Refusals-to-Deal after *Trinko*

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In a short but portentous opinion, the Supreme Court has rejected a claim under Section 2 of the Sherman Act[1] brought against Verizon, a New York incumbent local exchange telecommunications carrier ("ILEC"), by customers of AT&T, a competitive local exchange carrier ("CLEC"), seeking to compete in Verizon's local service area. The decision, *Verizon Communications, Inc. v. Law Offices of Curtis Trinko, LLP*,[2] promises to influence the contours of Section 2 claims for unlawful unilateral refusals-to-deal for years to come. This article reviews the background of the case, summarizes and critiques the Court's reasoning, and suggests some implications for unilateral refusal-to-deal cases in the future.

The Background.

The case was filed one day after the entry of a consent decree in which Verizon's predecessor, BellAtlantic, was fined by the FCC for failing to timely process service orders for CLEC customers, as required by the Telecommunications Act of 1996.[3] The plaintiff, representing the class of all New York CLEC customers, alleged that such violations amounted to anticompetitive conduct cognizable under Section 2. Relying on *Goldwasser v. Ameritech Corp.*,[4] in which the Seventh Circuit found that allegations involving similar claims against an ILEC failed to state a Section 2 cause of action, a New York district court dismissed Trinko's complaint. The Second Circuit reversed and reinstated the antitrust claim, suggesting that, depending on the proof, the claim could lead to Section 2 liability under either the essential facilities doctrine or under a theory of monopoly leveraging.

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[1]15 U.S.C. §2.

[2]540 U.S.___, 124 S.Ct. 872, 2004 WL 51011, 2004 Lexis 657, January 13, 2004.

[3]Pub. L. 104-104, 110 Stat. 56, codified at 47 U.S.C. 151 et seq. The Act opens local telecommunications markets to competition by, *inter alia*, requiring ILECs to lease parts of its local networks to "requesting carriers" and to interconnect with such CLECs at wholesale rates determined in a manner prescribed by the FCC. In exchange, ILECs, previously barred from offering long-distance services, are permitted upon a sufficient showing of competition in their local services areas to enter the long-distance market.

[4]222 F.3d 390 (7th Cir., 2000).

The Supreme Court granted *certiorari* to decide the narrow issue of whether the Second Circuit erred in reinstating the antitrust claim. The AAI filed a brief as *amicus* in support of the plaintiff, urging the Court to permit the case to proceed beyond the pleading stage. In reversing the Second Circuit's reinstatement of the antitrust claim, Justice Scalia, writing for six members of the Court, placed great weight on the limited benefits of an antitrust remedy in light of the availability of existing regulatory mechanisms serving an "antitrust function." The Court also took great pains to distinguish the circumstances of the leading refusal-to-deal case, *Aspen Skiing Company v. Aspen Highlands Skiing Corporation*,[5] from the facts before it. The Court in a footnote also reaffirmed the limits on the "monopoly leveraging" doctrine announced in *Spectrum Sports, Inc. v. McQuillan*.[6] Finally, although the Court saw no need to either "recognize or repudiate" the essential facilities doctrine, it did draw a sharp distinction between cases involving concerted action—*United States v. Terminal Railroad Assn. of St. Louis*[7] and *Associated Press v. United States*[8]—and cases involving unilateral action, *i.e.*, *Otter Tail Power Co. v. U.S.*[9] and *Aspen Skiing*, a case which the Court found to lie "at or near the outer boundary of §2 liability."

The Question of Antitrust Standing.

Justice Stevens, in a concurring opinion joined by Justices Souter and Thomas, agreed that the Second Circuit erred and that the complaint should have been dismissed, but in their view dismissal was warranted because the plaintiff lacked antitrust standing. The plaintiff's injury, according to the concurrence, was "purely derivative" of the injury suffered by AT&T, justifying dismissal based on the principles enunciated in *Associated General Contractors of Cal., Inc. v. Carpenters*,[10] an opinion authored by Justice Stevens some 20 years earlier.

In contrast to the concurrence, the main opinion did not address the issue of antitrust standing, although by remaining mute on the issue and reaching the merits of the case a majority of the Justices apparently found that the plaintiff did enjoy antitrust standing. The precedential value of the Court's opinion as it relates to specific principles of antitrust standing, however, is obscured by the two-pronged relationship of AT&T to Verizon (at once a wholesale customer and a retail competitor), and by the

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[5] 472 U.S. 585 (1985).

[6] 506 U.S. 447 (1993).

[7] 224 U.S. 383 (1912).

[8] 326 U.S. 1 (1945).

[9] 410 U.S. 366 (1973).

