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ABUSE OF DOMINANCE IN REGULATED SECTORS

(Background Note by the Secretariat)

-- Session III --

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ABUSE OF DOMINANCE IN REGULATED SECTORS

Background Note

by the Secretariat

1. Introduction

1. The phrase, “abuse of dominance in regulated sectors,” is both obvious and contradictory. Some might say that abuse can only be expected in sectors that have been singled out to be regulated. Others might say that if a sector were effectively regulated, then abuse cannot occur. But legal and institutional frameworks are not so tightly built, allowing at least the questions to be raised whether there is an overlap so that some conduct can be dealt with both as a regulatory matter and an antitrust matter, as well as whether there may be gaps between the implementation of the two approaches. Institutional structures may create a gap in which competition authorities find themselves deciding whether and how to address exploitative or exclusionary conduct by enterprises in dominant positions and, more rarely, by other parts of government. Where these gaps are in regulated sectors that are economically or politically important, such as telecommunications, electricity, and transport, competition authorities can be under intense pressure to solve market problems.

2. Governments impose economic regulation for a variety of reasons. These include economic reasons, such as reducing the effect of market failures, and political reasons, i.e., redistribution or hindering redistribution of wealth. Competition law usually contains prohibitions of abuse of dominance, that is, exploitative and/or exclusionary conduct by enterprises in dominant positions. Some market failures result in enterprises having dominant positions. Many environments with market failures are also environments in which exploitation or exclusion is feasible. Thus, it is not surprising that economic regulation and antitrust law are applied in close proximity in an economy.

3. Other sessions in the 2005 OECD Global Forum on Competition address two related issues, bringing competition into regulated sectors and the relationships between economic regulators and competition authorities. When sectors that had had a state operator or been subject to pervasive regulation are liberalised, in the sense that other enterprises can enter and begin competing in some markets, and that regulated enterprises gain freedom to make significant economic decisions, then there is wider scope for enterprises to engage in anticompetitive conduct. However, newly established or revived competition authorities may find their room for manoeuvre constrained by pre-existing sectoral regulators. This note fits between these two related issues—after competition has been introduced into a regulated sector and focusing on one aspect of the relationship between competition and regulation. That is, this note focuses on where there is economic regulation but dominance abuse prohibition can be a *substitute* in addressing a market failure (e.g., access to an essential facility can be mandated by regulation or by abuse prohibition), or can *reinforce* regulation (e.g., failure to comply with regulation can be treated as an abuse) or can *maintain the effectiveness* of regulation (e.g., prohibiting tying of unregulated to regulated services to evade regulation or prohibiting a price squeeze when the access price is regulated).

4. The rest of the note is organised as follows. First is a description of how competition and regulatory laws relate to each other. Second is a brief discussion of abuse of dominance, both in general and in specific, as a legal concept to address an economic concern.

2. How do the competition and regulatory laws relate?

5. Abuse of dominance prohibition and economic regulation may relate in a number of ways. They may be contained in the same or different laws. They may be enforced by the same or different institutions. (This is part of the topic of another Forum session.) They may be of interest to different levels of government, such as federal versus state. They may push enterprises' conduct in the same or in different directions. This section mentions some of the legal issues that arise in considering the relationship between these two policies.

6. The substance of the dominance abuse prohibition and of the economic regulation may be contained in the same law, such as a telecommunications act prohibiting dominance abuse as well as setting out the regulatory regime. Or the substance can be in different laws, such as a competition law and sector-specific regulatory laws. Then the principles by which conflicts of laws are resolved (such as specific laws overriding general laws unless this is explicitly not intended) can be called into play. Explicit exemptions or, in the other direction, "savings clauses" which say that the current law does not affect the application of the other explicitly identified law, may be contained in the laws themselves.

