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SUPREME COURT REJECTS "PRICE SQUEEZE" CLAIMS

On February 25, 2009, the Supreme Court further limited the circumstances in which the antitrust laws compel a firm to assist its competitors. In *Pacific Bell Telephone Co. d/b/a AT&T California* v. *linkLine Communications, Inc.*, No. 07-512, slip op. (Feb. 25, 2009), the Court held that § 2 of the Sherman Act does not reach "price squeezes" in settings where there is no "antitrust duty to deal." In this setting, a firm with monopoly power at the wholesale level cannot be attacked for selling wholesale inputs to its rivals at high prices and selling products at retail so low that the unintegrated rival lacks sufficient margin to compete. In so holding, the Court (1) overturned the 65-year-old seminal decision in *United States* v. *Aluminum Co. of America*, 148 F. 2d 416 (2d Cir. 1945), and (2) extended the Court's recent decision in *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

A. BACKGROUND

Defendant AT&T provides digital subscriber line (DSL) Internet service to customers in California and owns the key facilities—including "last-mile" connections—that are needed to provide that service. Slip Op. at 2. The Federal Communications Commission (FCC) required AT&T, as a condition for a recent merger, to provide wholesale DSL transport service to independent service providers (ISPs) "at a price no greater than the retail price of AT&T's DSL service." *Id.* AT&T also sells DSL service to end-consumers at retail, thereby participating in the DSL market at both the wholesale and retail levels. *Id.* at 2-3.

Plaintiffs, including linkLine, are ISPs that lease DSL transport service from AT&T in the wholesale DSL transport market and compete with AT&T in the retail DSL market. *Id.* They alleged that AT&T violated § 2 of the Sherman Act by exercising its monopoly power in the wholesale DSL market to drive them out of the retail DSL market in California. *Id.* at 3. Specifically, they alleged that AT&T "squeezed their profit margins" by charging them unreasonably high wholesale prices for DSL transport while concurrently charging retail customers unreasonably low prices for DSL Internet services—a "maneuver" that "allegedly 'exclude[d] and unreasonably impede[d] competition,' thus allowing AT&T to 'preserve and maintain its monopoly control of DSL access to the Internet.'" *Id.* (quoting App. 18-19).

Soon after the Supreme Court decided *Trinko* and "held that a firm with no antitrust duty to deal with its rivals at all is under no obligation to provide those rivals with a

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'sufficient' level of service," AT&T moved for judgment on the pleadings on the ground that *Trinko* barred the plaintiffs' claims. *Id.* at 3 (citing *Trinko,* 540 US at 410). The district court concluded that AT&T had no antitrust duty to deal with the plaintiffs, but denied AT&T's motion concerning the price-squeeze claims. *Id.*

On interlocutory appeal, the Ninth Circuit, by a 2-1 decision, affirmed the district court's decision. *Id.* at 4. The majority held that a traditional price-squeeze claim is actionable post-*Trinko* where there is a showing of specific intent to monopolize. Judge Gould dissented on the ground "that the plaintiffs' complaint did not satisfy [the *Brooke Group*] requirements because it contained no allegations that the retail price was set below cost and that those losses [occasioned by selling below cost] could later be recouped."[1] *Id.* at 4-5.

The Court had not addressed price-squeeze claims prior to *linkLine*, but, in a celebrated decision issued over six decades ago, Judge Learned Hand, writing for the Second Circuit, first established the elements that a plaintiff must prove to prevail on a price-squeeze claim under § 2 of the Sherman Act. *See Alcoa*, 148 F. 2d at 416-38.[2] Since *Alcoa*, the circuits have taken vastly different approaches in analyzing price-squeeze claims. *See Town of Concord* v. *Boston Edison Co.*, 915 F. 2d 17, 23-29 (1st Cir. 1990) (Breyer, J.) (holding that a price squeeze occurring in a *fully regulated* industry generally will not violate § 2); *but see City of Anaheim* v. *Southern Cal. Edison Co.*, 955 F. 2d 1373, 1377-78 (9th Cir. 1992) (holding that full regulatory oversight does not automatically bar price-squeeze claims).

