Legal Times

WEEK OF December 15, 2003 • VOL. XXVI, NO. 50

ANTITRUST LAW A Practice Focus

What Giants Can Do

Verizon v. Trinko may set new rules for the business conduct of monopolists.

BY JANET L. MCDAVID, MARY ANNE MASON, AND DAVID J. MICHNAL

On Oct. 14, the Supreme Court heard oral arguments in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko.* The case poses important, difficult, and subtle questions as to how antitrust law should address aggressive behavior by a lawful monopolist, and how to distinguish vigorous competition from predatory conduct.

The underlying dispute in *Trinko* involves claims under Section 2 of the Sherman Act arising from conduct by Verizon toward AT&T that allegedly violated the Telecommunications Act of 1996. The act requires that incumbent local exchange carriers, such as Verizon, share their facilities at wholesale prices with would-be competitors, such as AT&T. Pursuant to this requirement, Verizon agreed to supply local phone service at a discounted rate to AT&T for resale.

Shortly after entering the agreement, AT&T began complaining to regulatory authorities regarding lost and delayed customer orders. Verizon eventually signed a consent decree with the Federal Communications Commission settling Telecom Act charges. A day after the settlement, local phone service customers served by AT&T through Verizon brought a class action against Verizon, alleging that it used its monopoly power in the local phone market to hinder the access of its competitor AT&T, and that AT&T's customers were injured when they were unable to obtain satisfactory local phone service from AT&T.

The District Court dismissed the Section 2 claims, holding that the plaintiffs had failed to state a claim of monopolization in violation of the Sherman Act. The court also dismissed amended Section 2 claims, finding that the act does not impose a general duty on monopolists to cooperate with competitors. The U.S. Court of Appeals for the 2nd Circuit reversed, holding that the plaintiffs' complaint supported an antitrust claim under two different theories of monopoly conduct. *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp.,* 305 F.3d 89 (2d Cir. 2002).

THE BIG PICTURE

Section 2 of the Sherman Act prohibits monopolization, which requires proof of both the possession of monopoly power and the willful acquisition or maintenance of that power. In *Trinko,* the plaintiffs rely on two theories of monopolistic behavior—denial of access to essential facilities and monopoly leveraging. Because certain assets owned or controlled by a monopolist may be essential to participation in the competitive arena, the *essential facilities doctrine* says that the monopolist must provide competitors with reasonable access to them. *Monopoly leveraging* occurs when a monopolist seeks to use its monopoly power in one market as a lever to achieve either an unfair competitive advantage (the 2nd Circuit's rule) or a dangerous probability of monopoly (the majority rule) in another distinct market.

On defense, Verizon, joined by the Department of Justice and the Federal Trade Commission, asks the Supreme Court to draw a bright line establishing when exclusionary conduct is sufficient to support a Section 2 claim. Specifically, the government argues that Section 2 claims must include allegations of exclusionary or predatory conduct characterized by the defendant's sacrifice of short-term profits.

The plaintiffs and supporting amici respond that this standard is too narrow to capture the entire spectrum of exclusionary conduct. They argue that a test based on the sacrifice of short-term profits is only one tool for distinguishing monopolistic behavior from legitimate competitive conduct that maximizes social welfare. They contend that other conduct, such as that of Verizon in *Trinko,* may also be monopolistic, and should not necessarily escape Section 2 review solely for lack of predatory pricing.

Also before the Court is the 2nd Circuit's unique formulation of the monopoly leveraging doctrine. The 2nd Circuit defines monopoly leveraging as the use of monopoly power in one market to *gain competitive advantage* in another market. But the majority of federal circuits require the use of monopoly power in one market to *monopolize or threaten to monopolize* another market, with a dangerous probability of success.

Trinko could also be decided without addressing questions of unlawful conduct under Section 2. Verizon contends that the

plaintiffs, who were not directly injured by Verizon, lack standing to assert a claim because their injury is merely derivative of that suffered by AT&T.

They Argued

In its petition for certiorari, Verizon argues that the 2nd Circuit's decision would impose a new duty to assist competitors—a duty that does not exist under the antitrust laws and was emphatically rejected in *Goldwasser v. Ameritech Corp.,* 222 F.3d 390 (7th Cir. 2000). Instead, Verizon contends, the antitrust laws should only sanction conduct that actively hinders a rival, and should not require a monopolist to provide affirmative assistance to its competitors.

However, counsel for Verizon admitted during oral argument that in both *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973), and *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.,* 472 U.S. 585 (1985), the Court recognized a Section 2 duty of affirmative assistance. Verizon attempted to distinguish *Otter Tail* and *Aspen Skiing,* noting that both cases included an element of discrimination among customers. If the Court were to adopt Verizon's formulation, the essential facilities doctrine would appear to have little remaining vitality.

The government's amicus brief supporting Verizon does not mirror Verizon's assault on the essential facilities doctrine, although the government criticizes the doctrine. Rather, the government advocates a bright line test that conduct violating Section 2 must be "exclusionary or predatory" in that it makes no business sense except as an effort to diminish competition. In a July 3 speech to the National Economic Research Associates, Deputy Assistant Attorney General Deborah Platt Majoras explained it thusly: "The Sherman Act does not impose a duty to sell to rivals in an evenhanded fashion unless the refusal is predatory or exclusionary, i.e., unless the refusal represents a *sacrifice* of profit or goodwill that makes sense only because it has the effect of injuring competition." Majoras qualified the government's position by noting that "we do not mean to suggest that [this test] necessarily encompasses every single type of conduct that may violate Section 2."

Applying this test to the facts in *Trinko,* the government argues that Verizon's efforts to maximize profits and exclude AT&T made business sense, and therefore should not be deemed predatory for purposes of liability under Section 2. Thus, the government argues, the 2nd Circuit's reasoning should be rejected because it would expand antitrust liability.