7. It is unusual for a sector to be exempt from the competition law because the sector is also subject to economic regulation. But legislators do not always see the implications of broad exemptions. An example is provided by South Africa. "[T]he 1998 Competition Act excluded 'acts subject to or authorised by other legislation.' Courts began to interpret this phrase so that firms in regulated sectors escaped Competition Act oversight whether or not the other regulatory process also controlled anticompetitive conduct. [Bank mergers were exempted; an agricultural co-operative was exempted.]...[T]he legislation was amended to avoid the problem in the future." (OECD, *Competition Law and Policy in South Africa*, 2003, p. 51)

8. A more difficult issue is the relationship between abuse of dominance and regulation when they might apply to the same conduct or to very closely related conduct. A 2003 European Commission decision on *Deutsche Telekom* is interesting in this respect. The incumbent telecom company was found guilty of an abusive margin squeeze, that is, of charging too low a price to consumers given the price it charged its rivals for access to some of its facilities. The access price was partly regulated by regulatory authorities, but the retail price was not regulated. It was chosen by Deutsche Telekom. It appears to be the rule that where enterprises have economic freedom under the regulation then the competition law, with its abuse of dominance prohibition, applies. This decision is also interesting as an example of the relationship between European Union competition law and a Member State's regulatory law, a topic taken up below.

9. Consider now the relationship between abuse of dominance and regulation when the laws might apply to the same conduct. There could be an explicit exemption. The more interesting question is, what if there is not? One interpretation of the 2004 US Supreme Court's decision, *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, is that if a regulatory regime is effective in performing the same functions as the antitrust (competition) regime, at least with respect to denial of access, then antitrust law does not apply.¹ The traditional default position is for the antitrust law to apply: "Repeal of the antitrust law by implication from a regulatory statute are strongly disfavoured, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." (*United States v. Philadelphia National Bank*, 374 U.S. 321, 350-51 (1961) cited in *Antitrust Law Developments (Fifth)*, p. 1239.) The traditional rule is being tested by decisions such as *Trinko*.

10. Both the specific versus general distinction and the sovereignty of constituent parts are significant in the "state² action doctrine" in the US. This doctrine effectively insulates state government and private parties from the application of the competition laws when the anticompetitive conduct is

undertaken within a “clearly articulated” and “actively supervised” state policy. State regulation that is “clearly articulated” and “actively supervised” is the usual example.

11. The “state action doctrine” in the US contrasts with the analogous relationships within the European Union and in the Russian Federation. The European Union has been the inspiration and even impetus for much regulation by Member States, although the regulation of such sectors as telecommunications and energy is performed by the Member States. National regulation must comply with applicable EU law, including EU competition law.

12. The Russian Federation provides yet another way to resolve conflicts between competition law at the federal level and regulation at the level of constituent parts. In Russia, actions or decisions by federal bodies of the executive power, state bodies of the subjects of the Federation (i.e., its constituent parts) and bodies of local government are prohibited if they restrict the independence of economic actors or create discriminatory conditions, and if those actions or decisions have or may have as a result the prevention, restriction or elimination of competition, and they infringe the interests of economic actors. Some of the items in the non-exhaustive list of prohibited actions or decisions have their anticompetitive effect through exclusion of competitors, and thus arguably are an analogue of abuse of dominance. Officials are subject to civil, administrative, or criminal liability for violations. (Federal Law on Competition and Restriction of Monopolistic Activity on Product Markets, articles 7 and 21, respectively.)

13. This section has touched on some of the legal issues that arise in considering the relationship between abuse of dominance prohibition and economic regulation. Where these policies conflict, managers of enterprises need to know the rules by which the conflict will be resolved. In much of its past work, the OECD has strongly endorsed a policy that competition law have the greater weight and regulation be designed to have the least anticompetitive effect. Where these policies point in the same direction, one way to choose which policy takes the lead is on the basis of which would be the least costly. Other bases for decision-making—likelihood of capture, institutional characteristics, and so on—are discussed in another session of this Forum. However, in some instances, the constitutional division of power determines how the abuse of dominance prohibition relates to economic regulation. In sum, competition authorities face different constraints in their ability to use abuse of dominance prohibitions in regulated sectors.

3. What is abuse of dominance?

14. Jurisdictions differ in their definition of the legal term, “abuse of dominance.” They have two tests, but they differ in how they apply the two tests. The first test is that the enterprise³ (or enterprises, see below) must have a dominant position in a relevant market. The second test is that the conduct must be “abusive.” The remainder of this section mentions the more important issues related to these two tests.