[10] 459 U.S. 519 (1983).

reliance by the concurrence on *Associated General Contractors* rather than on other, more narrowly drawn precedent, such as *Illinois Brick Co. v. Illinois*[11] or *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*[12] Unlike these earlier decisions, the holding in *Associated General Contractors* is based on the cumulative effect of several factors: the nature of the injury under the *Brunswick* test, whether the injury was direct or derivative, the nature of the parties' relationship, the speculative or uncertain nature of the damages, the likelihood that an antitrust violation would go undetected or unremedied, and the necessity of keeping the scope of antitrust trials within judicially manageable limits. Presumably, these factors in concert led the concurring Justices to conclude that the plaintiff in *Trinko* fell outside the definition of a "person" entitled to sue for a violation of the antitrust laws set forth in §4 of the Clayton Act.[13]

The main opinion, which suggests that customers of a party denied access by an unlawful refusal-to-deal will not be barred as a matter of law from seeking an antitrust remedy, appears to be substantially more in keeping with existing antitrust standing jurisprudence. The view that the plaintiff's injury was "purely derivative" of the injury suffered by AT&T is difficult to reconcile with the circumstances of the case. Unlike the typical *Illinois Brick* scenario, in which overcharges due to monopoly pricing are passed on by the monopolist's customers to the ultimate consumers, injuries stemming from Verizon's refusal to grant access to AT&T would have been in the nature of lost profits. The plaintiff's damages were of an entirely different character, *i.e.*, the payment of supra-competitive prices due to the inability of AT&T to provide service. The factors that usually defeat antitrust standing, the problems attendant to duplicate recoveries, apportionment of damages, and the remoteness of the injury, were entirely absent in the case before the court.

The Decision on the Merits.

On the merits, Justice Scalia's reasoning proceeded from the oft-quoted proposition that "the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*" [emphasis in the original]. The issue presented, therefore, was the extent to which a refusal-to-deal may constitute the requisite anticompetitive conduct. The Court noted that forcing a monopolist to share an otherwise lawfully acquired monopoly distorts the competitive incentive that the antitrust laws were intended to promote. Forced sharing places on antitrust courts the difficult burden of being a "central planner" required to decide price, quantity, and the other terms of dealing. The general rule for refusals-to-deal announced in *Trinko*,

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[11] 491 U.S. 720 (1977).

[12] 429 U.S. 477 (1977).

[13] 15 U.S.C. §15.

based on a partial quotation from *United States v. Colgate & Co.,*[14] is that the antitrust laws do not restrict the right of an entirely private business freely to exercise its discretion as to parties with whom it will deal. The Court's holding, therefore, turned on whether the complaint had alleged sufficient facts to establish an exception to the ordinary "freedom to deal."

After *Trinko*, there can be little doubt that exceptions to private parties' freedom to deal are narrow, indeed. The Court portrayed the recognized precedents, *Aspen* and *Otter Tail*, as outliers, still good law only because of the particular circumstances involved in those cases. The Court took great pains to emphasize the short-term losses incurred by the defendant in *Aspen*—refusing even to sell at retail, and terminating a presumably profitable prior arrangement—and the similar termination of presumably profitable business activities in *Otter Tail*. The loss of profit occasioned by the refusals-to-deal in those cases provided the necessary indicia of anticompetitiveness which the Court found lacking under the facts alleged in *Trinko*.

To emphasize its point that the sacrifice of profits accompanying the refusals-to-deal in *Aspen* and *Otter Tail* was dispositive for the cognizability of the Section 2 claims brought in those two cases, the Court ran roughshod over important distinctions between them. While it cannot be disputed that *Aspen* involved the discontinuation of a pre-existing business relationship between horizontally related competitors, no such pre-existing relationship existed in *Otter Tail*. The *Otter Tail* case involved the refusal by a vertically integrated electric utility to wheel wholesale power to a municipal provider which the town had established upon the expiry of its retail supply contract. To leverage its regional monopoly in wholesale power distribution to the retail market, the defendant refused to sell at wholesale to the newly established municipal system. Given the vertical leveraging involved, the claim in *Otter Tail* represents a much closer analog to the claim in *Trinko* than does *Aspen*. Moreover, despite whatever validity there may be to the view that *Aspen* lies at the outer boundary of Section 2, *Otter Tail* cannot reasonably be considered anything other than a mainstream application of the anti-monopolization statute. Conflating it with *Aspen* and distinguishing it from the case before it by stating that "the defendant [in *Otter Tail*] was already in the business of providing a service to certain customers (power transmission over its network), and refused to provide the same service to certain other customers," the *Trinko* Court appears to have indulged in a kind of legal dissimulation.

To be sure, prior to the "Vail Compromise" and passage of the Mann-Elkins Act of 1910,[15] larger local telephone companies had no apparent legal duty to interconnect

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[14] 250 U.S. 300 (1919).

