



# **PRICE SQUEEZE TEST IN ELECTRONIC COMMUNICATIONS: THE SPANISH APPROACH**

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# **I. Definition of margin squeeze**

# I: Definition of margin squeeze

- A margin squeeze is a situation where a vertically integrated firm with market power in a key upstream market, supplies rival firms in associated downstream markets and sets prices for the input and the downstream service in a way that renders unprofitable the activities of its competitors in the retail market.
- The abuse can result from too low a retail price, too high a wholesale price or both.
- In principle, a margin squeeze is a form of price discrimination when the integrated firm supplies the input to competitors at a price that is larger than the transfer price it charges to its own retail arm.
- However, a margin squeeze can occur even with no such price discrimination, but on these cases it entails that the retail price of the integrated firm is predatory in nature, although it may not imply that the integrated firm operates at a loss as the downstream loss could be cross-subsidised with “wholesale profits”

## **II. A snap-shot of the obligations for Telefónica**

## II. A snapshot of the obligations for Telefónica

Types of intervention and authorities involved	
Type of intervention (ex-ante, ex-post). Brief description	An explicit prohibition of anticompetitive bundling and margin squeeze
	An obligation for the SMP operator to communicate all retail prices to CMT in advance to their commercial launch.
Procedures	Market players to complain to CMT if the SMP operator is allegedly not complying with the obligations.
	CMT to ex-ante screen through offers identifying those with most likely anticompetitive effects.
	The ex-ante screening focus is the ability for rivals to replicate the bundle and its economic conditions. Hence, the analysis considers prices and the existence (or not) of relevant wholesale markets.
Current results	As a result of the ex-ante screening, no bundle of access with other services has been authorized yet, and a few double play bundles have been stopped (in 2007, around 3, % of all Telefonicas's notifications)

## II. A snapshot of the obligations for Telefónica

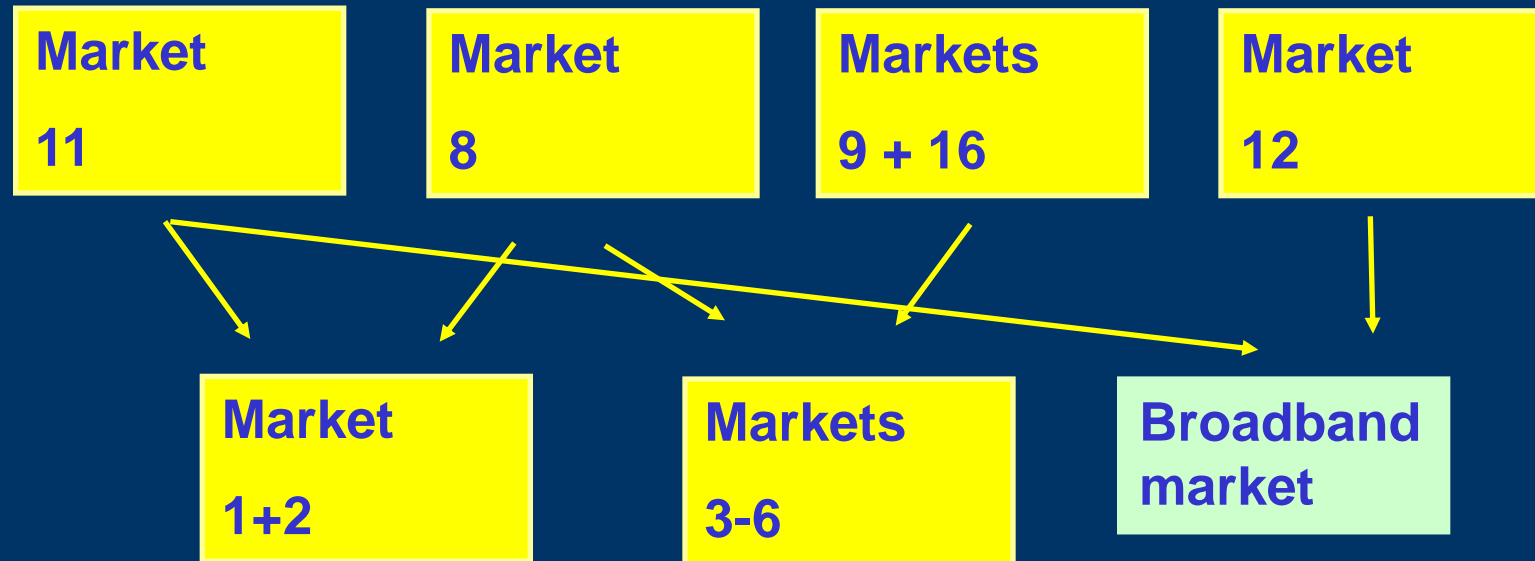
Methodologies	
Available data	<p>Submitted by Company: Price and retail conditions of product, including information on specific discounts and promotions (for example, gifts).</p> <p>CMT s estimate of a reasonable margin for different types of products, based on an efficient competitor test and generally using incumbent's data.</p> <p>Once the reasonable margin is established a maximum discount on a standard offer results.</p>
Markets where test is applied	Retail broadband, access and different telephone markets for fixed phone services.
Thresholds for tests to be applied	All promotions and standard retail offers of dominant firm, except standard offers (and promotions) directed to business clients or retail telephone service offers with small numbers
Determinants of a test "pass" or "fail"	Value of promotions and discounts exceeds authorized threshold or not.
Consequences of a test "pass" or "fail"	If pass, product is authorized. If fail, marketing of product is stopped temporarily and further study takes place for definitive decision.