3.1. What is a dominant position in a relevant market?

15. A dominant position is a legal term that expresses the economic concept of an enterprise having substantial, durable market power in a market. Put plainly, it means that an enterprise can keep prices substantially above competitive levels for some significant length of time. Buyers cannot switch to some other supplier or some other product easily and quickly. Rivals cannot enter or expand their capacity quickly.

16. The legal term “dominant position” also varies by jurisdiction from relatively formal to more analytic. At the formal end of the scale, some competition laws specify a market share and label enterprises with larger market shares dominant. At the more analytic end, the competitive constraints on the enterprise are considered more explicitly, with references to entry by new competitors, competitors’ changing their products to compete more directly or of expanding their capacities, buyers’ ability and practice of

switching suppliers, and so on. If entry at large scale is either unlikely or slow, or if rivals cannot expand capacity substantially or quickly, or if buyers cannot easily switch suppliers, then the enterprise may have a dominant position. Where the data exist, residual demand analysis (describing the demand that individual enterprises face) measures market power directly. In particular, this analysis allows the calculation of the effect on demand faced by a specific enterprise when prices change. If demand does not shrink by much when price increases, then the enterprise has market power and, if it is substantial and durable, a dominant position.

17. Another dimension in which jurisdictions differ in the definition of dominant position is the number of enterprises. In some jurisdictions, only conduct by a single economic entity could be identified as “abuse of dominance” whereas in other jurisdictions, conduct by more than one economic entity could be identified as an abuse. It’s worthwhile to note that, in the most prominent of these jurisdictions, the European Union, the concept of joint dominance is used much more in evaluating proposed mergers in oligopolistic markets than in abuse cases. With this in mind, this note does not further address joint dominance.

18. A “dominant position” is a “dominant position” in a relevant market, not an abstract dominance. Market definition in circumstances of possible dominance raises well-known problems. One is the need to avoid the “Cellophane fallacy,” i.e., the need to adjust the market-defining test often used in merger analysis (the SSNIP test or hypothetical monopolist test) to take account of the possible existence of market power.⁴ The second is the need to ensure that all competitive constraints are under consideration. For example, if several seaports are substitutes from the shippers’ point of view, then the exclusion of a ferry from one port might be calamitous for the ferry—it cannot provide the service it wishes to—but not really have an effect on the shippers.

19. In sum, for conduct by an enterprise to qualify as an “abuse of dominance,” the enterprise must be found to be dominant in a relevant market. In other words, “dominance” is a one-sided test; it screens out non-dominant enterprises. If the enterprise is caught by the screen, then the conduct must be examined for whether it is abusive. This is the subject of the next part.

3.2. *What is abuse?*

20. Circumscribing abusive from non-abusive conduct by a dominant enterprise is difficult. More than in most other areas of substantive competition law, jurisdictions differ. This part of the law presents two other difficulties. The first is that the economic effect of specific conduct depends greatly on the context in ways that we cannot yet generalise. Therefore, this part of the law appears to be more *ad hoc* even though the decisions follow underlying principles. The second difficulty is institutional. Unlike merger review or cartel enforcement, dominance abuse typically comes to the attention of the authorities on the basis of complaints, and the economic interests of those complaining do not systematically align with the economic interests of society more generally. This means that authorities must distinguish the specific from the general, and in particular whether the specific harm to one or two rivals is the harbinger of general harm to the process of competition or just some sour grapes.

21. Exploitative conduct is one of the two general categories of abusive conduct. From the outset, an important observation is that jurisdictions differ in whether a dominant enterprise’s conduct that is directly and immediately exploitative is prohibited and, if prohibited, how assiduously they prosecute it. The principal example of this sort of conduct is a monopoly charging monopoly prices.

- In some jurisdictions, this is not illegal. The thinking is that markets are flexible enough that rivals will appear soon enough and, besides, monopoly profits are the incentives that drive innovation and the development of business acumen.

