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The Supreme Court Puts the Squeeze on "Price Squeeze" Claims

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This morning, in *Pacific Bell Telephone Co. v. linkLine Communications, Inc.*, Case No. 07-512,[1] the Supreme Court wove together multiple strands of recent antitrust precedent, and announced a clear rule relating to "price squeeze" claims. A price squeeze occurs when a vertically integrated firm that possesses monopoly power in a wholesale market simultaneously raises the wholesale price of inputs and cuts the retail price of its products, thus "squeezing" the profit margins of its retail rivals. In *linkLine*, the Court held that where a firm has no antitrust duty to deal with its rivals at the wholesale level and does not engage in predatory pricing at the retail level, the antitrust laws do not require it to price its products in a manner that preserves its rivals' profit margins.

Key Implications

The *linkLine* decision is important because:

- **The decision further circumscribes the kinds of unilateral business conduct that may subject a firm to liability under Section 2 of the Sherman Act**. The Court observes that there are "rare instances in which a dominant firm may incur antitrust liability for purely unilateral conduct," and "limited circumstances in which a firm's refusal to deal with its rivals can give rise to antitrust liability."[2] The Court then narrows the circumstances in which a "price squeeze" may give rise to liability, finding that "developments in economic theory and antitrust jurisprudence" make its own recent Section 2 precedent "more pertinent to the question before us" than the Second Circuit's 1945 decision in *Alcoa* and other lower court decisions involving price squeezes.[3]
- **The decision instructs lower courts to be particularly wary of claims based on allegations that a competitor's prices are too low**. The Court reiterates its concern that the recognition of such claims "would invite the precise harm we sought to avoid in [cases alleging predatory pricing such as] *Brooke Group*: Firms might raise their retail prices or refrain from aggressive price competition to avoid potential antitrust liability."[4]
- **The decision warns lower courts not to entertain antitrust claims that would require them to become business regulators**. The Court emphasizes that "[c]ourts are ill suited 'to act as central planners, identifying the proper price, quantity, and other terms of dealing,'" and concludes that "[t]he problem should be deemed irremedia[ble] by antitrust law" when the remedy would require a court to assume this role.[5]

Background and Summary

The *linkLine* case involved monopolization claims under Section 2 of the Sherman Act made by independent internet service providers ("ISPs") against Pacific Bell Telephone Co. ("AT&T"). Specifically, the ISPs alleged that AT&T "squeezed" their profit margins by raising the wholesale price of DSL services sold to the ISPs (who, in turn, resold those services to retail customers in competition with AT&T) and simultaneously reducing the price that AT&T charged retail customers for the same service.

In essence, the Supreme Court found that the ISPs were making two allegations in one – *first*, that the wholesale price offered by AT&T to the ISPs was too high, and *second*, that the retail price offered by AT&T to its retail customers was too low. The Court tackled each part of the ISPs' claim separately and found that neither states a cause of action under the Court's existing antitrust precedent. The Court reasoned that the ISPs could not "join a wholesale claim that cannot succeed with a retail claim that cannot succeed, and alchemize them into a new form of antitrust liability never before recognized by this Court."[6]

Discussion and Analysis

The Court grounds its decision on core antitrust principles from its recent Section 2 jurisprudence – most importantly, that "businesses are free to choose the parties with whom they will deal, as well as the prices, terms, and conditions of that dealing,"[7] and that "[l]ow prices benefit consumers regardless of how those prices are set . . . so long as they are above predatory levels, they do not threaten competition."[8]

The Court first considered the relationship between AT&T and the ISPs at the wholesale level. As in its 2004 decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*,[9] the Court found that AT&T had no antitrust duty to deal with its rivals at the wholesale level (based on the record, the Court concluded that "any duty to deal arose only from FCC regulations"). In *Trinko*, the Court held that a firm that has no antitrust duty to deal with its rivals is under no obligation to provide those rivals with a sufficient level of service. This reasoning, it found, applied with equal force in *linkLine* – since AT&T was not under any antitrust obligation to sell its DSL services to the ISPs in the first place, it certainly "was not required to offer this service at the wholesale prices the plaintiffs would have preferred."[10]

At the retail level, the Court again found that its existing antitrust precedent provides the standard against which the lawfulness of AT&T's retail pricing conduct should be measured. Emphasizing that "cutting prices in order to increase business often is the very essence of competition,"[11] the Court concluded that the lawfulness of AT&T's retail pricing must be judged under the predatory pricing test it announced in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.* Under that test, a defendant is guilty of predatory pricing only if (1) the prices complained of are below an appropriate measure of the defendant's costs, and (2) there is a "dangerous probability" that the defendant will later be able to raise the price above the competitive level, thereby recouping its "investment" in below-cost prices.[12]

The ISPs' price squeeze claim, in the Court's opinion, was "nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level."[13] Where both the wholesale price and the retail price are lawfully established, the Court concluded, there can be no antitrust liability simply because the combination of those prices "squeezes" the profit margins of its rivals.[14]

The Court left it to the District Court to determine whether the ISPs could make out a predatory pricing claim under *Brooke Group*, but cautioned that such a claim may not survive a motion to dismiss, "[f]or if AT&T can bankrupt the plaintiffs by refusing to deal altogether, the plaintiffs must demonstrate why the law prevents AT&T from putting them out of business by pricing them out of the market."[15]

Footnotes

[1] The Slip Opinion is available at: http://www.supremecourtus.gov/opinions/08pdf/07-512.pdf.

[2] Slip Op. at 7-8.

[3] Slip Op. at 12 n.3.

[4] Slip Op. at 11.

[5] Slip Op. at 12 (quoting *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408, 415 (2004)).

[6] Slip Op. at 17.

[7] Slip Op. at 7 (referencing *United States v. Colgate*, 250 U.S. 300, 3037 (1919)).

[8] Slip Op. at 11 (quoting *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990)).

[9] 540 U.S. 398 (2004).

[10] Slip Op. at 10.

[11] *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

[12] *Brooke Group*, 509 U.S. 209, 222-224 (1993).

[13] Slip Op at 12.

[14] Slip Op. at 15.

[15] Slip Op. at 16-17.

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