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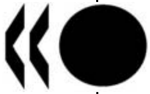

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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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Working Party No. 2 on Competition and Regulation

MARGIN SQUEEZE

-- Hungary --

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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1. Introduction

1. This contribution discusses the Hungarian experience on margin squeeze. It does not follow the structure of the questionnaire to this roundtable, although all issues that were raised by the questionnaire are addressed if the experience of the Hungarian Competition Authority (Gazdasági Versenyhivatal – GVH) allows it. After the introductory part it deals with law enforcement, then with regulation, finally it concludes in a summary.

2. European case law of margin (or price[1]) squeeze obviously determines the GVH's thinking on margin squeeze (even in cases investigated solely under the Hungarian Competition Act), since Hungary is a member state of the EU (from May 2004). According to the European approach, margin squeeze occurs when a vertically integrated firm hinders competition in the downstream market through the spread between upstream and downstream tariffs for comparable services. As to the conditions of margin squeeze, the firm concerned should operate in both of the upstream and downstream markets, and be dominant in the former by controlling a facility or service which is necessary for the production of the end-product (thus for the downstream rivals) and representing a substantial part of production costs. It is not necessary to establish dominant position in the downstream market, but the competition in this market should be limited as well. Last but not least the margin between the upstream and downstream prices should be insufficient for (as) efficient downstream firms to be/remain profitable, for a period long enough to be able to influence market conditions.

3. Regarding margin squeeze one should examine whether the downstream costs are covered or not by the spread between upstream and downstream prices. The test of margin squeeze consists of two steps: first one should calculate the difference of downstream (in most cases: retail) price and upstream (in most cases: wholesale) price (spread I). After this first step margin squeeze could be establish if spread I ≤ 0, otherwise one should go on and calculate spread II which is the difference of spread I and downstream (retail) cost. After this second step in case of margin squeezing spread II is below zero or it is too low to ensure profitability of the efficient firms' downstream activity (to cover cost of capital).

4. To establish the breach of the competition law the likely effects (harm) also should be showed. The margin squeeze enables the vertically integrated firm to transfer its upstream dominance on to the otherwise (to a degree) competitive downstream (product- or service-) market, and later to abuse this position to the detriment of consumers (by higher than the competitive downstream prices).

5. According to the current competition law practice and telecom regulation the margin squeeze is a separate form of abuse in Hungary. The GVH in some cases has used the definition of margin squeeze though the Competition Act itself does not define this behaviour explicitly, the telecom regulation do describe this conduct explicitly but regulatory authority has not applied these rules to date.

2. Competition law enforcement

6. Although there is no special rule of margin squeeze in the Hungarian Competition Act[2] (neither in Article 82 of the EC Treaty), the GVH defined the notion of margin squeeze in its decisions treating this behaviour under certain general sub-sections of Article 21.[3] This to some extent shows that the GVH in a

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[1] As a matter of terminology the GVH considers 'margin squeeze' and 'price squeeze' as convertible terms.

[2] Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices.

[3] Namely subsections i) and j) which prohibit to hinder, without justification, market entry in any other manner; and to create, without justification, disadvantageous market conditions for competitors).

sense distinguishes margin squeeze (and its standards) from excessive pricing, refusal to deal, and predation, which all are covered by distinct and explicit sub-sections.[4]

7. The Hungarian Competition Act – dealing with **predatory pricing** – prohibits setting too low prices which are likely to drive out competitors from the relevant market or to hinder their market entry, if those prices are not based on superior efficiency.

8. Applying this provision the GVH uses a "but for" logic. The Competition Council argued[5] that the economic rationality of prices resulting in permanent loss is "at least questionable", and usually there can be no other purpose but for predation (unless the dominant firm has clear justification such as the need to sell perishable goods). Thus, it is a necessary condition for a price to be predatory that it results in a loss to the firm.[6]

9. To determine whether the loss for this purpose is present the GVH uses a cost test. Following the practice of the European Commission the GVH applies the Akzo test.[7] In short, prices below average variable costs[8] are predatory, unless the firm proves legitimate business justification. Prices between average variable costs and average total costs are, in principle, not predatory, but they can be regarded as abusive, if further evidence suggests so. (Any other price is not predatory.)

