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MARGIN SQUEEZE

-- Germany --

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The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 19 October 2009.

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1. Introduction

1. For some time, margin squeeze cases have not figured prominently in the enforcement practice of the Bundeskartellamt. Until a few years ago, they rarely entered the enforcement agenda.[1] Recently, though, they have gained increased prominence. Not only did the German legislator in 2007 introduce statutory provisions that – provided that small and medium-sized companies are affected – explicitly deal with margin squeeze scenarios (Section 20 (4) clause 2 number 3 of the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, hereinafter: ARC)). In August 2009 the Bundeskartellamt also issued a comprehensive decision (B7 – 11/09 – *Deutsche Telekom/Mehrwertdienste*) that contributed to the clarification of the prerequisites applied to margin squeeze cases.[2] The following submission seeks to contribute to the discussion by providing an overview of the evaluation of margin squeeze cases in Germany. It will, however, not cover sector-specific provisions enforced by regulatory agencies (e.g., Section 28 paragraph 2 number 2 *Telekommunikationsgesetz;* hereinafter: TCA)[3].

2. Statutory provisions

2. In Germany, abusive practices by dominant undertakings – including margin squeeze scenarios – generally fall under Sections 19, 20 and 21 ARC. Section 19 ARC is similar to Article 82 of the Treaty Establishing the European Community (hereinafter: EC) and constitutes a general prohibition of abuse of market power by dominant companies as a blanket clause. Section 19 (4) ARC – as Article 82 sentence 2 EC – sets out four non-exhaustive examples of anticompetitive behavior. These include impairing the ability to compete, demanding unfavorable or discriminating business terms and the refusal to provide network or infrastructure facility access.

3. While section 19 ARC addresses only dominant undertakings, Sections 20 and 21 ARC – under certain circumstances – also apply to abusive practices by non-dominant firms.[4] Section 20 ARC provides that an undertaking with "superior market power" (*überlegene Marktmacht*) in relation to other undertakings must not unfairly abuse its position or hinder another undertaking without an objective justification. Section 21 ARC contains a special provision against requests to refuse to supply (so-called boycotts) which applies irrespective of a market power test.

4. German competition law does not contain general statutory provisions that explicitly address margin squeeze practices. Consequently, these scenarios are principally dealt with under the general provisions on abusive practices. However, as has already been pointed out, specific provisions exist, as far as small and medium-sized enterprises are affected (Section 20 (4) sentence 2 number 3 ARC). Against this background, the following contribution begins with an overview of the specific provisions that

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1 For an important margin squeeze case see BKartA WuW/E DE-V 289 – *Freie Tankstellen* (2000); OLG Düsseldorf WuW/E DE-R 589 – *Freie Tankstellen* and OLG Düsseldorf WuW DE-R 829 – *Freie Tankstellen*.

2 Decision available at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Missbrauchsaufsicht/B7-11-09.pdf?navid=40; in German only; English case summary available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/Fallberichte/B07-011-09-engl.pdf?navid=31).

3 Regarding Section 28 paragraph 2 number 2 TCA see, for example, *Bundesnetzagentur (Federal Network Agency)*, Hinweise zu Preis-Kosten-Scheren i.S.d. § 28 Abs. 2 Nr. 2 TKG vom 14.11.2007 (available at http://www.bundesnetzagentur.de/media/archive/11895.pdf; in German only).

4 According to Article 3 (2) sentence 2 of Regulation 1/2003, the Member States are not precluded from adopting or applying stricter national laws than the relevant European laws.

explicitly address margin squeeze practices (2.1). It will then go on to explain the application of the general provisions in margin squeeze cases (2.2).

2.1 Specific provisions

5. In December 2007, amendments to the ARC concerning abusive practices entered into force.[5] These mainly introduced specific provisions for the energy and food sectors, but one of them – the newly introduced Section 20 (4) clause 2 number 3 ARC – explicitly deals with margin squeeze practices.[6] The new Section reads as follows:[7]

> *(4) Undertakings with superior market power in relation to small and medium-sized competitors shall not use their market position directly or indirectly to hinder such competitors in an unfair manner. An unfair hindrance within the meaning of sentence 1 exists in particular if an undertaking […]*
>
> *3. demands from small or medium-sized undertakings with which it competes on the downstream market in the distribution of goods or commercial services a price for the delivery of such goods and services which is higher than the price it itself offers on such market,*
>
> *unless there is, in each case, an objective justification for this.*