1 Specifically, under *Brooke Group,* a plaintiff alleging a predatory pricing claim must show that (1) the defendant's prices are below an appropriate measure of cost and (2) the defendant had a "dangerous probability" of recouping its investment in below-cost prices. *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 US 209, 222-24 (1993).

2 These elements include: (1) the defendant firm has a monopoly power over a particular product; (2) its wholesale price for that product is "higher than a 'fair price'"; (3) that product must compete in a second (downstream) market where the defendant itself competes; and (4) the defendant's price in the downstream market is so low that competitors cannot match it and still earn a "living profit." *Alcoa*, 148 F. 2d at 437-38. *Alcoa* is deemed to have precedential value because the Supreme Court certified the case to a Second Circuit panel when the Supreme Court did not have sufficient quorum to hear the case. *See Am. Tobacco Co.* v. *United States*, 328 US 781, 812-13 & n.10 (1946).

Moreover, after the Supreme Court decided *Trinko*—which dealt with a refusal to deal with respect to the quality of service as opposed to a price term—it was unclear whether that decision limited or precluded price-squeeze claims based solely on margin between wholesale and retail prices. Thus, the circuits were split on their application of *Trinko* to price-squeeze claims. *Compare Pacific Bell Tel. Co.* v. *linkLine Communications*, *Inc.*, 503 F.3d 876, 883 (9th Cir. 2007) (post-*Trinko* price-squeeze claims cognizable where there is a showing of specific intent to monopolize); *with Covad Communications Co.* v. *BellSouth Corp.*, 374 F. 3d 1044, 1050 (11th Cir. 2004) (plaintiff's post-*Trinko* price-squeeze allegations remained viable, but only because they met the *Brooke Group* requirements for showing price predation); *Covad Communications Co.* v. *Bell Atlantic Corp.*, 398 F. 3d 666, 673-74 (D.C. Cir. 2005) (post-*Trinko* price-squeeze claims based solely on the margin between wholesale and retail prices are not viable under Section 2).

B. THE COURT'S OPINION

1. Overruling Alcoa and Barring Price-Squeeze Claims Where There Is No Antitrust Duty to Deal

The Court held that, absent a duty to deal arising under the antitrust laws, it is not a violation of § 2 of the Sherman Act for a dominant firm to set its wholesale and retail prices so as to squeeze an unintegrated rival out of the market. Slip Op. at 8-12, 16. The only question in this setting is whether the retail price, considered on its own, is below cost. *Id.* The Court considered the argument that "price-squeeze claims have been recognized by Circuit Courts for many years, beginning with Judge Hand's opinion in [*Alcoa*]." *Id.* at 12 n.3. But it politely overruled *Alcoa*, concluding that "[g]iven developments in economic theory and antitrust jurisprudence since *Alcoa*, we find our recent decisions in *Trinko* and *Brooke Group* more pertinent to the question before us." *Id.*

Under the Court's two-step holding, the first inquiry is whether there is an *antitrust* duty to deal. *Id.* at 8-9 & n.2. This is distinct from a duty to deal created by, for example, a *non-antitrust* statute like the Telecommunications Act of 1996 (as in *Trinko*) or by an administrative agency's consent decree. The Court assumed that "any duty to deal

[in *linkLine*] arose only from FCC regulations." *Id.* at 8 n.2; *see also id.* at 9 ("In this case, as in *Trinko*, the defendant has no antitrust duty to deal with its rivals at wholesale; any such duty arises only from FCC regulations, not from the Sherman Act.").

Once it has been determined that there is no antitrust duty to deal, the next inquiry is whether the antitrust defendant's wholesale price is too high and whether the retail price is too low in light of *Brooke Group* and *Trinko*. *Id.* at 8-12. With respect to the plaintiffs' claim that AT&T's wholesale price was "too high," the Court held that "[a] straightforward application of our recent decision in *Trinko* forecloses any challenge to AT&T's *wholesale* prices." *Id.* at 9. The Court had difficulty perceiving a situation in which the wholesale price would be too high, since, as the Court stated, allowing lawful monopolists to reap monopoly profits is lawful and, indeed, likely procompetitive. *Id.* at 10-12, 15.

