivals that encourages a sustainable pursuit of economic efficiency. Hence the Commission notes that it is “highly unlikely that abusive conduct of a dominant company with a market position approaching that of a monopoly,⁵ or with a similar level of market power,⁵ could be justified

⁵ A dominant firm is generally thought to be approaching a monopoly position if it holds close to 75% market share and its rivals offer little actual competition due to factors such as higher costs, capacity constraints, and high barriers to entry.

on the grounds that efficiency gains would be sufficient to counteract its actual or likely anti-competitive effects” (European Commission, 2005: 28).

Should an antitrust authority decide to intervene in a price squeeze case, there are several cost standards that could be applied, including long run incremental costs (LRIC), fully allocated costs (FAC); and the efficient component pricing rule (ECPR) or “imputation” rule. These various cost tests are discussed next.

4. Cost tests

4.1 Long run incremental costs and fully allocated costs

The Long Run Incremental Cost (LRIC) standard requires that the owner of the bottleneck input charges the incremental cost of supplying that bottleneck input. Ofcom used LRIC in the *BT/Freeserve* case and it used FAC in the *IPStream/ATM Interconnection* Direction, as did the OFT in its *BSkyB* investigation. While LRIC excludes overhead and other common costs, FAC allocates these costs to individual services. This is often done based on rules of thumb such as merely allocating costs equi-proportionately. This results in LRIC being below FAC *ceteris paribus*. LRIC includes only relevant costs of an efficient firm while the FAC approach is based on actual costs and so often includes inefficiencies. LRIC is based on the current replacement costs of a company’s assets whereas FAC often uses the historic prices at which assets were bought. Given that LRIC reflects costs of a benchmark efficient firm, not those actually realised by the incumbent, pricing methodologies based on LRIC places pressure on the incumbent’s ability to realise upstream profits. This approach also allows for no compensation for the foregone profits due to new entrants’ “poaching” of the incumbents’ customers using its own facilities, and hence promotes downstream competition at the expense of the incumbent’s upstream margins (Geradin & O’Donoghue, 2004).

Both the long run incremental cost and fully allocated cost measures do not take into account all of the opportunity costs for the owner of the bottleneck input, which may force the owner of the bottleneck to protect inefficient rivals. The efficient component pricing rule is therefore suggested by many scholars as the optimal means of pricing access. This is discussed next.

4.2 Efficient component pricing rule

The efficient component pricing rule (“ECPR”, also known as the imputation requirement, the principle of competitive equality, or the parity principle) says that a bottleneck input owner be compensated by a non-integrated downstream firm for the average incremental costs it incurs in providing the service to the downstream competitor as well as the opportunity costs that the monopoly provider of the input foregoes in selling it to its downstream rival (Baumol & Sidak, 1995a)⁶. Note that this is very different to the pricing rules implied by long-run incremental cost and fully allocated costs; the ECPR requires that not only the average incremental costs of the bottleneck input be paid to the bottleneck owner; it includes *opportunity costs* foregone by the monopolist in providing the downstream input to the downstream competitor. Baumol and Sidak (1995a) show that this rule ensures that only firms that are more efficient than the incumbent in providing the downstream component of the final product provide that component. The monopolist has no incentive to exclude the downstream rival in this case, since it is recovering its monopoly profit through sales to the downstream rival, and avoids the incremental costs of offering the downstream service. Preserving the presence of the firm with higher downstream average incremental costs than the incumbent will only raise prices to final consumers. Baumol and Sidak (1995) concede that the ECPR does not constrain monopoly pricing; they assume that the final price of the retail product is regulated at cost, and so this problem falls away.

Tye (1995), in reply to Baumol & Sidak (1995), says that where there are fixed sunk costs of new entry, then the ECPR will discourage new entrants, who may not be able to recover their fixed sunk costs, even if their average incremental costs in providing the downstream product are lower than those of the owner of the bottleneck input. Nonetheless, if these fixed sunk costs could be avoided by the incumbent, then the economy should benefit from the avoidance of these costs. This debate is similar to the ‘as efficient’ versus ‘reasonably efficient’ competitor tests discussed above.

In practice in telecommunications margin squeeze cases, the ECPR translates into the following, using the notation of Polo (2007)⁷: p is the incumbent’s final retail price (unregulated); a is the incumbent’s bottleneck price (for the local loop, for example, or high bandwidth transmission links); c_d incumbent downstream cost (the cost, for example, of offering internet access); c_i (additional interconnection costs that the incumbent does not

⁶ Kahn and Taylor (1995) agree that the ECPR should be used in pricing access to bottleneck inputs, and Sidak (2008) agrees that the ECPR should be implemented in a regulatory setting.

⁷ Bouckaert & Verboven (2004: 329) propose a similar test in their ‘economists’ view’ test.

incur when self-providing the local loop or high bandwidth transmission links). Note that, if the incumbent and competitors were equally efficient, competitors would always be at a slight disadvantage, due to the costs of interconnecting with another network; the incumbent does not incur interconnection costs.

Using the ECPR, there would be no margin squeeze if: $p > a + c_d - c_i$. In words, there would be no squeeze if the incumbent firm's retail price exceeds the access charge that it charges its downstream rivals plus its downstream costs, less interconnection costs, which the incumbent does not incur.

