

Margin squeeze in telecommunications in South Africa

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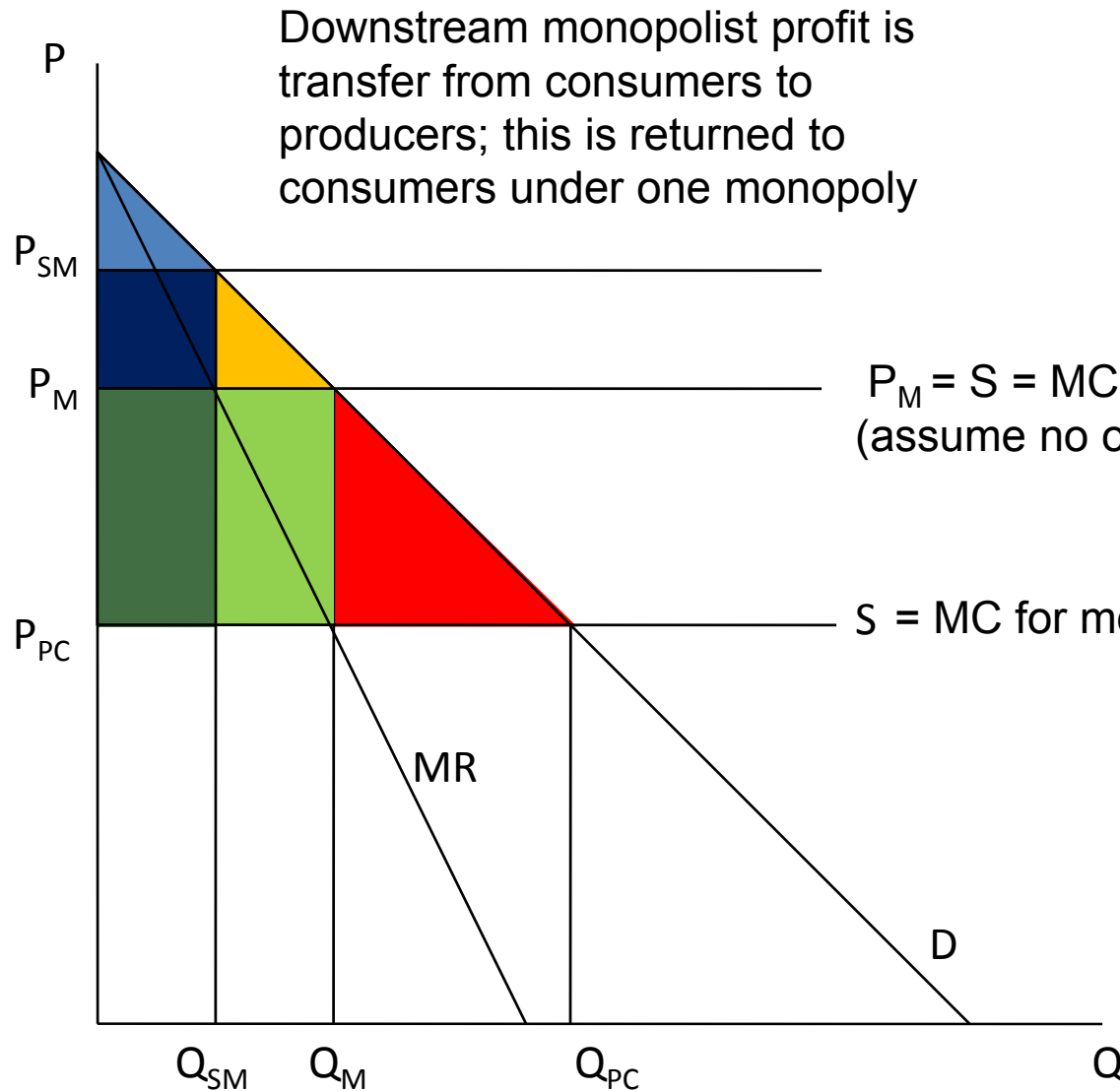
Outline

- One monopoly profit theory, and *Town of Concord* in the USA
- Is price squeeze a theory of abuse in the USA?
Discussions in *LinkLine*
- Policy approaches in the EU
- Cost tests
- Possible approaches in South Africa

One monopoly profit theory and *Town of Concord*

- Chicago school: Monopolist has one monopoly profit to make, cannot improve on this by *leveraging* dominance in one market (through margin squeeze or otherwise) into another downstream / adjacent market
- Where this does occur, it can enhance efficiency, where the downstream (or adjacent) market is not competitive – elimination of double mark-ups
- Judge Breyer in *Town of Concord* : potential anti-competitive harm by *leverage* is ‘finely balanced’ with pro-competitive benefits
- US antitrust talks of harm to the consumers through harm to the competitive process; explicitly don’t examine ‘harm to competitors’
- Previous margin squeeze case is *Alcoa* in the US (1945): upstream monopolist must charge a ‘fair price’ and allow downstream competitors a ‘living profit’

