Summary of Commission Decision
of 4 July 2007
relating to a proceeding under Article 82 of the EC Treaty
(Case COMP/38.784 — Wanadoo España v Telefónica)
(Only the Spanish text is authentic)
(2008/C 83/05)

On 4 July 2007, the Commission adopted a decision relating to a proceeding under Article 82 of the EC Treaty. In accordance with the provisions of Article 30 of Council Regulation (EC) No 1/2003 (1), the Commission herewith publishes the names of the parties and the main content of the decision, including any penalties imposed, having regard to the legitimate interest of undertakings in the protection of their business interests. A non-confidential version of the full text of the decision can be found in the authentic languages of the case and in the Commission’s working languages at DG COMP website at:

http://europa.eu.int/comm/competition/index_en.html

I. INTRODUCTION

The Decision imposes a fine of EUR 151,875,000 on Telefónica SA and Telefónica de España SAU (jointly and severally liable) for infringing Article 82 of the EC Treaty. From September 2001 to December 2006, Telefónica abused its dominant position by imposing unfair prices in the form of a margin squeeze in the Spanish broadband markets.

II. CASE DESCRIPTION

1. Procedure

On 11 July 2003, Wanadoo España submitted to the Commission a complaint alleging that Telefónica was engaging in a margin squeeze in the Spanish broadband internet access markets. The Commission sent a Statement of Objections to Telefónica on 20 February 2006, to which Telefónica replied on 19 May 2006. An oral hearing was held on 12-13 June 2006. On 11 January 2007, the Commission issued a letter containing additional factual information susceptible to being relied on in the draft decision. Telefónica replied to this letter on 12 February 2007.

The Advisory Committee on restrictive practices and dominant positions gave a favourable opinion on the draft decision on 29 June 2007.

2. Background

The main technology used in Spain to provide broadband internet access services to consumers is ADSL (80% of broadband connections at the end of 2006), which provides access using a fixed telephone line. The incumbent Telefónica is the only Spanish telecommunications operator that has a nation-wide fixed telephone network. It rolled out this local access network over significant periods of time protected by exclusive rights and was able to fund investment costs through monopoly rents.

Telefónica controls the entire ADSL value chain in Spain. It is uneconomical to duplicate Telefónica’s local access network. Therefore, alternative network operators wishing to provide retail broadband services have no other option but to contract wholesale broadband access products, all of which are built on Telefónica’s local access network. Entry on the basis of wholesale products built on alternative technologies (cable-modem) has not been possible.

3. Legal assessment

3.1. The relevant markets and dominance

The Decision identifies three relevant product markets, the retail broadband 'mass' market and two different wholesale broadband markets, namely the market for wholesale broadband access at regional level and the market for wholesale broadband access at national level.

The delineation of the wholesale markets is mainly based on the heavy network roll out investments required when switching from one wholesale product to the other: (i) national wholesale access concentrates traffic at a single point of access allowing operators to offer retail broadband services without having to roll out any (or hardly any) network; (ii) regional wholesale access requires rolling out a costly network reaching up to 109 regional access points.

Telefónica is also the exclusive supplier of a third type of wholesale broadband access, namely local loop unbundling which is not defined as a relevant market for the purposes of this Decision. In view of its very high investment-intensity it is not a substitute to the above-mentioned wholesale products. In addition, there have been significant problems with its effective availability, which have been sanctioned by the Spanish regulatory authority in November 2006.

Telefónica is dominant on both wholesale markets. It holds a monopoly in the provision of regional wholesale access and a market share of 80 % in the national wholesale market. Telefónica has been in the position to exert decisive influence (margin squeeze, generalised delays in the provision of local loop unbundling) on the availability of competing national wholesale offers (which are necessarily based on Telefónica’s other wholesale offers).

3.2. The abuse

From September 2001 to December 2006, the margin between Telefónica's retail prices and the price for wholesale access at regional level, on the one hand, and the margin between the retail prices and the price for wholesale access at national level, on the other hand, was insufficient to cover the costs that an operator as efficient as Telefónica would have to incur to provide retail broadband access.