As to the plaintiffs' assertion that AT&T's retail prices are "too low," the Court said that "plaintiffs' claims find no support in our existing antitrust doctrine," holding that a retail price is too low only if it is below cost under *Brooke Group*. *Id.* at 10-11. Reciting its earlier statement that "'cutting prices in order to increase business often is the very essence of competition,'" the Court reasoned that "[i]n cases seeking to impose antitrust liability for prices that are too low, mistaken inferences are 'especially costly, because they chill the very conduct the antitrust laws are designed to protect.'" *Id.* at 11 (quoting *Matsushita Elec. Industrial Co.* v. *Zenith Radio Corp.*, 475 US 574, 594 (1986), and citing *Brooke Group*, 509 US at 226; *Cargill, Inc.* v. *Monfort of Colo., Inc.*, 479 US 104, 121-22 n.17 (1986)); *see also id.* at 14-15 ("[T]he Sherman Act does not forbid—indeed, it *encourages*—aggressive price competition at the retail level, as long as the prices being charged are not predatory.") (citing *Brooke Group*, 509 US at 223-24).

The Court concluded that:

> Plaintiffs' price-squeeze claim, looking to the relation between retail and wholesale prices, is thus nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level. If there is no duty to deal at the wholesale level and no predatory pricing at the retail level, then a firm is certainly not required to price *both* of these services in a manner that preserves its rivals' profit margins.

Id. at 12. The Court further found that "[i]f both the wholesale price and the retail price are independently lawful, there is no basis for imposing antitrust liability simply because a vertically integrated firm's wholesale price happens to be greater than or equal to its retail price." *Id.* at 15. The Court thus concluded that it "need [not]…endorse a new theory of liability" advocated by the plaintiffs. *Id.*

Under the Court's holding, there is never a need to analyze the margin between wholesale and retail prices. Reasoning that there was no "independent competitive harm caused by price squeezes above and beyond the harm that would result from a duty-to-deal violation at the wholesale level or predatory pricing at the retail level," the Court concluded that "[t]o the extent a monopolist violates one of these doctrines, the plaintiffs have a remedy under existing law." *Id.* at 15 (citing 3A P. Areeda & H. Hovenkamp, Antitrust Law ¶767c, at 126 (2d ed. 2002)). The Court was not concerned that a downstream firm that is as efficient as the integrated monopolist might be squeezed out of the market, because the effect of the squeeze would be indistinguishable from the result if the integrated monopolist, which faced no antitrust duty to deal, simply refused to sell the input to its downstream rival. *Id.* at 10 ("[A] firm with no duty to deal in the wholesale market has no obligation to deal under terms and conditions favorable to its competitors. If AT&T had simply stopped providing DSL transport service to the plaintiffs, it would not have run afoul of the Sherman Act."); *see also id.* at 15 ("[I]t is difficult to see any competitive significance [of a price squeeze] apart from the consequences of vertical integration itself.") (quoting 3A P. Areeda & H. Hovenkamp, Antitrust Law ¶767c, at 126).

The Court was also wary of judicial policing of unilateral pricing conduct: "Institutional concerns also counsel against recognition of [price-squeeze] claims" in view of

"the importance of clear rules in antitrust laws." *Id.* at 12.[3] Given the complex, fluid factors involved in determining what is considered a "fair price" or "living profit" relevant to a price-squeeze claim, the Court concluded that " '[c]ourts are ill suited 'to act as central planners, identifying the proper price, quantity, and other terms of dealing.' " *Id.* at 12 (quoting *Trinko*, 540 US at 408); *see also id.* at 13 ("Recognizing price-squeeze claims would require courts simultaneously to police both the wholesale and retail prices to ensure that rival firms are not being squeezed. And courts would be aiming at a moving target, since it is the *interaction* between these two prices that may result in a squeeze.").

