Anti-competitive practices, unlevel playing field after the full opening of the postal market

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The experiences of full market opening of network services have so far shown an increasing role of competition regulation. The new entrants, trusting in the prohibition of competition restrictions, are trying to compete with incumbent service providers. On the field of postal services as a network service, however, the traditional form of regulation is sectoral regulation. The effective cooperation of the two regulatory regimes is especially important in order to evaluate state aid in line with EU principles. In the course of the regulation both the universal service provider's financial balance and the gains expected from increased competition must be secured at the same time. The third postal directive restricted the possibility of sectoral regulatory intervention to ensure a universal service, at the same time providing a wider decision-making authority to the regulators in this respect.[*]

Journal of Economic Literature (JEL) kód: K23, L51, L87.

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[*] The article is revised chapter of the study "Market opening, market competition and market strategies – The strategic responses of the incumbent postal service providers for the liberalisation of the universal postal services" (supervisor of research: *Miklós Károly Kiss*) finalised in April 2014 at the Centre for Economic and Regional Studies of the Hungarian Academy of Sciences and made for the Competition Culture Centre of the Hungarian Competition Authority. We are thankful for the support of the OTKA Number 105435. research fund.

The Hungarian version of the article was published in *Külgazdaság,* 2015, Vol. LIX, No. 5–6, pp. 30–57 (*Pál Valentiny:* Versenykorlátozó magatartás, egyenlőtlen feltételek a teljes postai piacnyitást követően).

Translated by *Anna Forgács.* Translation checked by *Chris Swart.*

This article will provide an overview of restrictive effect of the incumbent service providers' market conduct and business strategy on competition, and the possible market distortion effect of state aid. In the first part we will cover the problems arising from the regulatory framework of the third postal directive, the questions that have been left open, and the controversies between postal regulation and other regulatory fields. The second part will give an account of the most common restrictions of competition in postal services. Following this, the third and fourth parts will touch on the questions of state aid and mergers in the postal sector, lastly we will describe the main characteristics of Hungarian competition law cases.

Incumbents and third postal directive

Postal services are one of the most recently liberalised markets where most incumbents are state monopolies that have been able to keep most parts of their traditional markets even after the partial market opening, and in most places their market share has only been reduced slightly. The third postal directive (2008/6/EC),[1] as the final element of the postal regulatory process started in 1997, aimed at full postal market opening by 2010 (in some countries 2012).[2] The protective measures on the market of individual services have disappeared, nevertheless, the directive tended towards counterbalancing the additional burdens of universal service providers. The freedom of pricing has increased, the obligation to use uniform prices has been restricted, and the possible scope of universal services has been better defined. Additionally to the economic regulation of the sector, which was

[1] The first directive was published in 1997 (97/67/EC), while the second in 2002 (2002/39/EC).

[2] For the analysis of the market opening, see *Miklós Károly Kiss* [2013].

mostly limited to the scope of universal services, competition policy has come to play a greater role.

Pricing issues

Section 38 of the directive defines the major goals in relation to pricing: "In a fully competitive environment, it is important, both for the financial equilibrium of the universal service as well as for limiting market distortions, that the principle that prices reflect normal commercial conditions and costs is only departed from in order to protect public interests. This objective should be achieved by continuing to allow Member States to maintain uniform tariffs for single piece tariff mail, the service most frequently used by consumers, including small and medium-sized enterprises." In connection with this, the directive states regarding the amendment of the previous Article 12 that "prices shall be affordable and must be such that all users, independent of geographical location, and, in the light of specific national conditions, have access to the services provided". The directive defines neither the term affordable, nor the principles of how to measure it. The basic requirements of cost-calculations are, nonetheless, incorporated in the directive. Conforming with these requirements and with the criteria of affordability, the pricing of service providers can be considered free.

Access at the downstream market

The directive does not prescribe that market participants in the downstream market should have access to certain elements of the postal infrastructure, but it merely creates this possibility. It holds (Section 5 Article 12) that if such access was established, then "the tariffs, together with the associated conditions, shall apply equally both as between different third parties and as between third parties and universal service providers supplying equivalent

services." Under the directive, a greater flexibility at setting the tariffs may be provided, and according to Section 39 "…Tariffs should take account of the avoided costs, as compared to the standard service covering the complete range of features offered for the clearance, sorting, transport and distribution of individual postal items". In those countries that statutorily allowed for access to the downstream market, this led to pricing based on avoided (foregone) costs almost everywhere (Ecorys, 2008, p. 69).

In relation to the setting of access tariffs for the downstream market, the most common restrictions on competition due to the vertical structure may be the application of the later detailed price squeeze.[3] The evaluation of price-setting is possible in 8 countries in advance, in 6 countries afterwards, and in 4 countries at both times (ERGP, 2012*a*, p. 44). By allowing for flexibility in price-setting, the directive gave way rather to the predominance of competition law, especially considering that price squeeze tests had first been established in competition law – among others by applying them to postal services.

The scope of universal services and its unfair financial burdens

One of the most important questions in terms of regulation is the definition of the scope of universal services.[4] Knowing this, it is possible to enforce

[3] Under this, we understand the reduction of the margin between wholesale and retail prices in a way that is restrictive of competition.

[4] The fulfilment of the universal postal service requirement is a state responsibility, which is ensured by the state through the universal service provider. In the European Union, it is in the authority of the Member States to designate a universal service provider, in order to fulfil the universal postal service requirement. Universal services may also be provided by not designated service providers. In Hungary, the Magyar

the requirements of affordability and cost-based tariffs against the universal service providers, additionally to prescribe service-quality and performance standards for those providing similar services, and to determine the additional burdens of universal service providers. At the beginning, an exhaustive definition of universal services was common in most countries, which provided a strong regulatory potential for the regulatory authorities (Copenhagen Economics, 2010, p. 126). In the course of the market opening, however, the scope of universal services has started to be reduced. The most recent report shows that in the European Economic Area only 8 countries, with a share of 9 percent of the total mail market, list all services beyond express services in the scope of universal services, while in 11 countries accounting for 56 percent of the total mail market, only single piece items are considered to be a universal service. (See *Figure 1.*)

The minimum scope of universal services was defined by the first postal directive (Article 3, 1997/67/EC), at the same time also determining those basic requirements under which the services must be carried out (Article 5). The third postal directive then declared that "Obligations and requirements (…) may only be imposed on designated universal service providers" (Article 9). If there are more designated universal service providers, then neither services nor the areas of these services can be overlapping. The third directive stipulated that the universal service providers that are not designated but provide services constituting universal service activity, could be imposed on with requirements of quality, availability and performance of the relevant services. The content of the licences issued in relation, along

