

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Working Party No. 2 on Competition and Regulation

MARGIN SQUEEZE

-- Japan --

19 October 2009

The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 19 October 2009.

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1. Introduction

1. There are cases where an undertaking in the upstream market that supplies products that are necessary for carrying out business activities in the downstream market, operates in the downstream market at the same time. In this case, so-called “margin squeeze” is considered a conduct of a company setting the prices of its products supplied to the supply destination in the upstream market at a level higher than the prices of its products in the downstream market, or setting the prices of its products in the upstream market supplied to the supply destination and of its own products in the downstream market so closely that the undertakings of its supply destination are unable to compete by economically reasonable business activities.

2. This contribution paper mainly introduces the case of private monopolization by Nippon Telegraph and Telephone East Corporation (hereinafter referred to as “NTT East”), which could fall under the conduct of margin squeeze.

2. Outline of the private monopolization case by NTT East

3. The JFTC had investigated NTT East in accordance with the provisions of the Antimonopoly Act (hereinafter referred to as the “AMA”) and issued a recommendation on December 4, 2003, as NTT East was in violation of the provisions of Article 3¹ of the AMA (Prohibition of private monopolization). Because NTT East did not accept the recommendation, the JFTC decided to commence hearing procedures against NTT East on January 15, 2004. The JFTC subsequently instructed the hearing examiners to go through the hearing procedures and issued a hearing decision on March 26, 2007, as described below.

4. However, NTT East filed suit to rescind the decision. Whether there was any substantial evidence and whether there was any relevancy of the requirement of private monopolization stipulated by Paragraph 5 of Article 2 of the AMA were disputed. The Tokyo High Court thereafter decided to dismiss the appeal on May 29, 2009.

2.1 Outline of the hearing decision (March 26, 2007)

2.1.1 Outline of the violation

5. NTT East started to provide FTTH service² for detached houses called “New Family Type” from June 1, 2002. For the new service, NTT East had received approval of the interconnection charge for the interconnection with optical fiber equipment to provide New Family Type service through the system under which a single optical fiber between a station of NTT East and a user’s residence is split by branching devices so that multiple users can share it (hereinafter referred to as “branch system”), and also notified the user fee for the service. But NTT East did not actually use the branch system and provided the service through the system under which a single optical fiber cable is occupied by only one user (hereinafter referred to as “direct cable connection system”). NTT East set the user fee for the service as 5,800 yen per month at first and 4,500 yen per month from April 1, 2003. However, both fees are lower than the interconnection charge that the other telecom service providers pay to NTT East to provide FTTH

¹ Article 3 of the AMA stipulates, “No entrepreneur shall effect private monopolization or unreasonable restraint of trade.”

² “FTTH service” refers to a service that lays optical fibers from a telecom service provider’s station to users’ residences and that provides Internet connections that make high-speed, high-volume broadband communications possible.

service by interconnections with optical fiber equipment of NTT East through the direct cable connection system.

6. NTT East afterwards ceased providing the New Family Type service to its subscribed users by the direct cable connection system from April 2004.

2.1.2 *Outline of the main text of the hearing decision (Decision to declare a violation)*

- As to the FTTH service by optical fiber equipment, the conduct, committed by NTT East from June 1, 2002, and described in 2.1.1 above, excluded the business activities of the telecom service providers that provided the FTTH service for detached houses through interconnecting with the optical fiber equipment of NTT East, thereby it was causing a substantial restraint of competition in the field of the FTTH service for detached houses in eastern Japan. Such an act falls under the private monopolization stipulated by Paragraph 5 of Article 2 of the AMA, is in violation of the provisions of Article 3 of the AMA, and is recognized as having already ceased.
- No special measure was ordered to NTT East in relation to the violation committed by NTT East described above.³

3. **Background of this case in relation to margin squeeze**

7. The hearing decision recognized the following facts in relation to margin squeeze.

3.1 *Market structure*

8. As far as there were only two companies other than NTT East that provide FTTH service for detached houses, NTT East had an extremely large market share in almost all areas of eastern Japan in terms of the volume of holdings of subscribers' optical fiber lines, which was indispensable for providing optical fiber telecommunications service. In addition, NTT East also had an overwhelmingly large market share in almost all areas of eastern Japan in terms of the number of subscribers' lines for detached houses.

