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Implications Of Pacific Bell V. LinkLine

Law360, New York (March 31, 2009) -- In Pacific Bell Telephone Co. dba AT&T California v. LinkLine Communications Inc., 129 S. Ct. 1109 (Feb. 25, 2009), the United States Supreme Court held that a “price squeeze” claim is not a valid basis for relief under Section 2 of the Sherman Act.

In the process, the Supreme Court resolved a split among the federal Courts of Appeals, extended its own holdings in two recent antitrust decisions and partially overturned a long-standing antitrust precedent on the basis of developments in economic theory.

Background

A price squeeze occurs when an integrated firm with market power in a wholesale, or “upstream,” market attempts to gain an advantage over its retail, or “downstream,” competitors by raising the price of its wholesale offerings while cutting the price of its products or services at retail.

In LinkLine, the plaintiffs were four Internet Service Providers (“ISPs”) who lease wholesale digital subscriber line (“DSL”) services from AT&T. DSL is a form of high-speed Internet access that utilizes telephone lines as a means of transmitting data.

According to the plaintiffs’ allegations, AT&T controls the lines that connect homes and businesses in California to the telephone network, giving it a monopoly over wholesale DSL “transport” services. AT&T also competes in the retail DSL market.

The plaintiffs alleged that AT&T engaged in a price squeeze by setting the price of its wholesale DSL services so high, and the price of its retail DSL services so low, that standalone ISP competitors were unable to make a profit in the retail market.

The Supreme Court rejected the idea that price squeeze allegations, standing alone, are sufficient to state a claim under Section Two of the Sherman Act.

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To state a claim, a plaintiff is required to show either that its integrated competitor had an antitrust duty to deal — i.e., an independent legal obligation to sell to rivals — at the wholesale level, or that the competitor's prices were predatory — i.e., below an appropriate measure of cost — at the retail level.

Absent such a showing, an integrated firm cannot be found liable for refusing to deal with its downstream competitors on terms that are "fair" or that enable such competitors to operate profitably — even where the integrated firm has a monopoly in the upstream market.

This result, the court concluded, was compelled by its decisions in Verizon Communications Inc. v. Law Offices of Curtis V. Trinko LLP, 540 U.S. 398 (2004), which held that but for a few narrowly defined exceptions, there is no duty to aid competitors under the antitrust laws, and Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993), which defined predatory pricing as charging prices that are below cost, where there is a dangerous probability that the predator will recoup the profits it loses from such prices.

Where a defendant's upstream practices are not a basis for liability under Trinko and its downstream practices are not a basis for liability under Brooke Group, the court concluded that no amalgamation of the two can serve as a basis for liability on the theory that it constitutes a "price squeeze."

As the court succinctly put it: "Two wrong claims do not make one that is right."

Price Squeeze Claims Before and After Trinko

Price squeeze allegations are not a new development in antitrust law.

In United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945) ("Alcoa"), the plaintiffs alleged that Alcoa, the defendant, had "squeezed" competitors in the "aluminum sheet" market by selling them aluminum ingot — the material used to manufacture sheet — at such a high wholesale price that they were unable to make "a living profit" by charging the same retail prices Alcoa itself charged downstream customers for sheet.

Alcoa had a monopoly in the upstream ingot market, though not in the downstream sheet market even though it was the largest maker of aluminum sheet.

In an opinion by Judge Learned Hand, the Second Circuit Court of Appeals observed that it was "unquestionabl[y]" an unlawful exercise of Alcoa's monopoly power in the ingot market "to set the price of 'sheet' so low and hold the price of ingot so high."[1]

Given its manufacturing costs, moreover, the court found that the price Alcoa was charging for ingot "must be regarded as higher than a 'fair price.'"[2]

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And although Alcoa had not attempted to monopolize the sheet market, the court held that it was nonetheless unlawful for it to exercise its monopoly power in the ingot market by implementing the price squeeze.

Citing Alcoa, the Ninth Circuit Court of Appeals in LinkLine noted that “[f]or over six decades, federal courts have recognized price squeeze allegations as stating valid claims under the Sherman Act.”[3]

Nevertheless, the court confronted the question of whether the Supreme Court’s decision in Trinko barred a plaintiff from claiming a Sherman Act Section Two violation on the basis of price squeeze allegations, where the alleged perpetrator of the price squeeze had no duty to deal with the plaintiff under the antitrust laws.

In Trinko, the Supreme Court held that a monopolist that, absent statutory compulsion, has no duty to deal with its rivals is not required to provide services to its rivals on any particular terms or conditions.

The Court of Appeals in LinkLine emphasized that Trinko did not involve a price squeeze theory and that such a theory “formed part of the fabric of traditional antitrust law prior to Trinko.”[4]

This conclusion was consistent with that reached by the Eleventh Circuit in 2004, just after Trinko was decided, but inconsistent with that reached by the District of Columbia Circuit in 2005, in decisions that also involved price squeeze allegations in the DSL industry.[5]

The Supreme Court reversed the Ninth Circuit, holding that Trinko foreclosed any challenge to AT&T’s wholesale pricing decisions or to the impact of such decisions on downstream competitors.

The court explained that Trinko “makes clear that if a firm has no antitrust duty to deal with its competitors at wholesale, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous.”[6]

In LinkLine, as in Trinko, “the plaintiffs alleged that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market. Trinko holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal.”[7]

Nor could plaintiffs support a claim for liability on the basis that AT&T’s pricing at the retail level was “too low.” “Cutting prices in order to increase business,” the court noted, “often is the very essence of competition.”[8]

Accordingly, AT&T’s retail prices could only be challenged if they were predatory under the standard set forth in Brooke Group, and plaintiffs had not alleged a predatory pricing claim in their original complaint.