6. The introduction of this new Section goes back to the competitive situation on the German markets for gasoline stations:[8] The wholesale price that gasoline companies charged to independent gas stations (so-called "*freie Tankstellen"*) was sometimes higher than the retail price they charged to end consumers. The Bundeskartellamt had tried to prosecute the allegedly unlawful conduct based on the existing general statutory provisions,[9] but it had proven quite difficult to demonstrate that the relevant prerequisites were met[10]. Against this background, an important reason for the introduction of the new provision was that it extended the presumption contained in Section 20 (4) clause 2 ARC (cf. quote above: "An unfair hindrance […] exists […]") to margin squeeze cases.[11] Consequently, any margin squeeze that

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5 These provisions were introduced by the "Gesetz zur Bekämpfung von Preismissbrauch im Bereich der Energieversorgung und des Lebensmittelhandels" (*Act on the Prevention of Price Abuse in the Areas of Energy Supply and Food Trade*). Regarding this act, see, for example *Ritter*, Regierungsentwurf zum Gesetz zur Bekämpfung von Preismissbrauch im Bereich der Energieversorgung und des Lebensmittelhandels, in: WuW 2008, page 142.

6 Regarding the new section 20 (4) clause 2 number 3 ARC see, for example *Westermann*, in: Münchener Kommentar zum Europäischen und Deutschen Wettbewerbsrecht (Kartellrecht), München, 2008, Bd. 2, § 20, para 166ff. and *Loewenheim*, in: Loewenheim/Meessen/Riesenkampff, Kartellrecht, München, 2009, § 20, para. 157ff.

7 Please note that the amendments will only remain in force until December 31, 2012; after which date the original versions will be reinstated.

8 See *Ritter* (footnote 5), page 143/144.

9 See BKartA WuW/W DE-V 289 - *Freie Tankstellen* (2000).

10 As a consequence of these difficulties, the above mentioned decision (see footnote 9) was not upheld in court (see OLG Düsseldorf WuW/E DE-R 589 – *Freie Tankstellen* and OLG Düsseldorf WuW/E DE-R 829 – *Freie Tankstellen*).

11 See „Beschlussempfehlung und Bericht des Ausschusses für Wirtschaft und Technologie" (*Recommendation and Report of the Parliament's Committe on Economics and Technology*), BT-Drucks. 16/7156, page 10/11.

falls under Section 20 (4) clause 2 number 3 ARC is now presumed (*Vermutungsregel*) to be an unfair hindrance of competition.

7. As far as the definition of the relevant behavior is concerned, Section 20 (4) clause 2 number 3 ARC requires a *formal* comparison of the prices charged by the undertaking with superior market power on the upstream market (i.e. wholesale prices charged to small and medium-sized companies with which it competes on the downstream market) and the prices charged on the downstream market (i.e. retail prices charged to individual customers); cost considerations are not taken into account. The prices on the upstream (wholesale) market must not be higher than the prices on the downstream (retail) market.

8. The elements that have to be established in order to find a margin squeeze scenario anticompetitive under Section 20 (4) clause 2 number 3 ARC include:

- Superior market power;
- unfair hindrance (presumed if a margin squeeze as defined by section 20 (4) clause 2 number 3 ARC is recognized); and
- absence of an objective justification.

9. The first prerequisite that needs to be fulfilled in order for Section 20 (4) clause 2 number 3 ARC to be applicable is that the relevant undertaking possesses superior market power in relation to its small and medium-sized competitors on the downstream market.[12] As far as the definition of superior market power is concerned, the criteria laid down in Section 19 (2) number 2 ARC can generally be applied. Consequently, factors like financial power, access to supplies and markets, links with other undertakings, legal and factual market entry barriers as well as market shares may be taken into account. Regarding the definition of small and medium-sized enterprises, these terms have to be defined in relation to the size of the undertaking with superior market power. The Bundeskartellamt has emphasized in its Notice no. 124/2003 that companies with a turnover of less than EUR 50 million may – in relation to companies with a turnover of more than EUR 500 million – be considered small and medium-sized.[13]

10. As has already been shown, another prerequisite that needs to be fulfilled is the absence of an objective justification. This prerequisite requires a comprehensive weighing up of interests and is the central element in the assessment of all abusive practices.[14] As part of the weighing-up process, the competitive interests of small and medium-sized companies have to be weighed up against the interests of the undertakings with superior market power. In this process, the aim that competition between undertakings should – as much as possible – be free of limitations, has to be taken into due consideration at

12 Regarding this prerequisite see, for example *Loewenheim* (footnote 6), § 20, para. 131ff. and the "Bekanntmachung Nr. 124/2003 des Bundeskartellamtes zur Anwendung des § 20 Abs. 4 Satz 2 GWB" (*Notice on the application of § 20 section 4 sentence 2 ARC*) (hereinafter: Notice no. 124/2003; available at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Merkblaetter/Merkblaetter_deutsch/Bekanntmachung_Einstandspreis.pdf; in German only), page 3.