3.2 *Interconnection obligation and interconnection charge*

- NTT East is obliged under the Telecommunications Business Act to accept requests from other telecom service providers for interconnection with the optical subscriber equipment (Category 1

³ While the recommendation issued on December 4, 2003, ordered the following measures, the hearing decision did not order any measures as the violation had already ceased.

(1) NTT East should cease and desist from conduct that interferes with the new entry of other telecom service providers that provide the FTTH service using interconnection with subscriber optical fibers of NTT East, into the field of the FTTH service for detached houses, by allowing each user to occupy a single optical fiber cable in providing the New Family Type service, although it sets the interconnection charge and the user fee by way of the branch system.

(2) NTT East should make fair and proper indications on the contents of the New Family Type service based on the actual facility set used for the said service towards general consumers.

(3) NTT East should notify the telecom service providers who provide the FTTH service using interconnection with subscriber optical fiber of NTT East and general consumers of the measures taken in accordance with (1) above, as well as its commitment to the effect that it will refrain from conduct similar to that described above in the future.

(4) NTT East should refrain from similar acts as mentioned in (1) above in the future.

Designated Telecommunications Facilities)⁴ held by it. It shall set the interconnection contract, interconnection charges, etc. and have them approved by the Minister of Internal Affairs and Communications.

- Since other telecom service providers that intend to operate a telecommunications business using Category 1 designated telecommunications facilities set the user fee (fee payable by users) on the basis of the interconnection charge as the minimum necessary cost, the Ministry of Internal Affairs and Communications (hereinafter referred to as the “MIC”) has given administrative guidance specifying that NTT East should not set its user fee below the interconnection charge (the contents of this administrative guidance are called the “Imputation Rule”).
- It is provided for NTT East that it shall properly classify its assets, costs, and profits related to the telecommunications business into those of Category 1 Designated Facilities Management Division and those of Category 1 Designated Facilities Utilization Division, and that it shall deal with transactions between these divisions by transferring payments of the interconnection charge described in the interconnection contract.

3.3 Structure of fees and costs (Please refer to the attached sheet)

3.3.1 When providing service through the direct cable connection system

9. When a new telecom service provider provided the FTTH service using the equipment of the direct cable connection system, just as NTT East did, the interconnection charge payable to NTT East was 5,074 yen per optical subscriber line. In addition to this, the new telecom service provider needed to pay the charge for the media converter (MC) installed in the NTT East station and the interconnection charge for the local IP network at least.

10. Therefore, a new telecom service provider needed to pay NTT East the amount of 5,074 yen + 1,254 yen (charge for connection with the MC installed in the NTT East station) = 6,328 yen per user, as well as the charge for interconnection with the local IP network per port in the station.

11. However, as NTT East sets the user fee for New Family Type service at 5,800 yen, a new telecom service provider was forced to bear a large amount of deficit to set the user fee to be competitive with that of NTT East while paying the above interconnection charges to NTT East. Therefore, it was impossible for such a new telecom service provider to continue doing business while maintaining competitiveness with NTT East.

3.3.2 When providing service by the branch system

12. When considering the possibility of entry using the branch system, which was originally presumed for the service of the New Family Type, it was necessary for a new telecom service provider to acquire a sufficient number of users in order to gain a larger income than the interconnection charge of the branch system (the basic charge was 20,130 yen⁵). While the interconnection charge would have increased in accordance with the increase of the number of users, the interconnection charge per user would have

⁴ Telecommunications facilities designated by the Minister of Internal Affairs and Communications as the equipment whose interconnection with telecommunications equipment of other telecom service providers is indispensable for the improved convenience of users as well as the total and rational development of telecommunications.

⁵ The basic charge has been reduced to 17,145 yen since April 2003. If all of the 32 split lines for a single cable have users, the interconnection charge per user will be 1,746 yen.

declined vice versa. If all of the 32 split lines for a single cable had users, the interconnection charge per user would be 2,326 yen. (In reality, the cost per user for interconnection with the local IP network, etc. was added to the basic charge.)

