Telia margin squeeze saga takes new turn in Court of Appeal – Sweden

SWEDEN

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New twist to the story

Following the infringement case brought by the Swedish Competition Authority before two Swedish courts – a preliminary ruling from the Court of Justice in Luxembourg (CoJ), and two related private follow-on damages claims – the recent Svea Court of Appeal (the 'Court of Appeal') ruling marks the next chapter in the story of Swedish telecom incumbent Telia Company's (previously TeliaSonera) alleged abuse of dominance by way of margin squeeze.[1]

Contrary to all previous rulings of the national courts, the Court of Appeal, in one of the two follow-on cases, concluded that Telia had in fact not abused its dominant position. Similar to all of those courts, the Court of Appeal found that Telia had a dominant position and had applied negative margins during certain periods. Taking this as the basis for discussion, this article focuses solely on the various courts' different analyses of effects relating to negative and insufficient margins.

Background

Telia was accused of having abused its dominant position in the market for fixed access to networks, via reselling of ADSL connections, during the early 2000s. The transfer from dial-up internet connections (using a modem) to various types of broadband connections with a considerably higher transmission speed was in full swing in Sweden. At the time, the most widespread form of broadband connection was the asymmetric digital subscriber line (ADSL) by using the Telia-owned copper telephone lines created for fixed telephony. The local loop is the physical twisted metallic pair circuit in the fixed public telephone network connecting the network termination point at the subscriber's premises to the main distribution frame – in other words the part of the copper pair telephone network which connects the telephone operators to the subscriber's telephone. Telia offered local loop access to other operators in two ways: (1) unbundled access (Local loop unbundling (LLUB)) in accordance with the obligations imposed under EU Regulation 2887/2000 on unbundled access to the local loop; and (2) an ADSL product intended for wholesale users, enabling them to supply their broadband connection services to end users. Telia also offered broadband connection services directly to end users. Telia was thus a vertically integrated undertaking. Between 2000 and 2003, Telia had allegedly applied a pricing policy whereby the difference between the prices of ADSL products intended for wholesale users and the retail prices to end users was negative or insufficient.

The preliminary ruling

In the hotly debated case C-52/09, *TeliaSonera Sverige*, which was referred for a preliminary ruling by the district court in the infringement case[2], the CoJ reiterated that the mere existence of a pricing practice of a dominant undertaking which leads to a margin squeeze of its equally efficient competitors cannot constitute an abuse; at least potentially anti-competitive effects must be demonstrated.[3] Such an anti-competitive effect is present when the practice in question is capable of making new entry of at least as efficient competitors difficult, or impossible.[4] The court then introduced a probability test whereby, put simply, margin squeezes by a dominant company will probably (but not definitely) result in at least potentially anti-competitive effects when either the product/service is indispensable[5], or margins are negative.[6] If neither of those two criteria is fulfilled, it must be demonstrated that the margin squeeze is likely to make it at least more difficult for the operators to trade on the market.[7]

The infringement case

In the infringement case, the district court came to the conclusion that there was strong evidence indicating that Telia's product intended for wholesale users was indispensable. However, the court did not render a final judgment on the matter. In the context of the preliminary ruling stating that negative margins result in a 'probability' of exclusionary effects, the court stressed that a finding of abuse requires more than mere probability. The court's assessment consisted of measuring the evolution of the market as a whole and how the competitors' ability to offer services had been affected against the counterfactual, that is without the margin squeeze. The court found that the margin squeeze had delayed entry for competitors since, for a long period of time, they were compelled to either sell at a loss or at a profit that was so low that they could not engage in active marketing to win new customers. Arriving at this conclusion, the court cited statements provided by competitors suggesting that there was no room for expansion and that their shares on the dial-up internet market were not reflected proportionally on the ADSL market. Since this amounted to tangible evidence of anti-competitive effects, Telia was found to have abused its dominant position and was imposed with a fine.

