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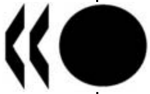

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

07-Oct-2009

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/WP2/WD(2009)34
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Working Party No. 2 on Competition and Regulation

MARGIN SQUEEZE

-- Chile --

19 October 2009

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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JT03271225

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1. Introduction

1. The anticompetitive behaviour known as "margin squeezing" (sometimes, price squeezing) encompasses some forms of exclusionary abuse involving an interaction between two levels in a supply chain. This conduct applies to cases where the controller of an essential facility or input, who has a dominant position, seeks to keep to himself parts of a related downstream market.[1]

2. The Chilean Competition Act (DL 211[2]) —the purpose of which is "*to promote and defend free competition in markets*" [Art.1]— includes in its Article 3 a general provision stating that "*the anticompetitive illicit are any deed, act or contract that prevents, restrict or obstruct free competition, or that tends to produce these effects*" in a wide sense. Art.3's literals, however, exemplify different types of anticompetitive conducts, such as collusive agreements [Art.3 a)], abuses of dominant position [Art. 3 b)] and predatory practices [Art.3 c)].

3. In addition, the DL 211 neither addresses market share presumptions nor establishes *per se* treatments for any conduct. In any case, the actual or potential harmful effects on competition in the relevant market must always be proved, following the rule of reason. Therefore, alleged *margin squeeze* behaviour must be considered in itself or by means of the figure of abuse of dominance.

4. According to technical literature and international experience, margin squeeze practices are usually observed in the telecommunications sector. In Chile, the corresponding sectoral or regulatory framework[3] includes no express definition of margin squeeze. Nevertheless, in one of its articles the GTL states that regulated firms cannot transfer the cost of their unregulated activities to the regulated ones, by increasing the basis for calculating the efficient-tariff definition (GTL, Art. 30 e)[4]). It is worth noticing, however, that there is no regulatory accounting framework or principles to guide the cost imputation procedure.

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1 Following this, some exclusionary conducts can be viewed as a case for extreme margin squeeze.

2 Decree Law No. 211/ 1973 and its subsequent amendments, enacted by Law No. 19911/ 2004 –which introduced structural changes for the Competition System, mainly the setting up of the *Tribunal de Defensa de la Libre Competencia,* a judicial specialised body. It was also amended by Law No. 20361/ 2009 – which increases the investigative powers of the *Fiscalía Nacional Económica* (the competition agency) when dealing with cartels and collusive agreements.

3 The regulatory law for the telecom sector is Law No 18,168 (from September 1982; and its subsequent amendments), also known as General Telecommunication Law (TGL). This legal body contains general specifications on franchising, violations and penalties, among others, and permits exploitation and operation of telecom services.

4 GTL's Article 30 states that "For *each area, efficient tariff rates are determined, understood as those that, applied to expected demand for the lifespan of the corresponding expansion project, generate a revenue equal to the respective development's incremental cost."* Its literal e), includes clauses regarding unregulated services belonging to the same provider, establishing that *"If, having defined the efficient firm ... for reasons of indivisibility of expansion projects, these also allow satisfy the demand, in a whole or in part, referred to unregulated services that the concessionaires provide, it should be considered only a fraction of the incremental costs for development, for purposes of calculating efficient tariffs. This percentage shall be determined in accordance with the rate at which the project's assets are used by regulated and unregulated services.*" (non-official translation)

2. Chilean case law on margin squeeze

5. Ever since the current Chilean Competition System came into operation in 2004, the *Tribunal de Defensa de la Libre Competencia* (hereafter, TDLC[5]) has issued 87 decisions in contentious procedures, just one of which makes explicit mention of margin squeeze as a potential anticompetitive conduct (Case GPS Chile vs. Entel PCS). Later on, a second case on margin squeeze in the telecom sector was brought before the TDLC (Case OPS, Etkom, Interlink and Sistek vs. Telefónica Móviles 'Movistar', better known as the "Celulink" [6] case). Decision in this case is still pending.

6. The following section will discuss the main aspects involved in both.

2.1 Case GPS Chile vs. Entel PCS

2.1.1 The facts

7. In October 2006 *GPS Chile* –a GPS solutions provider– brought a lawsuit to the TDLC against *Entel PCS*, a local mobile operator, charging it with several abuses of its dominant position and with unfair competition.[7]

8. *GPS Chile* began operating in Chile in 2001, with its focus on selling GPS satellite receivers, imported from US GPS products manufacturer, Garmin, and on supplying real time positioning services. *Entel PCS,* in turn, launched its GPS system around 2002 through *Entel GPS.*

9. According to *GPS Chile*, cross subsidies and *Entel PCS'* major financial capacity enabled the company to sustain a predatory pricing policy aimed at eliminating competition in the automatic vehicle location (AVL) services market. Secondly, the lawsuit established that *Entel PCS* had also carried out a margin squeeze policy derived from *Entel's* integrated participation in the intermediate wireless data transmission market (upstream), which is an essential input for the service.

