SHEARMAN & STERLING LLP

Client Publication

Litigation, Antitrust | March 4, 2009

Supreme Court Continues to Throttle Antitrust Suits: The Court Sends Another Strong Message that Price Claims Should Be Dismissed Unless They Allege Below Cost Pricing

Last Wednesday, February 25, 2009 the Supreme Court, in *Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc.*, No. 07-512, 2009 WL 454286 (US), argued on December 8, 2008, unanimously decided that a "price-squeeze" claim may not be brought under § 2 of the Sherman Act when the defendant has no antitrust duty to deal with the plaintiff at wholesale. "If both the whole sale 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 is greater than or equal to its retail price."

The Alleged § 2 Violation

As a condition for a recent merger, the Federal Communications Commission ("FCC") required Pacific Bell Telephone Co., d/b/a AT&T California ("AT&T"), to provide wholesale DSL (digital service line) transport service, a method for connecting to the Internet at high speeds over telephone lines, to independent firms at a price no greater than the retail price of AT&T's DSL service. Plaintiffs, independent Internet service providers who compete with AT&T in the retail DSL market in California, did not own all the facilities to supply DSL service. AT&T owned much of the infrastructure and facilities needed to provide DSL service in California. In particular, AT&T controlled most of what is known as the 'last-mile'-the line that connects homes and businesses to the telephone network. Thus, Linkline had to lease wholesale DSL transport service from AT&T.[1] Plaintiffs brought suit alleging that AT&T unlawfully "squeezed" their profit margins and made it impossible for them to compete by setting too high a price for the wholesale DSL transport service it sold and too low a price for its own retail service. AT&T moved for a judgment on the pleadings.

"Where there is no duty to deal at the wholesale level and no predatory pricing at the retail level, a firm is not required to price both . . . in a manner that preserves its rivals' profit margins."

[1] Until recently, the FCC required incumbent phone companies, such as AT&T to sell transmission services, but FCC abandoned this approach in 2005, in light of competitive market beyond DSL for high-speed Internet service. *Pacific Bell* at *4.

Tracking the Case

In relying on *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 410 (2004), where the Court held that a firm with no antitrust duty to deal with its rivals has no obligation to provide those rivals with a "sufficient" level of service, the District Court found AT&T had no duty to deal with its rivals. Nonetheless, the court denied defendant's motion and certified it for interlocutory appeal on the issue of whether *Trinko* bars price-squeeze claims when the parties are required to deal by federal communications law, but not antitrust law. The Ninth Circuit affirmed, holding that the complaint stated a potentially valid § 2 claim because *Trinko* did not address the viability of price-squeeze claims. The Supreme Court of the United States unanimously reversed. On remand, the Court ordered the District Court to consider whether an amended complaint filed by the plaintiffs states a claim upon which relief may be granted pursuant to the pleading standard articulated in *Bell At'l v. Twombly*, 550 U.S. 544 (2007).

The Decision

In writing the majority opinion for the Court, Chief Justice Roberts wrote, "a price-squeeze claim may not be brought under § 2 when the defendant has no antitrust duty to deal with the plaintiff at whole." The majority, in which Scalia, Kennedy, Thomas, and Alito joined, refused to adopt Linkline's proposition that AT&T's conduct created an impermissible competitive advantage. Chief Justice Roberts noted the dangerous chilling effect on aggressive pricing competition of allowing a § 2 price-squeeze claim in the absence of a showing of below-cost retail pricing. "Recognizing a price-squeeze claim where the defendant's retail price remains above cost would invite the precise harm we [seek] to avoid: . . . Firms might raise their retail prices or refrain from aggressive price competition to avoid potential liability." *Id.* at *9. In addition to this chilling effect, the opinion points to a bedrock principle of antitrust law to support its decision: there must be clear rules in antitrust law. "Courts are ill-suited to act as central planners, identifying the proper price, quantity, and other terms of dealing." *Id.* at *10. Such court supervision is impractical to the policing of so-called price-squeezing behavior. "No court should impose a duty to deal that it cannot explain or adequately and reasonably supervise." *Id.* The Court concludes that there is "no guidance" available for price-squeeze claims.

Justice Breyer filed a concurring opinion in judgment, in which Stevens, Souter, and Ginsburg joined, where they would remand the case to allow the District Court to determine whether respondents may proceed with a predatory pricing claim.

What It Means

First, the decision sends a strong message that competition on price is generally pro-competitive and the only pricing claims that the Supreme Court will consider viable are predatory pricing claims in which the plaintiff alleges below-cost pricing and a dangerous probability that the defendant will recoup any lost profit. Competitors are not entitled to a fair or adequate margin between wholesale and retail prices to preserve their profit margins, where defendant operates as both a wholesaler and retailer of the product or service in question. Even if defendant's whole price exceeds its retail price, no viable § 2 antitrust injury has occurred.

Based on this decision, it is unlikely other pricing claims such as bundling claims will survive before the high court unless the plaintiff can show predatory conduct. The decision is a clear continuation of the high court's shift in favor of defendants in antitrust cases.

The decision also furthers the trend adopted by the Supreme Court two years ago, in *Bell At'l v. Twombly*. In *Twombly*, the Court clarified that a plaintiff alleging a Sherman Act § 1 conspiracy violation will not satisfy Rule 8 pleading requirements with bald, conclusory assertions that defendants participated in a conspiracy. Rather, a plaintiff must allege *specific facts* that suggest the defendants reached an agreement. Similar to the Court's *Bell v. Twombly*, the recent *Pacific Bell* decision institutes even clearer and tougher standards and provides another mechanism for early disposition of antitrust cases.

Under the new standard, unless pricing claims allege that prices are below the current measure of cost, the complaint should be dismissed at the pleadings stages.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this memorandum, you may contact your regular Shearman & Sterling contact person or:

Heather L. Kafele
Litigation
+1.202.508.8097
hkafele@shearman.com

©2009 Shearman & Sterling LLP. As used herein, "Shearman & Sterling" refers to Shearman & Sterling LLP, a limited liability partnership organized under the laws of the State of Delaware.