OMPT: elimination of double marginalisation



Profit under single monopoly is greater than under successive monopolies

Deadweight loss is greater under successive monopoly than single monopoly

One monopoly profit theory and *Town of Concord*

- OMPT holds only where the downstream product is produced using *fixed proportions* of the bottleneck input
- OMPT is a static model: In a dynamic context, monopoly could be preserving dominance in *primary market* by limiting competition in an adjacent market
 - If the monopoly wants to deny new upstream competitors customers, for example
 - If the monopoly wants to prevent downstream rivals from gaining scale and experience to enter upstream
- Further: If monopolist cannot obtain monopoly profit upstream, it has an incentive to monopolise adjacent market
 - Monopolist is regulated upstream
 - Monopolist has a credibility problem with resellers

Is price squeeze a plausible theory of harm:

Linkline

- Complaint relates to a seller of internet access with a bottleneck input: the last mile to the customer's premises
- Some scholars say that price squeeze should not be a theory of antitrust harm (Sidak, 2008):
 - Investment upstream would be deterred, as would voluntary supply arrangements
 - It would cause downstream co-operation (non-vertically integrated competitors would force upstream firms to raise downstream prices)
 - Courts would become price regulators (fact intensive cost enquiry)
- 'Price squeeze' that would exclude a competitor could be pro competitive:
 - if 'owning the customer' is important, then the opportunity cost of losing a customer is worth more than the incremental cost of supplying the product in question to the downstream customer (Sidak, 2008)
 - Economies of joint production may be lost (Hovenkamp & Hovenkamp, 2008)

Policy approaches in the EU

- Unlike US EC see margin squeeze as a plausible contravention of competition law – large fines have been imposed on offenders
- Burden of the authorities:
 - Unnecessary to show harm to consumers; harm to intermediaries assumed to harm final consumers (British Airways)
 - Unnecessary to show exit by rivals; demonstrating the conduct's potential to restrict competition is sufficient
 - Demonstrating a dominant undertaking's practice whose object is to restrict competition is sufficient, regardless of its success

General assessment of margin squeeze cases in EU

- Necessary properties of input in question
 - must be essential to downstream product or service
 - must constitute a relatively high and fixed proportion of downstream firms' costs to show effect on profitability
- Upstream monopolist must have ability to absorb all downstream rivals' customers
- How large a positive margin is required for healthy competition?
 - Could the monopolist or an **as efficient competitor** operate profitably if faced with the internal transfer price charged to competitors?
 - Can a **reasonably efficient competitor**/entrant operate profitably on the basis of the margins available?

Defenses for margin squeeze (EU)

- Objective justification (requires indispensability)
- Meeting competition
- Resulting efficiencies that outweigh anticompetitive effect must:
 - Efficiencies must be specific to the conduct
 - Efficiencies must benefit consumers
 - Competition in respect of a substantial part of the products concerned may not be eliminated

Cost tests: The efficient component pricing rule vs. LRIC and FAC for pricing access

- Long run incremental costs uses long run incremental costs of an efficient competitor
- Fully allocated costs uses actual costs of firms, including joint and common costs
- Efficient component pricing rule (ECPR) adds average incremental costs of providing the bottleneck to downstream competitors to the 'opportunity costs' of the monopolist (Baumol & Sidak, 1995)
 - Only more efficient rivals enter the downstream market
 - Does not result in competitive pricing in final product, however
 - Where there are fixed, sunk costs of new entry, these will not be recovered and thus entry is deterred, even if the new entrant has lower incremental costs than incumbent (Tye, 1995))

Cost tests: The efficient component pricing rule vs. LRIC and FAC for pricing access

- Using the ECPR, regulating margin squeeze in practice is as follows (Polo, 2007):
 - Test whether $P - A \geq C_D - C_I$, where:
 - “P” is the incumbent’s final retail price
 - “A” is the incumbent’s bottleneck price (for the local loop, for example, or high bandwidth transmission links)
 - “ C_D ” is the incumbent downstream cost (the cost , for example, of offering internet access)
 - “ C_I ” is the additional interconnection costs that the incumbent does not incur when self-providing the local loop or high bandwidth transmission links – allows economy to benefit from efficiencies arising from vertical integration

Margin squeeze in telecommunications in SA

- Key question is (in response to OMPT): could Telkom be trying to preserve its monopoly in its primary (fixed line transmission) market?
- Neotel recently entered, the mobile operators have announced they are building fixed links, and Altech judgement (if upheld) means hundreds of non-Telkom VANS providers too
- The Competition Tribunal in Telkom / BCX said that one of Telkom's documents revealed that it would, among other things, "*counter revenue erosion to the SNO*"
- Therefore, Telkom might be monopolising a downstream market (such as internet access) to deny customers to a new entrant (such as Neotel), or prevent a non-Telkom VANS provider from gaining scale and experience downstream in order to prevent their entry upstream in the future

Margin squeeze in telecommunications in SA

- Note: In SAA v. Commission, the Competition Tribunal held that anti-competitive effect can be shown 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.”
- Therefore, arguably, no need to deal with OMPT (harm to consumers)
- The risks of a lessening of competition in Telkom’s primary market need to be weighed against:
 - The competition authorities’ aversion to becoming a price regulator; and
 - The risks of chilling competition downstream between the vertically integrated upstream incumbent and its downstream rivals