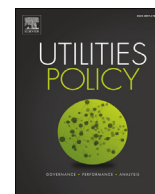


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The political economy of margin squeeze liability in the Turkish telecommunications market: A comparative assessment

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ABSTRACT

This paper studies the increasing importance of margin squeeze issue in the Turkish telecommunications market with a comparative assessment. Recent literature does not provide enough insight into the political economy of margin squeeze. The ideological background of the countries dominates their margin squeeze policies. The socialist experience and ordoliberal ideologies affect European Union (EU)'s margin squeeze policy. The EU policy leads to endorse margin squeeze as a standalone liability and it becomes relevant to the regulation and competition law. Turkey is one of the follower of the EU policy. However, the EU margin squeeze size does not fit to Turkey. The EU perspective is not an appropriate politically because it leads to the risk of conflict of authority. This risk has not existed yet in the EU because the EU has a supranational structure that allows the EU Commission to act as a central planner. However, the risk of conflict of authority is politically significant because Turkey is a nation state that does not allow the administrative authorities to act as a central planner. The EU margin squeeze policy is also not suitable for Turkey in terms of economics. Since, the EU approach leads to waste of resources. On the other hand, United States (US) courts endorse margin squeeze as a regulatory instrument and irrelevant to the imposition of antitrust law. The US practice seems to be more suitable for Turkey because it eliminates the risk of conflict of authority and waste of resources. The new Turkish regulatory framework on margin squeeze is more compatible with the US practices. Although the Turkish practice has formed under the influence of the Deutsche Telekom, Telefonica and Teliasonera cases, new margin squeeze regulation allows to follow the Linkline and Trinko decisions to ensure consumer welfare rather than competitors' profitability.

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1. Introduction

During the last decade, margin squeeze cases have increased in the US, EU and Turkish telecommunications markets (Gaudin and Saavedra, 2014).¹ There are three main reasons behind the increasing number of the cases. First, the degree of ex ante regulation in vertically integrated markets has steadily fallen in recent years. Thus, ex post margin squeeze examinations has become an important instrument for deregulated retail markets.

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¹ See also TCA decision dated 04.03.2010 and no. 10-21/271-100 for the growing importance of margin squeeze examinations in the Turkish telecommunications market.

Second, rivals try to raise the costs of vertically integrated operator(s) through bringing vexatious claims as a strategic behavior (Salop and Scheffman, 1983; Krattenmaker and Salop, 1986; Easterbrook, 1986; Granitz and Klein, 1996; Scheffman and Higgins, 2003; Normann, 2011).² Finally, some states use anti-trust investigations as an instrument to pressure foreign and politically opponent firms.³ For instance, the Chinese government has imposed administrative fines to the US firms about

² Normann (2011) provides experimental evidence in favor of the raising rivals' costs theory which is against the Nash equilibrium but consistent with the quantal-response generalization of Nash equilibrium. Author states that "Markets with a vertically integrated firm are significantly less competitive than those where firms are separate."

³ <http://online.wsj.com/articles/eu-urges-china-to-ease-pressure-on-foreign-firms-1407932332> <http://online.wsj.com/articles/u-s-treasury-warns-china-over-antimonopoly-efforts-1410687635>.

antitrust violations for the sake of economic protectionism. The reason behind this policy is based upon the political character of telecommunications services. Governments especially in the developing countries regard goods and services produced in regulated industries as political goods (Oguz et al., 2014: 382). For instance, fixed and mobile telephony services may be regarded as political goods in telecommunications market and the trend is shifting toward broadband internet services. In recent years, the Turkish government has expressed special interest in broadband internet services rather than telephony.

The rest of the paper is organized as follows. In section two, we discuss the US and EU margin squeeze experiences and their roles in the Turkish practice. In this section, we also analyse inconsistent margin squeeze decisions in Turkey which contradict with the modern principles of rule of law. Section three comprises prospects of new Turkish margin squeeze regulation in the light of conflict of authority compared to the US and EU policies. The paper concludes with policy implications and discussions on the issues of margin squeeze liability and conflict of authority. Final section also provides recommendations for Turkey.

2. The US and EU margin squeeze experiences and their roles in the Turkish practice

The divergence between the US and EU margin squeeze policies have been reflected by administrative authorities and the courts in several cases. Margin squeeze is accepted as a standalone liability both in the EU and Turkey. Since, the Turkey's competition and regulatory frameworks have been constituted on the same pillars of the EU. Although there is no legal obligation, compatibility of regulations pushes Information and Communications Technologies Authority (ICTA) and TCA to follow the EU practices.