[15] Ch. 309 §7, 36 Stat. 539, et seq. The compromise, in which AT&T agreed to interconnection with independent local carriers and regulated prices in exchange for a monopoly in long-distance and local service in its existing service areas, is named after Theodore Newton Vail, General Manager and President of AT&T, 1879-89 and 1907-19.

with smaller competitors. Since then, however, the Supreme Court decided not only *Aspen* and *Otter Tail,* but MCI successfully challenged AT&T's monopoly in long distance telephony[16] and the government succeeded in dismantling the Bell System and imposing on the resulting regional carriers the duty to interconnect with non-Bell inter-exchange carriers,[17] neither of which involved any showing of a prior arrangement between the parties. Thus, while the outcome in *Trinko* may not be revolutionary, it is somewhat atavistic. All these examples of judicially imposed access are still considered welfare-enhancing, pro-competitive outcomes in many respectable quarters. The result in *Trinko* required the Court to either disingenuously interpret these precedents or ignore them altogether.

The "Sacrifice Test."

The net result of the *Trinko* Court's treatment of its own unilateral refusal-to-deal precedents was to assign a central role to the "sacrifice test" as an indicium of the unlawfulness of a refusal-to-deal. In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,[18] the Court solved the difficult problem of differentiating between lawful pro-competitive price-cutting and unlawful anticompetitive predatory pricing by requiring a predatory pricing plaintiff to demonstrate that the defendant incurred some measure of short-term profit loss in a rational hope (accompanied by a demonstrable possibility) of earning long-term monopoly rents. The *Trinko* Court appealed to the same calculus to determine that Verizon's alleged refusal-to-deal with AT&T could not have been unlawful. Because any refusal by Verizon would have been to deal on *wholesale* terms, a business arrangement which, but for the interconnection mandate in the 1996 Act, Verizon would never have offered to *any* of its customers (particularly to retail customers or competitors), the Court concluded that the complaint in *Trinko* could not have alleged a sacrifice of short-term profits, and so did not state a Section 2 cause of action.

By omitting any reference either to the *MCI* case before the Seventh Circuit or the district court's handling of *U.S. v. AT&T*, the Court avoided the uncomfortable fact that neither of these cases involved any demonstrable sacrifice of short-term profits. The superficial treatment of *Otter Tail* accomplished the same result. Thus, it is not unreasonable to wonder whether these cases would ever have survived a motion to dismiss had the *Trinko* decision already been on the books.

The extent to which the *Trinko* decision raises the bar for future to refusal-to-deal

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[16] *MCI Comm. Corp. v. AT&T, Co.,* 708 F. 2d 1091 (7th Cir.), *cert. den.,* 464 U.S. 891 (1983).

[17] *U.S. v. AT&T, Co.*, 552 F.Supp. 121 (D.D.C., 1982), *aff'd sub nom., Maryland v. U.S.*, 460 U.S. 1001 (1983).

[18] 509 U.S. 209 (1993).

cases is open to some interpretation. The more sweeping view is that to meet the exception to the general rule that refusals to deal are lawful, a plaintiff now must prove that the refusal involves the sacrifice of short-term profits. Read in this light, the decision hands a substantial victory to the government, which had argued that the Court should adopt the sacrifice test as the *sole* basis for determining willfulness in all Section 2 refusal-to-deal cases.

But, as economists William J. Baumol, Janusz Ordover, Frederick R. Warren-Boulton, and Robert D. Willig pointed out in their *amicus* brief, a profit-sacrifice requirement is conceptually flawed. While the sacrifice of short-term profits of the type described in *Brooke Group* can serve as evidence of willful exclusionary conduct, it does not follow that such conduct occurs *only* in the presence of such a sacrifice. That is, the sacrifice of short-term profits may well be a sufficient condition for demonstrating anticompetive conduct, but it is not a necessary one.

The reason is that when regulation or other constraints not related to market influences shape business behavior, there may be other reliable evidence of anticompetitiveness, even in the absence of a sacrifice of short-term profits. In the view of these economists, the *Trinko* case presented just such a context. In light of the *specific repudiation* in pro-competitive legislation of refusals-to-deal as being anticompetitive (*i.e.*, the 1996 Act), the presumption that such refusals represent welfare-enhancing profit-seeking of the type the antitrust laws are intended to promote is manifestly inappropriate. For the same reason, the Court's reliance on avoiding "false positives" in adjudging such behavior as anticompetitive seems equally misplaced.

Given that the case was decided on a motion to dismiss, the interpretation that the sacrifice of short-term profits is now a necessary element of a unilateral refusal-to-deal claim does not require much of a stretch. A less sweeping interpretation of the role assigned to the profit-sacrifice test by the *Trinko* Court, however, and one which is more accommodating to the economics professors, is that proof of a profit-sacrifice is but one kind of evidence that could support a finding that a refusal-to-deal is actionable. But in light of the fact that the Court gave the plaintiff no opportunity to plead or adduce such alternative evidence, this less restrictive interpretation may ultimately be repudiated.

