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Dear Directorate-General for Competition, European Commission,

**Re: Section 4.2.5, Proposed Guidelines on the Application of Article 102 TFEU to Abusive Exclusionary Conduct by Dominant Undertakings - Margin Squeeze Liability**

## Key Points

- In its proposed guidelines, the EC treats margin squeeze abuses as “price-based conduct” in the same category as predation, and therefore suggests analysing such abuses with a price-cost test.
- Fideres believes a margin squeeze is distinct from “price-based conduct” because it entails raising downstream rivals’ cost in a way price-cost tests are incapable of considering.
- Because of this distinction, a firm engaging in a margin squeeze can abuse upstream dominance to fully prevent or limit both downstream (vertical) and upstream (horizontal) competition in ways the EC’s proposed price-cost test will routinely fail to identify.
- By only analysing margin squeeze cases with a price-cost test, the EC could induce suspect-firms to evade liability by increasing retail prices. This would have the perverse effect of protecting competitors while failing consumers.
- The flaws present in the EC’s proposed margin squeeze analysis speak to a broader conceptual pitfall of applying “line in the sand” tests to exclusionary abuses which should be analysed by their effect on consumers.

## Introduction

Our comments focus on Section 4.2.5 of the proposed Guidelines on the Application of Article 102 TFEU to exclusionary conduct by dominant undertaking.

The European Commission (EC) suggests screening margin squeeze abuses with a price-cost test. In doing so, the EC implicitly presumes that margin squeeze conduct is only abusive when

it would drive the margins of an as-efficient downstream competitor to be negative.<sup>1</sup> We are concerned that this assumption represents an oversimplification of the relevant academic work on this subject, which may ultimately lead to under-enforcement at the expense of consumers.

Unlike a standard predation case (where costs are exogenous to the challenged conduct), a firm engaging in margin squeeze has two choice variables – input cost and retail price. This affects the potential abuses it could employ and in turn dictates the applicability of the price-cost test to margin squeeze cases in a way which we believe the proposed guidelines have not adequately considered. In other words, it is conceptually inaccurate to call a margin squeeze “price-based conduct” in the same way as predation.

Specifically, the vertically integrated undertaking can increase the costs of downstream rivals, reducing their ability to compete without removing them from the downstream market. This theory, first published by Salop & Scheffman in the American Economic Review in 1983, is known as Raising Rivals’ Costs (RRC) and is a form of partial vertical foreclosure.<sup>2</sup>

The EEC framework was designed to detect horizontal foreclosure (predation and loyalty rebates) and is ill-suited to identifying partial vertical foreclosure under RRC. Too broadly applying the EEC framework to margin squeezes could induce a dominant undertaking to evade detection without reducing consumer prices in either the short or long term. Consequently, the proposed guidelines could mark an unplanned departure from the consumer welfare standard.

More fundamentally, we are concerned that the proposed guidelines’ attempt to provide clarity on 102 TFEU enforcement would have the unintended consequence of giving *de facto* safe harbour treatment to abuses which have historically, and with good reason, been analysed by their effect on consumer welfare. Indeed, the economic literature on margin squeeze emphasizes the necessity to analyse the end effect on consumer welfare, as this may vary both when the price-cost test is failed and when it is passed. In this sense, the price-cost test is neither necessary nor sufficient for a proper analysis of margin squeeze abuses.

## The Price-Cost Test in Margin Squeeze Cases

### The conceptual purpose of the price-cost test

The price-cost test is a practical implementation of the equally efficient competitor (EEC) conceptual framework. This evaluates exclusionary conduct by asking if the conduct would be capable of excluding the dominant firm itself from the market. I.e., would a firm that is equally efficient to the dominant undertaking be able to profitably enter the market given the challenged conduct.

The purpose of the framework is to ensure competition law does not find liability when a firm simply out-competes other firms – “competition on the merits.” The EEC framework is typically relevant when the mode of exclusion is the firm’s price (“price-based conduct”). The canonical example is predation, where an incumbent prices below cost to exclude competitors, then recoups monopoly profits in later periods.

