

Price Squeezes: *LinkLine v. Pacific Bell*

Alden F. Abbott
Associate Director, Bureau of Competition
Federal Trade Commission
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(Views expressed solely attributable to me)

What Constitutes A Price Squeeze

- Sales by integrated firm to downstream unintegrated competitors that deny the latter sufficient profits to compete with the integrated firm at the retail level
- Unintegrated firms are “squeezed out” of competition at the retail level by integrated firm which gets higher retail margins
- But what are the efficiency and the consumer welfare implications?

Carlton on Price Squeezes

- May be efficient, consumer welfare enhancing vertical integration in the presence of preexisting market power
- Dennis Carlton: arguments against liability
 - Liability likely to chill competition and harm consumers
 - Where duty to deal, application of theory likely to create incentives for inefficiency as firms raise prices or cease production
 - Where no antitrust duty to deal, application of theory likely to spur withdrawal of goods from market, harming consumers

Economics of Price Squeezes in an Unregulated Environment

- When market power exists both upstream and downstream, it is the reduction in downstream margins – the price squeeze – that mitigates the effects of double marginalization and leads to lower retail prices and greater retail output
- If downstream market perfectly competitive, if downstream margin is constrained to be higher than level associated with a price squeeze, it may not be possible for integrated firm to introduce lower cost/higher quality product

Economics of Price Squeezes in a Regulated Environment

- Imperfect (above MC) wholesale price regulation preserves integration incentives
- If market power in downstream market, upstream firm will have incentive to integrate forward to reduce downstream price, increase quantity it sells at regulated wholesale price, and raise its profits in upstream market
- Upstream firm also benefits from integration if it can produce at lower cost or offer higher quality than downstream rivals – this would raise quantity it sells and increase profit it earns at the regulated wholesale price
- Both these efficiency-enhancing explanations for vertical integration lead to efficiencies due to price squeezes

Economics Summary

- Efficiency reasons for vertical integration involve price squeezes, benefit consumers
- These price squeezes harm competitors, but not competition
- Forcing an integrated firm to raise its downstream margin yields higher prices, lowers consumer welfare in these cases
- Vertical price squeeze by itself does not harm competition absent successful downstream predation; *Brooke Group* standard avoids chilling effects on pro-consumer price-cutting

U.S. Legal Background

- *Alcoa* decision (1945)
 - Unintegrated competitors entitled to “living profit”
 - Focus on competitors, not on consumer welfare
- Several lower court decisions have upheld price-squeeze claims
- But rejected in others
 - *Town of Concord* (then-Judge Breyer – quotes below)
 - “[m]erely eliminating competitors not necessarily anticompetitive” and price squeeze “might simultaneously bring about economic benefits”
- Never directly addressed by Supreme Court

Brooke Group and Price Squeeze Theories Compared

- Classic single product predation case concerned with harm to downstream consumers: *Brooke Group* required (1) below cost pricing and (2) recoupment
- Price squeeze concerned about harm integrated firm imposes on downstream competitor, without directly evaluating ultimate effects on consumers (more later)
- Harm to competitor proxy for harm to competition under price squeeze theories

LinkLine Case: Facts

- Linkline sells internet services at retail
- Pac Bell owns local phone infrastructure
- In order to provide retail services, Linkline leased internet “DSL transport” from Pac Bell on a wholesale basis
- Pac Bell also sold internet services to retail customers, competing with Linkline

Linkline’s claim

- Pacific Bell violated antitrust law through a vertical price squeeze.
- Linkline could not compete against Pac Bell in the retail market due to small margin between
 - the wholesale price at which Pac Bell sold access to Linkline
 - and Pac Bell’s price to retail customers

Court of Appeals decision

- Majority opinion for Linkline
- Dissenting opinion for Pac Bell
- Read in context of Supreme Court's *Trinko* decision (2004), holding (1) even a firm with monopoly power has no general antitrust duty to assist its rivals, (2) low prices above predatory levels "do not threaten competition", and (3) "charging of monopoly prices[] . . . not unlawful".