2. *Extending the Court's Holding Concerning Refusals to Deal in Trinko*

The refusal to deal at issue in *Trinko* involved a *nonprice* term, because the plaintiffs in *Trinko* challenged the quality of Verizon's interconnection service. Slip Op. at 10. The Court in *linkLine* extended *Trinko* to preclude claims involving refusals to deal with respect to price terms, thereby further narrowing the circumstances under which a monopolist can face antitrust liability for unilaterally refusing to aid its competitors. *Id.* ("[F]or antitrust purposes, there is no reason to distinguish between price and nonprice components of a transaction.").

In *United States* v. *Colgate & Co.*, 250 US 300, 307 (1919), a Section 1 case, the Court held that "[i]n the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal." The Court had quoted this language in finding a refusal to deal unlawful in *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp.*, 472 U.S. 585, 602 (1985), a Section 2 case.

3 The Department of Justice (DOJ) and the Federal Trade Commission (FTC) took different positions on linkLine's claim, with the DOJ supporting AT&T's petition for *certiorari* and filing an amicus brief in support of AT&T at the merits stage, while the FTC refused to join the DOJ's brief supporting the petition. *See* Statement of the Federal Trade Commission, Petition for a Writ of Certiorari in *Pacific Bell Telephone Co. d/b/a AT&T California* v. *linkLine Communications, Inc.* (No. 07-512), (opposing the DOJ's petition and characterizing the Ninth Circuit's decision as "unquestionably correct").

In *Trinko*, the Court rejected antitrust liability for a unilateral refusal to deal, selectively quoting from *Colgate* by dropping the introductory clause ("in the absence of any purpose to create or maintain a monopoly"). *Trinko*, 540 U.S. at 407. *linkLine* makes clear that the selective quotation of *Colgate* in *Trinko* was intentional, again relying on *Colgate* as support for the proposition that "*[a]s a general rule*, businesses are free to choose the parties with whom they will deal, as well as the prices, terms, and conditions of that dealing. . . . But there are *rare instances* in which a dominant firm may incur antitrust liability for purely unilateral conduct." Slip Op. at 7-8 (citing *Colgate*, 250 US at 307) (emphasis added).

Thus, in *linkLine*, as in *Trinko*, the Court has made clear that even if a firm acts with a purpose to create or maintain a monopoly, the Sherman act does not, *except in rare instances*, restrict the right of the firm to select its customers and set its terms.

C. THE IMPACT OF LINKLINE

The bright-line rule in *linkLine* is clearly favorable to firms that allegedly possess monopoly power or a dangerous probability of obtaining such power. The *linkLine* decision provides dominant firms having no antitrust duty to deal with wider discretion in selecting their customers and setting their (price and nonprice) terms in dealing with rivals. *See* Slip Op. at 11 ("Recognizing a price-squeeze claim where the defendant's retail price remains above cost would invite the precise harm we sought to avoid in *Brooke Group*: Firms might raise their retail prices or refrain from aggressive price competition to avoid potential antitrust liability.") (citing *Brooke Group*, 509 US at 223).

Through *linkLine*, the Court continues the trend of being hostile to attempts to use the antitrust laws to compel firms to act contrary to their economic self-interest, at least when the conduct in question is unilateral. The Court thus seeks further to minimize false positives involving unilateral pricing conduct. The Court's decision also reaffirms the pillar of antitrust policy that the antitrust laws are intended to protect competition, not competitors, and reflects considerable deference to both modern economic theories and concerns about judicial competence in policing unilateral pricing conduct.

After *linkLine*, standalone antitrust claims under a price-squeeze theory will be very difficult to bring. Such claims are viable only if it can be shown that the defendant has an antitrust duty to deal with the plaintiff in the wholesale market—a duty which, as distinct from, for example, a statutory or regulatory duty, arises only under rare circumstances—or the defendant charges predatory prices (i.e., prices below cost) in the retail market. This is likely to be a significant hurdle.

If you would like more information about the linkLine decision, please contact your Arnold & Porter attorney or:

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