When the theory of harm is that a dominant undertaking uses its market power to make would-be competitors less efficient (i.e., a Raising Rivals Costs (RRC) story) the EEC framework is inapposite. Put another way, if the primary reason challenger firms are less efficient than the dominant undertaking is the challenged conduct, applying the EEC framework (via a price-cost

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<sup>1</sup> For this reason, the price cost test is also sometimes called an “As Efficient Competitor” (EEC or AEC) test.

<sup>2</sup> Salop, Steven C., and David T. Scheffman. “Raising Rivals’ Costs.” *The American Economic Review* 73, no. 2 (1983): 267–71. <http://www.jstor.org/stable/1816853>.

test) makes little economic sense. This is often, though not always, the case when a dominant undertaking can abuse its power across vertically related markets.

A margin squeeze abuse is conceptually distinct from the usual use-case for the EEC framework precisely because it entails vertical leveraging in a way that predation and loyalty discounts do not. In margin squeeze cases, the dominant undertaking can use both the downstream price it charges customers *and* the wholesale cost it charges competitors to manipulate competition. Whereas in predation and loyalty discount cases, the dominant undertaking can only use the price it charges customers to exclude competitors. An obvious question, which the EC's proposed guidelines have unfortunately not considered, is therefore – can a margin squeeze cause either complete or partial foreclosure even where a price-cost test is not satisfied. As we will proceed to explain, the academic literature recognises that it can as it *“is better to compete against high-cost firms than low-cost ones.”*<sup>3</sup> We therefore conclude that the EEC framework generally and price-cost test specifically should not be applied as “line in the sand” tests for margin squeeze abuses.

### The practical specification of the price-cost test

Before proceeding, we note that the price-cost test in margin squeeze cases does not follow the standard form in predation cases, and indeed the EC notes in its proposal that *“for a margin squeeze to be abusive, it is not necessary to establish that ... the downstream prices are in themselves predatory.”*<sup>4</sup> The proposed guidelines suggest that:

*“A margin squeeze is generally demonstrated by showing by means of a price-cost test that the downstream arm of the dominant undertaking could not operate profitably on the basis of the upstream price charged to its downstream competitors and the downstream price charged by the downstream arm of the dominant undertaking.”*<sup>5</sup>

In the margin squeeze context, this test can be expressed as:

$$\pi_{D,EEC} < 0$$

$$P_{D,M} - (C_{W,R} + C_{D,M}) < 0$$

Where  $\pi_{EEC}$  is the profit of an equally efficient downstream competition,  $P_{D,M}$  is the dominant undertaking's downstream price,  $C_{D,M}$  is the cost specific to the dominant undertaking's downstream arm, and  $C_{W,R}$  is the wholesale cost the dominant undertaking charges downstream rivals.

We also note that the EC's proposed price-cost test in margin squeeze cases diverges from the tests promoted by Fumagalli & Motta and Jullien et al. For example, in their submission to the EC, Fumagalli & Motta note:

*“in this context we are inclined to interpret the price-cost test as a test for profit sacrifice, which aims at checking whether the margin obtained by the vertically integrated firm on the sales to the final market is lower than the margin obtained by supplying the input to the downstream*

<sup>3</sup> Salop and Scheffman 1983.

<sup>4</sup> Draft Guidelines on the application of Article 102 TFEU, accessed September 26, 2024, ¶125.

<sup>5</sup> Draft Guidelines on the application of Article 102 TFEU, accessed September 26, 2024, ¶130.

rival, which represents the opportunity cost of downstream sales. If so, the vertically integrated firm sacrifices profits in the short run in an attempt to foreclose independent rivals.”<sup>6, 7</sup>

This version described by Fumagalli & Motta is distinct from the test proposed in practice by the EC – at least as it is presently formulated. Similarly, in the case of differentiated products, Jullien et al. advocate for a “VI-adjusted sacrifice test.”<sup>8</sup> They express this as:

$$M_R \geq C_U + D \times R$$

Where  $M_R$  is the retail margin of the dominant undertaking,  $C_U$  is the cost specific to the dominant undertaking’s upstream arm,  $D$  is the diversion ratio and  $R$  is the dominant undertakings wholesale revenues per sale of its downstream rival (this will be the same as we have defined  $C_{W,R}$  above).

At a minimum, we would invite the EC to consider if the price-cost test it proposed is correctly formulated.