10. In many cases it is an important issue, how indirect costs should be allocated to several activities and to what proportion they are variable costs. In this relation the Competition Act does not give any guidance, therefore the GVH tends to regard any or any reasonable allocation of indirect costs as acceptable.[9]

11. The GVH adds to the cost test that conceptually the possibility of the recoupment of losses in the post-predatory period is a necessary condition for prices between average variable costs and average total costs to be predatory.

12. The theory of harm of **margin squeeze** is more or less similar to that of predation. Margin squeeze however can happen without charging low (below-cost) downstream prices. One consequence is that competition law infringement can be found without proving that the company has suffered losses. Another consequence is that the potential harm would not necessarily be a subsequent increase in downstream price (compared to previous levels).

13. The rest of this section describes how the treatment of margin squeeze has evolved in GVH practice. This more or less can be translated into a sector by sector overview since the first margin squeeze

[4] Excessive pricing: 21. § a), refusal to deal 21. § c), predation 21. § h).

[5] The Competition Council outlined the approach of GVH towards predatory pricing in its decision in the Vj-88/2007 case against T-Kábel.

[6] Loss is not sufficient, however, since it may be a result of the parties being less efficient than their rivals, in which case, loss inducing prices do not lead to the exit of rivals.

[7] See the Akzo Chemie BV v Commission (C-62/86.) decision, 3 July 1991 [1991 ECR p. I-3359, para. 71-72., 81., 114-115.].

[8] The price applying firm's own costs are used in the calculations, reflecting the consideration that a lower-than-rivals' price resulting from the price applying firm's higher efficiency does not hurt competition, only competitors.

[9] In Vj-88/2007 against T-Kábel, for instance, the CC accepted the cost allocation submitted by T-Kábel without comments.

issues emerged in funeral services, later were raised in telecommunications and most recently appeared in the railway sector.

2.1 Funeral Services

14. In the funeral services decisions of the GVH do not use the expression of margin squeeze, however the GVH investigated issues basically similar to margin squeeze.[10] In this sector cases of refusal to deal and excessive pricing appeared earlier and they were followed by (effectively) margin squeeze cases. The case types and their treatment by the GVH went through three stages of development. Each of them appeared during a more or less distinct time period and a development can be observed towards classic margin squeeze cases.

15. Before 1996 a number of refusal to deal and excessive pricing cases were investigated. In these cases the subsections of the Competition Act explicitly covering these types of abusive behaviour were applied. The firms concerned were vertically integrated funeral providers[11]. They either did not allow morticians (their downstream rivals) to provide funeral services in the graveyard or determined their upstream prices so that it would be disadvantageous for the downstream rivals. The latter was achieved by setting the prices excessively high, or using a fee structure that replicated price discrimination in favour of its own downstream activity, or determining unjust payment conditions. Three of the cases resulted in establishing infringement, two on the basis of refusal to deal and one on the basis of excessive pricing.

16. Between 1997 and 2000 the GVH had cases that were margin squeeze in an economic sense, but that were still treated under excessive pricing provisions of the Competition Act. In these cases the allegation was that the funeral provider set its upstream prices excessively high while the retail price remained at the preceding level. The GVH did not find abuse in any of these cases. In the majority of cases upstream prices proved to cover justified costs or they were raised by less then the inflation rate. It is worth to note that the decision in the last one of these cases was dropped in 2000 because the upstream prices were regulated by the municipality. The GVH explained in its decision that it has no authority to revise regulated prices. Since then no margin squeeze case concerning regulated prices has been dealt with under excessive pricing provisions of the Competition Act .[12]

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[10] In Hungary graveyards and mortuaries are owned by municipalities or parishes, and usually operated by a single firm, which can be a private firm (typically a mortician) as well as a firm owned by the local municipality. The operator of the graveyard has exclusive rights to operate the mortuary and to conduct the final disposition of deceased human bodies (in our context these are the upstream activities) and – in case it is an integrated provider of funeral services – at the same time it competes with other morticians in the market of downstream funeral services (e.g. selling funeral goods, preparing the deceased bodies for the final disposition, arranging the funeral ceremony). Some of the downstream activities (e.g. the funeral ceremony) necessarily take place within the graveyard and/or the graveyard's mortuary, while the rest of the services are conducted in the facilities of the mortician (e.g. the preparation of the deceased bodies). In other words, graveyards are essential facilities of the former group of activities, and integrated providers may have an incentive to abuse their exclusive access rights to the essential facility, thus emerged the cases outlined here.