In accordance with established case law the methodology applied for establishing the existence of a margin squeeze consists in assessing whether Telefónica’s downstream arm would operate profitably on the basis of the upstream charges levied by Telefónica’s upstream arm. Two profitability methods are used: the so-called period-by-period (which assesses Telefónica’s profitability every year), and the discounted cash flows (DCF) method (which allows below cost pricing in the initial phase of an expanding market (1) but requires Telefónica to be profitable over 2001-2006) proposed by Telefónica itself. Both methods lead to the same conclusion: Telefónica engaged in a margin squeeze from September 2001 to December 2006.

According to Telefónica, the practices concerned by the decision, i.e. margin squeeze, constitute a constructive refusal to supply and therefore the Commission should have proved that the criteria applied in the Oscar Bronner case (2) are fulfilled. However, the factual, economic and legal circumstances of this case fundamentally differ from those in Oscar Bronner. In the present case, Spanish regulation compatible with Community law imposes on Telefónica an obligation to provide wholesale access at both regional and national level. This duty has been established with a view to promoting competition and consumer interest and results from a balancing test made by the public authorities between the incentives of Telefónica and its competitors to invest and innovate and the need to promote downstream competition in the long term. In any event, Telefónica’s ex ante incentive to invest in its infrastructure have never been at stake in the present case: Telefónica’s upstream network is to a large extent the fruit of investments that were undertaken well before the advent of broadband services in Spain and in a context where Telefónica was benefiting from special or exclusive rights that protected it from competition.

(1) For example, the DCF method takes into account learning effects and economies of scale that characterise fast growing markets like the one at hand.

At no time was Telefónica prevented from putting an end to the margin squeeze by proposing lower wholesale prices to its competitors. Until 21 December 2006, its national wholesale prices were not subject to any price regulation and wholesale regional prices have been regulated in the form of maximal prices only.

The abuse ended with the intervention of the Spanish regulatory authority in December 2006, which reduced the wholesale prices. The regulator never pronounced itself as to the existence of a margin squeeze in relation to Telefónica’s two national wholesale products, and its assessment as to the existence of a margin squeeze in relation to Telefónica’s regional wholesale product were based on forecasts made in October 2001 by Telefónica, whereas the Commission used the effectively incurred historical costs.

3.3. The effects of the abuse

In the case at hand, there was likely foreclosure because the margin squeeze affected Telefónica’s competitors’ ability to enter the relevant market and exert a competitive constraint on Telefónica (1). The margin squeeze restricted competition by imposing unsustainable losses on equally efficient competitors: they were either ultimately forced to exit or in any event constrained in their ability to invest and to grow. Even if they met Telefónica both on prices and marketing expenditure, they were poorly placed in the long run to offer a vigorous competitive challenge to Telefónica as a result of their continuing losses. As a result, Telefónica’s conduct was likely to delay the entry and growth of competitors. Therefore, Telefónica’s conduct was likely to delay as long as possible the arrival of ADSL operators at a level of economies of scale which would have justified investments in their own infrastructure and, ultimately, the use of local loop unbundling.

The immediate harm to consumers was likely to be significant: absent the distortions resulting from Telefónica’s margin squeeze in this case, the retail market for broadband services would have been likely to have witnessed more vigorous competition and would have delivered greater benefits to consumers in the form of lower prices, increased choice and innovation.

The margin squeeze has had concrete foreclosure effects in the retail market and a detrimental impact for end users. Due to the margin squeeze, the Spanish retail prices are among (if not) the highest amongst EU-15 and the Spanish broadband penetration rate is below EU-15 average. There are no demand or supply factors that can adequately explain the high level of the Spanish retail prices. It follows that Telefónica’s conduct has led to significant consumer harm.