# A snap shot of the obligations in Spain

- During 2007, 372 offers and promotions were communicated to CMT
- 6 of those were stopped
- New guidelines on margin squeeze and bundling analysis published on July 2007

### **III. How were those obligations set**

### III. How were those obligations set



**Yellow markets- where Telefónica is SMP**

**Obligations in 3-6 include no anticompetitive behaviour and communication of offers to CMT**

**Obligations in 12 include communication of retail offers to CMT for margin squeeze purposes**

## **IV. Margin squeeze analysis**

## IV. Margin squeeze analysis

1. Market definition. First retail then wholesale
2. SMP in wholesale markets



3. Use margin-squeeze test



Allow offer if test is ok

Otherwise, check impact of offer on competition to decide

In practice, we use the SMP identification from the MD

$P \geq a$  (regulated access price) + additional costs + Retail cost

## IV. Margin squeeze analysis

$$P \geq a + \text{other costs} + \text{retail cost}$$

Really not prices-  
Will include all  
revenues, may be  
recurrent or not,  
direct or  
additional

Accounting data from Telefónica is used to estimate the following costs (efficient operator standard).

Billing, product development, customer attention, sales cost's  
(average cost per line)

Sales, Debt Recovery, Advertising, taxes  
(average cost per customer & type of service)

Equipment costs

Further information requests: Average life-time of customers, Traffic data

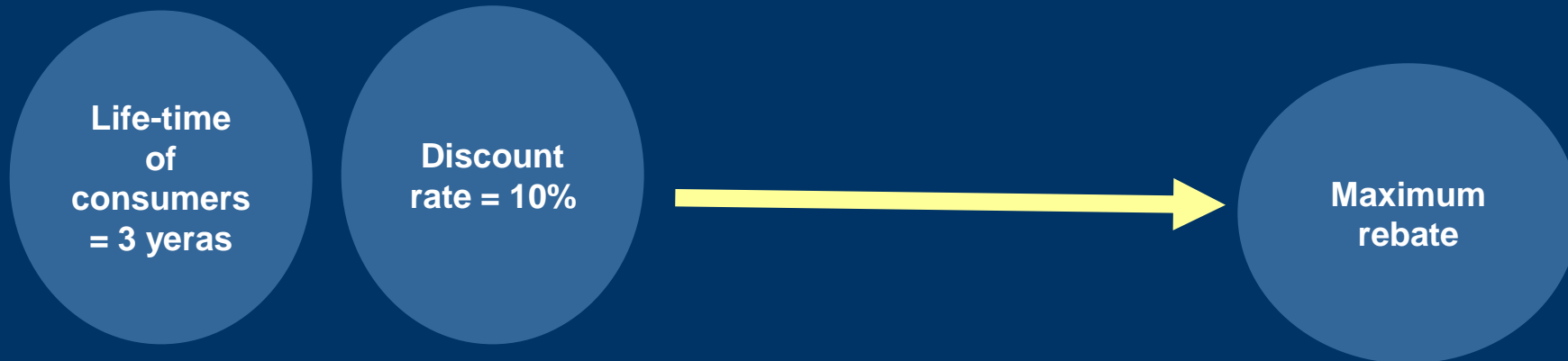
# IV. Margin squeeze analysis

Voice flat rate with minutes FM included

Revenue	€	19	Retail cost	€	2
Total Cost	€	9	Regulated costs	€	3
Margin	€	10	Other costs	€	4