The Market Court's[8] reasoning for its decision, in regards to the effects of the conduct, is only two-pages long,[9] citing the fact that reports suggested that Telia had: (i) achieved a first-mover advantage in the ADSL field; (ii) that prices for ADSL were not considered to allow for fair competition; (iii) that Telia considered the market for housing and real estate management companies to be of particular interest as it opened up the opportunity to impact a large number of customers through limited sales efforts; and (iv) that Telia made a loss when it entered certain framework agreements. Somewhat oddly, the analysis carried out by the Market Court makes no explicit reference to the issue of indispensability. One report by the European Commission stated that it was of importance to competitors that Telia began offering its product to wholesale users, but the court did not comment on whether this would amount to indispensability. In view of the number of customers covered by the framework agreements, the court found that the practice must have had at least potential anti-competitive effects. The Market Court found that Telia had abused its dominant position and imposed a fine.

The follow-on cases at the district courts

The two follow-on damages claims were brought by Tele2[10] and Yarp[11]. In the case involving Tele2, the district court did assess the indispensability issue, concluding that the product intended for wholesale users was of substantial importance to Tele2's ability to compete.

The *Yarp* case concerned the internet service providers Spray and Tiscali. After concluding that the margins were negative and insufficient, the district court found that Telia's conduct gave rise to at least potential negative effects, as competitors were forced to sell at a loss. No explicit reference was made to the indispensability issue.

In both the *Tele2* and *Yarp* cases, the courts held that the number of customers covered by the framework agreements was regarded as evidence of at least potential anti-competitive effects.

The *Yarp* case in the Court of Appeal

The first striking difference from the analyses of effects (including indispensability) is the length. While the other courts dedicated only a few pages to the question, the Court of Appeal gave it attention for some 18 pages.

The Court of Appeal identified the indispensability issue as being crucial. Yarp argued that it would not have been profitable for Spray or Tiscali to make the investment needed to gain access to the copper network through LLUB and that Telia had offered poor and complicated terms. This argument was dismissed. In light of the *Bronner* case,[12] these factors were not sufficient to prove indispensability. Furthermore, another internet service provider was in fact, through LLUB, offering a service that competed with Telia's product. Yarp had not offered any tangible evidence demonstrating which terms offered by Telia had served to prevent Spray and Tiscali from investing in LLUB. LLUB was found to be a potentially viable alternative, at least during certain periods. Interestingly, the Court of Appeal did not consider LLUB and the product intended for wholesale users sufficiently substitutable to belong to the same relevant wholesale product market, but recognised the former as sufficiently viable an alternative to render the latter not to be indispensable.

The Court of Appeal interpreted the preliminary ruling to mean that, if a product is not indispensable, a margin squeeze does typically not lead to anti-competitive effects. As regards the negative margins, they were applied for eleven months and covered around one fifth of the relevant market for end consumers. The Court of Appeal stressed that this period was relatively short in comparison with cases at EU level. Comparisons were made with the *Telefónica* and *Deutsche Telecom* cases, where the margin squeezes occurred for over five years. The Court of Appeal considered that the magnitude of the conduct, taking into account the period in which the conduct continued and the market share it has affected, did not heavily imply that the margin squeeze actually led to any anti-competitive effects.

The Court of Appeal noted that, even though the concept of abuse is objective, Telia's pricing strategy should be taken into account. Telia argued that it had set the initial price based on overly optimistic assumptions as to how and the rate at which the market would evolve, which required the company to later adjust the prices upwards. Several framework agreements had been entered into for several years and, most importantly, before the product intended for wholesalers was offered to the market. The only way to have avoided a margin squeeze would have been either not to have offered the services or to have offered them at a price sufficiently lower than the price that was set for the framework agreements years earlier. In addition, the price was already insufficient to cover the costs associated with its offering. Therefore, according to the court, the evidence did not indicate that Telia had intended to foreclose the market.

The Court of Appeal also dismissed the argument that the absence of a correlation between the market shares of dial-up internet and broadband operators indicated an inability to compete. The court noted that the business models between the offerings of the respective services differed, suggesting that the market shares would not necessarily correlate.

Consequently, since the Court of Appeal did not find evidence of anti-competitive effects, there was no abuse of a dominant position. Therefore, the Court of Appeal changed the ruling of the district court and dismissed the claims in full.

