Supreme Court Holds That Price Squeeze Claims Are Not Cognizable Absent a Duty to Deal at the Wholesale Level

On February 25, 2009, the Supreme Court issued a unanimous decision in *Pacific Bell Tel. Co. d/b/a AT&T California* v. *linkLine Commc'ns, Inc.*[1] Resolving a split among the lower courts, the Court held that a price-squeeze claim may not be brought under Section 2 of the Sherman Act[2] unless the defendant has an antitrust duty to deal with the plaintiff at wholesale. The Court also clarified that the pleading standards announced in *Twombly*, which arose in the conspiracy Section 1 context, apply to Section 2 monopolization claims.

I. Background

As first articulated by Judge Hand in *United States* v. *Aluminum Co. of America* ("*Alcoa*"),[3] "a price squeeze occurs 'when a vertically integrated company sets its prices or rates at the first (or 'upstream') level so high that its customers cannot compete with it in the second-level (or 'downstream') market.'"[4] Judge Hand held that such a price squeeze was actionable under Section 2 of the Sherman Act, and a number of other lower courts have recognized price-squeeze claims in other contexts.

The viability of a price squeeze claim under Section 2 has been called into question as a result of the Supreme Court's monopolization jurisprudence over the last couple of decades. In *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*,[5] the Supreme Court held that a predatory pricing claim under Section 2 of the Sherman Act could only be asserted against a monopolist if the pricing is below cost and the alleged monopolist is likely to recoup its losses.

In a later decision, *Verizon Communications, Inc.* v. *Law Offices of Curtis V. Trinko, LLP* ("*Trinko*"),[6] the Supreme Court held that the failure by a monopolist to deal with a competitor on certain service terms when that monopolist was under no antitrust duty to deal with the plaintiff competitor, whether or not there was any other statutorily imposed duty to deal, did not state a claim under Section 2 of the Sherman Act.

In *Trinko*, a customer of one of Verizon's rivals alleged that Verizon had engaged in anticompetitive practices by discriminatorily delaying interconnection orders placed by customers of Verizon's competitors—orders Verizon was required to fill by the Telecommunications Act of 1996. The Supreme Court held that "Verizon's alleged insufficient assistance in the provision of service to rivals is not a recognized antitrust claim under this Court's existing refusal-to-deal precedents."[7] The Court stated that the Sherman Act does not restrict the right of a private business to refuse to deal, although the right is not unqualified.[8] In concluding that Trinko's

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1 *Pacific Bell Tel. Co. d/b/a AT&T California* v. *linkLine Commc'ns, Inc.*, No. 07-512, slip op. (U.S. Feb. 25, 2009).

2 Section 2 of the Sherman Act states that "[e]very person who shall monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ."

3 148 F.2d 416, 437-38 (2d Cir. 1945).

4 *linkLine Communications, Inc.* v. *SBC California, Inc.*, 503 F.3d 876, 880 (9th Cir. 2007) (quoting Von Kalinowski et al., 2 *Antitrust Laws and Trade Regulations* § 27.04 [1], 27-40 (2d Ed. Matthew Bender 2007)).

5 509 U.S. 209 (1993).

6 540 U.S. 398 (2004).

7 *Id.* at 410.

8 *Id.* at 408.

allegations did not make out an antitrust claim, the Court emphasized "the existence of a regulatory structure designed to deter and remedy anticompetitive harm."[9] *Trinko* did not address price squeeze claims specifically, and there was a split in the courts of appeals as to whether a price squeeze claim survives the combination of *Trinko* and *Brooke Group*.[10]

II. Facts and Procedural History of *linkLine*

The plaintiffs in *linkLine Comm'ns, Inc.* v. *SBC Cal., Inc.*, No. CV 03-5265 SVW (C.D. Cal. 2003) were Internet Service Providers ("ISPs") who sell digital subscriber line ("DSL") access to the internet to retail customers. Plaintiffs leased infrastructure and facilities for transmitting data between the internet and customers variously from SBC California, Inc., Pacific Bell Internet Services, and SBC Advanced Solutions, Inc. (collectively "AT&T Entities"). The AT&T Entities sold both wholesale DSL access to plaintiffs and other independent ISPs as well as retail DSL access to individual consumers.[11]

