Judge Breyer and the Price Squeeze Problem
(Town of Concord, Mass. v. Boston Edison Co., 915 F.2d 17 (1st Cir. 1990)

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Judge Breyer's decision in *Town of Concord, Mass. v. Boston Edison*, complete with two academic appendices, is a classic example of using abstract economic theory to deny or override factual realities. While I can not say that the ultimate holding in the case was necessarily wrong, it is very clear that the approach adopted is antithetical to a reasoned, fact based inquiry into what are in real world terms very difficult and complex legal-economic questions. This is even more troubling because the decision has the effect of empowering large and dominant utilities to engage in anticompetitive, strategic regulatory behavior. In an era of large scale deregulation, especially in the telecommunications area, Judge Breyer has repeated the error that he made as a staff advisor to Senator Kennedy in preparing the airline deregulation legislation: he has assumed despite generations of real world experience to the contrary that business's will not seek and exploit strategic opportunities to gain unjustified competitive advantage. Only strict but thoughtful antitrust review can police such market conduct and ensure that the nominally competitive market is competitive in practice so that consumers gain the theoretically predicted advantages.

The facts of the *Concord* case appear to be that Concord and another locality had municipally owned, local power systems. These systems purchased the bulk of their power from Boston Edison at a wholesale rate. Boston Edison also provided retail power service in a number of adjacent communities. Boston Edison convinced the Federal Energy Regulatory Commission (FERC) that its costs of producing power had increased and so its wholesale rates (the prices charged to the independent distribution systems like Concord that retailed power) should go up. However, Boston Edison did not ask the Massachusetts Department of Public Utilities for an increase in its own retail rates for the service it provided in 39 adjacent towns. In consequence, Concord found that while it had to raise its retail rates, retail customers in the adjacent communities faced no comparable price increase. Such a "price squeeze" would directly affect Concord's ability to compete for new customers that used substantial amounts of electricity. In

addition (this is perhaps the greater competitive evil), the lesson for communities using Boston Edison's service is that retail prices would go up in any community that sought to take control over its own local electric service.

Although Concord satisfied a jury and trial judge that the price squeeze existed and that its purpose was to harm the competitive capacity of the towns being squeezed, Judge Breyer writing for a three judge panel rejected the verdict and ordered the case dismissed. The decision rests on two conclusions: first, that the antitrust laws should not generally be used to condemn price squeezes engaged in by monopolists if both levels of price are subject to direct regulation. Second, the Court concluded that Boston Edison lacked monopoly power in the business of supplying electricity and so the predicate monopoly power necessary for any finding of illegality was missing. This second conclusion makes the entire discussion of the merits of the conduct unnecessary for the result in the case. One can not help but wonder why Judge Breyer undertook such a lengthy (8+ pages compared to only 3 for the legally controlling issue) analysis of the price squeeze issue which advances several controversial positions when a second issue was controlling in any event [1]

Judge Breyer starts his analysis of price squeezes by arguing that the competitive risks of such conduct have been exaggerated and the potential efficiency gains largely ignored in contexts outside those presented by regulated industries His proof consists of citations to the Areeda and Turner treatise on antitrust law, a dissenting opinion by Judge Easterbrook, one of the most persistent users of economic theory to deny the reality of business experience, and a quotation from a Supreme Court decision that had nothing to do with price squeezes. This is hardly an overpowering array of support for the proposition that price squeezes are not generally a serious threat to competition. This conclusion is then linked with the more plausible contention that determining the facts about a purported price squeeze is a difficult judicial task. The combination of arguments in turn justifies a negative attitude toward price squeezes as potential

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[1] The monopoly power analysis is questionable on its own merits and was applied in the case in a way that ignored the potential of an attempt to monopolize claim that might have been a more relevant way to evaluate the jury's ultimate decision. In order not to unduly lengthen this discussion, I will focus only on the price squeeze issue which represents the most troublesome aspect of the case as a precedent restricting antitrust review of strategic conduct in regulated industries

antitrust violations. While repeatedly asserting that the opinion does not "question that conclusion. . . " (p. 25), the implication is that Judge Breyer is very skeptical that any price squeeze occurs except for legitimate business reasons. Indeed, Judge Breyer might be on stronger ground with respect to unregulated markets where entry and exit can occur without lengthy administrative processes.