[11] When talking about the funeral services industry we consequently use the term "funeral provider" to identify the integrated provider of upstream and downstream funeral services, and "mortician" for firms that provide only downstream funeral services.

[12] The background of the decision is that sector-specific regulation was updated in 2000, which turned municipalities into price regulators of the upstream activities. The effects that the update of the sector-specific regulation had on the treatment of margin squeeze cases is explained in somewhat more detail in chapter 3.

17. Between 2001 and 2004 the GVH initiated three cases of margin squeeze in the funeral industry. Although the term itself was not used, these cases were *de facto* margin squeeze cases in an economic sense and were also treated under the same subsections of the Hungarian Competition Act, which were invoked subsequently in the cases in the telecom industry between 2002 and 2004 in margin squeeze cases. In all three cases the GVH found infringement, and in two of them imposed a fine of considerable amount. In one of these cases the analysis of the pricing behaviour resembled very much the margin squeeze test in the later telecom cases. In this case the funeral provider priced its downstream services lower than the access to the mortuary (the price that downstream competitors had to pay for using the mortuary), that is, effectively spread I was shown to be negative. In both the other two cases some unregulated elements of the upstream price were found to be abusive (excessively high) and either the upstream or the downstream price was established to hinder market entry or create disadvantageous market conditions for competitors.

18. Since 2004 a few refusal to deal cases have been investigated, but no abuse has been found, since in all of these cases the integrated firm allowed access to the graveyard once the GVH investigation has started.

2.2 Telecommunications

19. Telecom margin squeeze cases illustrate the GVH's approach to margin squeeze best, since the decisions on them resulted in quite general conclusions on certain issues. The GVH's approach and tests used are basically in accord with that of the European Commission's Deutsche Telekom (2003/707/EC) case (even before Hungary joined the European Union in May 2004). Right after the first steps of market opening in the telecom sector (2002-2004), the GVH launched several cases concerning the telecom markets (broadband internet access (ADSL) and fixed line telephone services markets) in which the GVH introduced the concept of margin squeeze into the Hungarian case law. The GVH found abuse in only one of these cases.

20. Regarding margin squeeze proceedings concerning regulated sectors (such as telecoms), in order to evaluate the applicability of competition law, it is essential to analyse sector-related regulation from the point of view of whether and to what extent it gives a room to manoeuvre (freedom for action) for the incumbent to freely develop its market practice and make its pricing decisions. In certain cases, the competition authority may come to the conclusion that the restrictive market practice may be derived from regulation, as it restricted the freedom for action of the incumbent to an extent, which did not allow it to avoid margin squeeze within the framework of the regulation. For instance one of the interconnection margin squeeze cases was ceased because the GVH found that squeezing was caused by the regulation itself: both wholesale and retail prices were regulated, but retail prices by price caps, which ensured some elbow-room, thus competition law was applicable in theory. The GVH however found that the dominant firm exhausted almost all its possibilities within the price cap to increase prices, even if this was not sufficient to avoid squeezing.

21. The way in which the wholesale level of the ADSL service works (due to the single-point access), ensures little choice for the Internet service providers to make their pricing decisions, therefore the suspicion of margin squeeze arose in several occasions. That time the prices of ADSL services were not regulated, so the competition law was applicable. The GVH pursued two formal procedures against vertically integrated incumbent telecom operators in 2002 and 2003. The Matáv DSL case[13] was closed because the squeezing could not be proved. In the former Vivendi DSL case[14] the squeezing itself could be established, but the GVH taking into account the contestability of the market and the long-term effects of the conduct terminated the procedure, finding that the Vivendi (currently called 'Invitel') could not in the

[13] Vj-124/2003.

[14] Vj-101/2002.

future be capable of raising and permanently maintaining its retail prices above the competitive price level (so the recoupment stage was unlikely).

22. In 2002 and 2003 the GVH had two **interconnection margin squeeze cases**: first,[15] related to the business (hereinafter: **Matáv business case**), second,[16] to the residential market (hereinafter: **Matáv residential case**) against the largest fixed line operator, Matáv (currently called 'Magyar Telekom', a subsidiary of the Deutsche Telekom, which owns 39 primary areas in Hungary out of the 54 and provides all retail and wholesale voice services, and mobile, Internet and cable TV services as well). The alleged infringement was – *inter alia* – that the interconnection fees were higher than some retail tariffs of fixed line telephone services.