Plaintiffs alleged, *inter alia*, that the AT&T Entities monopolized and attempted to monopolize the regional DSL market in violation of Section 2 of the Sherman Act by creating a price squeeze by intentionally charging independent ISPs wholesale prices that were too high in relation to prices at which the defendants were providing retail DSL services and necessary equipment to end-user customers. The DSL market was only partially regulated—there were FCC and state regulations in place at the wholesale level, but no comparable regulations of retail pricing.[12]

The United States District Court for the Central District of California denied the AT&T Entities' motion to dismiss for failure to state a claim and certified the order for interlocutory appeal. The Ninth Circuit reviewed the district court's decision *de novo* and affirmed. The court concluded that *Trinko* did not "completely eliminate the viability of a Section 2 price squeeze theory in regulated industries."[13] Judge Gould dissented, stating that the price-squeeze claims were barred by the Supreme Court's holdings; he would have remanded the case to allow plaintiffs to assert a claim for predatory pricing if they could.

The AT&T Entities petitioned for certiorari, arguing that the Supreme Court should reject the Ninth Circuit's articulation of the price-squeeze doctrine. During its oral argument, plaintiffs, rather than defending the decision below, urged the Court to vacate the Ninth Circuit's decision and send the case back to the district court to allow plaintiffs to file an amended complaint in which they would allege a *Brooke Group*-type predatory pricing claim, in accordance with the dissent in the court of appeals decision.[14] The Supreme Court permitted an

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9 *Id.* at 412-14.

10 *Compare linkLine Communications, Inc.* v. *SBC California, Inc.*, 503 F.3d 876, 880 (9th Cir. 2007) (holding that price squeeze claims survive *Trinko*) *and Covad Communications Co.* v. *BellSouth Corp.*, 374 F.3d 1044, 1050 (11th Cir. 2004) ("Bell-South") (same) *with Covad Communications Co.* v. *Bell Atlantic Corp.*, 398 F.3d 666, 673 (D.C. Cir. 2005) ("Bell Atlantic") (holding that they do not).

11 *linkLine* at 877-78.

12 *Id.* at 885.

13 *Id.* at 883. The court framed the question before it as whether the "Supreme Court's decision in . . . *Trinko* bars a plaintiff from claiming a violation of [Section] 2 of the Sherman Antitrust Act by virtue of an alleged price squeeze perpetrated by a competitor who also serves as the plaintiff's supplier at the wholesale level, but who has no duty to deal with the plaintiff absent statutory compulsion."

14 In it Opposition Brief, however, linkLine had argued that the Ninth Circuit's decision should stand. Brief in Opposition at 14-15, *linkLine*, 128 S. Ct. 2957 (2008) (No. 07-512), *available at* http://www.scotusblog.com/movabletype/archives/07-512_bio.pdf.

amicus group, the American Antitrust Institute, to participate in oral argument in support of affirming the Ninth Circuit holding.

III. The Supreme Court's Decision

The Supreme Court concluded that plaintiffs' claims were not moot because the parties continued to seek different relief and it was unclear whether plaintiffs had unequivocally abandoned their price-squeeze claim.[15] The Court also cited prudential concerns, noting that the circuit conflict the Court granted certiorari to resolve would persist if the Court did not decide the question presented.[16] Having determined that the case was not moot, the Court then proceeded to analyze the two components of the price squeeze claim—the setting of high prices at the wholesale level and low prices at the retail level—separately.[17]