The second stage of the argument against price squeezes is the more remarkable. Without any examination or recognition of the lengthy, well worked out theories of how regulatory processes can be and are used strategically to harm consumer and other public interests, Judge Breyer starts from the naive assumption that regulation is done in the public interest. Hence he asserts that "regulation significantly diminishes the likelihood of major antitrust harm." (at 25) He then advances a simple proposition: when both levels of price are subject to direct regulation there should be little or no risk of anticompetitive exploitation of price.

Indeed, if a SINGLE, well-motivated regulator controlled both levels, such a presumption might seem plausible on its face. But in this, and as far as I have seen all comparable cases, the key and central regulatory fact is that DIFFERENT REGULATORS CONTROL PRICES AT THE TWO DIFFERENT LEVELS. Thus, FERC only controlled Boston Edison's wholesale price while the Massachusetts regulator alone controlled its retail prices. This regulatory division creates an obvious opportunity to manipulate the retail-wholesale difference in strategic ways. The integrated company can shift costs to wholesale customers (who also compete for new retail business) while not igniting a fire storm of local opposition because no application is made to the state authorities to increase retail prices (who else is going to force up retail prices to reflect the new, higher nominal wholesale price?). Unlike some predatory practices, this squeeze results in shifting costs to the competitor which enhances the profits of the dominant firm while penalizing the other firm. According to antitrust history, John D. Rockefeller got the railroads to pay rebates to Standard Oil based on the volume of oil shipped by its competitors (thus both lowering Standard's costs and raising those of its rivals); yet Judge Breyer is both unaware of the analogy and insensitive to the manifest competitive risks that dual regulation presents in this case.

Indeed, not one word in the opinion addresses the tension that necessarily exists when two regulators share authority over the final price to consumers and are not required to

coordinate their actions. Such a situation, where the mandated prices must be charged as a matter of legal requirement, creates a particularly attractive opportunity for strategic behavior that can shift costs, deter existing competition, and retard the incentives for new entry of locally owned retail distribution systems. Yet Judge Breyer, a man who made his reputation as a scholar by writing about the problems of effective regulation, does not even acknowledge the issue. Instead, he uses general concerns about how antitrust review might disrupt public interested, regulatory efficiency to validate further his preference for ignoring the competitive risks involved. A similar inability to see the risks inherent in airline deregulation (a project in which Judge Breyer played an important role as a staffer for Senator Kennedy) caused that legislation to become law without the necessary protections against anticompetitive mergers and conduct.

The spirit of the *Concord* decision is close to that of Justice Scalia in *Business Electronics Corp. v. Sharp Electronics Corp,* 485 U.S. 717 (1988). In that decision, Scalia claimed that economic theory established that vertical restraints not directly controlling prices could have no anticompetitive effect despite thousands of real world examples to the contrary. The better approach is that eloquently articulated by Justice Blackmun, whom Judge Breyer is to replace, in the recent decision of *Eastman Kodak v. Image Technical Services, Inc.* __U.S._, 112 S.Ct 2072 (1992). Justice Blackmun used economic theories to assist in evaluating the particular facts of the case. Theories were rejected if they could not explain the facts rather than the other way around.

The *Concord* decision is particularly troubling because it refuses an antitrust review in a context of regulatory conflict and uncertainty. It invokes sweeping theories having little empirical support and no particular relevance to the specific factual context. As the states and the federal government move toward more competitive public utilities, we need the spirit of Blackmun with his concern for understanding the competitive realities and not another Scalia type theorist who, having imagined a pro-competitive explanation, ignores the record and the context to refuse a focused antitrust evaluation of the merits of the conduct at issue.