The Economics of Pacific Bell v. linkLine Communications

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The Supreme Court recently granted certiorari in Pacific Bell Telephone Co. v. linkLine Communications. The grant was controversial, with the Department of Justice arguing the Court to hear the case and the Federal Trade Commission disapproving. The case raises important questions concerning antitrust economics of price squeezes and the incentives to invest in certain telecommunications networks.

linkLine accuses Pacific Bell (now AT&T) of setting its wholesale and retail rates for DSL service so close together that a competitor could not profitably buy wholesale DSL access and then resell the service to retail customers. Thus, linkLine accuses Pacific Bell of engaging in a classic price squeeze. The Supreme Court will decide whether a firm can be held liable for a price squeeze even though the firm is under no antitrust duty to deal.

At first blush, the economic implications of this case appear to be limited, at least in telecommunications, since the FCC does not require firms to grant wholesale access to new infrastructure. However, a ruling in favor of linkLine could have far-reaching implications for investment in any network subject to so-called “open access” requirements, such as those the FCC imposed in its most recent spectrum auction.

The open access rules stipulate that a network built using a particular part of the spectrum be open to any compatible device and service. The extent to which the network will actually be open will depend on the wholesale price for access, and no regulatory decisions have yet been made concerning that price.

Should the Supreme Court find for linkLine, then a company operating an open network could be subject to the argument that its wholesale and retail prices are too close together. By default, the first aspect of price regulation would therefore be a defined gap between the provider’s retail and wholesale prices. The result would be either a floor on the incumbent’s retail price or a ceiling on its wholesale price. Those limits make it difficult for the provider to compete at retail. Limiting the provider’s ability to compete will also limit potential returns from network investments. As a result, providers may reduce their investment, or perhaps choose not to build the network at all.

Also In This Issue

Resale Price Maintenance and the Rule of Reason

Laura A. Malowane uses a recent case in Kansas State Court to discuss how courts may deal with resale price maintenance under the rule of reason. In such cases, a court must address two issues. First, was the RPM policy anticompetitive? Second, if the RPM policy was anticompetitive, did it result in injury or damage to the plaintiffs, in this case the members of a class? In addressing these issues, it is important to remember that manufacturers often have procompetitive reasons for RPM. Such policies may enable manufacturers to give retailers incentives to carry and invest in its brands, thus making the manufacturer a stronger competitor for other brands. As a result, rather than suffer antitrust injury, consumers may benefit from RPM. The Kansas court granted defendant summary judgment, because plaintiffs could not present compelling evidence of injury.

The McCarran-Ferguson Act’s Antitrust Exemption: Lessons from Europe

The insurance industry has certain exemptions from the competition laws in both the United States and the European Union (EU). David D. Smith describes how the EU’s review of its insurance industry’s antitrust exemption could have important lessons for the United States. In the United States, the McCarran-Ferguson Act exempts from the federal antitrust laws collaborative behavior by the insurance industry under certain circumstances. In the insurance industry, some cooperation among competitors can substantially increase efficiency. Nonetheless, this special treatment of one industry has been under attack for complicating antitrust enforcement and creating economic distortions across industries. The EU’s consideration of this issue will provide Americans with an opportunity to follow a debate on the need for antitrust exemptions specific to the insurance industry.