As for the wholesale component, the Court found that *Trinko* barred any challenge to the AT&T Entities' wholesale prices.[18] The plaintiffs' price-squeeze claim was foreclosed by *Trinko* because the nature of the conduct complained of was the same—"abuse of power" at the wholesale level to prevent rivals from competing at the retail level.[19] *Trinko* held that such claims are not viable under the Sherman Act where there is no antitrust duty to deal.[20] The Court noted that the only duty to deal between linkLine and the AT&T Entities arose only from FCC regulations, not from antitrust law.[21]

Turning to the second aspect of the price squeeze claim—setting low prices at the retail level—the Court concluded that plaintiffs' allegations did not fall within the limited set of circumstances set forth by the Court in *Brooke Group* under which plaintiff can state an antitrust claim by alleging that prices are too low.[22] The Court summed up its holding thus: "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."[23]

The Court cited institutional concerns which counsel against recognizing claims such as plaintiffs'.[24] The Court noted the importance of clear antitrust rules and the difficulty courts would have in policing prices if such claims were allowed.[25] The Court found most troubling the potential lack of a "safe harbor" from price-squeeze liability if the standard is the commonly articulated "fair" or "adequate" prices.[26] The Court was not persuaded

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15 *linkLine*, No. 07-512, slip op. at 5-7.

16 *Id.* at 7.

17 *Id.* at 9-15.

18 *Id.* at 9.

19 *Id.* at 10.

20 *Id.*

21 *Id.* at 9.

22 *Id.* at 11.

23 *Id.* at 12.

24 *Id.* at 12-15.

25 *Id.* at 12-13.

26 *Id.* at 13-15.

that there is any independent competitive harm caused by price-squeezes above and beyond the harm that would result from a violation under the principles in *Trinko* or *Brooke Group*.

Finally, in considering the District Court's conclusion that the amended complaint, generously construed, could be read as alleging conduct that met the *Brooke Group* pleading requirements, the Court confirmed that the heightened pleading standards set forth by the Court in *Bell Atlantic* v. *Twombly*[27] apply to claims brought under Section 2.[28]

In an opinion concurring in the judgment, Justice Breyer, joined by Justices Ginsburg, Souter and Stevens, wrote that the case should have been remanded to allow the trial court to consider the viability of plaintiffs' predation claims. More significantly, the concurrence seems to reveal a doctrinal difference on the Court about how exclusionary conduct should be defined under Section 2. The concurrence is wary of the bright-line rules favored by the majority and notes that "means of illicit exclusion, like the means of legitimate competition are myriad."[29]

IV. Significance of the Decision

The Court essentially eliminated a price-squeeze claim absent an antitrust duty to deal with the plaintiff at wholesale. In order to state a price-squeeze claim, it is no longer sufficient, as in *Alcoa*, to allege only that the alleged monopolist's price at the wholesale level is too high and the price at the retail level is too low. There must also be allegations of an antitrust duty to deal. This decision continues a trend seen in recent years of increasing the burdens on plaintiffs seeking to assert Sherman Act claims in federal court. The decision also carries on the Court's efforts, which began with *Brooke Group*, to limit the kind of conduct actionable under Section 2 of the Sherman Act.

In addition, the Court returned to several familiar themes in its recent antitrust jurisprudence:

- Emphasizing yet again the "importance of clear rules in antitrust law," requiring that, in the words of Justice Breyer as an Appeals Court Judge, "rules 'must be clear enough for lawyers to explain them to clients.'"
- Clarifying that the rigorous pleading standards identified in *Twombly* in the context of pleading the existence of a conspiracy violating Section 1 of the Sherman Act also apply to Section 2.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Patricia Farren at (212) 701-3257 or pfarren@cahill.com, Elai Katz at (212) 701-3039 or ekatz@cahill.com, Dean Ringel at (212) 701-3521 or dringel@cahill.com, Laurence T. Sorkin at (212) 701-3209 or lsorkin@cahill.com or Julie A. Allsman at (212) 701-3133 or jallsman@cahill.com.

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27 550 U.S. 544, 561-63 (2007).

28 *linkLine*, No. 07-512, slip op. at 16.

29 *Id.* at 1 (Breyer, J., concurring in judgment).