## Average traffic per consumer, month and type

Local	Min/month and client	1500
Regional	Min/month and client	57,5
National	Min/month and client	42,5
International	Min/month and client	1,234
Fix -Mobile	Min/month and client	2,523

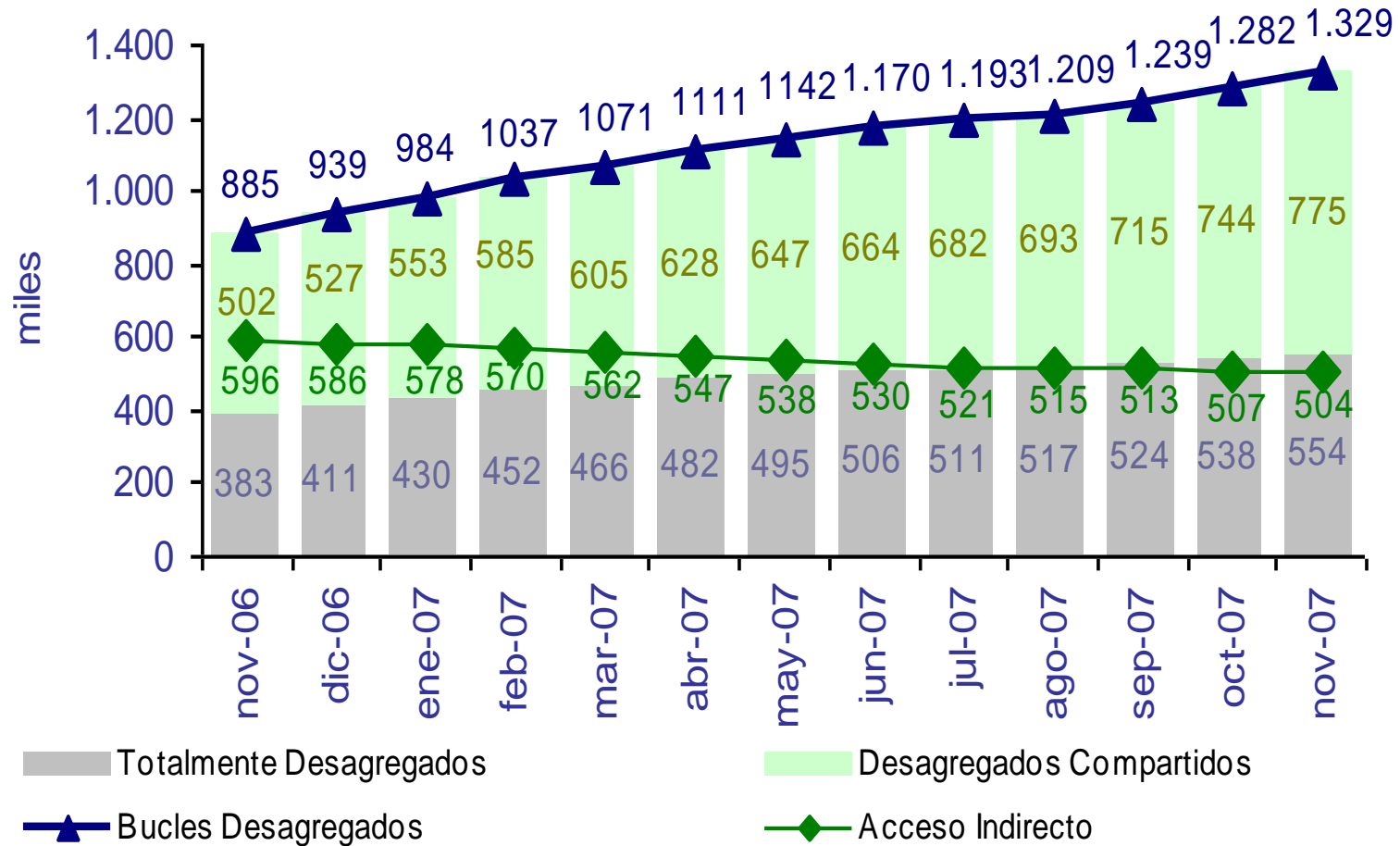


## **IV. Margin squeeze analysis- summary**

**Hence:**

- “efficient” operator**
- discounted cash-flow approach based on current margins**
- unit of reference is a specific offer/service- not the whole market**
- upstream prices for broadband services, we consider an average of the prices of different wholesale services**