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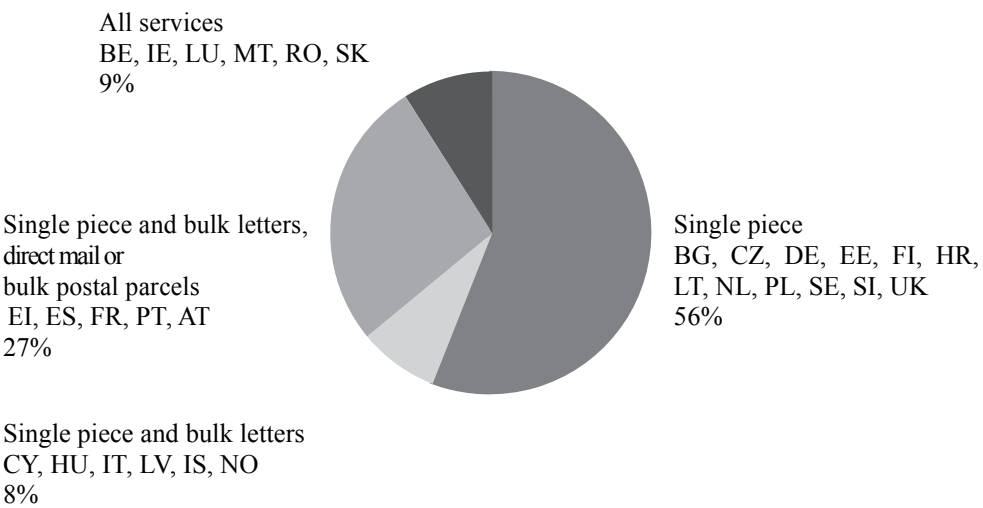
Posta Zrt. has been designated to provide this state task until 31 December 2020 according to the CLIX. Act of 2012 on the postal services.

with the scope of service requirements and the question of possible financial contribution to comply with the universal service are all dependent on regulatory intervention.

Not designated service providers, providing services which fall within the scope of the universal service, may be obliged to contribute to the net costs of sustaining universal services. In the case of mandating service-quality and performance requirements, however, the service providers could not be obliged to make financial contributions (Section 33, 2008/6/EC). For the compensation of the unfair burdens of the universal service obligation the third directive offers different options. The form of this could be “public compensation and cost sharing between service providers and/or users in a transparent manner by means of contributions to a compensation fund”, but there is also the possibility that profits accruing from other activities of the universal service provider outside the scope of the universal service are to be assigned, in whole or in part, to the financing of the net costs of the universal service (Section 26, 2008/6/EC).

Figure 1

The scope of universal services in the European Economic Area



Note: The country abbreviations are the following: AT – Austria, BE – Belgium, BG – Bulgaria, CH – Switzerland, CY – Cyprus, CZ – Czech Republic, DK – Denmark, DE – Germany, EE – Estonia, IE – Ireland, EL – Greece, ES – Spain, FI – Finland, FR – France, HU – Hungary, IS – Iceland, IT – Italy, LI – Liechtenstein, LT – Lithuania, LU – Luxembourg, LV– Latvia, MT – Malta, NL – Netherlands, NO – Norway, PL – Poland, PT – Portugal, RO– Romania, SI – Slovenia, SK – Slovakia, SE – Sweden, UK – United Kingdom.

Source: WIK [2013], p. 130.

In order to calculate the net costs, universal service providers shall keep separate accounts in their internal accounting system for the services that constitute universal service to differentiate them from the other services and products. The proper accounting separation may also be imposed by Member States on postal service providers who have to contribute to the compensation fund. The principles of net cost calculation are incorporated in Article 14 amended by the third directive, while the European Regulators Group for Postal Services (ERGP) provides regular assistance in the

execution of cost-calculations and the interpretation of cost-categories (ERGP, 2012*b,* 2013).

The relationship of regulation and competition policy in postal services

The first directive contained provisions on the designation of the legally and functionally independent national regulatory authorities. The national regulatory authorities may also be entrusted with the enforcement of competition rules in the postal sector. Even though the mission statements of numerous regulatory authorities contain the task of strengthening competition, most of the authorities believe that the primary enforcer of competition rules is the national competition authority. According to a 2009 survey of WIK, 22 countries, representing the 77 percent of the EU/EEA market, stated that in the supervision of the conditions of competition the primary organisation is the competition authority (WIK, 2009, p. 242). Ten Member States held that national regulatory authorities have a secondary supervisory role in the enforcement of competition rules.

The completion of market opening in network services proved that the role of competition rules will increase following a full market opening. The new entrants of the market by using the prohibition on restrictions of competition attempt to avert the market-protection steps of the incumbent service providers. By providing exclusive authority to regulate competition to the sectoral regulatory authorities, the chance the capture of the authority – well-known in the literature – would increase. The application of the rules of state aid for postal services is a very common case. The resolution of the European Commission (hereinafter: Commission) is needed for most of the

questions regarding compensation. Although since the Altmark case[5] state aid allocated for services of general economic interest[6] is easier to assess, the actual application requires complex cost-calculations. Cost-calculations are mostly supervised by the national regulatory authorities, and when the four conditions established by the Altmark case are not fulfilled, the compensation may constitute a state aid that must be examined by the Commission. If the compensation is too high, the aid may be considered illegal. For this reason, the coordination between regulatory and competition authorities is crucial, since in course of the regulation both the financial balance of the designated universal service providers and the realisation of benefits from the increased competition must be ensured. Due to this, the third postal directive has limited the intervention of the sectoral regulators to the level necessary for ensuring universal service, however, at

[5] Based on the judicial stand in the Altmark case: (1) the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined, (2) the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, (3) the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, (4) the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, (Altmark, 2003, pp. I–7847–7848).

[6] The services of general economic interest mostly consist of public services provided on market basis. These services are under the scope of public service obligations, for example these are the services of the energy sector, or the transport or telecommunications services.

the same time it provided greater authority in this realm (*Eccles,* 2010, pp. 49–52).

One of the most important measures of the postal regulatory authority is the determination of prices or the approval thereof. This becomes especially essential in the question of access, as for example the access fees to the post offices managed by the incumbent. In some countries the authority has recently introduced – for example the Dutch authority (*Eccles,* 2014, p. 183) – the investigation of companies with significant economic power, based on the example of electronic info-communication.[7] The background of this was the swift change on the Dutch postal market, when the number of national service providers was reduced from four to two between 2010 and 2013. The intent was the ex ante elimination of the potential restrictions of competition. The investigation is still in progress whether this change complies with the European regulatory provisions, considering that the Dutch competition and sectoral regulatory authorities have been merged into one organisation in 2014.