In an amicus brief supporting the plaintiffs, four prominent economists—William Baumol, Janusz Ordover, Frederick Warren-Boulton, and Robert Willig—vehemently oppose the government's position requiring predatory conduct as a prerequisite to an essential facilities claim. The economists argue that the "sacrifice" test referenced in the government's brief was developed to differentiate only some forms of predatory conduct. They contend that it serves as only one means of identifying conduct for which there is no rationale other than to eliminate competitors. The economists suggest that other forms of conduct unrelated to price, such as fraud or bad faith, can be predatory too. In essence, the economists argue that the sacrifice test is too narrow to be the sole basis for liability under Section 2.

In the House

Members of the House Judiciary Committee also expressed concern with the government's position at a Nov. 19 hearing. Congressional worries focused on the potential of the government's position to have the effect of interpreting the Telecom Act as a repeal of the antitrust laws as to the telecom industry.

Chairman F. James Sensenbrenner Jr. (R-Wis.) asserted that the savings clause—which states, in effect, that the 1996 act is not to be construed as limiting antitrust liability—is quite clear that the antitrust laws trump the Telecom Act. Sensenbrenner warned that if the 2nd Circuit's decision is overturned, "the clear intent of Congress will be eroded."

Ranking Minority Member John Conyers Jr. (D-Mich.) noted that Congress "was quite specific" with respect to the role of antitrust law in the telecom sector, and asked, "How could we have written that more clearly?"

Assistant Attorney General R. Hewitt Pate was there to testify. While acknowledging that the savings clause embodied in the Telecom Act provides that the antitrust laws are not displaced by the act, Pate explained that the government's position means that "for an incumbent's denial of an essential facility to a rival to constitute a Section 2 violation, the denial must be predatory or exclusionary. That is, it must make business sense for the incumbent only because it has the effect of injuring competition."

Pate added, "While the Telecommunications Act can and does impose other requirements, we believe it is important to preserve the distinction between a violation of the Telecommunications Act and a violation of the Sherman Act."

Questions for the Court

So what will the Supreme Court do with *Trinko*? The Court's decision to grant certiorari could indicate that the justices are prepared to provide important guidance on Section 2. The Court's decision could: (1) resolve the question of standing for claimants who suffer derivative harm; (2) determine whether a monopolist has some duty to cooperate or assist its competitors who seek access to essential facilities; (3) address the 2nd Circuit's more expansive view of monopoly leveraging, and resolve the conflict among circuits as to whether Section 2 liability exists for behavior that falls short of attempted monopolization in a second market; and (4) address the general scope of Section 2 liability, including the government's proposal that exclusionary or predatory conduct only violates Section 2 when short-term profits are sacrificed.

- *Standing.* Although both the District Court and the 2nd Circuit held that the plaintiffs had standing, Verizon appealed, arguing that the class's alleged injuries were wholly derivative of the direct customer's (AT&T's) injury. Justice Sandra Day O'Connor raised this concern during oral argument, pointing out that AT&T was the primary injured party. In addition, Verizon notes that *Illinois Brick Co. v. Illinois,* 431 U.S. 720 (1977), bars standing to indirect purchasers.

The 2nd Circuit reasoned that the indirect purchaser doctrine does not apply in this case because the plaintiffs were harmed because they were customers of Verizon's *customer* AT&T, not because they were customers of Verizon's *competitor* AT&T. However, the Supreme Court could conclude that the plaintiffs' injuries were derivative whether or not AT&T is characterized as Verizon's competitor or customer, and therefore the plaintiffs lack standing under Section 2.

- *Essential facilities.* The justices could clarify a monopolist's

duty to deal with competitors under the essential facilities doctrine. The Court has only addressed this doctrine a few times, and it has long been criticized by lower courts and commentators. Courts have struggled with the need to apply a special rule that requires a monopolist to provide assistance to rivals when providing such assistance could, in effect, penalize the monopolist for legitimate business behavior.

If the Court were to adopt Verizon's position, the essential facilities doctrine would have little future viability. The government's test for predatory conduct would also effectively restrict the doctrine's applicability. The four economists, however, argue that because the factual record in *Trinko* is not fully developed, the case provides an insufficient basis for the Court to provide guidance on what constitutes predatory conduct.

• *Monopoly leveraging.* The Court could also address the scope of liability in cases of monopoly leveraging. As noted, the 2nd Circuit's rule imposes liability where a monopolist uses its monopoly power in one market merely to gain competitive advantage in another market. In other circuits, liability is imposed only if there is an attempt to monopolize the second market, and there is a dangerous probability that the attempt will succeed. A decision either way would resolve a significant split among the circuits and bring clarity to Section 2 leveraging issues.

• *Section 2 liability generally.* In its brief, the government argues that the 2nd Circuit's decision "creates the risk of Section 2 liability based merely on the needs of the rival, the violation of regulatory requirements, or perhaps even simple breach of contract." Whether the Court affirms or reverses the 2nd Circuit's decision, it could provide important new guidance on the standards for assessing the lawfulness of behavior by a monopolist faced with rivals seeking entry into arenas over which the monopolist has control.

If the Supreme Court chooses only to resolve the question of standing for derivative harm, *Verizon v. Trinko* will admittedly have limited impact. But the case offers the prospect for a major ruling with long-lasting influence on the antitrust rules that govern the business conduct of monopolists. ■

Janet L. McDavid and Mary Anne Mason are partners, and David J. Michnal is an associate, in the D.C. office of Hogan & Hartson. All three are members of the firm's antitrust, competition, and consumer protection practice group. They can be reached through the firm's Web site, www.hhlaw.com.