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The Court's Departure from Alcoa

In a footnote, the LinkLine court acknowledged that a price squeeze claim had been upheld in Alcoa, but observed that more recent "developments in economic theory and antitrust jurisprudence" made the court's decisions in "Trinko and Brooke Group more pertinent to the question before us."[9]

The court's comments were directed to the aspect of Alcoa that held that price squeezes were "unquestionabl[y]" unlawful. But the implications of the court's decision in LinkLine, together with Trinko, arguably suggest a broader departure from Alcoa.

Judge Hand's opinion in Alcoa is often cited for the proposition that a monopoly acquired by virtue of one competitor's "superior skill, foresight and industry" does not, by its mere existence, amount to a violation of the Sherman Act: "The successful competitor, having been urged to compete, must not be turned upon when he wins."[10]

At the same time, the court emphasized that in passing the Sherman Act Congress "did not condone 'good trusts' and condemn 'bad' ones; it forbad all."[11]

Given Alcoa's overwhelming share of the aluminum ingot market, which the court held amounted to monopoly power, the court found that "the plaintiff had gone far enough": it was left to the defendant to prove that it had not abused such power.

In Trinko, the Supreme Court echoed the sentiment that Section Two requires a demonstration of "'the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen or historic accident.'"[12]

But the court also observed that "[t]he mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system."[13]

In doing so, the court implicitly rejected Alcoa's premise that an upstream monopolist may be constrained in its dealings with downstream competitors by an objective notion of a "fair price."

Viewed in this light, the court's footnote in LinkLine merely confirmed what Trinko had already established — that Section Two of the Sherman Act does not impose a restraint on the price, terms, or other conditions on which a firm voluntarily chooses to deal with its rivals, even where that firm is a monopolist.

Whereas the Alcoa court framed its result as being compelled by what Congress intended in passing the Sherman Act, the LinkLine court took recent "developments in economic theory and antitrust jurisprudence" as its guide — reflecting a "common law" approach to interpreting the antitrust laws that is also embodied in other recent Supreme Court decisions.[14]

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Applying Twombly in the Section Two Context

As the court in LinkLine acknowledged, there were several procedural irregularities to the case — some of which provoked the argument, set forth in a concurrence, that it was improper for the court to reach the merits of plaintiffs' price squeeze theory.

Notably, the plaintiffs themselves abandoned that theory prior to argument before the Supreme Court, choosing instead to pursue a predatory pricing claim which the court eventually held could survive its ruling.

In fact, before the case even reached the high court, the plaintiffs had already made their predatory pricing claim the basis for an amended pleading, which the district court determined satisfied the requirements of Brooke Group.

The Supreme Court nonetheless remanded the case for further consideration of whether plaintiffs' amended complaint was sufficient to survive a motion to dismiss. The rationale for the remand was twofold.

First, the issue of whether plaintiffs' amended complaint adequately stated a claim for predatory pricing was not before the court of Appeals and thus was not a part of the question presented to the Supreme Court.

Second, the district court's order upholding that claim was issued before the Supreme Court's decision in Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007) and was based on the "no set of facts" pleading standard that the court in Twombly rejected as being too lenient.

Accordingly, the court left it "for the District Court on remand to consider whether the amended complaint states a claim upon which relief may be granted in light of the new pleading standard we articulated in Twombly."[15]

LinkLine marks the first time that the Supreme Court has held that the pleading standard set forth in Twombly — which held that plaintiffs alleging conspiracy claims under Section One of the Sherman Act must allege "enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement" — also applies to Section Two allegations. That holding resolves what had been another open issue in the lower courts.

Implications for Future Cases

The Supreme Court's decision in LinkLine is particularly important for any firm that sells both an input at wholesale and a finished product at retail. The court foreclosed competitors of such firms from asserting price squeeze theories as a basis for Section Two liability.

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The court also clarified that challenges to an integrated firm's high wholesale prices cannot survive where the firm has no antitrust duty to deal with competitors, and that challenges to an integrated firm's low retail prices can only survive where they meet the criteria for predatory pricing set forth in Brooke Group.

Finally, the court established that Section Two plaintiffs, like Section One plaintiffs, must meet the more stringent pleading standards set forth in Twombly in order to survive a motion to dismiss.

Given these hurdles, the LinkLine decision may mean that in regulated industries such as telecommunications, would-be plaintiffs will increasingly turn their efforts to administrative bodies, such as the Federal Communications Commission, rather than bringing challenges to their competitors' pricing under the Sherman Act.

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[1] 148 F.2d at 438.

[2] Id.

[3] LinkLine Commcn's Inc. v. SBC Calif. Inc., 503 F.3d 876, 880 (9th Cir. 2007).

[4] 503 F.3d at 883.

[5] Covad Commcn's Co. v. Bell South Corp., 374 F.3d 1044 (11th Cir. 2004); Covad Commcn's Co. v. Bell Atlantic Corp., 398 F.3d 666 (D.C. Cir. 2005), reh'g denied, 407 F.3d 1220 (D.C. Cir. 2005).

[6] 129 S. Ct. at 1119.

[7] Id.

[8] Id. at 1120.

[9] Id. at 1120 n.3.

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[10] 148 F.2d at 430.

[11] Id. at 427.

[12] 540 U.S. at 407 (quoting United States v. Grinnell Corp., 384 U.S. 563 (1966)).

[13] Id.

[14] See Leegin Creative Leather Prods. Inc. v. PSKS Inc., 127 S. Ct. 2705, 2720 (2007) ("Just as the common law adapts to modern understanding and greater experience, so too does the Sherman Act's prohibition on 'restraint[s] of trade' evolve to meet the dynamics of present economic conditions.").

[15] 129 S. Ct. at 1123.

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