Statement of the Federal Trade Commission

Petition for a Writ of Certiorari in *Pacific Tel. Co. d/b/a AT&T California v. linkLine Comms., Inc*. (No. 07-512)

The Commission declines to join the U.S. Department of Justice in recommending that the U.S. Supreme Court review the Ninth Circuit's decision in *linkLine Comm'n v. Pacific Bell Telephone Co.*, 503 F.3d 876 (9th Cir. 2007), because we disagree with DOJ's analysis, and because this case does not appear to be worthy of review at this time. The vote was 3 - 0 with Chairman Kovacic recused. In the interests of transparency, this statement describes the reasons for the Commission's decision.

BACKGROUND

In 2003, linkLine filed a complaint alleging that Pacific Bell (d/b/a AT&T) had monopolized and attempted to monopolize the relevant DSL Internet services market, in violation of Section 2 of the Sherman Act, by, among other things, "creat[ing] a price squeeze by charging ISPs a high wholesale price in relation to the price at which defendants were providing retail services." Pet. App. 4a; Cmplt. ¶ 23(a). Pacific Bell moved for judgment on the pleadings on the ground that the Court's decision in *Verizon Comms. Inc., v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) compelled judgment in defendants' favor. The district court denied that motion, holding that "because a price-squeeze claim is actionable under existing antitrust standards, and because the Ninth Circuit has upheld the viability of price-squeeze claims in the context of highly regulated industries, *Trinko* does not bar Plaintiffs' price-squeeze claim." Pet. App. 91a. However, it ordered plaintiffs to file an amended complaint "limited to the price-squeeze claim that details beyond the normal requirements of Rule 8 specific facts supporting Plaintiffs' price-squeeze claim." *Ibid*.

Respondents' amended complaint elaborated on the price-squeeze claim by providing the additional allegations that

> defendants * * * engag[ed] in an unlawful price squeeze by intentionally charging independent ISPs wholesale prices that were too high in relation to prices at which defendants were providing retail DSL services and necessary equipment to end-user customers – and for a period by charging wholesale DSL prices to competing ISPs (such as plaintiffs) that actually exceeded the prices at which defendants' retail affiliate (PBI) was charging retail end-user customers for DSL services and necessary equipment * * * .

Pet. App. 5a-6a; Am. Cmplt. ¶ 25(A)(1). Respondents alleged further that

> if defendants themselves charged their retail affiliates the same wholesale costs for DSL transport that they charged their wholesale ISP customers (such as plaintiffs), defendants could not cover their wholesale costs and make a profit from DSL service at their low retail prices for their bundled offering of DSL, Internet Service and necessary equipment * * * . Given the price margin

> relationship between retail and wholesale prices, defendants are clearly attempting to compensate for deliberately sacrificing profits on the retail end of their operations (with offsetting margins on the wholesale side) in order to stifle, impede and exclude competition from independent ISPs such as plaintiffs that are both wholesale customers and retail rivals.

Pet. App. 6a-7a; Am. Cmplt. ¶ 25(A)(3).

Pacific Bell moved to dismiss the price-squeeze claim in the amended complaint for failure to state a claim in accordance with the standards of *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). The district court denied that motion, holding that "even if the *Brooke Group* requirements were applied, the FAC [first amended complaint] would satisfy those requirements." Pet. App. 47a-48a. The district court then granted AT&T's motion to certify its earlier order regarding *Trinko*'s application to price-squeeze claims for interlocutory appeal pursuant to 28 U.S.C. § 1292. Pet. App. 56a, 8a. The district court noted, however, that in light of its holding that linkLine's amended complaint satisfied *Brooke Group*'s dual conditions, "the issue before the Ninth Circuit will not only be whether *Trinko* bars price-squeeze claims generally but, more specifically, whether it bars predatory price-squeeze claims (i.e., price-squeeze claims which comply with the *Brooke Group* requirements)." Pet. App. 56a n.22.