13. On introduction of the New Family Type service, however, even NTT East, which had already started the actual provision of the FTTH service for detached houses, judged that the FTTH service by presuming the branch system would not be profitable unless its demand increased and, therefore, decided not to install the equipment of the branch system for a while. Even more, it was actually impossible for other telecom service providers who intended to newly enter the FTTH service business to acquire an adequate number of users so as to make the business profitable.

3.4 Situation of entry and competition

3.4.1 Customer acquisition for New Family Type service

14. After NTT East started to receive applications for the New Family Type service in May 2002, the number of applications was about 1,000 per month until August of that year. From September, however, several thousands of applications were made each month. The total number of applications in 10 months until February 2003 was about 33,000. In March 2003, reduction of the user fee for the New Family Type service from April was announced, with the service provision area enlarged and the period until the start of the service reduced. This led to an increase in the number of applications per month with about 7,500 in March 2003, and the number of applications further increased to about 20,000 per month for the period from April to June.

15. The number of subscribers' lines of the FTTH service rendered by NTT East (other than those for apartment houses) amounted to 193,000 at the end of September 2003, and 324,000 at the end of March 2004.

3.4.2 Entry

16. In the eastern area of Japan, there were only two companies who noticeably provide the FTTH service for detached houses other than NTT East. This situation had been unchanged until the end of March 2004.

17. After the introduction of the New Family Type service by NTT East, only one company entered the market of the FTTH service for detached houses using interconnection with the optical subscriber equipment of NTT East.

4. Application of the Law

18. The AMA prohibits as private monopolization "such business activities, by which any entrepreneur, individually or by combination or conspiracy with other entrepreneurs, or in any other manner, excludes or controls the business activities of other entrepreneurs, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade (Paragraph 5 of Article 2)."

19. "Exclusion" in this definition is interpreted as making it difficult for other companies to continue their business activities or to enter the market. "Control" is construed as depriving other companies of their freedom to make decisions concerning their business activities and forcing them to obey the controller's intent. Any act, if it causes "substantial restraint of competition" by "exclusion" or "control", is prohibited as private monopolization.

20. In this case, the conduct by NTT East was judged to fall under the private monopolization stipulated by Paragraph 5 of Article 2 of the AMA and violated the provisions of Article 3 of the same Act, as described in 2.(2).1 above.

4.1 *Difference with other anticompetitive conducts*

21. The AMA prohibits “Unfair Trade Practices” (Article 19)⁶. The term “Unfair Trade Practices” means any acts prescribed in each Item of Paragraph 9 of Article 2 of the AMA which tend to impede fair competition and are designated by the JFTC. The designation of “Unfair Trade Practices” is stipulated by Public Notice (“Designation of Unfair Trade Practices” (Fair Trade Commission Public Notice No. 15 of June 18, 1982) (hereinafter referred to as “General Designation”).

22. So-called “margin squeeze” could be prohibited as an Unfair Trade Practice (Refusal to Trade (Paragraph 2 of the General Designation), Discriminatory Treatment (Paragraph 3 of the General Designation), Unjust Low Price Sales (Paragraph 6 of the General Designation), etc.)⁷. However, by reviewing the status of NTT East in the telecommunications market, the volume of optical fiber held by NTT East and the effects of the conduct to a new entry etc., the JFTC judged the conduct of NTT East fell under private monopolization as the conduct by NTT East excluded the business activities of other telecom service providers and caused a substantial restraint of competition.

5. Relation to the regulation by the business law

23. The hearing decision (March 26, 2007) said “Considering that the MIC as a specialized agency regulating the telecommunications business had studies from the viewpoint to promote competition in the business and to provide profits to users and granted approval after the procedures of inviting public comments and examination at the Information and Communications Council, the level of the charge subject to approval has no problem under the Telecommunications Business Act unless there are special circumstances. However, the application of a certain law itself to an action is not excluded just because such an action does not violate another law, unless there is an express provision for exemption.”