The distortions caused by value added taxes and customs

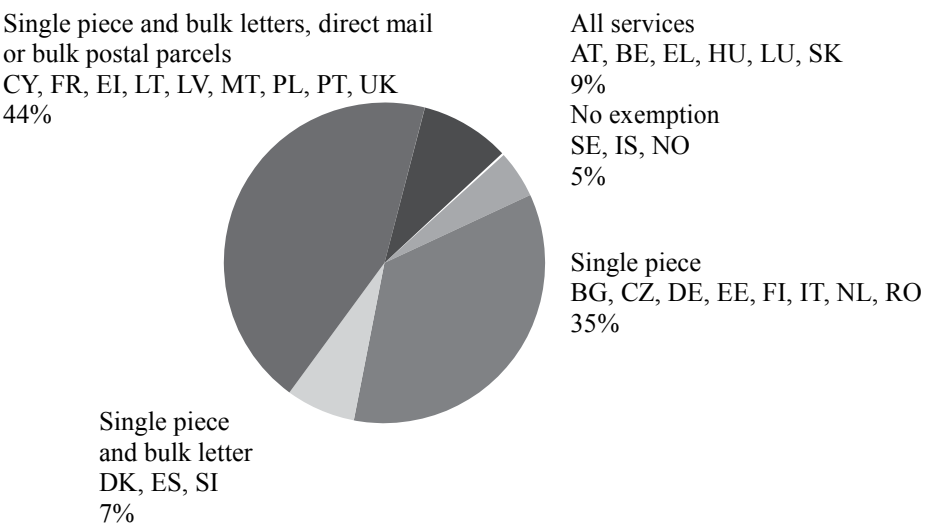
Traditionally, Member States exempt state service providers from the scope of value added taxes (VAT) for the whole or a part of the postal services, while private service providers are obliged to levy value added tax for the same service. The ERGP [2012*c*] has also examined the market distortion effects, also assessing the distortions between Member States. Under the

[7] The term significant market power (SMP) is used in sectoral regulation. If the regulator finds on the investigated market that the competition is not efficient enough, it can prescribe obligations for the service providers with significant market power to strengthen competition, based on the analysis of the market structure and the behaviour of service providers.

summery of WIK [2013], three Member States do not provide any kind of exemption for postal services, while six Member States apply it for all types of services. In total, ten Member States apply reduced value added tax to a wider scope than universal services (the percentage data means the ratio of the given group in the mail market turnover). (See *Figure 2.*)

Figure 2

Value added tax exemption of universal service in the European Economic Area



Note: For the country abbreviations see *Figure 1.*

Source: WIK [2013], p. 62.

Another study, the analysis of the Copenhagen Economics, evaluated the supplier side of postal service and showed that in countries without value added tax exemptions it is worth to outsource most of these activities, while in countries with reductions the service provider is interested in keeping as

much portion of these activities within the company as possible (Copenhagen Economics, 2013, p. 174). The study analysed the economic effects of VAT reductions for a wide range of public utilities (waste management, sewage treatment, education, cultural services, hospitals, broadcasting and postal services). Based on their model-calculations, they concluded that the abolishment of the VAT reductions for these public services would result in a profit equivalent to the 0.34 percent of EU GDP (Copenhagen Economics, 2013, p. 12). The question of value added tax reductions has been long debated among EU decision-makers, in regard of the postal services the 2009 decision of the European Court of Justice has not changed the status quo.[8]

The custom rates applicable to postal services are mostly regulated by the agreements of the Universal Postal Union (UPU). These entitle the universal service providers to exceptional rights in the custom clearance of incoming mails. A WIK survey (2013, p. 65) makes it apparent that the preferential options do not only apply to the services within the scope of universal service. As a consequence, all Member States have exempted their universal service provider from the obligations provided by custom regulations, at the same time not providing the same preferential treatment to other market actors, competing service providers.

The regulation of international postal services

Additionally to EU directives, international postal services are regulated by the UPU, as an international organisation of the United Nations. These rules touch on the scope of universal services, the requirements of service-quality, and among others those terminal dues, which are imposed by the

[8] C-357/07, TNT Post UK Ltd. See http://curia.europa.eu

incumbent and mostly state-owned postal services on each other. The principles, on which the UPU rules are based, are largely different from the principles of the EU. More than half of the postal regulatory authorities of the EU Member States assumed that they would be unable to apply the postal directive, or would be uncertain how to apply it, if it contradicts an UPU rule. Only 10 smaller Member State argued that they consider the directive to be the relevant law for all international postal service activities WIK (2013, p. 92). The directive requires cost-orientation, transparency and non-discrimination in terms of prices. The national regulatory authorities do not ensure that the terminal dues of universal services reflect these principles. The terminal dues determined by UPU do not correspond with either the actual cost, or the national postal price-determinations. Such a determination of terminal dues in the EU legal system is close to being price-fixing as a conduct restricting competition, and the incumbents applying these may be accused of abuse of dominant position.[9]

In this situation, it seems that some Member States and authorities alone are not enough to enforce the EU directives, so a more active role would be needed from the EU institutions. Since the 1998 Communication of the Commission (Communication, 1998*b*), two new postal directives have been adopted and the Commission and the Court have declared their position in more than one questions relating to international postal services. The incorporation of these and their harmonisation with the UPU provisions would require new initiatives from the EU institutions and the renewal of the communication. The authors of the WIK [2013] study would require even further steps: they recommend an EU consultation regarding terminal

[9] For an analysis of the cases, see WIK [2013], pp. 114–126.

dues and the assessment of the situation, and they urge for a united EU approach for the next UPU Congress (2016) and for the next rounds of negotiations of the international trade agreements (WIK, 2013, p. 342).

Restrictions of competition in postal services

The most commonly appearing restriction of competition in postal services is the abuse of dominance. The decisions reached in these cases were aided by the Commission Communication published in 2009.[10] Such behaviour may be observed at predatory pricing, at the refusal of supply, at margin squeeze[11] and at price reductions, which we will discuss in detail later on. Bundling and tying, however, is rare in postal services, between 2007 and 2013 only one national authority (Dutch) dealt with such questions.[12]

Predatory pricing

The treatment and review practice of predatory pricing – such pricing by which an at least similarly efficient competitor may be excluded from the market – has recently been gradually changing. This is also reflected by the 1998 Notice of the Commission (Notice, 1998*a*). The Notice deals with the application of the competition rules to access agreements in the telecommunications sector, however, it is considered to be applicable to a wide range of network services. The Notice attended the questions of cost-

[10] On the expectable effects of the Communication [2009], see the analysis of *Geradin–Henry* [2010].