A "New" Section 2 Theory?

The *Trinko* Court also appeared to reckon that on account of the 1996 Act, the plaintiff's theory presented something new in Section 2 jurisprudence. If so, it follows that the Court's cost/benefit analysis, pitting the costs of potential antitrust liability against the benefits of relying on what it perceived to be "antitrust functions" of the 1996 Act, may have been an appropriate basis on which to determine whether the suit

should have been dismissed. But the plaintiffs (and the AAI) argued that under settled antitrust principles, conduct in the form of a gateway-monopolist refusing or retarding interconnection should be actionable. In a corollary to the economists' argument, plaintiff and its *amici* argued that the *Trinko* case presented something like *Town of Concord, Ma. v. Boston Ed. Co.*,[19] in reverse. If the presence of price regulation in *Concord* created circumstances that made anticompetitive pricing less likely, and provided a basis for precluding a Section 2 action without the need to find antitrust immunity, certainly the *withdrawal* of state-granted monopoly status and the institution of a new, competitive regulatory regime created new circumstances that made anticompetitive conduct *more* likely (or at least easier to demonstrate, given the legislative prohibitions on certain behavior). Thus, while the circumstances and regulatory regime may have been new, the underlying Section 2 theory was not. Unfortunately, this reasoning was turned on its head, and *Concord* was enlisted by the Court as authority for dismissing the action. In the presence of such detailed regulation (never mind that its intent is to encourage competition), the Court found that anticompetitive conduct was *still* less likely!

By treating the plaintiff's theory as something new, the Court not only opened the door to deciding the case on the basis of a cost/benefit analysis, but it also empowered the Court to use the Act's antitrust savings clause as ammunition for dismissing the complaint. Thus, when the Act states, in effect, "Nothing herein shall affect existing antitrust law," the Court was able to claim that *Trinko* presented precisely the kind of new application of antitrust law that Congress intended to forestall. This perverse reasoning harkens back to *Goldwasser*, a decision that relied heavily on the reasoning that what was not an antitrust action before the Act is still not an antitrust action after the Act.

Off-loading the remedy for a failure to grant access to infrastructure onto the existing telecommunications regulatory regime is puzzling. There remain numerous outstanding issues related to the FCC's administrative remedies, so the case for antitrust law as a backstop is quite strong. Moreover, the Chairman has acknowledged that the FCC's remedial authority is weak and in need of strengthening, creating a danger that incumbent monopolists may view administrative fines as merely a cost of doing business.

The *Trinko* case is likely to have implications in other regulated industries, such as electric utilities. Although substantial differences exist between the Telecommunications Act and the Energy Policy Act, the Federal Power Act, or the regulations of the Federal Energy Regulatory Commission as they relate to access to transmission grids, plaintiffs attempting to use the antitrust laws to enforce access are likely to face an uphill battle. Nothing in the opinion limits its applicability to telecommunications, and there is every reason to believe that an antitrust claim based

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[19] 915 F.2d 17 (5th Cir. 1990).

on lack of access will have to overcome the argument that in order to survive a motion to dismiss the defendant must be alleged to have either terminated an ongoing relationship, incurred some kind of short-run profit sacrifice in the hope of the later recoupment of supra-competitive profits, or both.

Conclusion: Is the 1996 Act Sufficient?

Apparently, the Court's "bottom line" was that the remedies contained in the Telecommunications Act were sufficient in themselves to deter the kind of anticompetitive conduct complained of in *Trinko,* and despite contrary indications this view has a great many adherents among antitrust practitioners and analysts. But such a conclusion begs the question: *Why* did Congress enact the antitrust savings clause? If the Act provides sufficient relief, how is it that the plaintiff in *Trinko* has no recourse under the Act? Or that whatever remedy it may have under existing FCC law (a matter that is still largely undetermined) is at best a paltry administrative remedy compared to the much more substantial consequences of a private, treble-damage suit, *i.e.*, the type of remedy Congress thought appropriate in the case of anticompetitive harm? If Trinko's law business was disrupted by not obtaining or over-paying for local phone service because Verizon could not or would not promptly interconnect AT&T, it is cold comfort indeed that his remedy is to complain to the FCC, which may have no power to compensate the complainant and is unable to impose a stiff enough penalty to deter the same kind of conduct in the future.

It makes more sense to believe that it was precisely the *Trinko* result—that antitrust suits against incumbent monopolists are precluded by the Act—that Congress was trying to avoid by enacting the savings clause. Indeed, as *Trinko* and the multitude of suits like it demonstrate, Congress had good reason to believe that the Telecommunications Act of 1996 by itself was not sufficient to bring the benefits of competition to the nation's local exchange markets. After *Trinko*, only further legislation can make that clear.

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