- In other jurisdictions, a monopoly charging monopoly prices is illegal, but the authorities pick and choose when they think markets are sufficiently open that rivals will lower prices soon. One example of this approach is provided by the Office of Fair Trading with respect to scientific publishing. The OFT found indications of high prices and profits, but decided not to intervene “for now” since “it remains to be seen whether market forces...will remedy the problems that may exist,” but it kept the position under review. (“The market for scientific, technical and medical journals,” a statement by the OFT, September 2002)
- Other jurisdictions prosecute exploitative conduct such as a monopoly charging monopoly prices.

22. Exclusionary conduct is the other general category of abusive conduct. This term means that a dominant enterprise engages in some sort of conduct that forces another enterprise from a market, or keeps it out in the first place. Some typical examples are provided in the cases submitted for this session: the operator of a port denies access to rival stevedores, or the owner electricity transmission denies access to rival electricity generators-marketers, or the incumbent telecoms enterprise charges prices that prevent unintegrated rivals from competing in markets that the regulatory regime intends to be competitive. As for exploitative conduct, jurisdictions differ in how they treat exclusionary conduct.

3.2.1 *Some generalisations*

23. Some generalisations may help provide some order to the list of potentially abusive conduct. First, market failure can help to focus attention on the economic effect of conduct. Second, an awareness of the complaint-driven nature of abuse of dominance investigations can help focus investigations on harm to the competitive process. Third, limiting the topic to regulated sectors has some implications on the effect of the conduct, evidence, and remedies.

24. The economic effect of specific conduct depends greatly on the context in ways that we cannot yet generalise. We can, however, generalise in some ways, in particular about market failures. Market failure is an economic concept meant to convey the idea that some market outcomes could be improved for both buyers and sellers if there were different prices, varieties, or patterns of innovation.⁵ Natural monopoly, entry barriers, externalities and asymmetric information are examples of market failures. Sometimes economic regulation is imposed to try to correct market failure, so the regulated sectors that are the topic of this note are likely to have market failures. Furthermore, some abuses are simply the manifestation of market failure. E.g., charging monopoly price is what one expects in a natural monopoly, a market failure. Some abuses are a reaction to market failure. E.g., rebates when certain retail sales targets are met may be the efficient way for manufacturers to overcome their inability to monitor retailers’ sales efforts. Hence, evaluating market failures are a key part of analysing the context of conduct, and thus its economic effect.

25. Second, complaints about exclusion present an inherent difficulty which can result in over- or under-enforcement. As noted above, authorities typically learn about dominance abuse from complaints. The economic interests of those complaining do not systematically align with the economic interests of society more generally. However, harm to the competitive process begins with harm to individuals who may complain to the competition authorities. The problem of when to act is a bit like the problem in distinguishing between competitive prices and predatory prices. If we have an efficiency objective, we would like inefficient competitors to exit a market but we do not want all competitors to exit a market, except in particular circumstances. If we have other objectives, like preserving a right to be in business or preventing the concentration of economic power within an economy, then we may be willing to have somewhat inefficient enterprises in markets. Wherever the line is ultimately drawn, there remains the

problem of distinguishing harm to competitors from harm to competition, a distinction that might be difficult to draw during the process of harm or the investigation of the harm.

3.2.2 What is the significance of “in regulated sectors”?

26. Regulation can affect whether specific conduct is found to be abusive. In addition, it can affect whether certain facts constitute evidence for dominance, the size of punishment, and the decision about what remedies would be feasible.

27. Whether conduct violates regulation may affect whether it is abusive. For example, in the United States, a monopolist’s conduct that contributes to establishing or maintaining monopoly power *and* is improper for reasons outside the antitrust laws is considered to be abusive. False advertising, product disparagement, filing baseless legal proceedings and violation of regulatory requirements have been found to qualify. (ALD5, pp. 246 and following)⁶

28. Further, regulation and abuse prohibition may be substitutes, the choice depending on the feasibility of deciding in advance whether particular conduct is harmful. Conduct that can be judged *ex ante* as generally abusive is probably more cheaply dealt with by a prohibition *per se*, as in regulation. But for that conduct for which *ex ante* judgement has many errors (prohibited conduct is not harmful, permitted conduct is harmful), then it is probably cheaper—taking into account both the direct costs and the costs of erroneous judgements—to apply competition law’s usual case-by-case approach. It is these difficult cases, in which many facts and circumstances are considered, that remain as “abuse of dominance” cases.