The Ninth Circuit affirmed. It noted that price-squeeze claims were recognized under Section 2 of the Sherman Act long before the Supreme Court's *Trinko* decision.[1] Pet. App. 8a-9a (citing, among other decisions, *United States v. Aluminum Co. of America*, 148 F.2d 416, 437-38 (2nd Cir. 1945) ("*Alcoa*"); *City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373 (9th Cir. 1992). It then asked "whether *Anaheim* remains viable after *Trinko*," Pet. App. 13a, and concluded that several factors mandate that its own price-squeeze precedent survives the Supreme Court's decision. First, *Trinko* "took great care to explain that in this particular regulatory context, 'claims that satisfy established antitrust standards' are preserved." Pet. App. 14a (quoting 540 U.S. at 406). Thus, the price-squeeze claims that were recognized in *Anaheim*, and which "formed part of the fabric of traditional antitrust law" prior to *Trinko*, "should remain viable notwithstanding either the telecommunications statutes or *Trinko*." *Id*. Second, both *Trinko* and *Anaheim* recognized that "courts should tread carefully" when dealing with allegedly anticompetitive conduct in regulated industries.[2]

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[1] Price squeeze, said the Ninth Circuit, "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." Pet. App. 8a (citation omitted).

[2] *Trinko* declared that "the existence of a regulatory structure designed to deter and remedy anticompetitive harm" was "*[o]ne factor* of particular importance." Pet. App. 13a (citing *Trinko*, 540 U.S. at 412-14) (emphasis by the 9th Circuit). *Anaheim*, for its part, "carefully circumscribed" the price-squeeze theory by "requir[ing] a showing of specific intent on the part of

Applying both *Trinko* and its own *Anaheim* decision, the Ninth Circuit noted that unlike the circumstances in those cases, the challenged conduct in the *linkLine* case concerned "a partially regulated industry." Pet. App. 16a. It emphasized that Federal Communication Commission regulation "applies only to the wholesale prices [AT&T] charged linkLine; there is no comparable regulatory attention paid to the retail DSL market. Any restrictions on pricing at the retail level derive primarily from the antitrust laws." Pet. App. 18a. Thus, "since linkLine could prove facts, consistent with its complaint, that involve only unregulated behavior at the retail level, its action or lawsuit survives a motion for judgment on the pleadings." *Ibid*.

DISCUSSION

The holding of the Ninth Circuit is unquestionably correct, and indeed merely echoes what other courts of appeals have held on the narrow issue presented to the court below: that claims of a predatory price squeeze in a partially regulated industry remain viable after *Trinko*.[3]

It bears emphasis that the price-squeeze theory pleaded in *linkLine* is not novel. As the court of appeals noted, *Trinko* "took great care" to preserve "'claims that satisfy established antitrust standards'." Pet. App. 14a (quoting 540 U.S. at 406). Price-squeeze claims have long

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the wholesale monopoly holder to 'serve its monopolistic purposes at [retail competitors'] expense' in order for § 2 liability to attach." Pet. App. 14a-15a (quoting *Anaheim*, 955 F.2d at 1378). The Ninth Circuit concluded that "[w]here * * * there is nothing built into the regulatory scheme which performs the antitrust function, the benefits of antitrust are worth its sometimes considerable disadvantages." *Ibid*. (quoting 540 U.S. at 412) (internal citation, quotation marks and alterations omitted).