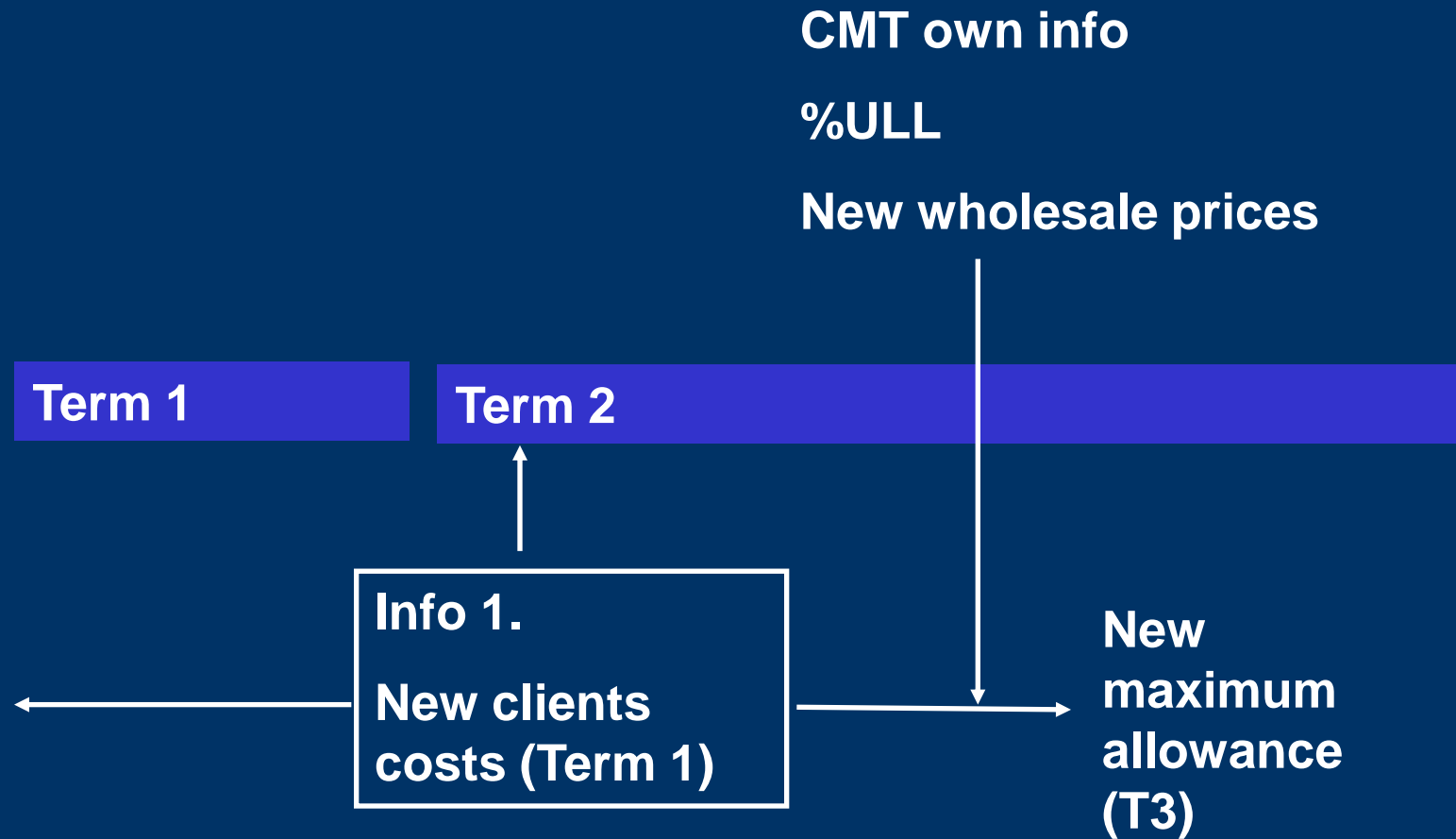
# Margin squeeze analysis- broadband upstream