Final remarks

This saga is a remarkable one as the Court of Appeal in the *Yarp* case came to a conclusion that is completely at odds with that of the other national courts. It should be noted that the former competition act applied to the relevant cases and that there is now no possibility for a court in a follow-on damages case to re-examine an infringement that has already been established.[13]

Two of the previous courts did not explicitly discuss the indispensability issue and none of them expressly stated that the product was in fact indispensable. Since, as stated by the CoJ and shown by the Court of Appeal, the indispensability issue is of major importance, it is unfortunate that a more in-depth analysis was not carried out in this regard. In view of the reasoning by the Court of Appeal, when determining indispensability it is important not to narrow down on the relevant product market but to look wider and assess alternatives that may perhaps be less advantageous and/or economically profitable from a customer perspective, but which are still viable.

Be it not obvious why anti-competitive effects would be probable merely because of negative margins (regardless of the number of options), the Court of Appeal in the *Yarp* case interprets the preliminary ruling in a somewhat flexible manner. The Court of Appeal is not clear-cut in explaining how its interpretation that a margin squeeze (when the product is not indispensable) does not typically lead to anti-competitive effects is consistent with the statement by the CoJ that anti-competitive effects are probable when margins are negative.

The preliminary ruling merely provides for an assumption of probability, not certainty. The test, as laid down by the CoJ, is whether the practice produces (at least potentially) anti-competitive effects.[14] If the ability for competitors to penetrate the market, regardless of the fact that the product is indispensable or the margin is negative, is not made more difficult, there are no, even potentially, anti-competitive effects.[15] Other factors that are to be considered are for example, the period in which the conduct took place, the share of the market it has affected and the pricing strategy of the dominant undertaking.

This hotly debated issue has arrived in the hands of the Court of Appeal for the first time, a court that has proved capable of giving the saga a completely new twist. The story is, however, not over yet. The judgment in the *Tele2* case was delivered in late December 2017 and it added further to the confusion.[16] In that judgment the Court of Appeal, in contrast with the *Yarp* case, found that Telia had in fact abused its dominant position. On the basis of the preliminary ruling the Court of Appeal took the view that both indispensability and negative margins are presumed to lead to anti-competitive effects. Since margins were negative there was a presumption of anti-competitive effects even though the product was not considered indispensable. That presumption was not rebutted. However, as regards the claims for the actual damages, the Court of Appeal stressed that in difference to what is required for a finding of abuse, where it is sufficient to prove at least potentially anti-competitive effects, the claimant must prove the causality between the conduct and the damages. Tele2 did not manage to prove such causality and the claims were therefore dismissed. The *Yarp* case has been appealed to the Supreme Court[17] (leave to appeal pending) and it has, amongst other things, been argued that the Court of Appeal has unduly deviated from the binding CoJ preliminary ruling. Thus the saga continues.

Notes

1 Although Telia was also accused of refusal of delivery and discrimination, the article will not address these matters.
2 Case T 31862-04.
3 Case C-52/09, *TeliaSonera Sverige*, para. 61.
4 *Ibid*, para. 63.
5 *Ibid*, para. 63 and 70–71.
6 *Ibid*, para. 73.
7 *Ibid*, para. 74.
8 As of 1 September 2016, a new judicial system has entered into force in Sweden, where the previous court of first instance (ie, the District Court) has been replaced by the Patent and Market Court, and the superior court, the Market Court, has been replaced by the Patent and Market Court of Appeal.
9 Case M 2013:5.
10 Case T 10956-05.
11 Case T 15382-06.
12 Case C-7-97, *Bronner*, see in particular para. 43–46.
13 See Chapter 5, section 9 of the Competition Damages Act (Sw. Konkurrensskadelag (2016:964)) which im-plements Directive 2014/104/EU on antitrust damages actions.
14 Case C-52/09, *TeliaSonera Sverige*, para. 77.
15 Case C-52/09, *TeliaSonera Sverige*, para. 66.
16 Case T 5365-16.
17 Case T 3756-17.