On the other hand, in the Linkline⁴ case, margin squeeze is not endorsed as a standalone antitrust liability under section 2 of the Sherman Act. In this case, the Supreme Court considered whether a plaintiff can claim margin squeeze when the defendant has no obligation under the antitrust laws to deal with the plaintiff at wholesale level. With this case, "LinkLine widens the gap between US antitrust law and European competition law on abuse of dominance issues ... LinkLine as the high point in divergence between US and European competition law." (Grimes, 2010: 3). According to the logic of the Linkline decision, margin squeeze has two components which are predatory pricing at retail level and refusal to deal at wholesale level. In such a case, relevant conditions of margin squeeze are based upon the requirements of predatory pricing or duty to deal. As a result, the Supreme Court gave market oriented decision in the Linkline case. One of its significant economic consequence is to protect competition rather than competitors.

First margin squeeze case is Alcoa in the US. In this case, judge Hand emphasized the importance of 'living profit' of the rivals that they can survive. The Court decided that "the prices Alcoa were higher than a 'fair price' that depriving the competitors of a reasonable profit." (Grimes, 2010: 5). The logic of Alcoa is parallel with the EU approach, because 'living profit' requires a court to act as a central planner. The Court protected competitors' profit in Alcoa case. Margin squeeze examinations in regulated sectors, e.g. energy and telecommunications, were started with Town of Concord⁵ case which is close to Linkline.

The U.S. Court of Appeals for the First Circuit examined margin squeeze claims against Boston Edison Co. which operates in the markets of electricity production and distribution. Town of Concord claimed that while Boston Edison Co. ratified its increased wholesale tariffs, it pegged its retail prices. The Court rejected disclusionary effect of margin squeeze in full regulated markets. It also rejected margin squeeze claim under section 2 of the Sherman Act. The Court also emphasized that margin squeeze examinations must be conducted by regulatory authority in regulated markets.⁶

Contrary to this, the US courts became close to the EU approach in the Anaheim⁷ and BellSouth⁸ cases. The US Court of Appeals for the Ninth Circuit in the Anaheim⁹ case affirmed margin squeeze claims which rely on anticompetitive intention and without objective justification under the section 2 of the Sherman Act. The US Court of Appeals for the Eleventh Circuit affirmed margin squeeze claims under section 2 of the Sherman Act whether predatory pricing conditions exist which were formed in Brooke Group case¹⁰. The Court expected from Covad to allege two points. Covad must allege "the prices complained of are below an appropriate measure of its rival's costs." and BellSouth had "a dangerous probability of recouping its investment in below-cost prices." The Court affirmed Covad's price squeezing claim on the basis of traditional antitrust doctrine. The Court also stated that margin squeeze claim is not specifically barred in the Trinko case so as to justify its argument.

The main difference between the US and EU is that the US perspective reduces margin squeeze to refusal to deal and predatory pricing. The Supreme Court considers whether or not defendant's behavior meets the requirements of duty to deal in Trinko case and predatory pricing in Brooke Group case. With this framework, margin squeeze does not have standalone requirements. On the other hand, margin squeeze has standalone requirements that differs from the requirements of predatory pricing and refusal to deal in the EU.

In Turkey, vertically integrated firms generally allege arguments in favor of the US cases like Trinko and BellSouth in order to justify their defence.¹¹ However, TCA unexceptionally refers to the EU cases and does not endorse the US perspective as a justifiable argument.¹² The reason behind this approach is based upon 'follow the EU regulations and practices' policy. The EU experience in margin squeeze examinations is much more relevant to the Turkish practice. Turkish telecommunications regulatory and competition rules are excerpted from EU legislation. As a result, ICTA and TCA try to mimic the EU practices both in ex ante and ex post margin squeeze analyses. For instance, TCA was influenced from the ana-

⁶ "In sum, the relevant antitrust considerations differ significantly, in degree and in kind, when a price squeeze occurs in a fully regulated as opposed to an unregulated industry. Indeed, these considerations, which are closely balanced in the ordinary price squeeze, change so significantly when the squeeze takes place in a fully regulated industry that, in our opinion, the legal consequences of the squeeze change as well. That is to say, a price squeeze in a fully regulated industry such as electricity will not normally constitute "exclusionary conduct" under Sherman Act § 2."

⁷ *City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373 (9th Cir. 1992).

⁸ *Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004).

⁹ *City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373 (9th Cir. 1992).

¹⁰ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222, 113 S.Ct. 2578, 125 L.Ed.2d 168 (1993).

¹¹ TCA decision dated 19.12.2013 and no. 13-71/992-423, p. 32 and p. 40.

¹² TCA decision dated 19.11.2008 and no. 08-65/1055-411; TCA decision dated 19.12.2013 and no. 13-71/992-423.

⁴ *Pacific Bell Telephone Co. v. LinkLine Communications, Inc.*, 129 S. Ct. 1109 (2009).

⁵ *Town of Concord v. Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990).

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