23. As to the regulatory environment of this interconnection margin squeeze cases: the first stage of market opening (liberalization) took place from the end of 2001 (with a telecom regulation based on the "old regulatory framework" of the EU). Wholesale interconnection prices became regulated from July 2002 (from the regulatory approval of reference interconnection offer – RIO, and reference unbundling offer – RUO), actually there was a duty to deal, and from July 2002 the conditions and prices of this wholesale deal were also regulated. As it was mentioned the retail prices were under a price cap, which provided a certain amount of freedom for action, which is a prerequisite for the applicability of competition law.

24. In these cases excessive pricing was excluded because it was very difficult in the telecommunication sector to properly determine costs of individual services. Moreover, under national competition law the GVH had no legal possibility to examine RIO and RUO charges as they were approved by the Communications Authority and therefore had to be considered as cost based prices.

25. Predatory pricing also was rejected by the GVH. In the business segment, based on the testimony procured from rivals predation was not presumed. Moreover, **Matáv**'s operating revenues were too high to assume that its retail prices were below costs, and actually most of the revenues came from the residential market, so in spite of the delays in tariff rebalancing predatory pricing applied by **Matáv** was not probable. On the other hand, future recoupment of a presumed sacrificed profit was not likely, either.

26. Recoupment in the form of price increase was unlikely in the margin squeeze framework too, but the potential harmful effect of squeezing could also be that it would maintain higher prices and postpone entries (and at the same time the pressure to decrease prices). So the margin squeeze between wholesale and retail tariffs proved to be the only proper approach.

27. The GVH followed a market-oriented approach in its price-squeeze tests in these telecom margin squeeze cases (and also in the later railway case). This means that when facing with various retail and/or wholesale offers, or multi-component fee structures, it did not performed its analysis by types of services or by fee components, but it analysed the overall relationship between the services and/or fee components belonging to - from a competition law perspective - the same downstream market and their counterparts on the upstream market.

28. At retail level the GVH defined the relevant market as the one for fixed line telephone services offered to business customers comprising access, local and national long distance call services and another one for fixed line telephone services offered to residential customers. Although the GVH admitted that theoretically the different call services and access services created distinct markets, it found that in practice there was no individual demand for these services, costumers took them together in one package.

[15] Vj-100/2002.

[16] Vj-73/2003.

29. The GVH first had to identify the wholesale contents of the retail packages' service components, in order to make prices of retail packages comparable with proper bundle of wholesale prices, doing so the GVH created a model in which wholesale (infrastructure-related) costs of the concerned services were built up from RIO and RUO price-elements. The call origination, call termination (and call transit) services (as the wholesale counterparts of retail calls), and LLU (local loop unbundling as the wholesale counterpart of retail access) were the relevant services at upstream (wholesale) level, which were taken into account in the calculation of the costs incurred by **Matáv** due to providing these retail packages.[17]

30. Other tariffs and fees[18] determined in the commercial contracts or in the RIO were omitted from the calculation because they do not occur if **Matáv** as a vertically integrated operator provides the retail services itself. So the GVH applied in its margin squeeze cases the so called 'as efficient competitor test'. According to the GVH in a margin squeeze test created for competition policy purposes the synergies and cost savings deriving from vertical integration must be taken into account (which is favourable for the incumbent). Regulation can apply more easily tests that reflect the intention to encourage the creation of, and establish the conditions for competition, as opposed to maintain the competitive status quo.

31. In the margin squeeze test the GVH first compared Matáv's monthly total income stemming from providing retail voice services to business or residential customers (including monthly rental and revenues of local and national long distance call services) to the estimated monthly wholesale costs of these services (including the monthly fee of local loop unbundling and the sum of the various interconnection services, i.e. origination and termination).[19] This difference was named as Spread I.

32. In Step 2 the GVH calculated the downstream costs of providing retail voice services, which included the costs of marketing, product, sales and active debts managements, billing and customer service. The retail cost data came from the firm's ABC (Activity-Based Costing) accounting system. The difference of Spread I. and these downstream costs resulted in the determination of Spread II.

33. The GVH in the Matáv residential case used the direct costs allocated to the downstream service submitted by Matáv.

34. Results of the tests in the interconnection margin squeeze cases (return on revenues):

SEGMENT	PERIOD	SPREAD I.	SPREAD II.
Business market	February – July 2002	Negative	not applicable
	July 2002 – April 2003	about 10%	not applicable
Residential market	2002	3-7%	less than 1%
	January – September 2003	less than 10%	5-10%

[17] Matáv's dominant position could be established regarding call origination, call termination and local access services.