13 See Notice no. 124/2003 (footnote 12), page 3.

14 See, e.g., OECD Roundtable on Refusal to Deal – Note by Germany, Doc. no. DAF/COMP/WD(2007)91, para. 9ff.

all times.[15] As a consequence thereof, the freedom of market participants to set their market prices as they deem appropriate (*Preisbildungsfreiheit*) has to be recognized with particular and distinct gravity.[16]

11. Aspects that also play an important role in the weighing-up process include, for example, the degree of superior market power on the downstream market, the degree of unfair hindrance, and whether there has previously been a supply relationship between the relevant parties. Particular interests that might be considered on behalf of the undertaking with superior market power include, for example, significant price reductions by competitors or market entry strategies. In this context, it may play a role whether or not the undertaking with superior market power (also) dominates the upstream (wholesale) market.[17] Because if it did not dominate this market, it would also generally not be under a duty to deal with its competitors. This, in turn, could influence the justification to the benefit of the undertaking with superior market power. Furthermore, intent may also play a role in the weighing-up process, as a justification will usually not be recognized if the margin squeeze is used to deliberately squeeze competitors out of the market (*Verdrängungsabsicht*).[18] The burden of proof regarding the existence of a justification rests with the undertakings with superior market power.[19]

2.2 General provisions

12. Margin squeeze cases that do not fall under the specific statutory provisions of Section 20 (4) clause 2 number 3 ARC can – as mentioned above – principally be dealt with under the general provisions of Sections 19, 20 ARC. The Bundeskartellamt has in the past recognized margin squeeze practices as a separate, stand-alone form of abuse (*eigener Behinderungstatbestand*).[20] These practices are to be distinguished from refusal to deal at the wholesale level as well as from predatory pricing at the retail level, both of which also constitute separate, stand-alone forms of abuse under Sections 19, 20 ARC. In contrast to refusal to deal proceedings, which (may) focus on excessive pricing at wholesale level (so-called constructive refusal to deal), and predatory pricing proceedings, which focus on abusive pricing at retail level, margin squeeze proceedings focus on the relation between the prices on the wholesale and the retail level.

13. Concerning the definition of the relevant behavior, the Bundeskartellamt has defined margin squeeze as a situation in which the difference between the price charged by a vertically integrated dominant undertaking on the downstream market (i.e. the retail price for consumers) and the price charged on the upstream market (i.e. the wholesale price for competitors) is either negative or not sufficient for the dominant undertaking (or an 'as efficient competitor') to cover its product-specific costs for providing its own retail services on the downstream market.[21] This definition was influenced by the practice of both the European Commission and the European Court of First Instance.[22]

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15 See Notice no. 124/2003 (footnote 12), page 7 and *Loewenheim* (footnote 6), § 20, para. 160.

16 See, for example OLG Düsseldorf WuW/E DE-R 2235 (2240) – *Baumarkt* (2008) and *Henk-Merten*, Die Kosten-Preis-Schere im Kartellrecht, 2004, page 141ff.

17 See, for example, *Bechtold*, Kommentar zum Kartellgesetz, München 2008, § 20, para. 84h; *Westermann* (footnote 6), § 20, para. 167.

18 See Notice no. 124/2003 (footnote 12), page 7.

19 See Notice no. 124/2003 (footnote 12), page 6; *Loewenheim* (footnote 6), § 20, para. 160.

20 See, e.g., BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 49.

21 See BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 49.

22 See BKartA decision B7–11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 49, footnote 8, in which the Bundeskartellamt cites, for example, the Commission Decision of 04.07.2007 Case

14. The elements that have to be established in order to find a margin squeeze scenario anticompetitive under Sections 19, 20 ARC include:

- Market dominance;
- unfair hindrance; and
- absence of an objective justification.