[11] For a more exhaustive and detailed analysis of these conducts, see *Valentiny* [2004], *Valentiny–Kiss* [2009].

[12] In the field of postal services, the De Post-La Poste case was the first, in which the Commission held that the incumbent abused its dominant position by providing a price reduction for mail services only attached to a new business-to-business (B2B) service. The Commission considered this to be a very serious violation of rights, which must have strengthened its deterrent effects. (De Post-La Poste, 2002, Section 86.)

calculation methodology in detail. In the Notice, the Commission argued that cost-calculation based on the incremental costs may be the calculation base for the lower threshold of predatory pricing. Nonetheless, it was also stated that the direct introduction of incremental costs would lead to a very low price floor in network services, which function with a much higher common cost-ratio compared to other industries.

This principle was further developed by the Commission by analysing multi-product companies, such as postal services. In the 2001 Deutsche Post case (Deutsche Post, 2001), it held that predatory pricing occurred in relation to the cross-financing of reserved services [13] and competing services. In order for a company to avoid being accused with predatory pricing, it must show such the earnings of its specific competing service could cover the average incremental cost of providing the service. In contrast, between 1990 and 1995 the earnings for the examined services were below this, thus the services were constantly loss-making. The earnings were not even enough to cover the network capacity costs of the services (Deutsche Post, 2001, point 10. and 36.). Thus full market opening has eliminated the possibility of cross-financing starting from the reserved services, however, the possibility of predatory pricing still exists. Thus the Notice of the Commission found it necessary to differentiate between below-cost selling and anti-competitive rebates.

The Commission considers it below-cost selling, if the dominant undertaking suffers an avoidable loss. For the calculation of this, the

[13] Reserved services could have been provided only by the universal service provider, until the full market opening. This allowed a statutory monopoly for the universal service provider to cover its possible additional burdens.

Commission has introduced the use of average avoidable cost (AAC).[14] "If a dominant undertaking charges a price below AAC for all or part of its output, it is not recovering the costs that could have been avoided by not producing that output: it is incurring a loss that could have been avoided. Pricing below AAC will thus in most cases be viewed by the Commission as a clear indication of sacrifice" (Communication from the Commission, 2009, Section 64). The Commission also declared that the average avoidable cost and the average variable costs are the same. If, however, they are different, then the average avoidable cost is the better choice, since it includes the possible costs of capacity expansion.

The Communication clearly intended to take into account the elements of strategic conduct at below-cost selling. With this attitude, it took a step in the debates around predatory pricing towards the approach building on modern economic principles, on the importance of the conduct-analysis of market actors, and on game theory. "In order to show a predatory strategy, the Commission may also investigate whether the allegedly predatory conduct led in the short term to net revenues lower than could have been expected from a reasonable alternative conduct, that is to say, whether the dominant undertaking incurred a loss that it could have avoided. (...) Only economically rational and practicable alternatives will be considered which, taking into account the market conditions and business realities facing the dominant undertaking, can realistically be expected to be more profitable." (Communication, 2009, Section 65). The evidence proving this may be found – among others – in the documents of the undertaking.

[14] The average avoidable cost contains all costs that are avoidable, if the production of a certain product or certain conduct (e.g. market entry) do not happen.

In case of anti-competitive market foreclosure the competitors exit from the market is not necessary. The Communication [2009] considered the weakening of a strong competition or the following of the prices of the dominant undertaking as having a market foreclosing effect. The consumers are likely to suffer harm, if the dominant company can expect that after ending the predatory behaviour its market power will increase. Then not only a price increase may happen, but also it is sufficient if the dominant company is able to impede or delay an expected price decrease. "Identifying consumer harm is not a mechanical calculation of profits and losses, and proof of overall profits is not required. Likely consumer harm may be demonstrated by assessing the likely foreclosure effect of the conduct, combined with consideration of other factors, such as entry barriers" (Communication, 2009, Section 71).

Among the cases of predatory pricing, many refer to the 2012 Post Danmark case of the Grand Chamber of the European Court of Justice as a landmark decision.[15] In 2004, the Danish incumbent service provider gained three major consumers from its largest competitor (Forbruger-Kontack) in the distribution of unaddressed mail by using a lower price compared to the ones used with prior consumers. The price offered to one of the major consumers, the Coop group, did not allow Post Danmark to cover its average total costs, it did allow it to cover its average incremental costs. The competitor submitted a complaint to the competition authority, then the case landed at the Danish Supreme Court, which referred it to the European Court of Justice for preliminary ruling.

[15] We describe the case based *Geradin–Malamataris* [2014], and *Szentléleky* [2013].

The European Court of Justice found both predatory pricing and above-cost selectively low prices among the anti-competitive pricing options. For predatory pricing the European Court of Justice applied the test established in the AKZO case (1991). A pricing practice that is above the average variable cost but below the average total cost is abusive, insofar as its purpose is to drive out a competitor. When calculating the costs, instead of using the average variable cost, the average incremental cost was applied just as in the Deutsche Post case. This approach was also supported by the European Court of Justice, since in the case of network services the use of average variable cost may be misleading due to the commonly high fixed costs and the low variable costs.

The cost-calculation was carried out by the Danish competition authority, which – as opposed to the Deutsche Post case that used only the fixed and variable costs connected to the service, when estimating the average variable costs – included the common variable costs, the common costs of logistical capacity and some of the non-attributable common costs. Consequently, the larger part of the costs ended up being below the average incremental costs, which could have been calculated using the Deutsche Post methodology. The European Court of Justice did not deal with the specifics of the cost-calculation, it only noted that such a method of attribution seeks to identify the great bulk of the costs attributable to the activity (Case C-209/10 Post Danmark A/S v. Konkurrencerådet, Section 34, see http://curia.europa.eu).

According to a preliminary ruling provided to the Danish Supreme Court, if the price contains the great bulk of the costs, then the competitive position of the market actors similarly efficient as the dominant undertaking is not worse. In the case of a price below the average total cost, but above the

average incremental cost only the detailed analysis of the companies' conduct could ascertain the exclusion.[16] The European Court of Justice also noted in relation to the case that the competitor of Post Danmark managed to maintain its distribution network, and then it was able to win back the Spar group, which also speaks against the exclusionary abuse (Case C-209/10 Post Danmark A/S v. Konkurrencerådet, Section 39).

