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U.S. Supreme Court Addresses "Price Squeeze" Claim and Application of *Twombly* Pleading Standard to Section 2 of the Sherman Act

On February 25, 2009, the United States Supreme Court issued a decision concerning the viability of "price squeeze" claims under Section 2 of the Sherman Act and confirming that the pleading standard articulated in *Bell Atlantic Corp. v. Twombly* applies outside the context of conspiracy claims under Section 1 of the Sherman Act.

In *Pacific Bell Telephone Co., dba AT&T California v. Linkline Communications, Inc.*, No. 07-512, the Court held that "price squeeze" claims are not a valid basis for relief under Section 2 of the Sherman Act. A price squeeze occurs when an integrated firm with market power in a wholesale ("upstream") market attempts to gain an advantage over its retail ("downstream") competitors by raising the price of its wholesale offerings while cutting the price of its products or services at retail. This type of strategy can have the effect of raising downstream competitors' costs, lowering competitors' revenues and profits, and potentially driving competitors out of the retail market. The Court held that where there is no antitrust duty to deal—i.e., an independent legal obligation to sell to rivals—and where there is no evidence of predatory pricing—i.e., pricing below an appropriate measure of cost—a defendant selling an input at the wholesale level and a finished product at the retail level need not allow competitors to make a profit by setting its wholesale prices below a certain level.

The case originated in the context of a dispute over high-speed Internet (DSL) service. The plaintiffs were four Independent Service Providers ("ISPs") who lease wholesale DSL transport services from AT&T. They alleged that AT&T was selling DSL transport service at a price so high, and retail DSL service at a price so low, that standalone ISP competitors were unable to make a profit in the retail market.

AT&T competes in both the retail and DSL transport markets. The retail market is competitive, but AT&T was alleged to have a monopoly in the wholesale DSL transport market. According to plaintiffs' allegations, AT&T owns much of the infrastructure and services necessary to provide DSL service in California. In particular, AT&T controls what is known as the "last mile"—the lines that connect homes and businesses to the telephone network.

After the complaint was filed, the Supreme Court issued its decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), in which it held that a monopoly that does not have an "antitrust duty to deal" with its rivals does not need to provide services to its rivals. Based on the *Trinko* decision, Paul|Weiss

AT&T moved for dismissal, which the district court denied. The Ninth Circuit affirmed, emphasizing that *Trinko* did not involve a price squeeze theory and noting that other federal Courts of Appeals have held that price squeezes are cognizable under the Sherman Act.

The Supreme Court reversed, holding that any challenge to AT&T's wholesale prices is foreclosed by *Trinko*. The Court explained that *Trinko* "makes clear that if a firm has no antitrust duty to deal with its competitors at wholesale, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous . . . . Here, the plaintiffs alleged that the defendants abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market. *Trinko* holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal."

The Court emphasized that the plaintiffs' price squeeze theory was premised on the notion that the defendant's retail prices were "too low," yet "[c]utting price in order to increase business often is the very essence of competition." As a result, the Court held that AT&T's retail prices could only be challenged if they were predatory.

The ISP plaintiffs asked the Court for leave to amend their complaint to add a conventional predatory pricing claim. Although the Court refused to address the issue (leaving it for remand), the Court noted that the district court had held that the operative complaint already included a predatory pricing claim and that the district court had been unwilling to grant a motion to dismiss that claim. The Court stated that the district court had "applied the 'no set of facts' pleading standard" that the Court had rejected as "too lenient" in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and that it was "for the District Court on remand to consider whether the amended complaint states a claim upon which relief may be granted in light of the new pleading standard we articulated in *Twombly*." The Supreme Court's decision in *Linkline* thus marks the first time that the Supreme Court has held that the pleading standard set forth in *Twombly*—which held that plaintiffs alleging conspiracy claims under Section 1 context must allege "enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement"—also applies to Section 2 allegations.

As a practical matter, the Supreme Court's decision is particularly important for any firm that sells both an input at wholesale and a finished product at retail. The decision also suggests that non-integrated firms that compete with upstream monopolies may increasingly turn to regulatory bodies, such as the Federal Communications Commission, to seek relief from a monopolist's conduct rather than bringing claims under the Sherman Act on the basis that a wholesale competitor's prices are too low.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum may be addressed to any of the following:

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