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Antitrust Looms Large in the Supreme Court's Past Term

Prepared by the Antitrust Litigation Committee

The Supreme Court had an uncommonly active year in 2007 in the area of antitrust, deciding four cases:

- In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[1] the Court overruled nearly a century of precedent when it held that vertical agreements between manufacturers and retailers to set minimum resale prices are to be analyzed under a rule of reason standard, rather than under the *per se* rule.
- The Court re-examined the pleading standard on a Rule 12 motion to dismiss in *Bell Atlantic Corp. v. Twombly*,[2] dealing specifically with complaints alleging a conspiracy based on parallel behavior.
- In *Credit Suisse Securities (USA) LLC v. Billing*,[3] the Court held that the antitrust laws were implicitly repealed by the securities laws with respect to conduct involving the promotion and sale of newly issued securities.
- Finally, the Court held in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*[4] that the legal standard applicable to predatory pricing by a monopolist also applies to allegedly predatory buying activity by a monopsonist.

We discuss each decision further below.

Leegin: Liability for Vertical Minimum Resale Price Maintenance Re-Evaluated

In *Leegin Creative Leather Products, Inc. v. PSKS, Inc. d/b/a Kay's Kloset*,[5] the Supreme Court continued its trend favoring rule of reason analysis, instead of *per se* condemnation, for competitive practices challenged under Section 1 of the Sherman Act. This time, the Court set its sights on vertical agreements between manufacturers and retailers to set minimum resale prices, a practice deemed a *per se* violation of Section 1 of the Sherman Act since the Court's 1911 decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[6] A "minimum" resale price maintenance arrangement sets the floor price, below which a retailer may not sell.[7]

In a 5-4 decision, the majority overruled *Dr. Miles* and its progeny. Justice Kennedy authored the majority decision and was joined by the Chief Justice along with Justices Scalia, Thomas, and Alito. Justice Breyer authored the dissent and was joined by Justices Stevens, Souter, and Ginsberg.

Defendant Leegin Creative Leather Products ("Leegin") is a manufacturer and distributor of leather goods and accessories sold under the brand name "Brighton" throughout the United States in more than 5,000 retail stores. Beginning in 1997, Leegin instituted the "Brighton Retail Pricing and Promotion Policy," whereby it refused to sell Brighton products to retailers who discounted them below Leegin's "suggested" retail prices.[8] Plaintiff PSKS operated a retail store known as Kay's Kloset ("Kay's"). Kay's agreed to the Brighton Retail Pricing and Promotion Policy, but subsequently began discounting Brighton products by 20 percent. When Kay's refused Leegin's request to stop discounting from the suggested retail prices, Leegin stopped selling Brighton products to Kay's. Kay's alleged that it was injured because retail sales of Brighton products accounted for approximately 40-50 percent of its profits.

Kay's filed suit in the Eastern District of Texas alleging a *per se* violation of Section 1, premised on a retail price maintenance conspiracy between Leegin and its retailers adhering to the Brighton Retail Pricing and Promotion Policy. The District Court ruled that Leegin could not present expert testimony in support of a rule of reason defense because *Dr. Miles*'s *per se* rule applied.[9] A jury found for Kay's and awarded it $1.2 million in damages. After trebling and costs, the District Court entered judgment for Kay's in the amount of $3,975,000. The Fifth Circuit Court of Appeals affirmed the judgment, rejecting Leegin's argument that the rule of reason applied to its pricing agreements with retailers.[10] When Justice Scalia granted a stay of the Fifth Circuit's judgment in August 2006,[11] the Supreme Court's likely willingness to revisit *Dr. Miles* quickly captured the attention of the antitrust bar. The grant of certiorari itself came in December 2006.[12]