In the following sections, we contextualize the EC’s proposed guidelines within the range of theories of harm for margin squeeze abuses. In doing so, we explain which instances the proposed test is well suited for, and, more importantly, which it is not.

## Potential Theories of Harm in Margin Squeeze Cases

Margin squeeze cases can involve one of two abuses under 102 TFEU, exclusion or exploitation. Within the exclusionary abuses, foreclosure may be also either vertical or horizontal – there are therefore, broadly speaking, three theories of harm for margin squeeze abuses.

- Vertical Foreclosure (both complete and partial)
- Horizontal Foreclosure (both complete and partial)
- Exploitation

The EC’s proposed guidelines, by their stated purpose, focus solely on exclusion, but within that implicitly only consider complete vertical foreclosure, ignoring possible instances of partial foreclosure and horizontal foreclosure.

### Complete Foreclosure

#### *Vertical foreclosure*

As a threshold matter, in cases where the Single Monopoly Profit theory applies, a vertically integrated upstream monopolist has no interest in excluding downstream competitors – as it can use the wholesale price to extract the full monopoly rent derived from end-consumer demand. We may be concerned that this, in and of itself, represents an exploitative abuse – and indeed we discuss related concerns below. In any event, rebuffing this critique is a common step for properly formulating a theory of harm in vertical exclusion cases, including a margin squeeze. We therefore find the proposed guidelines’ silence on this point surprising. Of course,

<sup>6</sup> Motta-Fumagalli - Questions.doc (europa.eu), p. 18.

<sup>7</sup> Jullien et al. present a similar test where the dominant undertaking (M) would fail a price-cost test when the *opportunity cost* < *total cost* + *wholesale margin* × *M’s access need*. Where the opportunity cost is defined as *opportunity cost* = *total cost* + *wholesale margin* + *E’s access need* where E is the downstream rival.

<sup>8</sup> Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.” [https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 29.

modern economic thinking broadly recognises that the Single Monopoly Profit theory only applies in specific circumstances – so in many cases we do not anticipate the Single Monopoly Profit theory to prove dispositive.<sup>9</sup>

We note that the EC has apparently not considered the case of partial foreclosure, which can occur where a price-cost test finds no liability – we discuss this under a raising rivals’ costs (RRC) framework below. We also submit that any price-cost test is poorly suited to analysing differentiated products, with results becoming increasingly unreliable as the degree of differentiation rises.

That said, we agree with the EC’s assessment that, insofar as the complete vertical foreclosure of commodity products is concerned, the price-cost test will often (though not necessarily always) detect when the margin squeeze has the effect of removing equally efficient competitors from the market. However, we note that complete vertical foreclosure could take two forms, which may merit distinct modes of analysis:

- Excluding firms already in the market.
- Preventing entry of would-be competitors.

In the latter instance, a vertical integrated dominant undertaking might use the fixed costs it sets to downstream rivals as an entry deterrent, even if increasing those costs does not induce firms already present to exit.

Under basic microeconomic theory, marginal costs influence price, and fixed costs influence entry decisions. A firm only enters a competitive market if the surplus it achieves from selling at marginal cost is large enough to recoup any fixed costs – typically when marginal costs are upward sloping. Given large enough fixed costs, a firm may not choose to enter the market even if it could profitably sell at marginal cost.

This begs the question – how do we define an equally efficient competitor? Is it enough if excluded firms have equally efficient marginal costs, but higher fixed costs? What about when they also have the same fixed costs, but lower volume?

Economists generally use Long Run Average Incremental Cost (LRAIC) in EEC tests – but LRAIC is itself a function of quantity. A firm with identical fixed and marginal costs, but more volume will have a lower LRAIC than a firm with less volume but otherwise identical costs. When markets have fixed costs, an incumbent monopolist could always have a lower LRAIC than other firms simply because those fixed costs are spread across more volume. In such cases, a challenger firm with identical fixed and marginal costs could only be equally efficient from an LRAIC perspective if it became an overnight monopolist itself. Yet clearly this is not what competition enforcement is designed to protect.