The European Court of Justice also dealt with the question of above-costs selectively low prices (from a different perspective: selective price reductions), since Post Danmark offered to two out of the three companies prices above the average total prices. Even though in two prior cases (Case C-395-396 Compagnie maritime belge, Case C-497/99 Irish Sugar, http://curia. europa.eu) the Court has reached decisions to consider the regular and selectively applied price reduction above the average total costs as aiming at the deterrence and exclusion of competitors, in this case this was not upheld, and the opinion of the Advocate General also emphasised the specific circumstances of the two cases.[17]

[16] "In order to assess the existence of anti-competitive effects in circumstances such as those of that case, it is necessary to consider whether that pricing policy, without objective justification, produces an actual or likely exclusionary effect, to the detriment of competition and, thereby, of consumers' interests" (Case C-209/10 Post Danmark A/S v. Konkurrencerådet, Ruling, see http://curia.europa.eu).

[17] It seems to me that the Court's case-law must be interpreted as meaning that, where the (relatively exceptional) conditions of the Compagnie maritime belge transports and Irish Sugar cases are not fulfilled, and in particular where no intention on the part of the dominant undertaking to drive out a competitor or competitors can be inferred from the circumstances other than offers of selective prices, a selective price reduction must be examined by reference to the costs of the dominant undertaking, following the example of

The refusal of supply

The 2009 Communication of the Commission assumed that all companies – irrespective of dominance – have the right to choose their trading partners. However, service providers that operate in a vertical chain, which often possess such infrastructural elements that are crucial also for other companies, can easily abuse their dominant position. "Typically competition problems arise when the dominant undertaking competes on the 'downstream' market with the buyer whom it refuses to supply. The term 'downstream market' is used to refer to the market for which the refused input is needed in order to manufacture a product or provide a service" (Communication, 2009, Section 76).

The application of the definition of essential facility provides the competitors with the right to access such assets that use would not be at their disposal otherwise (*Valentiny–Kiss,* 2009). The essential facilities are part of a vertical supply chain, and their use makes it possible to provide the next phase of the supply chain. The application of this term goes together with the restriction of right to the freedom of contracting and the freedom to dispose over property. Naturally, under certain circumstances these rights may be restricted in other cases, however, the question remains whether such conditions exist in case of the essential facilities. Some claim that the hindrance of use of these assets is merely the case of an unreasonable refusal to deal and do not need an independent legal formula.

One of the most debated questions of postal services is the problem of access. The third postal directive stated that postal service providers must

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the criterion used in paragraphs 114 and 115 of Akzo v Commission. (Opinion of Advocate General *Paolo Mengozzi,* C-209/10 case, Section 95, see http://curia.europa.eu)

have access to the postal network under conditions which are transparent and non-discriminatory. The transparent, non-discriminatory access conditions are separately mandated to certain elements of postal infrastructure or services. This means the access to such elements and services like the postcode system, address database, post office boxes, delivery boxes, information on change of address, re-direction service and return to sender service (2008/6/EC Article 11 and 11*a*).

The Directive – just like other EU legal instruments usually do – does not determine the legal basis for identifying the access to these certain elements. For postal services the point of reference and example is always the telecommunications sector. On the wholesale market of telecommunications, falling under ex ante regulation, the regulators always prescribe obligation of access.

The first aid to this was contained in the Notice on the application of the competition rules to access agreements in the telecommunications sector published at the beginning of the market liberalisation of telecommunications. Section 68 of this stated that "the expression essential facility is used to describe a facility or infrastructure which is essential for reaching customers and/or enabling competitors to carry on their business, and which cannot be replicated by any reasonable means" (Notice, 1998*a* Section 68). Naturally, the telecommunications analogy is only applicable with certain limitations. The postal network does not represent such a physical network like telecommunications networks. The postal network means mostly an organisational system connecting physical elements, in which logistical structures play a crucial role.

Based on the Communication, it seems that the Commission regards the question of access to the essential facilities as a case of the refusal of

supply. “The concept of refusal to supply covers a broad range of practices, such as a refusal to supply products to existing or new customers, refusal to license intellectual property rights, including when the licence is necessary to provide interface information, or refusal to grant access to an essential facility or a network” (Communication, 2009, Section 78).

The Communication also states that the refusal of supply does not require that the refused product to have already been traded. It is sufficient, if there are potential buyers and thus a potential demand exists for the planned service. For this reason, an actual refusal is not necessary either, a “constructive refusal” is sufficient. “Constructive refusal could, for example, take the form of unduly delaying or otherwise degrading the supply of the product or involve the imposition of unreasonable conditions in return for the supply” (Communication, 2009, Section 79).

It was due to constructive refusal that the Commission condemned the Deutsche Post in another 2001 case. Letters coming from the United Kingdom with a German reply address were considered to be domestic mail by the Deutsche Post, who then intercepted these and delivered them with delays, only after additional tariffs were paid. The Commission condemned the Deutsche post for unlawful discrimination, excessive pricing, limitations of market and constructive refusal.[18]

Based on Section 81 of the Communication, authorities are obliged to take action against such conduct that raises the suspicion of restriction of competition, if they become aware of the refusal of such a service that is objectively necessary, the refusal of which is likely to lead to the elimination of effective competition and to consumer harm. However, the

[18] Commission Decision on Deutsche Post, IP/01/1068.

Communication also made a crucial statement regarding postal (and network) services, when it held that imposing an obligation to supply cannot have negative effects on the obliged service provider's investments and innovations. When imposing an obligation, nevertheless, it can be assumed that the incentives of innovation have already been taken into account by the authorities when introducing such an obligation to supply. "This could also be the case where the upstream market position of the dominant undertaking has been developed under the protection of special or exclusive rights or has been financed by state resources. In such specific cases there is no reason for the Commission to deviate from its general enforcement standard of showing likely anticompetitive foreclosure, without considering whether the three circumstances referred to in paragraph 81 are present" (Communication, 2009, Section 82).

Margin squeeze

While predatory pricing may in theory be carried out in a wide range of sectors, the question of margin squeeze is analysed rather in regulated sectors, because these are mostly ruled by vertically integrated companies. These companies are present on the wholesale market (as the basic input provider) and on the retail markets at the same time. A vertically integrated company is able to induce such price movements in two markets (the wholesale and the retail market) that may be restrictive of competition. For example it raises the prices of the fundamental inputs and decrease the retail consumer prices. The aim of such price changes is to squeeze the margin between the costs and selling prices of the competitors (thus the name margin squeeze), and consequently forcing the efficient competitors out of the market. Given that this happens, the vertically integrated company raises consumer prices and by this regains its losses and acquires additional

profits. It is apparent that margin squeeze may be considered to be one version of predatory pricing. However, margin squeeze may also be handled as a business strategy chosen instead of refusal of supply.[19] This strategy can gain a momentum at the market opening of postal services, since by this conduct the vertically integrated incumbent companies can – at least temporarily – hinder the competitors on the downstream market, provided that they are unable to refuse access.

