Competition Law and Telecoms: 2009 Developments in the EU, the US and Australasia

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Competition law continues to be pushed and pulled as it deals with the challenge of delineating pro- and anti-competitive conduct by dominant firms, with many arguing it is too intrusive. In telecoms this year, we have three major telecoms cases from the EU, the US and Australasia, and a US administration that could target topics such as Google and cloud computing.

In telecoms this year we have:

- rejection of margin squeeze as a basis for anti-trust action by the US Supreme Court in *linkLine* (contrary to the well established EU position);
- more robust action by the Obama Administration signalled, such as in relation to cloud computing and Google (but will the US Courts allow this?);
- an EU case, also about xDSL access, where the European Court of Justice (ECJ) confirmed liability for predatory pricing, against France Telecom's competitors (the *Wanadoo* case); and
- in Australasia, the Privy Council decisions on the so-called counterfactual test are under review in the "0867" internet access case against New Zealand incumbent, Telecom.

The tensions

Formulating and applying a monopolisation law is difficult. There are said to be two competing tensions:[1]

- curtailing powerful firms from stifling their rivals and entrenching themselves as the dominant player; and
- encouraging powerful firms to engage in healthy competitive behaviour, leading to greater efficiency, innovation, choice etc.

Many argue, particularly applying theories of the Chicago school, that anti-trust intervention often has the ultimate effect of failing to achieve greater efficiency, innovation, or choice. Concepts and words such as *"chilling effect"* and *"false positives"* are often used.

Cases frequently quote Chicago School supporter, Judge Richard Posner:[2]

> *The lawful monopolist should be free to compete like everyone else. Otherwise the antitrust laws would be holding an umbrella over inefficient competitors….A firm with lawful monopoly power has no general duty to help its competitors, whether by holding a price umbrella over their heads or by otherwise pulling its competitive punches.*

Of course there are views both ways on this.[3]

The US and *linkLine*

Broadly the US Supreme Court tends toward approach of less not more intervention. For example, in February 2009 it rejected margin squeeze as a remedy in telecoms, at least in the circumstances in *linkLine*. Yet margin squeeze is well-established in the EU as a basis for anti-trust action. There the incumbent (AT&T) had no anti-trust obligation to supply the wholesale xDSL service. The claimant could only look to two other bases for anti-trust remedies: (a) anti-trust refusal to deal (as opposed to its regulatory equivalent); and (b) predatory pricing. These didn't apply. It was for the regulator (FCC) to formulate any relevant regulatory requirement, not anti-trust law.[4]

[1] R Adhar, *The unfulfilled promise of New Zealand's monopolisation law: Sources symptoms and solutions* (2009) CCLJ 291,292

[2] *Olympia v Western* Union 797 F 2d 370,375

[3] See for example R Adhar, Op Cit

[4] The FCC is regarded by many as a political body with clear political appointments and power over policy. However it is also constrained by previous thinking and the legal position is challenging even for the new administration. There is a current and major debate on this in the US at the present time and a series of filings

linkLine follows the earlier Supreme Court cases of which the most notable in telecoms is *Verizon v Trinko.*[5]

Enter the Obama Administration

Whether the US government should take anti-trust action often ends up on the desk of the Assistant Attorney General (AAG) at the Department of Justice (DOJ). The Chicagoan approach of the Bush Administration, reflected in a 2008 DOJ Monopolisation Report, is largely reversing itself with the appointment of Cristine Varney as AAG in the new administration. However, the new approach is far from one that is baldly anti-big business.

The expansion of both Google and cloud computing is a useful example: [6]

> *Varney says that tech industries are unusually vulnerable to concentration of power due to what are known as network effects. The idea is that the more people join the network the more powerful that network becomes. …[L]awyers expect anti-trust officials to take a hard look at Intel and Google. In a June 2008 speech before she joined the Justice Department, she compared Google to Microsoft. Google, she said, was quickly gaining power in cloud computing, where technology is based on the Web not the PC, and may be able to block rivals in this key arena. "I think we're continually going to see a problem, particularly with Google", she said. "Companies will begin to allege that Google is discriminating, not allowing products to inter-operate with other products.*

However, it is one thing for DOJ (and the FTC) to want change, and quite another to achieve that change in the Courts, particularly with little sign of a changing power balance in the Supreme Court in the short to medium term. DOJ only chooses and prosecutes claims: it doesn't ultimately decide them.