Writing for the majority, Justice Kennedy reasoned that minimum retail price maintenance agreements no longer qualified as a restraint having "manifestly anticompetitive" effects necessary for *per se* class treatment.[13] The majority cited what it believed to be equivocal support in the economic literature endorsing the anticompetitive effects of such agreements, with some studies finding that retail price maintenance agreements produced desirable effects.[14] The majority also cited the support of the Department of Justice and Federal Trade Commission for replacing the *per se* rule with a rule of reason standard.[15] The Court seemed particularly concerned with a need to protect manufacturers and retailers from "free riding," which is said to occur when retail stores that rely on higher prices and margins, and whose reputation and practices can have positive effects on the products they sell, are undercut by discounting retailers like Wal-Mart and Sam's Club.[16]

The majority also took aim at *Dr. Miles*'s reliance on common law principles, an approach that, in the majority's view, was uninformed by economic justification, and thus produced an unreliable result. Demonstrating a willingness to consider anew antitrust decisions and rationales formulated in the early years following passage of the Sherman Act, the Court observed that it "should be cautious about putting dispositive weight on doctrines from antiquity but of slight relevance."[17]

Moreover, while acknowledging that a high incidence of manufacturers and retailers agreeing to set minimum retail prices could result in higher overall consumer prices, the majority believed that the practice of resale price maintenance is relatively uncommon.[18] The majority also believed that such agreements were likely to be beneficial because they can help promote interbrand competition, thereby promoting the policies underlying the antitrust laws generally. As a caveat, the majority did warn, however, that should retail price maintenance agreements become more prevalent, the federal courts should be ready to take account of the potentially anticompetitive effects of such agreements in undertaking the rule of reason analysis necessary to determine their lawfulness. Lastly, buttressed by the trend away from applying a *per se* rule to vertical restraints, the majority explained that overruling *Dr. Miles* was the next logical step based on a seemingly more informed interpretation of the economic and legal principles underpinning the antitrust laws.

Reflecting the closeness of the Court's ruling, the dissent took issue with the pillars on which the majority built its ruling. For example, Justice Breyer agreed that the economic literature was equivocal and that minimum retail price maintenance agreements probably did have both pro- and anti-competitive effects. But he also maintained that lack of economic consensus weighed strongly in favor of adhering to the long-standing *Dr. Miles per se* standard that pervades the expectations and decision-making of manufacturers, retailers and consumers.[19] Indeed, Justice Breyer noted that *Dr. Miles* has been cited with approval many times in 96 years, including in the very economic literature relied upon by the majority.[20]

The dissent also noted that while federal enforcers now supported jettisoning *Dr. Miles*, 30 years earlier those same agencies strongly endorsed repealing fair trade legislation because, as they then told Congress, the effect of vertical price-fixing was to increase consumer prices. There was, the dissent argued, no particularly strong empirical evidence developed during the intervening years that explained this changed federal position. Indeed, led by New York, 37 states took a position contrary to those of their federal counterparts and urged the Supreme Court to adhere to *Dr. Miles*.[21]

In all events, the Supreme Court reversed the Fifth Circuit and remanded the case for further proceeding consistent with the majority decision to apply a rule of reason analysis. The Fifth Circuit has remanded the case to the District Court.[22] A few federal courts have since cited the *Leegin* decision, but none has yet accepted the Supreme Court's invitation to explore adapting a rule of reason analysis to a vertical price-fixing agreement.

Twombly: Pleading Standard Re-examined in Conspiracy Action

In *Bell Atlantic Corp. v. Twombly*,[23] the Supreme Court re-examined the pleading standard in a case alleging a violation of Section 1 of the Sherman Act based on parallel behavior by telecommunications companies. The result was a decision that imposes a more rigorous standard in antitrust conspiracy cases--how much more remains to be developed--and that may well affect federal pleading standards more generally. Plaintiffs were telephone subscribers who alleged that defendants, local telephone carriers, conspired to avoid competition after they were encouraged to compete in one another's markets under the 1996 Telecommunications Act.