## IV. Margin squeeze analysis- promotions

- Telefónica uses seasonal discounts- what to do about those?
- As mentioned if the discount is smaller than the maximum allowance, there is a go-ahead
- We admit some discounts in excess of the maximum allowance (with limitations)
- But... we request that taking a service and averaging all “its” prices in six months Telefónica’s average discount is smaller than the allowance
- Hence there is a check, and every 6 months we request data from Telefónica.
- Strong penalties if the test is not abided with

# Squeeze- Timing



# V. Bundling

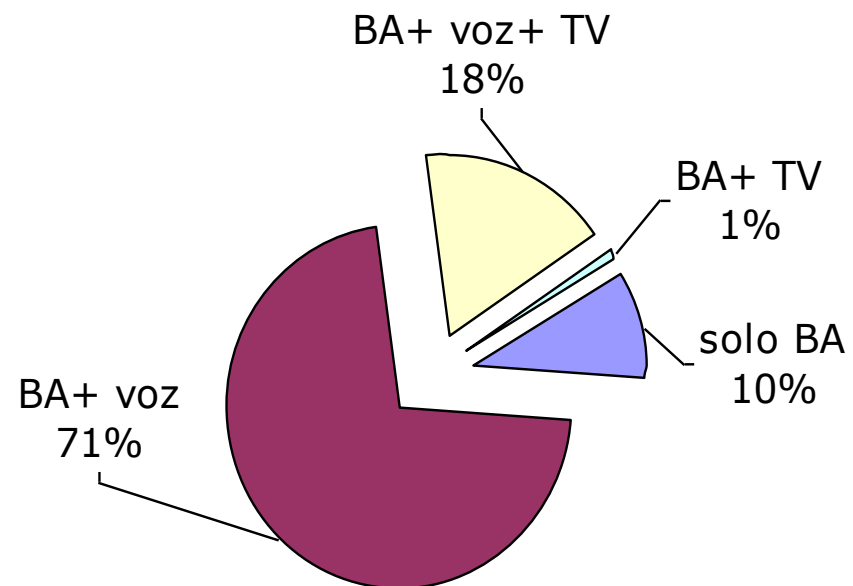
# V. Bundling

- Bundling is a predominant feature of the spanish telecom markets.
- Most bundles are mixed
- Telefónica is not allowed to bundle line rental with other services
- We developed a methodology to assess the replicability of bundles.

# Bundling

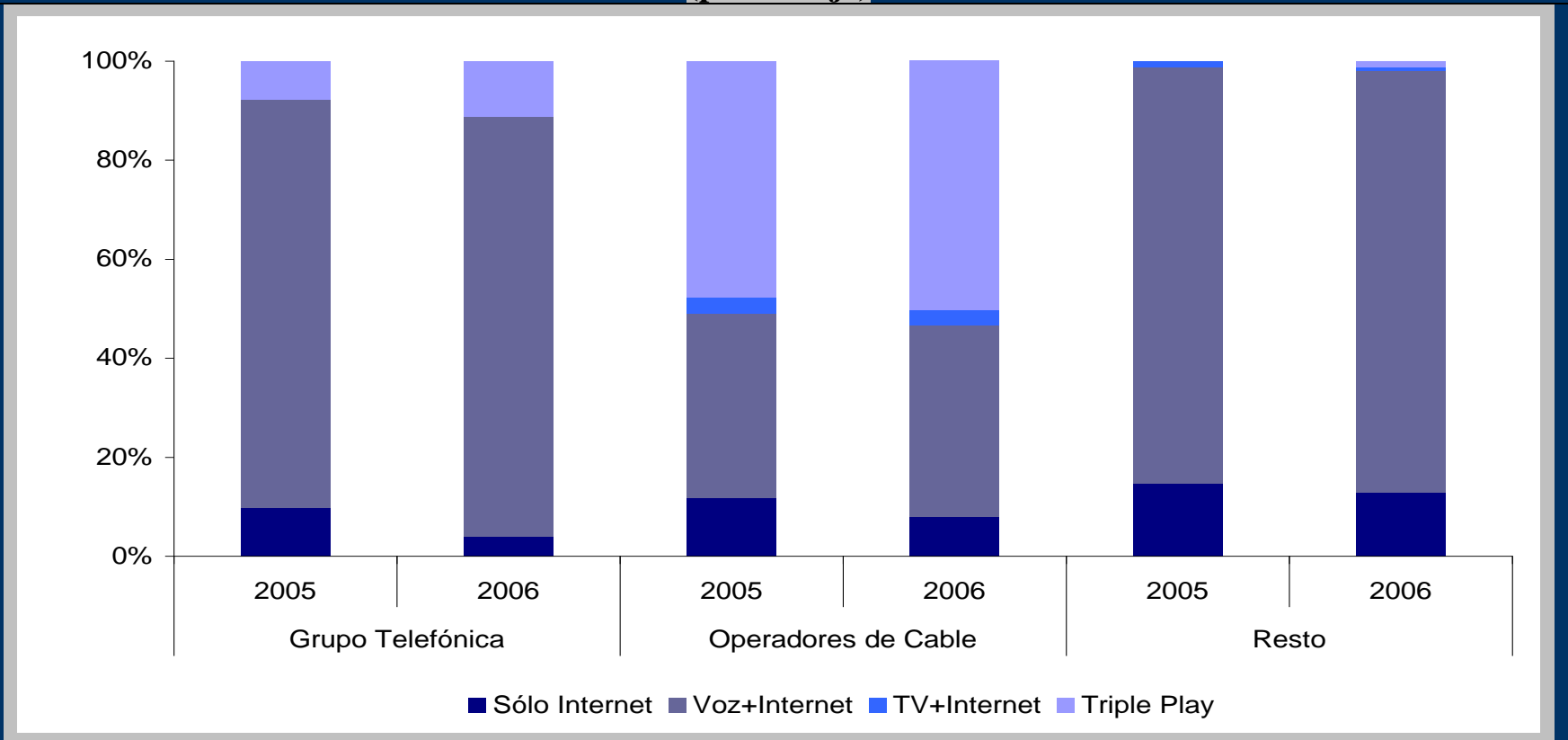
90% de broadband clients in Spain buy bundles where their service is included, mainly bundles with voice