29. Effective regulation affects the significance of evidence commonly taken to indicate dominance. Market shares are often used as evidence of dominance. As noted above, they are sometimes even included in the definition of dominance in competition laws. But where regulation prohibits an enterprise from raising price or from refusing to supply its rivals, then market shares have little indicative value. The absence of entry barriers may be taken as evidence pointing toward an absence of dominance. But regulatory barriers to entry (or exit) have the same effect as “natural” entry barriers. More generally, the significance of indicators of dominance changes when enterprises are subject to regulation. What matters, of course, is the actual regulation applied and not the rule book as such.

30. Regulation reduces the punishment for abuse, at least in certain circumstances. In particular, the “filed rate doctrine” in the US says that a person who is injured by high prices cannot recover treble damages (as the antitrust laws normally allow) if the prices (rates) had been filed with the relevant regulator. (ALD5, pp. 1240-2)

31. Regulation can make behavioural remedies cheaper than if a regulator were not already in place. But the overall cost of a behavioural remedy may still be higher than the cost of suffering the abuse or imposing a structural remedy.

32. In sum, regulation can affect the analysis of abuse of dominance cases in a number of ways. Understanding the regulation applied in a sector is crucial in evaluating the evidence for dominance, to understanding the effect of specific conduct, and feasible remedies.

33. The next section lists some conduct which, when engaged in by a dominant enterprise, has been found to be abusive in some circumstances. The list is by no means exhaustive and has been trimmed to correspond to some of the cases submitted for this session.

3.2.3 *Specific abuses*

34. As noted above, generalisation of how to distinguish abusive conduct from non-abusive conduct is difficult. One analysis of underlying principles has been made by Vickers. He identifies three tests that have been put forward to distinguish abuse from non-abuse: (1) the sacrifice test (whether the conduct would be profitable if it did not tend to eliminate or lessen competition), (2) the as-efficient competitor test (whether rivals who are as efficient as the dominant enterprise would be excluded by the conduct), and (3) the consumer harm test (whether consumer surplus or total surplus would fall as a result of rivals being excluded by the conduct). However, he notes conceptual difficulties with each test. (John Vickers, “Abuse of market power,” Speech to the 31st conference of the European Association for Research in Industrial Economics, Berlin, 3 September 2004.) These tests do, however, have the merit of focusing on the economic effect of the conduct, specific types of which are mentioned next.

35. **Refusals to deal.** The concern here is often a refusal by an enterprise controlling an essential facility to grant access to it, or the imposition of unreasonable changes in services provided or the rates charged. The focus for abuse of dominance cases in these situations is whether the facility is essential to competitive viability, whether the facility could be duplicated practically and reasonably, and whether granting access is feasible. There can be legitimate business reasons for denying access to an essential facility, beyond the issue of feasibility of sharing.⁷ Given that an essential facility is a natural monopoly⁸ with high entry barriers, both of which cause market failure, access is often regulated when such a facility has a significant economic or political impact.

36. Beyond outright refusal, the dominant enterprise may engage in a variety of conduct to harm its rivals. It may charge a “high” access fee, or provide only a degraded quality of access (not timely, or unreliable, or inconvenient). It may use information which is necessary to provide the access in order to target solicitation to the rivals’ customers. An enterprise may engage in similar conduct when another network must interconnect with its own network. In sum, even though some aspects of access to an essential facility may be regulated, there may be dimensions of denial discovered or invented only as the dominant enterprise seeks to keep its rivals wrong-footed. This conduct may need to be dealt with as abuse of dominance, rather than as regulatory evasion.

37. **Price squeeze.** The concern here is that an enterprise, dominant in an upstream market but facing rivals—whom it supplies—in a downstream market, could choose a combination of up- and downstream prices that eliminate rivals. Such elimination undoes the effect of a regulatory regime designed to foster such rivalry. Price squeeze is defined differently in different jurisdictions. Fundamentally, a price squeeze occurs when the difference between the downstream price and the upstream price is “too small.” Jurisdictions differ in how small “too small” is.⁹ The larger the required margin, the more inefficient surviving competitors can be. This means there are more competitors downstream, potentially offering greater product variety and scope for innovation, but can mean that consumers pay higher prices.