The 2009 Communication of the Commission emphasised the impact-based approach of the cases. The dominant company may choose to disable an equally efficient competitor from trading profitably in long term by setting prices, thus applying margin squeeze. "In margin squeeze cases the benchmark which the Commission will generally rely on to determine the costs of an equally efficient competitor are the LRAIC of the downstream division of the integrated dominant undertaking" (Communication, 2009, Section 80).

Among the national regulatory authorities, the German competition authority initiated an investigation against Deutsche Post in November 2012. The suspicion of predatory pricing and margin squeeze was raised based on the complaints of independent competitors providing mail service.

Price reductions

Price reductions are one of the most common forms of business practice, because by increasing the amount of products sold, an improvement in efficiency can be achieved, economies of scale can be exploited, the return

[19] The fact that the literature is oscillate on the question whether margin squeeze belongs to the realms of competition or sectoral regulation shows the two-sidedness of the classification of margin squeeze. This is analysed in detail by the articles of *Heimler* [2010] and *Geradin–O'Donoghue* [2005].

of fixed costs is faster, but it is also able to foreclose the market. The Commission evaluated the conduct of Deutsche Post to be such.[20] In this case the Commission found that the whole system of price reductions applied by Deutsche Post was anti-competitive. Between 1974 and 2000 Deutsche Post applied a rebate system, in which a special price was granted to customers for mail-order parcel services in exchange for requiring the customer to also send most of their non-bulk parcels via Deutsche Post. This system of rebates based on loyalty hindered the competitors from reaching the minimum necessary size to function. Without carrying out an economic analysis, the Commission held that such a rebate is not linked to quantity, but rather to loyalty, and as such it is an anti-competitive effect (Deutsche Post, 2001, Section 33).[21]

The rejection of loyalty rebates without any consideration has raised aversion both in legal and economic circles. Influenced by these, the Communication of 2009 has already recommended the use of the tools of economic analysis for deciding such cases. By this time the Commission has recommended the comparison of average avoidable cost (AAC) and long-run average incremental cost (LRAIC) for all price-based restrictions of competition. If the applied price is below the average avoidable cost, it means that the dominant company sacrifices its profits in the short term, and the equally efficient competitors is unable to stay on the market without producing losses. The long-run average incremental cost is usually higher than the average avoidable cost, thus the "failure to cover LRAIC indicates that the dominant undertaking is not recovering all the (attributable) fixed

[20] The case is more exhaustively analysed by *Geradin–Henry* [2010], p. 63.

[21] Deutsche Post [2001], Section 33.

costs of producing the good or service in question and that an equally efficient competitor could be foreclosed from the market" (Communication, 2009, Section 26).

Anti-competitive rebates are discussed in the Commission's Communication under exclusive dealing arrangements. The suspicion of restriction of competition is raised primarily in the case of conditional rebates, when the rebate is provided in exchange for a particular form of purchasing behaviour,[22] and the seller (service provider) is in a dominant position. It is possible that competitors are not able to compete on equal terms for the entire demand of each individual customer, thus the Communication divides the demand of customers into a contestable and a non-contestable portion. This latter is the part the customer necessarily buys from the dominant service provider. By applying retroactive rebates, the foreclosure of the market is possible, because customers would not tend to switch a smaller portion of their demand elsewhere, if this threatened the loss of the rebate. The higher the rebate as a percentage of the total price and the higher the threshold, the stronger is the likelihood of foreclosure of actual or potential competitors. For this reason, the Commission evaluates the whole system of rebates, and analyses whether the competitors have any realistic and effective counterstrategies, and if so to what extent. Relying also on the Communication, national authorities conducted investigations in

[22] The usual nature of a conditional rebate is that the customer is given a rebate if its purchases over a defined reference period exceed a certain threshold, the rebate being granted either on all purchases (retroactive rebates) or only on those made in excess of those required to achieve the threshold (incremental rebates) (Communication, 2009, Section 37).

9 price reduction cases between 2009 and 2013, out of which 3 also analysed the question of conditional rebates (WIK, 2013, pp. 68–70).

State aid

In the field of postal services it is extremely important that market actors, especially incumbent service providers, shall not gain undue advantages, but also do not suffer unfair disadvantages as compared to their competitors. To achieve this, state aid policy has a crucial role. Between 2010 and 2013 the Commission dealt with 19 cases, out of which it found in 14 that the state aid was appropriate, in two it mandated repayment, in another two it held that the paid compensation cannot be considered state aid, while in one the state measure was withdrawn (WIK, 2013, pp. 79–80). Based on EU law, the Commission first determines whether the compensation provided to the services of general economic interest (SGEI) could be considered state aid, and if so, in the second step it decides whether it is in line with the internal market rules of the EU. In determining the first question, the four conditions mentioned in the Altmark case shall be applied. (See footnote 8.)

In the De Post–La Poste- (now bpost), the La Poste- and the Post Office Ltd. cases[23] the Commission investigated the retail postal networks of the Belgian, French and British markets. In these cases the Member States submitted model calculations, showing a comparison between the costs of their existing delivery network with the costs of a hypothetical network without public service obligations. The difference between the two provided for the net cost, which emerges due to the obligation. In the De Post–La Poste case the Belgian state argued that the actual delivery network

[23] See the three cases in *Geradin–Malamataris* [2014], pp. 122–124.

is needed to comply with Belgian national law (for the density of service branches), thus the compensation right. However, the Commission did not accept this explanation, because the maintenance of the existing network was not included in the obligation as an independent condition, but it was only related to providing the universal service under sufficient quality requirements, thus a claim for state aid was not warranted.

In the French La Poste case, nevertheless, the Commission accepted that the statute differentiated between the access points ensured under the universal service obligation and the network ensuring geographically determined presence that is listed under the additional obligations, so that this latter was allowed to be accounted for as an obligation. Similarly, the British statutory provisions made a differentiation between the network necessary to conform to the universal service requirements and the retail network that is obligatory for services of general economic interest, thus making its subsidisation possible.

While the Commission approved the compensation granted for a wide range of public services (handling of social benefit payments, passport and vehicle license applications, public utility payment facilities, access to postal services and basic bank and cash facilities) of the British Post Office in March 2015 (Press Release, IP/15/4635). The Commission conducted an investigation based on the first point of the Altmark case.