2.1.2 Analysis during the judicial process

10. The TDLC granted *Entel PCS* a legal term to respond to the lawsuit, asking at the same time the Chilean competition agency, the "*Fiscalía Nacional Económica"* (hereafter FNE) to put forward an expert's report.[8] This one, submitted in May 2007, drew on information requested to the firms in the market and to the Sub secretary of Telecommunications (SUBTEL), the telecom regulator.

11. SUBTEL noted that by then there was not, nor will there be, a regulation of the global positioning services provided via mobile network (GPS), because it implies authorized means to dealers. In addition, and in view of access charges, the FNE asked whether the administrative structure required for the GPS business line is incorporated in the 'efficient-firm' model [9] for *Entel PCS*. SUBTEL answered

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[5] Competition Tribunal, which since the 2004 amendments to the Competition Law decides on antitrust matters with adjudicative powers.

[6] These are services provided by electronic gear acting as an interface between one or several cell phones with an Analog / Digital Phone Systems (PBX).

[7] The Chilean Competition Act allows for private enforcement of the law.

[8] Legally the FNE also serves as an expert reporter at the TDLC's request in cases not initially conducted by the agency.

[9] The "efficient-firm" has been the regulation model implemented in Chile for almost two decades. The efficient-firm regulation sets prices equal to the long-run average cost, which is optimal when the firm is to be self-financed.

negatively, remarking that the tariffs study incorporates only those essentials to offer regulated services. Thus, the latter's non-essential services must not be included in the tariffs determination.

12. Finally, the FNE's analysis focused on the economic rationale of *Entel*'s potentially predatory strategy and other exclusionary practices, such as crossed subsidies and margin squeezing. These practices could not be discarded as *Entel PCS* does not provide GPS service through a separate business line or a subsidiary, and consequently has no separate financial reports, out of which the FNE could not observe each line's indirect and incremental costs.

13. In particular, concerning margin squeeze, the transfer price –referred to as the net access charge- should be the same for *Entel PCS,* as a GPS service provider, and for its competitors. In this way, the price should reflect the opportunity cost of net use, thus precluding potential anticompetitive practices. Yet in the FNE's opinion and upon the incomplete information available,[10] *Entel PCS* was providing a product (data transmission in the GPRS network) to some customers (companies providing the GPS service in a related market) at a different rate, with no rationale to justify this differential within a pro competitive setting.

14. Nevertheless, in 2008 the TDLC issued its ruling[11] rejecting the lawsuit brought by *GPS Chile*, grounded on the fact that in the relevant input market *Entel PCS* displayed no market power enough to recover the short-term losses of a predatory pricing policy. Besides, the annual profitability of *Entel PCS*' AVL (analyzed as a whole, that is, considering the provision of both equipment and of GPS services), although decreasing from 2005 to 2006, remained positive.

15. On the other hand, the TDLC also rejected the margin squeeze plead, since it found it unsustainable that *Entel PCS* had set abusive prices in the wireless data transmission market (upstream) to allow GPS Chile's squeezing. This squeezing was deemed unlikely because this market was a duopoly and *Movistar* was (and still is) a strong competitor to *Entel PCS*. In addition, there is a clear possibility of entry by other operators (for instance, *Claro*, the third provider playing at the mobile services' market). Finally, the TDLC also rejected the cross subsidies *GPS Chile*, for the practice and its circumstances could not be fully established

16. After an appellation before the Supreme Court, its decision of April 2009 confirmed the TDLC ruling.

3. Final remarks

17. The theory for the analysis of margin squeeze has just recently been introduced to antitrust practices. The effects of such practice are still controversial.

18. In Chile, Competition Law does not specifically address margin squeezing as anticompetitive behaviour, thus further analysis on this subject will require a definition of the conditions and pieces of evidence typifying the conduct.

19. As stated above, the Chilean case law concerning margin squeeze is very limited, leaning on just two cases in the telecom sector, one already ruled and one pending. The only ruled case so far (GPS Chile v/s Entel PCS) stressed the relevance of the analysis of cost imputations for multiservice firms, in different stages of the upstream-downstream chain, as well as for other sectors without regulatory accountancy where margin squeeze conducts may arise.

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[10] Information submitted to the FNE by the firm, under request.

[11] Ruling No. 78, issued on December 4, 2008.

20. It follows from this that the network sectors –as essential inputs- and the rapid technological changes and developments leading to the regular emergence of new products, may propitiate risks in the relationship between suppliers and customers to allow for margin squeezing. Being aware of this risk, the FNE is currently deepening its efforts by preparing a market study in the telecommunication sectors and doing research on the scope of margin squeeze as an anticompetitive conduct.