24. Further, the Tokyo High Court said in the judgment of May 29, 2009, that NTT East “provided a service different from the one described in the application for interconnection charge approval by the Minister of Internal Affairs and Communications,” and “Even if it is acceptable under the Telecommunications Business Act that its interconnection charge was approved for the service provision using the branch system, this does not lead to understanding that the AMA is naturally inapplicable to the fact that the plaintiff (NTT East) actually uses the direct cable connection system instead of the branch system, and there is no room to understand that it is legal in the application of the AMA unless there are any special reasons.” It said, “Even if the Minister of Internal Affairs and Communications has not given

⁶ Article 19 of the AMA stipulates, “No entrepreneur shall employ unfair trade practices.”

⁷ The JFTC and the MIC published “Guidelines for Promotion of Competition in the Telecommunications Business Field” on November 30, 2001. These guidelines stipulate “If telecom service providers with essential facilities reject the competitors’ request to connect to their subscriber line networks and to allow collocation, or they offer unfavorable terms to competitors in such transactions compared with those in their own departments or to their affiliates for example, such practices would hamper the new entry of telecom service providers and make their business operation difficult. When those practices are found to substantially restrain competition, they are regarded as “private monopolization” that is prohibited by Article 3 of the AMA. Even if they are not substantially restraining competition in the market, but tending to impede fair competition, they are regarded as “unfair trade practices” that are banned by Article 19 of the AMA. (2.1.1.(2))”

any order to change the interconnection charge and user fee, it does not affect the judgment regarding whether the above action by the plaintiff (NTT East) is considered to be violating the AMA or not.”

6. Draft Guidelines for Exclusionary Private Monopolization under the AMA

25. To ensure transparency of the JFTC’s law enforcement and enhance predictability by clarifying the requirements that will constitute Exclusionary Private Monopolization to which a surcharge is introduced by the amendment of the AMA approved by the Diet on June 3, 2009, the JFTC prepared “Draft Guidelines for Exclusionary Private Monopolization under the AMA” (hereinafter referred to as the “Guidelines”) and asked for public comments on June 19, 2009.

26. The Guidelines describe the JFTC’s investigation policies on cases concerning Exclusionary Private Monopolization, and what conduct may fall under “Exclusionary Conduct” and “substantial restraint of competition in any particular field of trade” as the requirements constituting Exclusionary Private Monopolization.

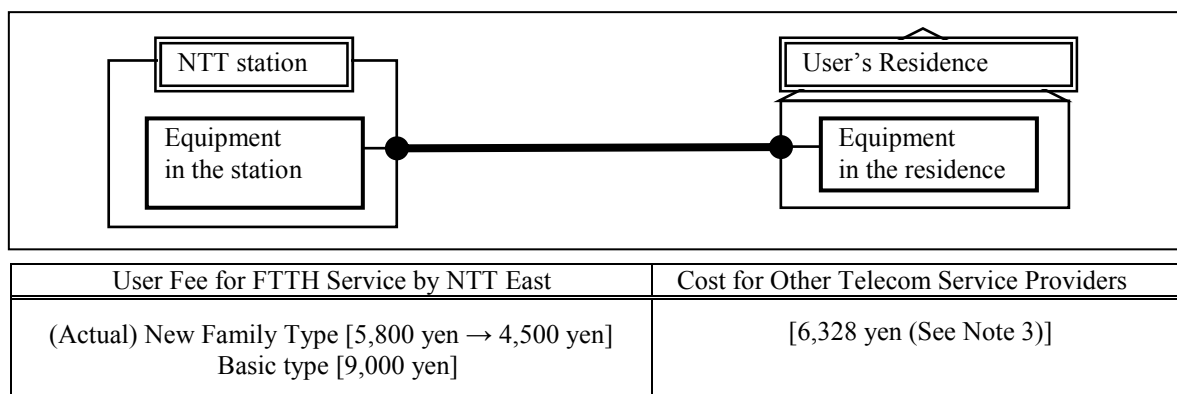
27. The Guidelines classify typical Exclusionary Conducts, mainly among those that have raised issues under the AMA in the past, into four categories: “Below-cost Pricing”, “Exclusive Dealing”, “Tying” and “Refusal to Supply and Discriminatory Treatment.” Whether so-called “margin squeeze” falls under Exclusionary Conduct or not will be determined from a similar viewpoint as Refusal to Supply and Discriminatory Treatment (that is, an entrepreneur refuses to supply, imposes restrictions on the quantity or contents of products to be supplied, or applies discriminatory treatment to the condition or implementation of supply, beyond a reasonable degree in terms of necessary supplies for those receiving them to operate in the market (downstream market)). Factors for assessment include (1) Entire conditions of the upstream market and the downstream market, (2) Positions of the said entrepreneur and its competitors in the upstream market, (3) Positions of the trading customers and its competitors in the downstream market, (4) Period of the conduct, and (5) Conditions of the conduct.