[18] For example prices charged for collocation or for the interconnection link between the incumbent and the downstream rivals.

[19] The notions total income and total cost mean that GVH did not compare the prices and costs of individual services or of an individual customer to each other but it calculated total revenues as the product of call charges and monthly call minutes plus the product of monthly rental and the number of subscribers, while total costs were calculated as the product of estimated wholesale costs of the different call types and monthly call minutes plus the product of monthly LLU fee and the number of subscribers.

35. The margin squeeze test showed that revenues from the provision of the retail business packages and offers had not covered the wholesale, infrastructure-related costs occurring due to these services from February 2002 to July 2002. In this period the margin proved to be negative, but afterwards, following the approval of the cost-based RIO tariffs this margin turned slightly positive, for lack of information on product specific or retail costs (in connection with the business segment) the GVH could not assess whether this positive margin had been sufficient in the sense that it could have covered all **Matáv**'s relevant costs and expenditures and profit expectations. This calculation however revealed that the former negative margins had been caused by the unduly high wholesale prices in the commercially negotiated contracts which problem was solved by the intervention of the Communications Authority, i.e. by the approval of the RIO and the cost-based prices therein.

36. **In the Matáv business case** in spite of the above-mentioned relatively short time period and the efficient intervention of the Communications Authority the GVH established that **Matáv** applied abusive margin squeeze from February to July 2002 and thus infringed competition law, because its behaviour was capable of excluding competitors or hindering them in entering the market (actual exit or harm was not proved).[20] By deciding so the GVH admitted that under its effects based approach, as a rule of thumb to find margin squeeze as an abusive behaviour under competition law it should be exercised over a longer period of time (or a perspective of that should be realistic). At the same time, the GVH held that right after liberalisation even a shorter time period could be crucial for the evolvement of the competition (and could contribute to maintain the positions of the incumbent), so in the market-opening context this strategy of **Matáv** had to be judged more severely.

37. In this case the GVH established the infringement, and imposed a fine (70 million HUF ≅ 265 thousand EUR), but did not apply any other remedy (since the changes in the regulation from July 2002 solved the problems).

38. As regards the **Matáv residential case** it was established without further or deeper investigation that in 2002 Spread II. was not sufficient to cover the cost of capital (profit) relating to these services and thus hindered new entry.[21] However, the GVH established no infringement because this situation was mainly caused by regulation (fixed wholesale charges and price caps for retail services). Though price cap regulation does not in itself preclude the applicability of competition law but in this particular case the freedom for action granted by the price cap was(had been) insufficient for the incumbent to put an end to this margin squeeze.

2.3 Railways

39. Due to the progress in the telecom regulation (detailed in the next section) margin squeeze cases (had) disappeared from the GVH's practice for a while, the phenomenon of margin squeezing re-emerged only in 2008 in connection with an other industry: the railway sector. The GVH pursued proceedings[22] against MÁV Hungarian State Railways and MÁV Cargo,[23] in which the upstream market was the

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20 The above mentioned Vivendi DSL case was terminated since the recoupment was not probable, in this interconnection case the GVH held that the consequence of margin squeeze is not necessarily the increase in retail prices, but the exclusion of competition may result in the hindrance of a latter price decrease (that would be forced by the pressure of rivals) as a potential harm.

21 It is clearly understandable that if return on revenues is less than 1% it could no way come up to the company's profit expectations.

22 Vj-5/2008.

23 Rail freight transportation company, founded by MÁV Hungarian State Railways, acquired by Rail Cargo Austria – EC approved this merger December 2, 2008 - COMP/M.5096 - RCA/ MAV CARGO.

commercial takeover of freight wagons in the Záhony area (in connection with the cross-border traffic at the border of Hungary and Ukraine), and the downstream market rail transport of bulk goods.

40. In this **railway margin squeeze case** the GVH explicitly tried to apply the avoidable cost concept. In this case the margin squeeze test was quite difficult, since there were no uniform and clear upstream and downstream prices, but lots of individual agreements. So the investigation tried to apply the efficient competitor test, analysed the conditions of these agreements and calculated the average variable cost (as a proper proxy for average avoidable costs[24]) for average tonnes-kilometres (EUR/tone). These cost were considered: Train with cargo – summa of railway infrastructure and traction charges on normal gauge; Train without cargo – summa of railway infrastructure and traction charges on normal gauge. Eventually it was found that the percentage of margin squeeze's occurrences was only approx. 8%, so the procedure was dropped in a relatively early stage.

