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Supreme Court Rejects Antitrust Price Squeeze Theory

Pacific Bell Telephone Co. v. linkLine Comm. Inc., No. 07-512, 555 U.S. __ (February 25, 2009)

The U.S. Supreme Court last week clarified antitrust law relating to a firm's unilateral conduct, holding that a "price-squeeze" claim is not viable absent a violation of an antitrust duty to deal at the wholesale level, or predatory pricing at the retail level. Slip op. at 12, 17. "If 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 *linkLine* plaintiffs, providers of digital subscriber line (DSL) service, bought telephone line access from defendant entities related to AT&T, which was also a DSL provider. Thus, AT&T participated in both the wholesale and retail market for DSL. Plaintiffs complained that AT&T engaged in a "price squeeze" by charging high wholesale prices for DSL transport to its DSL competitors, while charging low DSL service prices to its retail customers. *Id.* at 2-3. DSL competitors therefore had increased costs at the wholesale level that made them unable to remain competitive with AT&T retail prices. Plaintiffs alleged this price squeeze allowed AT&T to maintain monopoly control in the DSL market.

In its previous decision, *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), the Court held that antitrust law does not create a duty to deal with a competitor, except in rare instances. Absent an antitrust duty to deal in the first place, the Court ruled in *linkLine* that there could not be a duty to deal on any particular terms. Slip op. at 9-10. The *linkLine* decision thus extended the Court's somewhat similar holding in *Trinko*, that a failure to provide a "sufficient" level of service to a competitor could not constitute a violation, absent an antitrust duty to deal. *Id.* (citing *Trinko*, 540 U.S. at 410). Since the lower court in *linkLine* ruled that there was no antitrust duty to deal and since this ruling had not been appealed,¹ the plaintiff's price squeeze claim was rejected.

The Court found the price squeeze theory problematic for a number of policy reasons. By its very nature, a price squeeze claim challenges low retail prices. The Court noted that cutting prices is at the very essence of competition and benefits consumers. For this reason, courts should carefully limit "the circumstances under which plaintiffs can state a Sherman Act claim by alleging prices are too low." Slip op. at 11. The Court also expressed concern that courts are

¹ Although it did not address the "refusal to deal" issue on the merits, the Court expressed general agreement with the finding below, stating in dictum that it was "quite unlikely" that AT&T had an antitrust duty to deal with the plaintiffs because of ample competition in the retail "high-speed Internet service" market. Slip op. at 8 & n.2.

ill-suited to regulate pricing at either the wholesale or the retail level or to decide what kind of margin between the prices might be appropriate. *Id.* at 12-13.

The Court remanded the case so that the trial court could determine whether to permit plaintiffs to introduce a predatory pricing claim under the standards articulated in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993): (1) below-cost pricing and (2) a dangerous probability that defendant would recoup any lost profits. The Court expressed skepticism that such a claim could survive a motion to dismiss under the pleading standard established by *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). Although the result was unanimous, four justices concurred in a separate opinion authored by Justice Breyer that would have simply remanded for further proceedings under a predatory pricing theory, without prejudging the relevance of the price squeeze context.

Although the *linkLine* case will bar price squeeze cases in most circumstances, the price squeeze theory could survive in those limited circumstances in which a monopolist has a duty to deal under the antitrust laws. The question remains what economic test should be applied in these circumstances. In *linkLine*, the Antitrust Institute, as *amicus*, suggested the Court adopt a “transfer price test” for determining whether price squeezes are unlawful. Under this proposed test, a plaintiff could prove the retail price charged by an integrated firm is predatory by treating the integrated firm’s wholesale price as an internal transfer price, rather than actual cost, to determine the firm’s costs under *Brooke*. Slip op. at 14-15. The Court rejected the use of this test as a basis for finding a price squeeze unlawful where there is no antitrust duty to deal, stating that it would not even matter if the wholesale price exceeded the retail price in these circumstances. *Id.* However, the possibility remains that the “transfer price test” would be appropriate in the narrow set of cases in which there may be an antitrust duty to deal.

In considering the implications of this decision for pricing policy, companies must keep in mind that a number of states have separate antitrust statutes dealing with below-cost pricing and price discrimination. These state statutes may apply in some cases in which federal law will not apply. Similarly, companies must consider possibly inconsistent competition laws overseas in implementing pricing strategies on an international level.

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