Empaquetamiento de clientes residenciales de BA



# Bundling

**CLIENTES RESIDENCIALES DE INTERNET POR TIPO DE EMPAQUETAMIENTO  
(porcentaje)**



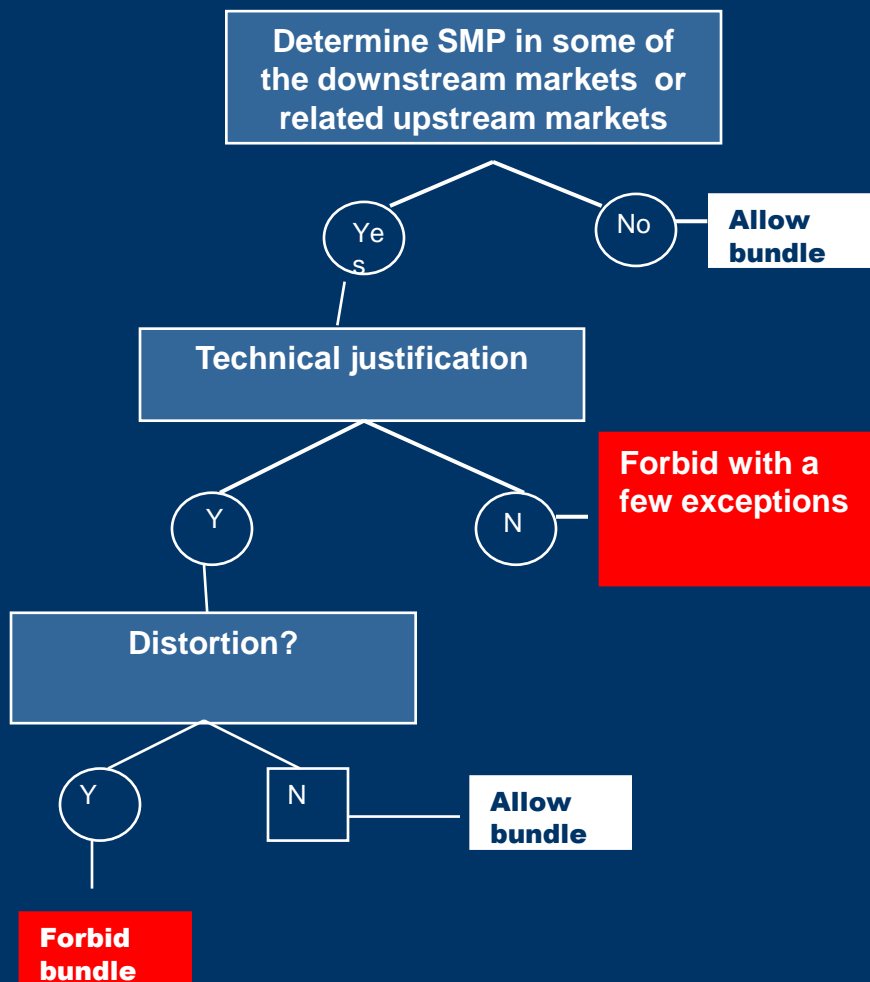
Fuente: CMT

# V. Bundling- pure bundles

-Not allowed pure bundles of access with other services, based on:

-SMP of Telefónica (market share around 80%)