3. Sector-specific regulation

41. The discussion of the Hungarian regulatory aspects follows the same sector by sector structure (which again corresponds to sequence in time). Only the telecom sector is discussed in more details, since solely the telecom regulation deals explicitly with the matter of margin squeeze.

42. **Funeral services** saw an updated regulation in 2000[25] that was initiated by the GVH and (partly) based on its recommendations. The recommendations of the GVH addressed issues that appeared in its practice during the early '90s, thus primarily related to cross-subsidisation and refusal to deal, and neither the GVH nor the regulation dealt with the issue of margin squeeze explicitly. The new regulation prescribes that integrated funeral providers must book upstream and downstream costs separately, and it includes rules about the range of services that may be provided exclusively by the integrated funeral provider. In relation to margin squeeze (and excessive pricing) the regulation obliges the municipalities to determine upstream prices and grants for them some freedom for action to extend the range of exclusive services that the Funeral Act grants to the funeral provider.

43. The regulation successfully eliminated refusal to deal cases (no serious case of this type has occurred since the regulation took effect). Regarding margin squeeze cases treated as upstream excessive pricing, after 2000 the possibilities of such a treatment are limited. On the one hand, the Funeral Act prescribes that the municipalities must lay down the prices of the exclusive upstream services in their regulations and the GVH acknowledges that it does not have authority to revise these regulated prices. On the other hand, the Funeral Act grants the municipalities freedom for action to legalize (quasi) any price level in the regulations and to determine (to some extent) which activities will be exclusive services and thus regulated. In the lack of price regulation skills at the municipalities, in some occasions municipal regulations became a root of margin squeeze behaviour by legalizing excessively high upstream prices or leaving some price elements unregulated. After the update of the regulation, when regulated upstream prices came under investigation the GVH treated margin squeeze under different regulations of the Competition Act. Subsequently, the same provisions were used that were invoked in the cases in the telecom industry between 2002 and 2004 in margin squeeze cases. However, in some post 2000 cases, in which it was possible to treat the particular upstream prices under excessive pricing regulations (because they are unregulated), also excessive pricing regulations were used parallel to margin squeeze regulations to set up infringement.

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[24] See COMMUNICATION FROM THE COMMISSION: Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, 3 December 2008., page 11. "In most cases, AAC and the average variable cost (AVC) will be the same, as it is often only variable costs that can be avoided."

[25] See Act XLIII of 1999 on Funeral Services (Funeral Act).

44. While the Funeral Act provoked a change in the *legal treatment* of margin squeeze cases in the industry, regarding the *analysis* of allegedly margin squeeze behaviours, it also made it easier for the GVH to analyse the prices of upstream and downstream funeral services.

45. In Hungary the **telecom regulation** covers the issue of margin squeeze. From 2004 the Hungarian telecom regulation,[26] on the contrary to the competition law, explicitly contains rules on margin squeeze: its definition, the related procedural and other rules etc., however the regulatory authority[27] has not applied these rules to date. This Telecom Act is based on the European telecom regulatory package of 2002 (hereinafter: NRF – new regulatory framework), which is based on competition law principles, but the Hungarian regulation is much more detailed and bearing some peculiarities (which fit in the framework of the NRF nevertheless).

46. The NRF contains only a few and quite general rules concerning margin squeeze, it merely defines margin squeeze (using the term: "price squeeze") as a potential harmful conduct of operators with significant market power (*"operators with significant market power should avoid a price squeeze whereby the difference between their retail prices and the interconnection prices charged to competitors who provide similar retail services is not adequate to ensure sustainable competition"*), and the scope of related regulatory interventions (*"a national regulatory authority […] may impose obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection and/or access, in situations where a market analysis indicates that a lack of effective competition means that the operator concerned might […] apply a price squeeze, to the detriment of end-users"*).