38. **Vertical agreements and other pricing that foreclose competition.** A concern in regulated sectors is tying unregulated services to regulated services as a way to evade regulation. (The enterprise makes monopoly profits on the tied product but complies with maximum price regulation on the tying product.) In both regulated and unregulated sectors, a concern is often provisions that raise the cost of consumers’ switching to another supplier, such as unreasonably long license periods, royalties based on a measure independent of quantity (e.g., the total number of personal computers rather than on the number of PCs using the intellectual property), bundled rebates, pricing dependent on exclusivity, and others. Raising switching cost, of course, raises barriers to rivals’ entry and hampers rivals’ expansion. Some, but not all, of these practices are reactions to the particular market failure known as “asymmetric information:” Contracts between producers and distributors, for example, can reduce some of the inefficiencies caused by asymmetric information such as by inducing the provision of difficult-to-observe retail services. Offering

various pricing schemes (bundling, rebates, two-part tariffs, etc.) can be an efficient way to discover various consumers' willingness to pay.

39. **New product introduction and promotion.** This concern arises when products are used in networks in which the various products need to be compatible. The concern is that a dominant firm introducing new products may harm smaller enterprises' ability to compete. However, innovation is an aspect of competition and a way to improve consumer well-being. This means that caution is required when considering whether an innovation is anticompetitive. The balance is reflected in the pattern of US court decisions in which the integration or modification of a computer system's components, when the changes improve performance or cut costs, have been consistently found to be legal even when the changes resulted in incompatibility. (ALD5 p. 291) While the language of this paragraph suggests high-tech products, the same issues of innovation and compatibility can arise in other contexts.

40. **Anticompetitive litigation.** Abuses of government process, such as filing lawsuits or administrative complaints in order to hinder competitors, can be an abuse. Standards for finding this to be an abuse are high, however. In the US, for example, the complaining party "must show (1) that the claim was objectively baseless, in that no reasonable litigant could have anticipated success on the merits; and (2) if and only if the "objectively baseless" test is met, that the party asserting the meritless claim had a subjective intent to interfere directly with a competitor's business relationships by means of the litigation process, regardless of the outcome of the case." (ALD5, pp. 295-6, citing *Professional Real Estate Investors v. Columbia Pictures Industries*, 508 U.S. 49 (1993))

41. **Monopoly leveraging.** The concern is that an enterprise could use its dominance in one market to extend that dominance to another market, usually by tying or pricing with the same effect as a tie. Specific economic conditions are necessary for this strategy to be profitable and anticompetitive. The seminal example for when leveraging may be profitable is if the "tied" market is subject to economies of scale and thus is imperfectly competitive, and leveraging successfully induces exit of rivals from that market. (Michael D. Whinston, "Tying, Foreclosure and Exclusion," *American Economic Review*, vol. 80, pp. 837, 1990)

42. **Predatory pricing.** The concern is that an enterprise may charge a low price until its rivals exit the market, then subsequently exploit the resulting market power. The related concept of price squeezes was addressed above. In regulated sectors the concern centres on enterprises supplying two or more products, where entry into one market is constrained and the other market is potentially competitive. The concern is that the enterprise will apply profits generated in the "protected" market to fund predation in the potentially competitive market. Debate focuses on what cost measures are relevant (marginal cost, average incremental cost, another measure of cost that includes some of the common costs, whether or not to include foregone profits as an opportunity cost), whether or not assessing the ability to recoup the costs of the predatory strategy is a separate necessary analytical step, and how to assess the effect of predation in establishing a reputation as a formidable competitor and thus deterring future entry in other markets where the enterprise is active. Since none of the cases submitted deal with predation, this note does not further address this topic.

43. **Other conduct** which has been found to be abusive is:

- A regulated enterprise charges a price above the regulated price. A variant is, a regulated enterprise sells a given quantity at the regulated price and charges a much higher price for any amount above that quantity.
- A regulated enterprise ties the provision of the regulated product to the purchase of an unregulated product.

