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Italian Antitrust Authority fines Telecom Italia over €100m for abuse of dominance

Tommaso Salonico, Gian Luca Zampa, Laurent Garzaniti e Sophia Real, Freshfields Bruckhaus Deringer LLP

Summary

On 10 May, the Italian Competition Authority (the *IAA*) published a decision fining the Italian telecoms incumbent Telecom Italia €103,8m for abuse of dominance. The IAA found that Telecom Italia had hindered the expansion of other licensed operators (*OLOs*) competing with its own downstream operations as a result of:

- engaging in a selective discount policy (*margin squeeze*) in the market for retail access to the public telephone network; and
- a technical boycott of rivals of its wholesale broadband service through an unjustified number of refusals of requests to access Telecom Italia's network.

Introduction

On 23 June 2010, the IAA opened an investigation into Telecom Italia following complaints sent a few months earlier by Wind Telecommunicazioni S.p.A. and Fastweb S.p.A., two Italian telecoms operators, alleging that Telecom Italia had been engaging in, inter alia, anti-competitive refusals to supply and discount policies.

On 24 June 2010 the IAA carried out surprise inspections at Telecom Italia's offices in Rome and Milan.

The IAA's investigation took almost two years and uncovered that Telecom Italia had engaged in two distinct types of anti-competitive conduct:

- engaging in an exclusionary discount policy (*margin squeeze*) in the market for retail access to the public telephone network, and
- a technical boycott of rivals of its wholesale broadband service that included an increased and unjustified number of refusals for access to Telecom Italia's network.

The IAA concluded that, as a result of these conducts, Telecom Italia had hindered the expansion of OLOs competing with its own downstream operations, affecting the competitive process and thus ultimately restricting competition in the market.

The role of antitrust enforcement in highly regulated sectors

As a starting point, the IAA reaffirmed its jurisdiction over anti-competitive conduct occurring in highly regulated markets. It underlined the fact that sectoral regulation and the rules of competition law are meant to complement each other – sectoral regulation consisting of a framework of rules, put in place *ex ante* (and in conformity with the rules of competition law), with competition law aiming at verifying (and, where necessary, sanction) *ex post* possibly illicit conduct by undertakings active in that regulated sector. Thus even in heavily regulated sectors such as the Italian market for telecommunications, the intervention by the competition authorities is always a possibility, above all where the company subject to sectoral regulation enjoys a certain margin of discretion in how it applies such regulation. The IAA concluded that Telecom Italia did enjoy a significant margin of discretion in designing its organisational structures, its systems and processes and thus the level of efficiency with which it operates and how commercially it deals with its downstream competitors.

The margin squeeze

According to the IAA's decision, Telecom Italia had engaged in an exclusionary discount policy which could be equated to a margin squeeze as regards its large business customers in the market for retail access to the public telephone network. According to the IAA, Telecom Italia applied these discounts selectively as they were only available for certain customers which represented the contestable part of the market – ie the areas of the market subject to the unbundling of the local loop (*ULL*) where customers are 'accessible' by competitors.

As has been established by the Community courts, the IAA reaffirmed that a margin squeeze in breach of the competition rules consists of a reduction in the retail price combined with a high wholesale price in such a way as to leave competitors with a margin which is insufficient to cover the specific costs they need to bear to offer the relevant services to their final customers. In order to assess whether a dominant undertaking has engaged in an anti¬competitive margin squeeze the '*as efficient competitor*' test is applied.

This test involves showing that the vertically integrated incumbent would not be able to operate profitably for a sustained period of time if it had to bear the wholesale prices that it charges its downstream competitors. The relevant benchmark for applying this test being the long-run average incremental cost of the dominant undertaking – ie the total average cost (including both fixed and variable costs) the dominant undertaking has to bear to produce the relevant product or to provide the relevant service.

As became clear during the IAA's investigation, Telecom Italia in fact applied discounts that in some cases exceeded the maximum discounts provided for in internal marketing guidelines for the operation of customer contracts and contributions to be paid for network access by business customers. Moreover, the IAA's analysis showed that if Telecom Italia's own downstream operations had to sustain the same wholesale prices Telecom Italia charged its downstream competitors, they would not have been able to continue offering these discounts for a continuous period of time without incurring a loss. As such, Telecom Italia's discounting policy could not be replicated by an as efficient competitor without incurring losses and was thus capable of restricting competition.