The France v. European Commission case (Case T-154/10), in which the last decision was published on 3 April 2014,[24] was a case on the role of state intervention. France objected to the Commission's decision to consider

[24] JUDGMENT OF THE COURT (First Chamber) of 3 April 2014 in the C-559/12. P. case between the French Republic v. European Commission.

state guarantees granted to the postal service to be state aid, thus contested the decision at the European Court of Justice. The European Court of Justice rejected the French arguments. In the French administrative system, the La Poste is an establishment of an industrial and commercial character (établissements publics à caractère industriel et commercial – EPIC), which is financially independent and as a legal person responsible for the performance of a certain public services task. The Commission found that the insolvency and bankruptcy laws are inapplicable for EPICs, especially since an Act of 1990 on the division of postal and telecommunications services granted an unconditional state guarantee for bonds and saving bonds of La Poste, which can be considered a state aid. This unconditional state guarantee created much better credit terms for La Poste, for which the Commission did not even have to prove the actual effects,[25] but the unconditional guarantee had to be withdrawn.

In the case of the Italian postal service (Poste Italiane) the state subsidised the tariff decrease of certain consumer groups (publishers, non-profit organisations, candidates of elections) along with a universal service obligation (*Eccles,* 2014, pp. 180–181). Originally (between 2009 and 2012) the Commission was not notified of the compensation by the Italian state. The aim of the reduced tariffs was to sustain pluralism, and the difference between the reduced and normal tariffs were reimbursed to the postal service not by the finance ministry, but by an independent authority.

[25] "... simple presumption exists that the grant of an implied and unlimited State guarantee in favour of an undertaking which is not subject to the ordinary compulsory administration and winding-up procedures results in an improvement in its financial position through a reduction of charges which would normally encumber its budget" (French Republic v. European Commission, 2014, Section 98).

The Italian party assumed that – based on the Altmark case – the compensation could not be considered a state aid. However, the Commission held that the parameters underlying the compensation were only determined long after the start of payments, thus the second condition of the Altmark test was not fulfilled. The Italian postal service was also unable to sufficiently prove that the costs in all investigated cost-categories was in line with market tendencies, thus with the efficiently functioning typical company of the sector. Consequently, the fourth condition of the Altmark test was also not fulfilled, and the compensation had to be considered a state aid.

In this case the European Union framework for State aid in the form of public service compensation (Communication, 2012) had to be applied. In this regard, the duration of the public service obligation, the accounting division of trade and public service activities, the relation of costs and compensation were assessed. Based on all this, the Commission concluded that an excessive state aid could not be detected in relation to the universal service obligations and reduced tariffs of Italian postal service, thus it is not in violation of the requirements of state aid.

The question of pension funds also belongs to the realm of state aid. In many Member States – based on their prior monopoly position – the incumbent service providers have accumulated huge pension funds. This was considered to be a structural disadvantage compared to the private sector in many Member States, and for balancing it measures of pension fund compensation were introduced. The cases of the De Post–La Poste, the Deutsche Post and the Royal Mail Group of the Commission were such disputes (*Geradin–Malamataris,* 2014, pp. 125–126). The Commission presumed that the costs due to the labour laws and collective agreements

signed with trade unions are part of the expenditures of the normal course of trade, which should be borne by the businesses themselves. Nevertheless, the financing of pension fund compensations are carried out from state resources, they are selective and able to distort competition, and thus they shall be considered state aid.

The beneficiary of state aid has to prove that the measure (1) truly serves the public interest, (2) is necessary to achieve the goal, (3) is proportional. Regarding the first condition, the Commission held that such a market opening serves the public interest, which aims at creating equal conditions for all market participants, thus it is correct to release the incumbents from the past burdens of pension funds and all actors shall pay only social security equally. Regarding the second condition the Commission concluded that the state has previously not provided sufficient resources for the long term sustainment of pension funds, so the related financial measures are necessary for the sustainment of the funds. At assessing the third condition, the social security obligations that have evolved in the postal service sector were compared, considering the public servant status of the incumbents.

In practice, the three conditions were applied with flexibility. In the case of the German postal service, the Commission found some part of the compensation related to the pension funds unacceptable, because the postal service used a part of the stamp price increase for the funds, and this was found to be an unlawful state aid. In the De Post-La Poste case, the situations of the public servants and the contractual employees working for the incumbent were compared, and the amount of the compensation was found to be satisfactory. In Great-Britain, where it is common that major companies maintain pension funds, the basis of the comparison were these

companies, and the amount of the compensation was found to be lawful by the Commission.

Mergers

Mergers fundamentally influence the competitive circumstances of postal services, thus assessing the expected change of the competitive situation is a basic requirement for reviewing mergers. The rejection decision of the Commission in the case of the merger of UPS and TNT has been the third merger prohibition in the last decade.[26] If the two companies had merged, a significant decrease of competition would have occurred on the international market of express small package delivery in the European Economic Area. Only DHL and FedEx function in a similar integrator role on the markets, but the market share of FedEx is lower and in some countries it was not present on the market. The national postal services do not possess such an extensive air fleet and integrated road transport network, which could allow them to manage the service. The Commission held that by the merger the number of integrators would decrease from three to two in 15 Member States, while the barriers against market entry are high.

The arguments regarding efficiency advantages raised by the parties intending the merger were rejected by the Commission, stating that such advantages would be lost as a result of the price rises due to the softening competition. The Commission also rejected the commitments offered by the parties. They offered that in 15 Member States TNT would sell its subsidiaries, but this was rejected by the Commission, because very few

[26] Case T-194/13, United Parcel Service v. Commission, for a more detailed description of mergers, see *Eccles* [2014].

integrated companies had shown any interest towards them, and only such an offer would have been acceptable, which would entail a business strategy sustainable in the European Economic Area and would be able to expand. Since such offer was not made, the Commission prohibited the merger.

In the merger case of La Poste and Swiss Post,[27] the two companies decided to create a joint venture. The Commission had reservations regarding the original plan, because it would have resulted in the weakening of competition on the French market, and the strengthening of the dominant position of La Poste was assumed. The aim of the joint venture was to bring together the international mail market activities of the two companies. In the otherwise shrinking market a dynamic actor would have been diminished by the merger on the French market, and a newly entering undertaking was also not to be expected. In order to calm the Commission's concerns, the Swiss postal service offered that it would sell its French subsidiary to a third party. The parties also agreed that the Swiss postal office would share the information regarding its consumer contact network, and for a limited period it would allow access to its existing multilateral international agreements, additionally to allowing the temporary use of its established brands. Finally, the Commission approved the creation of a joint venture under these conditions.