4. Fines

Telefónica behaviour was intentional. Telefónica’s data shows that the company could not have been unaware that it was incurring downstream losses. With regard to the prices for regional wholesale access, even under the favourable assumption that Telefónica could have believed at the outset that the Spanish regulator’s model was based on realistic estimations, very soon it must have, or should have, realized that the actual cost data did not match these estimates. Seen in the most favourable light for the company, any continued reliance of Telefónica on the accuracy of the CMT’s estimates and calculations, despite the accumulation of actual data to the contrary, is — at the very least — seriously negligent behaviour. If at all relevant, the ex ante regulatory intervention in relation to the regional wholesale product may be considered as an attenuating circumstance. Therefore, a fine should be imposed on Telefónica.

The fine was determined in light of the gravity and duration of the infringement.

4.1. Gravity

The gravity of an infringement is determined by the nature and impact of the abuse, and by the size of the relevant geographic market.

(1) The establishment of foreclosure effects does not mean that rivals are forced to exit the market: it is sufficient that the rivals are disadvantaged and consequently led to compete less aggressively.
4.1.1. Nature of the infringement

Telefónica's conduct constitutes clear-cut abuse by an undertaking holding a virtual monopoly for which there are already several precedents. In particular the Deutsche Telekom Decision clarified the conditions of application of Article 82 of the EC Treaty to an economic activity subject to sector-specific ex ante regulation. Such abuse is capable of being qualified as a very serious infringement under the Commission guidelines on fines applicable at the relevant period of time.

As the Commission indicated in Deutsche Telekom, the type of abuse committed by Telefónica jeopardises the objective of achieving EU-wide establishment of an internal market for telecommunications networks and services with undistorted competition, and can certainly be ranked as a very serious infringement (1). The Commission at the time did not qualify Deutsche Telekom's abuse as a very serious infringement for a number of reasons, none of which apply in the present case.

4.1.2. Impact of the infringement

In determining the gravity of the infringement, the Commission has taken into consideration the fact that the relevant markets in this Decision are markets of considerable economic importance and which play a crucial role in the development of the Information Society. Broadband connections are a prerequisite for the provision of a variety of on-line commercial and public services to end-users.

As explained in 3.3 above, Telefónica's conduct has constrained the ability of competing ADSL operators to grow sustainably in the retail market and has led to significant consumer harm.

4.1.3. Size of the relevant geographic market

The relevant geographic market is Spain. The fact that the abuse was limited to one single Member State does not alter the finding that the infringement must be qualified as very serious, since the assessment of the gravity of an infringement has to be determined in the light of all the circumstances of the case. In the telecommunications sector, margin squeeze cases are necessarily limited to one Member State (the geographic scope of the incumbent's network) but prevent new entrants from other Member States from entering a fast growing market.

4.1.4. Conclusion as to gravity

In view of the above, the infringement must overall be qualified as very serious although it was not necessarily of uniform gravity throughout the period.

The initial amount of the fine takes into account the fact that the gravity of Telefónica's abuse became clearer throughout the relevant period and in particular after the Deutsche Telekom Decision.

4.2. Duration of the infringement

The infringement in the present case lasted from September 2001 to December 2006, i.e. 5 years and 4 months, which is a long duration abuse under the Commission's guidelines on fines.

4.3. Mitigating circumstances

On the basis of all the evidence available, the Commission considers that the existence of certain mitigating circumstances can be recognised in this case because, for part of the period in question, some of the charges applied by Telefónica were subject to sector specific regulation. Similarly to Deutsche Telekom where the fact that Deutsche Telekom's retail and wholesale charges were subject to sector specific regulation was taken into consideration as a mitigating circumstance and a reduction of 10 % was applied, a 10 % reduction is applied in this case, although Telefónica benefited from a much wider room of manoeuvre to set its price.

In view of all the factors considered above, the amount of the fine is EUR 151 875 000. This fine is jointly and severally imposed on Telefónica SA and its daughter company Telefónica de España SAU.

(1) See Deutsche Telekom, paragraph 203-204.