- An enterprise, subject to economic regulation only in part and enjoying substantial market power, introduces a contractual obligation or a pricing scheme which raises buyers' costs of switching to a different supplier. For example, it may require that all of a consumer's estimated use of the product, such as natural gas, be prepaid.
- A government office accepts only services provided by one of several potential providers. For example, the passport agency's local office accepts only photographs provided by a specific photographer, even though other photographers' photographs comply with regulation.

44. To summarise this section on abuse of dominance, jurisdictions differ in how they define the legal term, "abuse of dominance." Dominance must be defined in a relevant market, and is a one-sided test, i.e., enterprises not meeting the test cannot be found to be abusing their dominance. The second test is whether the conduct is abusive. The determination is based on economic effects, i.e., an analysis of the facts and context. Specific conduct can be abusive or not abusive, depending on the facts and context. Conduct taking place in a regulated sector can affect whether the conduct is abusive, the evidence for the dominance or otherwise of the enterprise, and whether behavioural remedies for abusive conduct are feasible. Refusal to provide access to an essential facility or price squeezes eliminate the competitors that regulation is designed to foster. Tying unregulated services undermines the effectiveness of maximum price regulation. Thus, some abuse of dominance has the effect of undermining the very objectives regulation was designed to achieve.

4. Observations

45. Abuse of dominance is not uncommon in regulated sectors.

46. Markets subject to failure may potentially receive the attention of the state through a combination of several instruments: state operation, regulation of corporate entities or private enterprises, and the competition law. The choice of instrument can reflect differing costs of application in the given circumstances. Among the potential costs would be the development of a concept of abuse of dominance that is not appropriate in markets not subject to economic regulation. For example, exploitative pricing might be better dealt with by regulation, then subsequently as regulatory evasion, than as dominance abuse.

47. The market failures that induced the regulation can make conduct abusive. For example, while normally an enterprise refusing to supply incurs no antitrust penalty, if that enterprise controls an essential facility, carefully defined, then its refusal to grant access to its rivals is an abuse.

48. The economic regulation put in place to address the market failure may do so incompletely. Economic regulation controls only a handful of an enterprise's economic decisions. Such an enterprise may find profitable conduct, not explicitly prohibited by regulation, but which is exploitative of its market power or exclusionary of rivals. Thus, a regulated enterprise can abuse a dominant position. Further, it may abuse its dominance through violation of regulation or through conduct that does not violate regulation.

NOTES

1. In that decision, the Court said that “One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm.” It found that “[t]he regime was an effective steward of the antitrust function.” The “slight benefit” of antitrust intervention in the case did not outweigh a “realistic assessment of its costs.” [*Trinko* at 412, 413, 414] It is important to note that, in this case, the regulatory structure dealt with the precise dominance abuse claimed.
2. Here “state” refers to the fifty states. The treatment of states is distinct from the treatment of states’ political subdivisions. The subdivisions may have immunity only if the state has authorised the anticompetitive conduct. However, *inter alia* local governments, local government officials, and private persons acting per their direction are not subject to antitrust damage claims according to the Local Government Antitrust Act of 1984.
3. No attempt is made in this note to discuss the nature of “that which can be the subject of competition law application,” e.g., how to define “enterprise” as used in this note.
4. Applying the SSNIP test when prevailing prices reflect the exercise of market power—asking whether an unregulated profit-maximising enterprise would impose a small but significant and non-transitory increase in price on a candidate market—would define too broad a market because it would indicate some products as substitutes that are not, in fact, substitutes at competitive prices.
5. A market failure is technically defined as a departure of the market equilibrium from the set of Pareto optimal allocations of goods and services. A Pareto optimal allocation is an allocation in which no economic agent can be made better off without making another worse off. We would not expect failure in a market that is perfectly competitive, in which there is complete information and costless transactions.
6. A more careful statement is: Once an enterprise has been found to be a monopoly, then a finding of monopolisation requires the conduct to be either (1) economically irrational but for the conduct’s adverse effect on competition, or (2) contributing to establishing or maintaining monopoly power *and* improper for reasons outside the antitrust laws. Conduct which has been found to qualify under item 2 has included false advertising, product disparagement, filing baseless legal proceedings and violation of regulatory requirements.
7. “While the requirement that the monopolist have a ‘legitimate business reason’ cannot be satisfied by the motive of preventing erosion of its monopolistic position, (citation omitted), the courts have found a monopolist’s goals of discouraging free riding, enhancing its image, or ensuring low cost of r its customers to be legitimate business motivations.” *City of College Station v. City of Bryan*, 932 F. Supp. 877 (S.D. Tex. 1996 cited in ALD5 p. 284)
8. Indeed, the definition of essential facility is much more restrictive than the definition of natural monopoly. Not all natural monopolies are essential facilities.
9. A price squeeze, in US jurisprudence, is said to occur when an enterprise has monopoly power over one product, its price for that product is “higher than a ‘fair price,’” that product is necessary in order to compete in a second market where the monopolist also competes, and the difference between the enterprise’s upstream price and its downstream price is so small that competitors cannot match the downstream price and still earn a “living profit.” (United States v. Aluminum Co. of America, 148 F.2d 416, 437-38 (2d Cir. 1945) cited in ALD5, p. 269.) US courts have applied three tests to determine whether the price of the monopolised good is unfair: 1) if the wholesale price is lower than the retail price then a price squeeze is presumed; 2) if the vertically integrated enterprise could have made a profit by selling at its own retail price if it had purchased at its own wholesale prices, then there is no price squeeze; 3) if the wholesale profit margin is significantly greater than the retail profit margin, then an illegal price squeeze probably occurred.