Competition law decisions regarding the Hungarian postal services

So far in the national practice, competition authority resolutions – and in some cases judicial decisions – have been adopted in cases of merger, abuse of dominant position and restriction of competition. Out of the nine cases

[27] Case No. COMP/M.6503 – La Poste/Swiss Post/JV.

that we will cover four deal with mergers. The Hungarian competition authority has approved all these merger cases, and in one case (Vj-45/2002/17 http://gvh.hu/dontesek/versenyhivatali_dontesek), it held that the submitted application could not be considered a reviewable merger. In two cases out of the nine, the competition authority found an abuse of dominant position (Vj-167/2001/52) and restriction of competition (Vj-140/2006/69).

The facts of the abuse of dominant position were regarding price reductions. The board of the competition authority held that the Hungarian postal service (Magyar Posta) abused its dominant position by providing higher rebates off its mail delivery prices, only in the case of using the services of its electronic centre. In its contracts between 1999 and 2001, the Hungarian postal service offered rebates higher than the average for customers, who had the postal service prepare their mail (usually invoices).

The restriction of competition was held in the case of Magyar Posta Zrt. and Magyar Lapterjesztő Zrt. According to the decision of the board of the competition authority, the parties have entered into an agreement restrictive of competition, under which the Magyar Posta would not have dealt with wholesale newspaper distribution between December 2001 to 31 December 2007, while the Magyar Lapterjesztő Zrt. would not have intruded into the prescription-based newspaper distribution of the Magyar Posta between January 2003 and 31 December 2007. The excessive amount of the fine was reduced by the appeal court, but it was reversed and upheld by the Supreme Court (*Versenytükör,* 2010, p. 9).

One of the features of the national competition law decisions related to postal services is that the question of newspaper distribution has come up in a relatively large number of cases (restriction of competition, merger), also

the problem of the legal status of state owned companies has been raised on numerous occasions. The board of the competition authority concluded in the merger case regarding the Magyar Posta gaining control over the Postabank (Post Bank) that when the governmental orders provided the Magyar Posta with control power over the Postabank, the governing structure of the two state-owned companies was restructured. The modification of the governance structure happened between two companies that are controlled by the state and are not independent. Consequently, the acquisition of control of Magyar Posta over Postabank occurred not between independent undertakings, thus it could not be considered a merger under competition law (Vj-45/2002/17), and it could not be reviewed.

In the case Vj/017-036/2012, the board of the competition authority authorised the Magyar Posta Zrt. the Magyar Villamos Művek Zrt. (Hungarian Electricity Inc., MVM) and the MFB Invest Befektetési és Vagyonkezelő Zrt. (Investment corporation of the Hungarian Development Bank) to create – under their joint control – the MPVI Mobil Zrt. Firstly, it investigated whether the MFB Invest and the Magyar Posta and/or the MVM belong to separate governance centres, even though in the end all three companies belong to the control powers of a ministry (the MFB Invest through the MFB itself, while the Magyar Posta and the MVM through the Magyar Nemzeti Vagyonkezelő – MNV, Hungarian National Asset Management Inc.). Since the MFB Invest is under the control of the MFB, the question was rather if the MFB is an independent governance centre of its own. “In case of the MFB Inc. the control powers of the minister are limited: the approval of the business plans (as the most important element of the independent decision-making power) belongs to the MFB Inc., and cannot be conducted by the minister. Considering all this, the board of the

competition authority held that the MFB Inc. constituted an independent governance centre, thus necessarily independent from the Magyar Posta and the MVM" (Vj/017-036/2012, Section 31). The acknowledgement of independence in this case meant the necessary condition to authorise the merger, since under the statute on competition it is sufficient, if there are at least two independent undertakings among the founders, thus the board of the competition authority "found it unnecessary to investigate whether the MNV is independent of the minister, respectively also to his right to give orders; and whether the Magyar Posta and the MVM have independent decision-making authority" (Vj/017-036/2012, Section 33).

Concluding remarks

We have provided an overview of the problems arising in the regulatory framework of the third postal directive, the controversies between the postal regulation and other regulatory fields. Then we gave an account of the most common restrictions of competition in postal services, the questions of state aid and mergers, and we described the main characteristics of the Hungarian competition law cases.

It may be apparent from the development of the regulatory environment that the directive, by providing flexibility in price-setting, promoted the predominance of competition law, especially considering that the tests for assessing certain questions (e.g. the test for margin squeeze) had been established first in competition law – among others by applying them to postal services. However, the third directive enabled that the universal service providers, who are not designated but provide services that constitute universal service activity, could be imposed with requirements of quality, availability and performance of the relevant services. The content of the licences issued in relation, along with the scope of service

requirements and the question of possible financial contribution to comply with the universal service are all dependent on regulatory intervention. In some questions – for example in relation to universal service (regarding the principle of calculating net costs) – it can be detected that the European Regulators Group for Postal Services may provide more and more assistance to the national regulatory authorities.

The completion of market opening in network services proved that the role of competition rules increase following a full market opening. The new entrants into the market attempt to avert the market-protection steps of the incumbent service providers by using the prohibition on restrictions of competition. By providing exclusive authority to regulate competition to the sectoral regulatory authorities, the chance of the capture of the authority – well-known in the literature – would increase. The harmonisation of the competition regulation and the sectoral regulation is needed in the field of postal services, for which the regulation of state aid could serve as an example. Cost-calculations are mostly supervised by the national regulatory authorities, and when the four conditions established by the Altmark case are not fulfilled, the compensation may constitute a state aid that must be examined by the Commission. If the compensation is too high, the aid may be considered illegal. For this reason, the coordination between regulatory and competition authorities is crucial, since in course of the regulation both the financial balance of the designated universal service providers and the realisation of profits from the increased competition must be ensured. Due to this, the third postal directive has limited the intervention competence of the sectoral regulators to the level necessary for ensuring universal service, however, at the same time it provided greater decisional authority in this realm.

The directive requires cost-orientation, transparency and non-discrimination in terms of prices. The national regulatory authorities so far have not ensured that the terminal dues of universal services reflect these principles. The terminal dues determined by UPU do not correspond with either the actual cost, or the national postal price-determinations. Such a determination of terminal dues in the EU legal system is close to being price-fixing as a conduct restricting competition, and the incumbents applying these may be accused of abuse of a dominant position.

In this situation, it seems that some Member States and authorities alone are not enough to enforce the EU directives, so a more active role would be needed from the EU institutions. Similarly, in the next rounds of the negotiations of international trade agreements a more united EU approach is called for.

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