-Complementarities in services which would imply a strong exclusionary effect



# V. Bundling- mixed bundles

1) An SMP position must be determined. In practice this is done in the market analysis procedure.

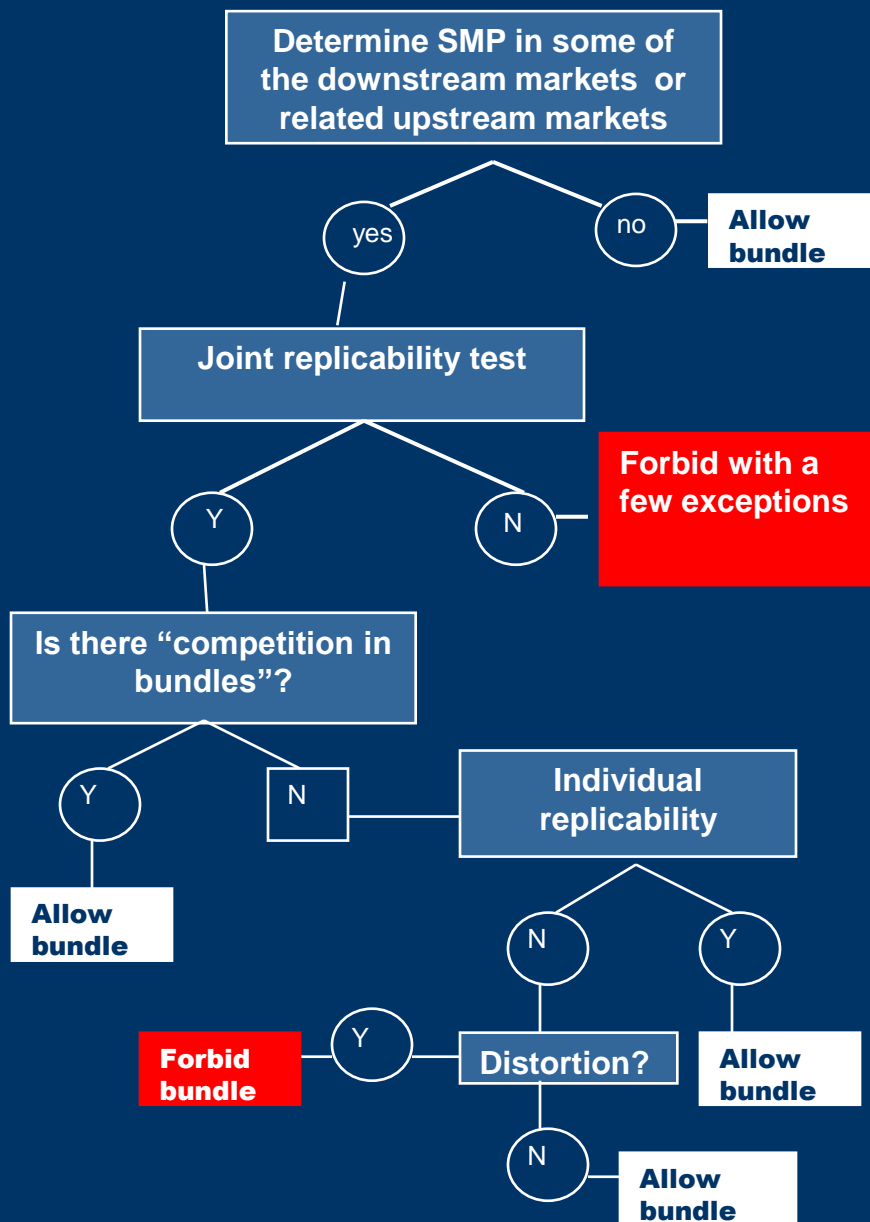
2) Joint replicability test (as before)

3) Is there competition in “bundles”?