These concerns are true of any EEC test but are particularly attenuated in a margin squeeze case. Consider a vertically integrated dominant undertaking facing downstream competition from entrants with identical marginal costs to the dominant undertaking. If the dominant upstream firm sells a good which is a fixed cost to the entrants, then it can increase the fixed costs (and consequently the LRAIC) of the entrants without affecting their marginal cost (supply)

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<sup>9</sup> Elhauge, Einer. “Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory.” *Harvard Law Review* 123, no. 2 (2009): 397–481. <http://www.jstor.org/stable/40379798>. See also Genakos, C., Kühn, K.-U. and Van Reenen, J. (2018), Leveraging Monopoly Power by Degrading Interoperability: Theory and Evidence from Computer Markets. *Economica*, 85: 873-902. <https://doi.org/10.1111/ecca.12257>, showing that foreclosing competition in adjacent complementary markets can enable a monopolist to better price discriminate in its core market, with a practical application to the EC’s SUN MICROSYSTEMS/Microsoft case.



curves. This can affect the firms' decision to enter *without* influencing what price they would charge should they choose to enter.

If competing firms entered the downstream market, they may expect to be price takers because they need to compete with other new entrants. Prior to that competition entering, an incumbent dominant undertaking may earn monopoly profits. Competitive entry therefore causes a paradigm shift. The dominant undertaking could prevent this paradigm shift by setting fixed input costs at such a high level they can *only* be recouped by a monopolist (therefore not violating a price-cost test given it is an incumbent monopolist). In this game, it is only feasible to `compete` for monopoly status, and the dominant undertaking may expect to prevail given its incumbency. In other words, the dominant undertaking abuses its control over input prices to turn an otherwise competitive downstream market into a `natural` monopoly it controls.

A price-cost test would find no liability, despite clear anticompetitive effects. Indeed, traditional price-cost tests were never designed to consider this possibility because rivals' input cost was not a choice variable for the dominant undertaking to manipulate. This thought experiment speaks to the more general utility of evaluating margin squeeze cases under the RRC framework.

Moreover, margin squeeze cases contain an additional consideration for vertical integration that standard predation cases never considered - somewhat similar to the double-marginalization argument. As Jullien et al. explain:

*“vertical integration and the existence of a positive upstream margin alters the nature of downstream competition. It follows that standard predation tests, such as the Areeda-Turner rule in the U.S. or those proposed by the AKZO jurisprudence in the EU, and which rely on the predator's downstream cost, no longer provide a proper benchmark.”*<sup>10</sup>

As mentioned above, a well-known short coming of the EEC framework is that its results become increasingly unreliable as product differentiation rises. This can prove dispositive when combined with the additional layer of vertical integration relevant in a margin squeeze case. In such instances *“the above test [EEC] induces an umbrella effect that protects competitors at the expense of competition and may induce excessive entry by competitors.”*<sup>11</sup> This is why the price-cost test in margin squeeze cases is neither necessary nor sufficient.

These added complexities are among the reasons why regulators around the globe have historically been reticent to codify “line in the sand” tests for vertical foreclosure abuses, even though such tests may, under case-specific circumstances, be applicable and informative.

#### *Horizontal foreclosure and pricing effects*

Given complementarity, a dominant undertaking can also use a margin squeeze (or any vertical foreclosure more generally) to shield its dominance in a core market from horizontal competition. This occurs when entry into an adjacent (often vertically related) and otherwise competitive market may, in the long run, facilitate entry into the core market in which the undertaking is dominant. As Jullien et al. explain:

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<sup>10</sup> Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.” [https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 29. For further discussion see Jullien et al. Section 6.

<sup>11</sup> Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.” [https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 29.

*“One instance of dynamic leverage is the so-called “ladder of investment” theory (Cave 2006). This refers to a situation where investment occurs step by step (the ladder), and firms need to complete one step before moving to the next. For instance, a telecommunication operator may need to gain enough expertise and scale before moving away from resale and developing its own network infrastructure. If such a ladder exists, the above discussion suggests that an aggressive behavior against competitors in the first step may prevent them from progressing on the ladder.”<sup>12</sup>*

In other words, denying scale to downstream competitors (partial vertical foreclosure) prevents attempts to compete upstream (complete horizontal foreclosure). A related example one might consider is markets which exhibit network effects. If an entrant can build network effects in one market which are applicable in the dominant undertaking’s core market (for example because they serve the same group of consumers), it may later use those network effects to challenge the dominant undertaking in the core market. This relates to why many digital platforms seek to curate an ecosystem of adjacent markets which leverage each other’s network effects to exclude competitors.