Plaintiffs alleged parallel conduct: none of the defendant companies entered another's market, and they employed similar restrictive practices to keep out new entrants. The district court granted defendants' motions to dismiss because plaintiffs failed sufficiently to allege "plus-factors" to support their theory of collusion. The Second Circuit disagreed, holding that the liberal notice pleading standards under Rule 8 did not require plaintiffs to plead more than parallel conduct. Reversing, the Supreme Court revisited the pleading standard on a motion to dismiss, derived from *Conley v. Gibson*.[24] In *Conley*, the Supreme Court held that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in

support of his claim which would entitle him to relief."[25] The *Twombly* Court, however, took aim at the *Conley* test:

> [T]here is no need to pile up further citations to show that Conley's "no set of facts" language has been questioned, criticized, and explained away long enough. . . . The phrase is best forgotten as an incomplete, negative gloss on an accepted pleading standard: once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint.[26]

The Court also advanced a new interpretation of Rule 8, which provides that a plaintiff must plead only "a short and plain statement of the claim showing that the pleader is entitled to relief." The Court drew a distinction between a "showing" and a conclusory assertion that the pleader is entitled to relief. The Court explained that "factual allegations must be enough to raise a right to relief above the speculative level."[27] The Court held that Twombly's complaint was legally insufficient because plaintiffs failed to state a claim for relief that was "plausible on its face."[28]

Twombly is significant in two respects. First, it already has been, and will continue to be, used to argue that a heightened pleading standard exists not only for antitrust conspiracy claims in particular, but also for all federal claims generally. This effect is inevitable, even though the Court expressly stated that it was *not* announcing a new heightened pleading standard, and indeed recognized that it lacked the authority to revise Rule 8.[29] Second, *Twombly* is notable for failing to shed light on the type of "plus-factors" that are necessary to state a legally sufficient conspiracy claim based on "conscious parallelism" under Section 1 of the Sherman Act.

***Billing*: Implicit Repeal of the Antitrust Laws Revisited**

In *Credit Suisse Securities (USA) LLC v. Billing*,[30] the Supreme Court clarified the extent to which the antitrust laws may be implicitly repealed when challenged conduct is heavily regulated. The decision thus reflects the disfavor, evident several years ago in *Trinko*,[31] for antitrust court review of business conduct within the authority of regulatory officials.

The plaintiffs were a group of buyers of newly issued securities, who alleged that underwriters of initial public offerings of securities ("IPOs") had agreed with each other to adopt restrictive practices that artificially inflated the price of new stock offerings. Among other things, the plaintiffs alleged that the underwriters had agreed with each other not to give allocations of newly issued stock in IPOs unless the recipient either pledged to buy additional shares of the same stock at higher prices or agreed to purchase other less desirable securities from the underwriters. The Court of Appeals for the Second Circuit concluded that the securities laws did not implicitly repeal the antitrust laws in this area and permitted the plaintiffs' lawsuit to proceed.

The Supreme Court, in a 7-1 decision,[32] reversed the Court of Appeals, holding that, in the context of the conduct alleged in this case, the securities laws and the antitrust laws were "clearly incompatible." First, the Court noted that the general type of activity in question--the efforts by underwriters jointly to promote and sell newly issued securities--is "central to the proper functioning of well-regulated capital markets."[33] Second, the Court observed that Congress had granted the Securities and Exchange Commission ("SEC") authority to supervise all of the activities in question, and that the SEC had in fact exercised that authority to regulate the general conduct that the plaintiffs challenged. Most significantly, the Court concluded that the application of the antitrust laws to the conduct alleged was incompatible with the SEC's administration of the securities laws, even though the current SEC regulations actually disapprove of that conduct. The Court explained that there was a clear incompatibility between the antitrust laws and securities laws because there is a fine line between what the SEC permits and what it forbids, and only the SEC has the expertise to determine whether certain conduct falls on one side of that line or the other. It found that if these determinations were made by the courts in antitrust cases, then there would be an unacceptable risk of inconsistent results and "unusually serious mistakes" that would cause underwriters to avoid a wide range of conduct that the securities laws permit or even encourage.[34]

Accordingly, the Court held that the securities laws were "clearly incompatible" with the application of the antitrust laws in this context, and that the application of antitrust laws to the conduct challenged by the plaintiffs was implicitly precluded. As a result, the plaintiffs' antitrust claims could not proceed. This decision will be important not only for companies in the securities industry, but also for those in regulated industries generally who maintain that the antitrust laws are inconsistent with the statutes and regulations governing their industries.