47. As to the specialities of the Hungarian telecom regulation, the Electronic Communications Act explicitly regulates the relationship between the two authorities' proceedings, with regard to margin squeeze. Margin squeeze can be caused by the wholesale price or the retail price-setting, the former is dealt by the Communications Authority, the latter by the GVH.. The Communications Authority controls whether the wholesale prices are cost based or not. If though a margin squeeze exists, the price of the network (upstream) service is adjusted to the costs arising in connection to the provision of that network service, the Communications Authority (the regulator) refers the case, to the GVH that will establish whether or not the price setting for the output subscriber (downstream) service constitutes a violation of the Competition Act. According to Act, in order to safeguard competition and to promote the uniform application of legislation, the Communications Authority and the Competition Authority closely cooperate with one another concerning matters affecting competition on the electronic communications market, in particular *inter alia* in proceedings concerning the development of methodology relating to the examination of margin squeeze and the examination of margin squeeze (and the definition of relevant markets of the electronic communications market, the analysis of competition on those markets, the identification of service providers with significant market power and the imposition of duties/obligations on them).

48. 1The regulatory definition of margin squeeze is basically market-oriented (in line with the underlying competition law principles), but it also allows investigating margins in connection with individual service components. Pursuant to the rules related to margin-squeeze the Communications Authority can apply more easily an approach which is more strict towards incumbents and more permissive for competitors, compared to basic competition law enforcement.

49. As it was mentioned, the Communications Authority has not had to apply these rules in individual procedures, has not even developed the methodology relating to the examination of margin

26 Act C of 2003 on Electronic Communications.

27 National Communications Authority – the Hungarian telecom regulator.

squeeze. In the era of this new regulation (since 2004) not any serious margin squeeze suspicion concerning telecom markets has come up, mainly due to other effective regulatory interventions (regulation of wholesale prices by retail minus method, or benchmarks, or cost-models), which could prevent margin squeeze situations.

50. As to **the railway sector** there is no regulation which would prevent the application of margin squeeze, or help to control that. Since the railway margin squeeze (detailed above) case highlighted some deficiencies of the sector-specific regulation, the GVH after the termination of this case informed the legislator and the regulator about the identified problems deriving from the situation that the cross-border traffic is controlled by a vertically integrated firm, which enjoys dominant position in the upstream market (the commercial takeover of freight wagons at the border of Hungary and Ukraine) thus it can hamper the downstream competition (in the market of the rail transport).

4. Summary

51. Dealing with margin squeeze has evolved over time in Hungary. First behaviours resembling margin squeeze emerged among “more traditional” forms of exclusionary practices, like refusal to deal or abusive upstream pricing behaviour, and were treated accordingly in funeral services. Then in the same sector, behaviours which today would be identified as margin squeeze were still dealt with under different labels and different provisions of the competition law, later the same sort of problems were still labelled differently but dealt under the provisions today referred to margin squeeze cases. The term of margin squeeze, and to regard it as a separate kind of infringement was imported from the EU. This approach and analytical framework appeared first in relation to integrated telecom firms in Hungary. The more recent developments are incorporating the concept of margin squeeze into sector-specific regulation which – ideally – would cause a decrease in number of this case type in competition law enforcement. This kind or regulation is present in telecommunications in Hungary.

52. The experience of the GVH suggests that it may have merit of the views in which margin squeeze could be regarded as an ultimately redundant concept and could be put into existing case boxes like price discrimination, (upstream) excessive pricing / constructive refusal to deal, or their combination. At the same time, as a practical matter, the pattern of margin squeeze is unique and beyond a certain number of cases it is useful to deal with it as a specific behaviour, because this implies more tailor made approach. It clearly makes easier to identify, understand and analyse certain restrictive practices, whatever they are labelled.

53. Not only the understanding of “more traditional” forms of exclusionary practices and of their borderlines influence whether, and how much margin squeeze is conceptually redundant, but also the other way around. In Hungary, for example the GVH has been limiting the concept of predation to cases where price is below cost – but it is possible that it would have been much more open towards not actually loss making forms of predation if the category of margin squeeze had not been available.

54. Developments in Hungary point towards the notion that margin squeeze can be dealt in principle by either competition law or regulation, and that regulation may be better placed to do it for two reasons. First, in the kind of analysis margin squeeze allegations price regulation skills can be beneficial. Second, regulation may be asymmetric more easily for the benefit of new entrants than competition law enforcement. It is clear from the Hungarian experience that appropriate upstream price regulation – whether or not explicit margin squeeze regulation is present – may prevent margin squeezing or certain forms of it.