Moreover, incentives to foreclose competition in adjacent markets need not be dynamic. As Genakos, Kühn, & Van Reenen explain using a static model, the inability of the integrated dominant firm to perfectly price discriminate in its primary market incentivizes it to partially foreclose rivals in the complementary secondary market. Once it has succeeded in this partial foreclosure, it can better extract rents from the primary market via second-degree price discrimination. Genakos et al. further claim that they believe dynamic effects would further increase the incentives to foreclose.<sup>13</sup>

In the context of the EC’s proposed guidelines, this story of horizontal foreclosure is useful to consider in instances which might otherwise be subject to the Chicago Single Monopoly Profit critique. More importantly, it also gives emphasis to the need for the guidelines to consider partial foreclosure (which is not typically detected by price-cost tests).

### **Exploitation and partial foreclosure**

The exploitative and partial foreclosure theories of harm are closely related in that they both entail the dominant undertaking increasing wholesale input prices to downstream firms - without raising them so high an equally efficient downstream firm would exit the market or be prevented from entering.

- An exploitative margin squeeze occurs when a dominant undertaking uses its control over wholesale prices to extract downstream rents it is not able to achieve with its own downstream arm.
- The partial foreclosure story follows a canonical RRC theory. In doing so, it diverges from the exploitative theory by recognising that the increase in input prices to downstream firms may distort downstream competition in a way exploitative cases do not traditionally consider.

Jullien et al. acknowledge that both the partial foreclosure RRC theory and the exploitation theory may be relevant:

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<sup>12</sup> Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.” [https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 18.

<sup>13</sup> Genakos, Kühn, and Van Reenen, “Leveraging Monopoly Power by Degrading Interoperability.” Available at <https://onlinelibrary.wiley.com/doi/10.1111/ecca.12257>

*“According to the raising rivals’ costs [RRC] logic (Salop and Scheffman (1983)), an increase of the wholesale margin that reduces wholesale revenue (due to lower demand) may be profitable if it reduces the competitive pressure on the downstream activity and, consequently, fosters the profit of the downstream unit. When this is the case, access prices may be excessively high and even evict competitors. It thus appears that the basis for margin squeeze concerns (even in a static framework) is two-folded: it may stem from concerns of excessive price (thus an exploitative abuse) or from concern of raising rivals’ cost practices.”<sup>14</sup>*

We believe that such conduct is most aptly characterized as partial vertical foreclosure because it constrains the ability of downstream rivals to compete with the dominant undertaking. Indeed, as Salop & Scheffman fittingly wrote over 40 years ago - “cost increases generally raise prices, not lower them.”<sup>15</sup> I.e., the margin squeeze prevents downstream price competition which would otherwise occur. This concern is not typically present in exploitative cases.

Moreover, the RRC margin squeeze can cause anticompetitive harm even when downstream competitors are *more* efficient than the dominant undertaking. Indeed, if downstream competitors are more efficient than the dominant undertaking’s downstream arm, it may prefer to allow them to remain in the market (avoiding liability under EEC) and instead use the wholesale price to extract rents from them rather than fully exclude them per an EEC theory:

*“The general lesson from the above discussion is that the exercise of market power by the integrated supplier may lead to wholesale tariffs that inefficiently restrict competitors’ output; when this is the case, prices may fail to satisfy an EEC margin squeeze test when the competitor is more efficient.”<sup>16</sup>*

In other words, a dominant undertaking may deliberately choose to engage in an RRC margin squeeze rather than an EEC margin squeeze because downstream competitors are more efficient. In such instances, the EEC framework is impotent. Similarly, a firm could engage in an RRC margin squeeze to evade detection from an EEC test, while still abusing its dominance.

If banning any individual form of margin squeeze induced firms to escape liability by switching to another form of margin squeeze (which could entail increasing consumer prices) – the guidelines could have the effect of failing consumers while serving competitors. Jullien et al. similarly emphasize the need to analyse an exploitative/RRC margin squeeze by their effect on consumers and ensure regulation does not induce firms to raise consumer prices.<sup>17</sup>

In predation cases, it may be desirable for the dominant undertaking to respond to enforcement by increasing prices because the predatory price is unsustainable and only available because the firm expects to recoup the loss in the long run. The same is not true of a margin squeeze

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<sup>14</sup> Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.”