[3] There is no real conflict between the narrow decision of the Ninth Circuit and the decisions of the two other courts of appeals that have considered price-squeeze claims in the wake of *Trinko* or between those two decisions. In *Covad Communications Co. v. BellSouth Corp.* ("*BellSouth*"), the Eleventh Circuit considered allegations substantially similar to those in linkLine's amended complaint, and held that the "price squeezing claim survives because it is based on traditional antitrust doctrine and is not specifically barred by *Trinko*." 374 F.3d 1044, 1050 (11th Cir. 2004). The D.C. Circuit considered the same issue in *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666 (D.C. Cir. 2005) ("*Bell Atlantic*"). The court dismissed Covad's price-squeeze claim. On rehearing, the *Bell Atlantic* court emphasized that its holding was limited to non-predatory price-squeeze claims. 407 F.3d 1220 (D.C. Cir. 2005). It noted that Covad's argument that its holding "eliminates" price-squeeze claims entirely "simply misreads our opinion," which focused on the non-voluntary relationship between Covad and Bell Atlantic. *Id*. at 1222. It then distinguished its own facts from those in the Eleventh Circuit's decision upholding predatory price-squeeze claims: "Notably, the court did not face a circumstance similar to that in [*BellSouth*], in which the Eleventh Circuit held a claim for predatory pricing of loops could proceed. * * * Here, Covad did not argue its claim as one of price predation and, unsurprisingly, we did not treat it as such." *Ibid*.

been part of the Section 2 doctrine, *see* Pet. App. 8a-9a. The price-squeeze theory pleaded in linkLine is similar to the theory first embraced by Judge Learned Hand in the Second Circuit's seminal opinion in the *Alcoa* case over sixty years ago. *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945). In *linkLine*, as in *Alcoa*, the defendant and the plaintiffs allegedly competed for retail customers, but plaintiffs alleged that the defendant enjoyed monopoly power over an essential input and had set wholesale prices for that input so high that plaintiffs could not profitably compete. *Compare linkLine*, 503 F.3d at 879, *with Alcoa*, 148 F.2d at 437-38.

The gravamen of the price squeeze found in *Alcoa* was that the downstream competitors could not make a "living profit" because they were squeezed between Alcoa's high price for ingot and its low price for sheet. Brief at 13. It has been suggested that the allegations in *Alcoa* were merely complaints about an insufficient margin by competitors and that the legality of the conduct turned on its effects on competitors rather than competition. Yet in *Alcoa,* the court took the price of Alcoa's ingot and its 'rolling' costs as a fair measure of costs and compared those costs to Alcoa's sheet prices. *Alcoa*, 148 F.2d at 437. It found that the margin was negative in many instances (that is, the costs exceeded the price) and only barely positive in other instances (by a few pennies). *Id.* In light of these facts, we understand Judge Hand's reference to "living profit" to be a profit sufficient for participants in the second market to compete. We believe this is a limiting principle, which is at least as clear as the undefined "below-cost" standard in *Brooke Group*.

A number of courts since *Alcoa* have held that price-squeeze allegations may support liability under Section 2. For example, the First Circuit in *Town of Concord* identified several respects in which a price squeeze may have anticompetitive effects. *See Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 28 (1st Cir. 1990) (Breyer, C.J.) (distinguishing several authorities that "suggest that a price squeeze may be unlawful in the regulated electricity industry" partly on the ground that in every one of those cases, "the price-squeeze allegation involved wholesale prices that *exceeded* retail prices") (emphasis original).[4] Even accepting "'the widely accepted' (albeit 'counterintuitive') economic argument * * * that 'there is but one maximum monopoly profit to be gained from the sale of an end-product'," *id*. at 23 (citing 3 P. Areeda & D. Turner, *Antitrust Law* ¶ 725b, at 199 (1978)), the anticompetitive effects of a price-squeeze scheme can still be significant.