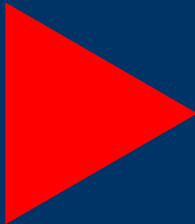
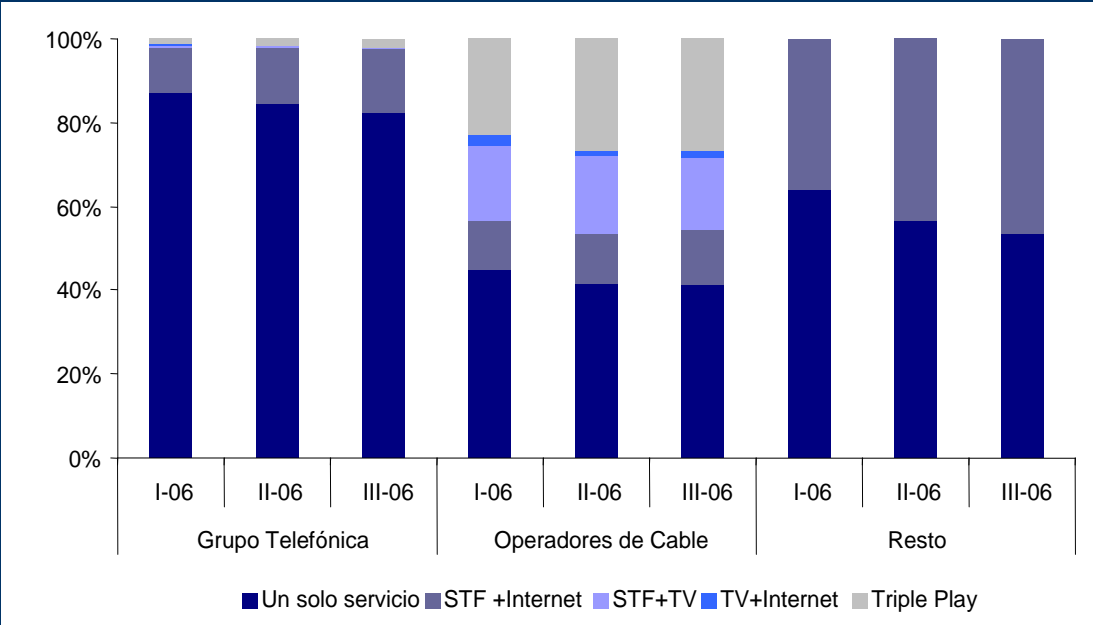
- If yes, we accept the bundle
- Otherwise, we use an ortho test- bases on the incremental revenue and cost of the more competitive market

4) Individual replicability

- If the ortho test is satisfied, final OK
- Otherwise we check for a distortion in the market



# v. Bundling



Voice+BB are offered by all operators

TV+BB is offered by cable+Telefónica

# Bundling. Conclusions on type of competition

## ➤ There is competition in broadband and voice bundles

- Started in 2004
- Regulated upstream services allow every operator to market these bundles

## ➤ There is competition in broadband voice and TV bundles

- Cable operators Orange and Jazztel offer these services
- Telefónica and cable operators have very similar services and coverage

## ➤ There is no competition between access and bundles. Rivals could not technically replicate this service (waiting for WLR).

In consequence, CMT uses a joint test for double and triple play. No Telefonica's pure bundles with access are allowed. Cuadruple play analyzed via ortho test

# Bundling. An example of the ortho test

## Double Offer bundle: Access and National Flat Rate (Plan de precios 10)

Revenues	
Bundle	20
Access	13,70
Difference	6,30
Costs	5,15
Retail costs	2,22
Network costs	2,93

**MARGIN: 1,15 eur/month**

10%  
(WACC)



3 years

Revenues	233,7
Costs	191,2
Maximum allowance	42,5

## **VI. Conclusions for the Seminar**

## IV. Conclusions for the Seminar

- **Ex ante** Price control
- **EEO** for alternative operators in the downstream market to obtain a normal profit
- Price squeeze test is performed **per service**
- Current cost accounting as a valuation method of assets + FDC + Top down
- **Wholesale services** on BB depend on the use of the alternative operators - dynamic
- Competition authorities and Regulators



➤ Any comments?

Thank you !