[https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 19.

<sup>15</sup> Salop, Steven C., and David T. Scheffman. “Raising Rivals’ Costs.” *The American Economic Review* 73, no. 2 (1983): 267–71. <http://www.jstor.org/stable/1816853>, p. 267.

<sup>16</sup> Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.”

[https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 25.

<sup>17</sup> “Banning such margin squeeze thus constrains the integrated firm, thereby limiting its ability to extract rents from competitors. Whether this can also enhance efficiency, promote competition and benefit consumers is a more complex question, however, as the integrated firm can react to the ban in two ways: It can choose to lower its wholesale prices, but may also raise its retail prices; and although both reactions may benefit competitors, the former one is less likely to benefit consumers than the latter one,” Jullien, Rey, and Saavedra, “The Economics of Margin Squeeze.”

[https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin\\_Squeeze\\_Policy\\_Paper\\_revised\\_March\\_2014.pdf](https://idei.fr/sites/default/files/medias/doc/by/jullien/Margin_Squeeze_Policy_Paper_revised_March_2014.pdf), p. 25.



because the dominant undertaking need not make a loss to exclude competitors, as the EC itself has acknowledged.<sup>18</sup> Therefore, unlike in predation, it is undesirable for firms to react to enforcement by increasing retail prices, and we would prefer to see prices fall as the firms instead reduce the wholesale cost to competitors. This again underscores why a margin squeeze is distinct from typical “price-based conduct.”

The EC’s proposed guidelines must therefore have an adequately flexible approach to tackling all forms of margin squeeze, which makes clear that firms cannot evade liability by increasing consumer prices. The current proposal to rely solely on a price-cost test falls concerningly short of this and risks giving vertically integrated dominant firms perverse incentives to raise retail prices without reducing wholesale costs.

Insofar as a margin squeeze has the effect of raising rivals’ costs, we therefore submit that this can and should also be characterized as an exclusionary abuse – which merits its own consideration separate from the EEC framework presently included in the proposed guidelines. The analysis of such cases should, as is common of exclusionary abuses under Article 102 TFEU, be effects based.

## Conclusion

In summary, because a margin squeeze involves a distortion of *both* the dominant undertaking’s price to consumers *and* the cost it imposes on competitors, it should not be analysed as “price-based conduct” in the same category as predation and loyalty rebates. Unlike such “price-based conduct,” margin squeeze cases can have at least three general theories of harm – vertical foreclosure, horizontal foreclosure, and exploitation. Within the vertical/horizontal theories, there is further segmentation for complete vs partial foreclosure. It is well understood that price-costs tests are ill-suited to identifying harm to consumers for partial foreclosure and exploitative abuses. Even in cases of vertical and horizontal foreclosure, the test may fail to identify both complete and partial foreclosure under a variety of strategies and industry characteristics. Most importantly, the universal application of the test could induce firms to change margin squeeze strategies in a manner that protects competitors without also protecting consumer welfare.

We therefore agree with Fumagalli & Motta’s point that “*in this case [margin squeeze], the application of the test should be guided by a convincing and solid theory of harm*”<sup>19</sup> – but we would go a step further in emphasizing that important theories of harm may not require a showing of below cost pricing at all. Therefore, the EC’s guidelines should not codify a price-cost test (at least as presently formulated) as the “correct” mode of analysis for all margin squeeze abuses.

We also submit that the flaws present in the EC’s proposed analysis of margin squeeze cases are more broadly instructive to the principle of applying “line in the sand” tests to abuses which should correctly be analysed by their effect on consumer welfare.

Yours faithfully,



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<sup>18</sup> “for a margin squeeze to be abusive, it is not necessary to establish that ... the downstream prices are in themselves predatory,” Draft Guidelines on the application of Article 102 TFEU, accessed September 26, 2024, ¶125.

<sup>19</sup> [Motta-Fumagalli - Questions.doc \(europa.eu\)](#), p. 18.