A subtly different definition of price squeeze is provided by the European Commission in the Access Directive as occurring when, “the difference between [the retail prices charged by operators with significant market power] and the interconnection prices charged to competitors who provide similar retail services is not adequate to ensure sustainable competition.” (Directive 2002/19/EC of 7 March 2002 On access to, and interconnection of, electronic communications networks and associated facilities, point 20). In the Commission’s decision in *Napier Brown/British Sugar*, the test was whether the margin of prices charged by a firm, dominant in both the upstream and downstream markets, exceeded its own costs in the downstream activity and restricted competition. (“The maintaining by a dominant company, which is dominant in the markets for both a raw material and a corresponding derived product, of a margin between the price it charges for a raw material to the companies which compete with the dominant company in the production of the derived product and the price which it charges for the derived product, which is insufficient to reflect that dominant company’s own costs of transformation (in this case the margin maintained by Napier Brown between its industrial and retail sugar prices compared to its own repackaging costs) with the result that competition in the derived product is restricted, is an abuse of a dominant position.” [European Commission Decision 88/518/EEC OJ [1998] L-284/41, para. 66].) The *Napier Brown/British Sugar* test is more similar to the second US test.

The differences between the two jurisdictions’ approaches become apparent when the vertically-integrated enterprise is not dominant downstream (this is not relevant in the US test) or when the vertically integrated enterprise is more efficient than its non-integrated rivals (the survival of the rivals is relevant in the EU test), perhaps by reason of economies of scope between the two activities.

The UK’s Ofcom has considered allegations of price squeezes several times. It uses various versions of the *Napier Brown/British Sugar* test, but highlights the importance of cost allocation with its note that it “will give close consideration to the method of cost allocation where [Ofcom’s Director General] believes that it may be being used to aid anticompetitive behaviour.” Paragraph 7.26 of “The Application of the Competition Act in the Telecommunications Sector”, OFT 417 (‘Ofcom’s Competition Act Guidelines’).

Cost allocation enters the price squeeze discussion when costs are used to regulate the upstream price. It is helpful to recall that fixed costs can be allocated among activities in a wide variety of ways, depending on the policy objectives. Often, the upstream price is regulated to ensure a “reasonable” payment toward fixed or common costs. This leaves scope for an enterprise to charge a downstream price that constitutes a “squeeze” but not predation, if marginal cost is considered to be the relevant test. If the upstream price is regulated as a maximum price, then presumably the enterprise could charge a lower upstream price—getting less payment toward fixed or common costs—in order to avoid a “squeeze.”

It can be noted here that the price one part of an enterprise charges another part of the same enterprise is irrelevant to a price squeeze test. However, the level of internal transfers affects, depending on the regulatory environment, taxes and allowed revenues, which do affect profits.