

Client Alert

A report
for clients
and friends
of the Firm March 2009

LinkLine: Little Room Left for Price Squeeze Claims

The Supreme Court ruled last week that “price squeeze” claims cannot be brought under the federal antitrust laws unless the defendant firm has a separate antitrust duty to deal with the plaintiffs in the first place. *Pacific Bell Tel. Co. v. LinkLine Communications, Inc.*, 555 U.S. __ (2009). This ruling overturns long-established appellate court precedent and effectively abolishes price squeeze liability as an independent basis for bringing antitrust claims against dominant vertically integrated firms. The decision also highlights the Supreme Court’s recent trend toward giving firms more room under the antitrust laws to take unilateral action against rivals without fear of liability.

What Is a Price Squeeze Claim?

A “price squeeze” occurs when a vertically integrated firm operates in wholesale and retail markets, has market power in the wholesale market, and uses that power to raise the prices it charges for wholesale inputs while, at the same time, cutting the price it charges for its own finished goods at retail. This has the effect of squeezing the profit margins of any rivals in the retail market, who are forced to purchase inputs at the higher wholesale prices, and compete for customers against the lower retail prices. This unilateral pricing behavior may constitute anticompetitive conduct under Section 2 of the Sherman Act (so the price squeeze theory goes) if the rival firms are no longer able to compete effectively, thereby allowing the defendant firm to extend its market power from the wholesale to the retail market. Federal courts have recognized some form of price squeeze claim as a basis for antitrust liability for over sixty years, starting with the Judge Hand’s fundamental decision in *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) (“Alcoa”). Although price squeeze claims have been upheld by

various federal district and appellate courts since then, the Supreme Court has not expressly considered the viability of such claims until now.

Background

Prior to 2005, the Federal Communications Commission required local phone companies to provide access to their networks and equipment to independent Internet Service Providers (“ISPs”), so that the ISPs could offer DSL internet service to their customers (in competition with the phone companies). Although this requirement has generally been lifted, Pacific Bell/AT&T was required as a condition of a recent merger to continue to provide its transmission service to ISPs at a reasonable price. Four ISPs in California brought suit alleging that AT&T was squeezing them out of the retail market for DSL access to the internet by hiking the wholesale prices it charged for its transmission service (and on which the ISPs depended in order to reach consumers), while simultaneously cutting the price of its own retail DSL service. The plaintiffs alleged that, separate and apart from the FCC’s requirements, AT&T’s price squeezing behavior ran afoul of the antitrust laws because it prevented the plaintiffs from effectively competing against AT&T, thus allowing AT&T to monopolize the market for DSL internet access.

The Court Extends *Trinko* To Abolish Price Squeeze Claims

After the plaintiff ISPs filed their complaint, the Supreme Court issued its landmark decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004). In that case, the Court held that while the defendant Verizon was obligated to share its phone network with its competitors under federal communications law, it had no separate duty under the antitrust laws to provide a “sufficient” level of network service to those competitors. Although the Court noted that in rare circumstances a dominant firm may be liable under the antitrust laws for refusing to deal with competitors, no such duty existed in *Trinko*, in part because Verizon was already dealing with the plaintiffs pursuant to federal regulations.

After *Trinko* was decided, AT&T argued that the same reasoning should preclude LinkLine's price squeezing claims against it: because AT&T had no independent antitrust duty to deal with the plaintiff ISPs (its only duty was under the FCC regulations), it could not be liable to the ISPs for raising prices on the transmission service. The district and circuit courts rejected this argument, finding that price squeeze claims had a long history in the case law, and that *Trinko* did not specifically address the viability of such claims. AT&T then appealed to the Supreme Court.

Although the Court's decision to reverse was unanimous, the justices split on the analysis. A 5-person majority found that the *Trinko* analysis also barred claims alleging that wholesale prices being charged to competitors were too high, absent an independent duty to deal with those competitors under the antitrust laws. The Court reasoned that because AT&T would not have faced antitrust liability if it had simply stopped selling transmission service to its competitors (although it was required by the FCC to provide the service), it could not be liable under the same laws for selling the transmission service at too high a price. The Court also found that the plaintiff ISPs could only complain about AT&T's retail prices being too low if they could meet the predatory pricing standard in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), which would require a showing that AT&T priced its retail service below its costs, and that it intended to recoup its profits after driving the plaintiffs from the market.

The decision thus effectively abolishes price squeeze claims as an independent ground of liability under the antitrust laws: in order to challenge too-high wholesale prices, plaintiffs now must prove that the defendant firm had an antitrust duty to sell the wholesale service to its competitors in the first place (which requires a showing of monopoly power, among other things); and to challenge too-low retail prices, plaintiffs need to make a predatory pricing claim under *Brooke Group*.

Greater Leeway for Single-Firm Conduct

The decision is significant not only because it gets rid of a long-standing ground of liability for single-firm conduct under Section 2 of the Sherman Act, but because it highlights the Supreme Court's recent trend toward allowing firms greater leeway to take unilateral action against rivals without fear of antitrust scrutiny, a trend which includes the Court's decision in *Trinko*, as well as *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. ____ (2007) (abolishing the rule of *per se* illegality for resale price maintenance agreements). A majority of the Court in this case had no trouble dispensing with years of case law from the federal courts — including the *Alcoa* case, which has long served as a foundation for much of the case law governing single-firm conduct under Section 2 — holding 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.” *LinkLine*, at p. 12 n.3. The majority also expressed a particular concern with making sure firms have “clear rules” to govern their conduct, including safe harbors within which they know their conduct will be insulated from antitrust review. *Id.* at 12-13.

Concurring Justices Base Decision on Narrower Grounds

Note, however, that four justices (Breyer, Stevens, Souter and Ginsburg) concurred only in the result, refusing to accept the more sweeping reasoning of the majority and instead finding that plaintiffs had abandoned their price squeeze claim. The concurrence urges restraint before taking on long-established antitrust concepts of liability. This more moderate approach may raise questions as to whether the Court will continue to push through far-reaching changes to the analysis of single-firm conduct under the antitrust laws.

BOCA RATON • BOSTON • CHICAGO • HONG KONG
LONDON • LOS ANGELES • NEWARK • NEW ORLEANS
NEW YORK • PARIS • SÃO PAULO • WASHINGTON, D.C.

Client Alert

The Antitrust and Trade Regulation Practice Group at Proskauer Rose LLP litigates on behalf of plaintiffs and defendants, and counsels clients in all areas of antitrust law, including Hart-Scott-Rodino Act compliance in mergers and acquisitions.

For more information, please contact:

Colin A. Underwood

212.969.3350 — cunderwood@proskauer.com

Noah Siskind Gitterman

212.969.3727 — ngitterman@proskauer.com

Proskauer Rose is an international law firm that handles a full spectrum of legal issues worldwide.

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

© 2009 PROSKAUER ROSE LLP. All rights reserved. Attorney Advertising.

You can also visit our Website at www.proskauer.com