The IAA also underlined the strategic importance of business customers who were granted these discounts by Telecom Italia for the OLOs. The business customer segment is crucial for the OLOs in order to be able to achieve economies of scale needed to render these services sustainable in light of the high fixed costs in providing these services. Telecom Italia's discount policy was aimed only at those areas of the market open to competition, ie those areas of the market in which efficient competitors are typically able to generate profits from investments in infrastructure. As such, Telecom Italia's discount policy affected the ability of otherwise efficient competitors to compete with Telecom Italia, threatening the OLOs' ability to consolidate their market position as well as, more generally, hindering effective competition in the market for retail access to the public telephone network. In turn, this also allowed Telecom Italia to slow down the erosion of its market share in the downstream markets following the liberalisation of the Italian telecommunications market.

The refusal to activate OLOs

The second behaviour sanctioned by the IAA was a refusal to supply. In order to provide their services to customers, OLOs have to send a request to Telecom Italia to activate the relevant services at the wholesale level (a process referred to as 'delivery'). Such activation requests can have a positive outcome, in which case the OLO is able to provide the relevant services to the final user, or a negative outcome (so-called KO). In case of a KO, the activation request may be sent anew once the problem giving rise to the KO has been resolved. There are multiple reasons giving rise to a negative outcome/KO, including incomplete or erroneous documentation or, for example, technical problems.

According to the IAA, Telecom Italia treated activation requests by OLOs in a discriminatory way compared to requests stemming from its own downstream operations.

Whilst the IAA underlined that even dominant undertakings have the right to choose their commercial partners, the IAA also emphasized that dominant undertakings may be subject to a duty to supply where the product or service offered by the dominant undertaking is objectively necessary to be able to compete in markets that are downstream of that product or service. The IAA underlined that there is no alternative infrastructure that would allow the OLO to provide telephone and broadband services across Italy that could be substituted for Telecom Italia's network and a replication of Telecom Italia's infrastructure would not be sustainable from an economic perspective or achievable in a reasonable timeframe. As such, Telecom Italia was under an obligation to provide access to its infrastructure on terms that are fair, reasonable and non-discriminatory (so-called '*FRAND terms*').

As became clear during the IAA's investigation, Telecom Italia had impeded access to its own infrastructure through refusing the OLOs' activation requests in an unjustifiably high number of cases.

In particular, the IAA uncovered that these refusals were the result of '...specific structural, organisational and procedural choices ...' governing delivery and were not due to any inefficiency on behalf of the OLO. It also became clear that Telecom Italia's own downstream operations were treated differently from the OLO in these regards.

The IAA stressed that the positive outcome of activation requests is essential for the OLOs for whom the acquisition of new customers is crucial (in particular to benefit from economies of scale that result from an increased customer portfolio). Negative outcomes therefore not only reduce OLOs' ability to acquire new customers but also seriously impedes their ability to establish themselves firmly on the market.

It is the view of the IAA that the elevated number of activation request refusals in the case of the OLO contributed to hindering the growth of Telecom Italia's competitors making it significantly more difficult and more costly for the OLO to attract new customers. Above all, Telecom Italia's conduct also had a negative impact on the reputation of the OLOs and their ability to provide the services in a set time acceptable to the customers.

The fine

The IAA's fine of €103,8m (€15.6m of which were imposed for the margin squeeze and €88.2m for the refusal to supply) takes account both of the steps taken by Telecom Italia in the past aimed at improving the access process for its competitors as well as the fact that Telecom Italia is a recidivist (Telecom Italia has previously been fined by the IAA for a similar abuse of dominance). The IAA also underlined that Telecom Italia's conduct was particularly serious as it affected the liberalisation of the telecommunications market in Italy.

Conclusion

The IAA's decision and the high fine are a clear warning to other dominant companies active in regulated sectors, not only former State-owned monopolies, to exercise caution in how they operate and the choices they make where sectoral regulation leaves them room for manoeuvre. Complying with regulatory provision is not sufficient to avoid infringements of competition law.

The high fine imposed by the IAA signals a return of the IAA under guidance of its new chairman to the fines level the IAA was used to at the beginning of the last decade, in sharp contrast to the more lenient fining policy pursued by the IAA in recent years.