The *Town of Concord* court pointed out at least two such harms: entrenching the monopoly in the upstream market, and eliminating non-price competition in the downstream market. *Id*. at 23-24. As to the first scenario, a monopolist in the upstream market can raise the

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[4] Indeed, even the allegations in the seminal price-squeeze case arguably fall under the predatory pricing squeeze rubric. *See Alcoa*, 148 F.2d at 436-37 (using the sum of Alcoa's wholesale price of aluminum ingot plus its "rolling" costs as a fair measure of its downstream "costs," and comparing that with Alcoa's prices for aluminum sheet, finding the downstream margin to be negative in some instances).

costs of entry into that market by extending its dominance to the downstream market. A prospective upstream new entrant will thus be deterred not only by the pre-existing entry barriers but also by the prospect of having to compete on unequal terms with the incumbent because of the latter's control over the downstream market. "And insofar as the monopolist previously set prices cautiously to avoid attracting a competitive challenge, the added security of a two-level monopoly could even lead that monopolist to raise its prices." *Id*. at 24 (citing *Areeda & Turner* ¶ 725h, at 204-08; William G. Shepard, *Potential Competition Versus Actual Competition*, 42 ADMIN. L. REV. 5-34 (1990)). Likewise, even assuming no price effects from eliminating the downstream competition of an integrated monopolist, non-price competition in areas like quality and service can also be harmed by reducing the incentives for the monopolist to develop better products and more efficient means of production, and by eliminating the possibility of an independent downstream actor challenging the monopolist by developing better and more efficient downstream products. *See id*. (citing *Areeda & Turner*).

Furthermore, while in *Trinko*, *Town of Concord*, *BellSouth* and *Bell Atlantic* the conduct of the defendants was constrained by regulation, the existence of a regulatory regime in this case does not sufficiently constrain AT&T's conduct, because the downstream or retail side of that market is unregulated. Thus, while the wholesale level is subject to "a series of regulatory mechanisms and regulatory agencies charged with assuring fair play," including, for example, "just, reasonable, and nondiscriminatory" pricing, Pet. App. 16a, 10a n.8, "[a]ny restrictions on pricing at the retail level derive primarily from the antitrust laws." Pet. App. 18a. Indeed, just such an anomaly was singled out by Justice (then Chief Judge) Breyer as an exception to the First Circuit rule that a non-predatory price squeeze in a fully regulated industry does not give rise to a claim under the Sherman Act. *See Town of Concord*, 915 F.2d at 29 ("We recognize that a special problem is posed by a monopolist, regulated at only one level, who seeks to dominate a second, unregulated level, in order to earn at that second level the very profits that regulation forbids at the first") (citing *Areeda & Turner* ¶ 726e, at 217-20 (1978)). Thus, the theory of price squeeze retains a significant role against anticompetitive unilateral conduct in a case like this and should not be summarily dismissed.

Moreover, as pleaded, this case does not undercut *Brooke Group*. The Supreme Court's stated concern in *Brooke Group* was that "false positives" may operate to deprive consumers of low prices. Assuming as true the allegations in linkLine's amended complaint, though, AT&T's retail pricing was predatory, and it was calculated to (and did) maintain monopoly power for AT&T in the retail market for DSL-based Internet access services. Thus, the plaintiffs in *linkLine* have alleged that consumers have paid supracompetitive prices as a result of AT&T's conduct. On an appeal from plaintiffs' pleadings, it must be assumed that consumers have paid those prices.

Indeed, the fact that the case would come to the Court at the pleadings stage reinforces the impropriety of review. That procedural posture not only deprives the Court of a fully developed record, but adds a further layer of complexity to the proper legal question presented. One of the central issues in this case will be which measure of AT&T's wholesale costs is

appropriate for predation analysis – a factual determination that has yet to be made by the district court. Thus, even if the Court goes beyond the actual question presented to consider the predation allegations in the amended complaint (with the attendant possibility for jurisdictional infirmity), it can hardly opine usefully on the issue without benefit of an appropriate measure of cost.

In sum, we do not believe this case is ripe for review by the Supreme Court. There is no apparent justification, based on only a partial record of the plaintiffs' pleadings in this case, for turning back 60 years of case law that embraces price-squeeze claims under Section 2 of the Sherman Act. The FTC and the Solicitor General frequently cooperate in fashioning recommendations to the Supreme Court regarding the grant or denial of certiorari, and likely will continue to do so.