5. Possible approaches to margin squeeze in telecommunications in South Africa

South Africa has recently seen the entrance of a second network operator that will compete with Telkom in offering fixed lines, Neotel, that will challenge for the first time Telkom's monopoly over fixed line links. At the same time, the three mobile network operators (MTN, Vodacom and Cell C) have been granted the right to 'self provide' their own fixed links, and a recent judgment in the High Court, pending appeal, may give dozens of Value-added network services licencees (VANS) the right to self provide.

The Tribunal has pointed out Telkom's own strategy documents which contemplate making it difficult for its customers to switch to its rivals in the primary market. For example, one of Telkom's strategic documents says that (*Telkom / BCX*, para. 80):

"We aim to counter arbitrage opportunities, defend fixed to mobile revenue stream and counter revenue erosion to the SNO and other competitors such as VoIP providers, through strategies including long term contracts, bundled discounts packages, calling plans as well as volume and term discounts."

Facing new entry, and in the context of the *Telkom / BCX* ruling, it is at least plausible that Telkom may wish, through margin squeeze, to prevent new entry in its primary market, either by denying customers to Neotel (in squeezing out independent internet services providers, large users of fixed line bandwidth), refusing Neotel access to its local loop (by margin squeeze or otherwise), or excluding downstream rivals, such as internet services providers, from downstream markets (such as internet access), in order to prevent their later entry into Telkom's primary fixed line markets. This would need to be weighed against the risks of chilling competition among downstream competitors, as upstream monopolists will become more reluctant to lower downstream prices (Sidak, 2008). It would also need to be weighed

against placing competition authorities in SA in the role of price regulators, a position the Competition Tribunal sought to avoid in *Mittal* (para. 37).

In respect of the one-monopoly profit theory (“OMPT”), we note that one interpretation of the *Commission vs. SAA* decision is that “harm to consumers” (the primary focus of the OMPT) is only one means of proving anti-competitive effects in SA competition law; the alternative is to measure the extent to which the market is foreclosed to rivals (See *Commission vs. SAA*, para. 132).⁸ Arguably therefore, the decision rule for margin squeeze in South Africa could apply a cost rule that provides a margin between access prices and retail prices that covers more than average incremental costs without examining whether consumers in retail markets would be harmed from possible double mark-ups arising from such a rule. Note that the ECPR discussed above imposes a rule that allows only downstream competitors that incur at most the monopolist’s downstream incremental costs to enter. Therefore, the ECPR does not encourage double mark-ups.

6. Conclusion

There are a number of policy considerations that regulatory authorities will have to take into consideration when evaluating whether indeed margin squeeze in the telecommunications sector is anti-competitive. The first is whether the authority will be able to intervene in a way that benefits consumers without becoming a price regulator. The second is whether a price squeeze case will ‘chill competition’, in that upstream monopolists if faced with an *Alcoa* style “living profit for downstream rivals” margin squeeze test will be cautious in lowering downstream prices, which could give rise to collusion among rivals. In South Africa, the Competition Tribunal has pointed out the means by which the fixed line incumbent, Telkom, has considered impeding its rivals’ entry in the market in the *Telkom / BCX* case. In the context of new entry into Telkom’s traditional markets, it is at least plausible that Telkom may engage in a strategy to protect its monopoly in its primary market (for fixed line telecommunications services) by foreclosing rivals from its secondary markets (such as internet access). The competition authorities therefore need to weigh the potential effects of foreclosure against chilling future competition between Telkom and its rivals.

⁸ Specifically, the Tribunal says that: “... we then enquire whether the *exclusionary act* has an anti-competitive effect. This question will be answered in the affirmative if there is (i) evidence of actual harm to consumer welfare or (ii) if the exclusionary act is substantial or significant in terms of its effect in foreclosing the market to rivals.”

7. Case law and administrative guidelines

European Union

British Airways plc v. Commission of the European Communities, Case C-95/04 P, Case 6/72, Judgment of the Court of Justice (Third Chamber), 15 March 2007

British Airways plc vs. Commission of the European Communities judgment of the Court of First Instance of 17 December 2003 in Case T-219/99

Compagnie maritime belge transports and Others v. Commission [1996] ECR II-1201, joined Cases T-24/93 to T-26/93 and T-28/93

European Commission, 1998, 'Notice in the Application of the Competition Rules to Access Agreements in the Telecommunications Sector – Framework, Relevant Markets and Principles', OJ[1998]C265/2

European Commission, 2005, "DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses: public consultation", available at <http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf> , last accessed on 24 October 2008.

Europemballage and Continental Can v Commission [1973] ECR 215

France Telecom, Judgement of 30 January 2007, Case T-340/03

Irish Sugar v Commission [1999] ECR II-2969, Case T-228/97

South Africa

Competition Commission and South African Airways (Pty.) Ltd., case number 18/CR/Mar01, available at <http://www.comptrib.co.za/comptrib/comptribdocs/110/18CRMar01final.pdf> , last accessed on 24 October 2008.

Harmony Gold Mining Company Limited and Durban Roodepoort Deep Limited and Mittal Steel South Africa Ltd., case number 13/CR/Feb04, available at

<http://www.comptrib.co.za/comptrib/comtribdocs/97/13CRFeb04reasons.pdf> , last accessed on 24 October 2008.

Telkom SA Limited and Business Connexion Group Limited, case number 51/LM/Jun06, available at: <http://www.comptrib.co.za/comptrib/comtribdocs/668/51LMJun06.pdf> , last accessed on 24 October 2008

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