The EU and *Wanadoo*

While the US Courts are said to consider conduct by firms with substantial market power through a *"special lens"*[7], the EU has more firmly engaged with this approach. The EU refers to the *"special responsibility"* on dominant firms. This point is reinforced by the ECJ in *Wanadoo*.[8] The ECJ considers that competition is already weakened where there is a dominant position, and thus imposes on the dominant firm:[9]

> *a special responsibility not to allow its behaviour to impair genuine undistorted competition.*

A litmus test used to identify whether there is predatory pricing can include the question of whether the firm can later recoup its losses, caused by its reduced pricing. This is a classic example of the Courts playing out the struggle of delineating pro- from anti-competitive conduct. In doing so, they are trying to achieve certainty, which also enables large firms to understand clearly their obligations. This is an objective that some regard as optimal and others as misconceived.

The ECJ in *Wanadoo* confirmed that the ability to recoup losses is a relevant but not essential component in defining an action as predatory pricing. The ECJ decision, and the Court of First Instance decision appealed from,

have been made at FCC on such things as the Access issues.

[5] This article only briefly summarises the two judgments of the Supreme Court. For more detail, see for example, Emch and Leonard, *Predatory Pricing after linkLine and Wandadoo* Global Competition Policy (May 2009: Release One)

[6] *The Antitrust Cop and the Tech Industry,* BusinessWeek, 31 July 2009

[7] *Eastman Kodak v Image Technical* 540 US 451, 448; R Adhar, Op Cit, at page 294

[8] In the EU the application of margin squeeze has recently been developed by the Court of First Instance in *Deutsche Telekom.*

[9] *Wanadoo* para 105.

develop the law on predatory pricing in the EU. [10]

There are clear differences between the EU and US approaches. For example, generally in the US, there will not be predatory pricing where the price is above average variable cost (AVC). In Europe, above AVC pricing can still be predatory where the firm has, for example, a plan to eliminate a competitor.

Australasia and the counterfactual test

In the 1994 case, *Telecom v Clear*[11], in which the Privy Council backed the controversial ECPR pricing model, the Privy Council relied on the so-called counterfactual test as a means to distinguish pro- and anti-competitive conduct.

This test has been applied – in New Zealand – such that the dominant firm is assessed as though it does not have *"special responsibilities"* (as in the EU). In fact the position is quite the opposite.[12]

There are arguments for[13] and against[14] the Privy Council's approach. Generally, New Zealand-resident judges differ strongly in their opinion from UK Privy Council judges on the usefulness of the counterfactual test.

In the *0867* case against the incumbent telco, the Commerce Commission sought leave in September 2009 to appeal the decision to the Supreme Court. The Supreme Court has replaced the Privy Council as New Zealand's highest appellate body. Now is the first time New Zealand-resident judges get to revisit the counterfactual test.

The appeal revolves around the ubiquitous application of the counterfactual test.

The Commission has outlined its views as follows:[15]

> *The counterfactual is an analysis that tries to create a hypothetical competitive scenario replicating to a reasonable degree the facts of the market circumstances under review. The intent is to determine whether the dominant market player would have done what it did if the market were competitive. If it would have behaved in the same way in the hypothetical competitive market, then it is inferred that what it did was not the use of its dominant position.*
>
> *In Australia the courts have used the counterfactual scenario as one of a range of analytical tools, and have applied the test in a relatively straightforward way making robust assumptions. In New Zealand, the counterfactual requires the hypothetical to replicate all the current circumstances save for the market power. This can prove very difficult to do, and is often a speculative and uncertain exercise, with significant dispute likely over the details of the hypothetical competitive scenario.*

In the 0867 case, the Court of Appeal was bound by the Privy Council's approach to the counterfactual test, but noted that it had concerns with application of the counterfactual test.[16] Any change to this can only be at Supreme Court level.

The outcome of the appeal may be closer alignment with Australian law (on which the relevant New Zealand law is modelled) along the lines noted by the Commission.

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[10] For a more comprehensive analysis of *Wanadoo*, in the context of *linkLine*, the Monopolisation Report by DOJ, and the similar EU report of 2008, see Emch and Leonard, op cit.

[11] [1995] 1 NZLR 385

[12] For a more detailed overview of the counterfactual test, see M Wigley, *0867 dials-up competition law changes?* NZ Lawyer 30 May 2008 (at http://wigleylaw.com/Articles/LatestArticles/-dials-up-competition-law-changes/) and R Adhar, Op cit.

[13] See for example M Berry, *Competition Law*, [2005] New Zealand Law Review 267

[14] R Adhar, Op Cit

[15] In its Media Release dated 1 September 2009

[16] *Commerce Commission v Telecom* [2009] NZCA 338 at Para 100

Conclusion

But this will not fully remove that difficult tension that Courts face in encouraging pro-competitive conduct by dominant firms, and discouraging the anti-competitive. This issue has a strong political overlay. Economists, judges, and others (such as those in the Chicago and Harvard schools respectively) have different views on the appropriate approach.

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