ANNEX

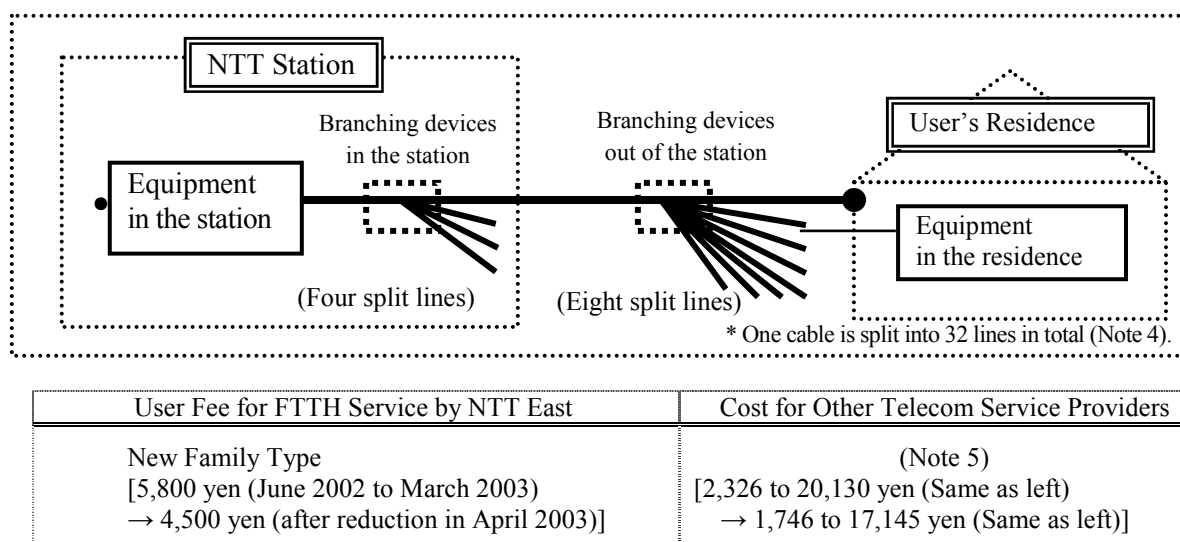
CONFIGURATION OF EQUIPMENT FOR NEW FAMILY TYPE SERVICE

28. The fee for the New Family Type service was set by presuming the use of the branch system, but it was actually provided to users using the direct cable connection system (until March 2004).




1. <Direct cable connection system> A single cable is used by one user



2. <Branch system> A single cable is used by up to 32 users



3. Notes

1. Other telecom service providers connect with the  section of the equipment owned by NTT with their own equipment at point .
2. With regard to the equipment in the station and that in the residence, the devices for the direct cable connection system and the branch system are different.
3. The amount equals the sum of the interconnection charge per cable for the optical subscriber equipment (the  section in the figure for point 1 above) (5,074 yen) and the charge for connection with the media converter (MC) installed in the station of NTT East (1,254 yen) (when used by as much as 16 users). In addition, other providers have to pay the interconnection charge for the local IP network.
4. Other telecom service providers are required to have the connections by one whole unit of equipment accommodating 32 split lines. They cannot use connections by each individual split line.
5. The amount of 20,130 (or 17,145 after price reduction in April 2003) yen is the basic charge when only one of the 32 split lines has a user. The charge increases according to the use of the equipment. If all of the 32 split lines have users, the interconnection charge per user will be 2,326 (or 1,746) yen (considering the demand in those days, it was practically impossible to have users for all of the 32 split lines). Other telecom service providers also have to pay the interconnection charge for the local IP network.