15. As a first step, the application of Sections 19, 20 ARC to margin squeeze scenarios requires that the relevant undertaking is dominant on a given market. Recently, the Bundeskartellamt found that it was necessary and sufficient that the relevant undertaking was dominant only on the *upstream* (wholesale) market.[23] Consequently, dominance on the downstream (retail) market is generally not required. Regarding the determination of market dominance and superior market power, the general criteria laid down in Sections 19 (2), (3) ARC and 20 (2) ARC apply.

16. Hindrance in the sense of Sections 19, 20 ARC is a behavior which has objectively negative effects on the affected firm. However, such a behavior is not abusive solely because of its negative effects. Rather, it has to be determined whether or not the behavior constitutes objectively justified competition on the merits.[24] Similarly, under Article 82 EC an abuse is generally defined as a behavior which, through recourse to methods different from those which condition competition on the merits, has the effect of hindering the maintenance of the degree of existing competition.[25]

17. For margin squeeze scenarios, the Bundeskartellamt has recently found that a *negative difference* between the prices a dominant undertaking charges on the downstream market (i.e. retail prices for consumers) and the prices it charges on the upstream market (i.e. wholesale prices for companies with which it competes on the downstream market) will generally be taken as an indication of an unfair hindrance in the sense of Sections 19, 20 ARC.[26] Furthermore, it has emphasized that the hindrance effect (*Behinderungswirkung*) was "evident" in these cases.

18. In contrast, if there is a *positive difference* between the retail price and the wholesale price, the existence of an unfair hindrance in the sense of Sections 19, 20 ARC cannot be recognized without due evaluation.[27] In these cases, it has to be shown that the difference between the retail price and the wholesale price is not sufficient for the dominant undertaking (or an 'as efficient' competitor) to cover its product-specific costs on the downstream market.[28] As a relevant measure of cost, the Bundeskartellamt

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Comp/38.754 – *Wanadoo Espana vs. Telefonica*, para. 278ff. and the Decision of the Court of First Instance of 10.04.2008 Case T-271/03 – *Deutsche Telekom/Kommission*.

23 See BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 51.

24 See BGH WuW/E BGH 1829 (1835ff.) – *VW Ersatzteile II* (1981) and OECD Roundtable on Refusals to Deal – Note by Germany (footnote 14), para. 5.

25 EuGH Slg. 1979 I, 461 – *Hoffmann-LaRoche*, para. 38 and OECD Roundtable on Refusals to Deal – Note by Germany (footnote 14), para. 5.

26 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para 53.

27 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para 53, 64ff.

28 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 64.

has – at least for the telecommunications sector – in a recent case used the long run average incremental costs (*langfristige durchschnittliche Zusatzkosten*).[29]

19. As far as the objective justification of margin squeeze practices is concerned, the criteria described above within the context of Section 20 (4) clause 2 number 3 also apply to Sections 19, 20 ARC. Consequently, a comprehensive weighing up of interests is required. In this process, criteria like the price setting freedom and the market power of the dominant undertaking are taken into account.[30] Furthermore, it may play a role whether the dominant undertaking is dominant not only on the upstream, but also on the downstream market.[31] Furthermore, intent may be of relevance. The Bundeskartellamt will usually not recognize a justification, if the dominant undertaking's price-setting strategy is used to deliberately squeeze competitors out of the market. Should a price setting strategy be pursued in such a way that the wholesale price is *higher* than the dominant firm's own retail price, the Bundeskartellamt will generally take this as an indication of intent and will consequently, as a rule, not recognize a justification.[32]

3. Conclusion

20. In Germany, margin squeeze practices are covered both by specific and by general statutory provisions. The specific statutory provisions – that were introduced in 2007 into Section 20 (4) sentence 2 number 3 ARC – apply only insofar as small and medium-sized undertakings are affected. Margin squeeze cases that do not fall under these provisions can principally be dealt with under the general provisions of Sections 19, 20 ARC. The Bundeskartellamt recognizes margin squeeze practices as a separate, stand-alone form of abuse that is to be distinguished in particular from refusal to deal at the wholesale level as well as from predatory pricing at the retail level. The relevant prerequisites were influenced by the Bundeskartellamt's enforcement practice, in particular by a recent decision concerning the telecommunications sector.

29 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 65.

30 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 52.

31 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para. 52.

32 BKartA decision B7-11/09 – *Deutsche Telekom/Mehrwertdienste* (footnote 2), para 52/53.