Majority decision

- Rejected Pac Bell's argument that price squeeze theory does not survive *Trinko*
- *Trinko* greatly limited refusal-to-deal-with-rival claims
- Court did not lay out requirements for price squeeze claim
- "[S]ince [respondents] could prove facts . . . that involve only unregulated behavior at the retail level" deny judgment on pleadings

Dissenting Opinion

- Complaint should have been dismissed
- *Trinko* “takes the entirety of wholesale pricing out of the case, and thus transforms what is left of any claim of ‘price squeeze.’”
- Thus “retail side of a price squeeze cannot be considered to create an antitrust violation if the retail pricing does not satisfy the requirements of *Brooke Group*.”
- Respondents could state valid claim only by alleging “market power in the retail market” plus *Brooke Group* requisites for predatory pricing

Petition for Supreme Court Review

- Cited 2 *Covad* decisions: D.C. Circuit held price squeezes did not survive *Trinko*, and 11th Circuit limited squeezes to cases where retail predatory pricing alleged
- Forcing integrated firm to price at a level that guarantees its rival a profit deprives it of efficiency gains flowing from integration
- Preservation of price squeeze would raise consumer prices, deter useful contracts

Opposition to Petition

- Argued that price squeeze claims are well established, standard no harder to apply than predatory pricing standard, and problems posed by Pac Bell's pricing not solved by the regulatory regime in place
- Relied on *Town of Concord* for proposition that price squeezes not problematic when monopolist regulated at retail and wholesale, but here regulation only at one level, thus *Concord* distinguished and "special problem" created

U.S. DOJ Position

- Supported petition, argued recognition of claims with no allegations of predatory conduct, no antitrust duty to deal, no conduct that harmed competition in a way forbidden by antitrust: (1) deters prices cutting; (2) encourages litigation; and (3) harms consumers
- Violation of statutory requirement to deal does not create antitrust duty: *Trinko*
- Charging prices that were too high could not be an antitrust violation when Pac Bell could refuse to deal entirely, so only viable antitrust claim retail predatory pricing, not alleged by Linkline
- Recognizing price squeeze claim without predation inconsistent with modern Supreme Court jurisprudence

FTC Statement

- By 3 Commissioners, Chairman recused
- Argued price squeezes established in antitrust, 9th Circuit “unquestionably correct” that predatory squeeze claims in partially regulated industry survive *Trinko*, so opposed cert.
- “Living profit” for competitors standard of *Alcoa* “at least as clear” as undefined below cost standard of *Brooke Group*
- Price squeeze scheme can cause harm by entrenching monopolist in upstream market and eliminating any pressure to compete on price in downstream market

Margin Squeezes in EU Law: *Wanadoo Spain (2007)*

- Telefonica dominates retail broadband, wholesale broadband markets
- 2001-2006, margin between Telefonica retail prices and price for wholesale access at regional/national levels insufficient to cover costs an operator as efficient as Telefonica would have to incur to provide broadband access, constituting Article 82 infringement
- Margin squeeze found to have foreclosure effects in retail market and to have harmed end use consumers

EU Margin Squeezes: *Deutsche Telekom v. Commission* (2008)

- EC fined DT in 2003 for charging competitors and end-use customers “unfair” prices for local network access
- DT argued its wholesale and retail charges subject to regulation but CFI agreed with EC that DT could have altered tariffs to end margin squeeze
- CFI: wholesale prices regulated but not retail prices, so DT could have raised retail prices
- Query: Wouldn't price rise harm consumers?

Outlook and Final Observations

- Some have argued Court took *Linkline* to vindicate *Trinko* and limit or eliminate price squeezes as a basis for antitrust liability
- Many U.S. economists support limitations on antitrust liability for price squeezes
- If price squeeze theories are cut back in U.S., this will create greater distance between EU and US law