***Weyerhaeuser*: Liability Test Established for Predatory Over-Bidding by a Buyer**

Antitrust actions brought against buyers, rather than sellers, are relatively unusual. Rarer still are antitrust actions brought against an individual buyer for offering to pay too much for a needed item. In *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*,[35] the Supreme Court considered the issue of predatory pricing liability by a monopsonist, i.e., a buyer with monopoly power. The case afforded the Court the opportunity to decide whether the analysis adopted in *Brooke Group Ltd. v. Brown &*

Williamson Tobacco Corp.[36] to evaluate seller liability for predatory pricing also applied to purchasing activity by a buyer. *Brooke Group* adopted a two-part test for proving predatory pricing by a seller:

> "First, a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs. . . ." Second, a plaintiff must demonstrate that "the competitor had . . . a dangerous probabilit[y] of recouping its investment in below-cost prices."[37]

In *Weyerhaeuser*, the Supreme Court considered not a seller alleged to have charged too little in order to drive out rival sellers, but rather a powerful buyer said to have paid too much as part of a scheme to exclude rivals from the purchase market. The Court unanimously endorsed the *Brooke Group* analysis, holding that it applied as well to predatory "buy-side" activity, the effect of which was to deny purchasing rivals access to a necessary input.

Weyerhaeuser involved the market for red alder sawlogs, which mills in the Pacific Northwest process into hardwood lumber. Ross-Simmons, the plaintiff, operated a sawmill in Washington until going out of business in 2001. Weyerhaeuser, a competitor, operated six sawmills in the region, and had a roughly 65 percent share of the market for the purchase of alder sawlogs--a "monopsony" or near-monopsony position. In the "downstream" or finished lumber market, however, alder lumber competed with other types of hardwood lumber. Thus, Weyerhaeuser's share of this downstream market was on the order of 3 percent.

In the period leading up to Ross-Simmons's cessation of operations, sawlog prices increased whereas finished lumber prices decreased--contrary to historical conditions in which sawlog prices fluctuated with finished lumber prices. With its input costs rising while prices for finished lumber declined, Ross-Simmons suffered losses and ended its operations.

Ross-Simmons alleged that Weyerhaeuser was the cause of its demise. Asserting Sherman Act § 2 monopolization and attempted monopolization claims, RossSimmons maintained that Weyerhaeuser engaged in "predatory overbidding and overbuying"--i.e., paying a higher price for sawlogs than the market otherwise called for, and purchasing more logs than it needed for business operations. According to Ross-Simmons, the effect of Weyerhaeuser's activity was artificially to inflate the price needed to acquire alder sawlogs, thereby unlawfully excluding Ross-Simmons and rival purchasers.

At trial, the district court instructed the jury that anticompetitive conduct, for Section 2 purposes, could be proven if Weyerhaeuser "purchased more logs than it needed, or paid a higher price for logs than necessary, in order to prevent [Ross-Simmons] from obtaining the logs they needed at a fair price."[38] The jury held that Ross-Simmons had proven its monopolization claim, and awarded damages of $26 million, which the district court trebled, producing a judgment of nearly $79 million.[39]

On appeal to the Ninth Circuit, Weyerhaeuser argued that the "over-buying" jury instruction was erroneous, and that, to establish liability for predatory buy-side conduct, the *Brooke Group* requirements needed to be met. The Ninth Circuit declined, however, to apply Brooke Group to predatory buy-side activity.

An important consideration underlying the *Brooke Group* analysis is that consumers benefit from the lower prices that result from allegedly predatory pricing by sellers. But in the Ninth Circuit's view, "consumers and stimulation of competition do not necessarily result from predatory bidding the way they do from predatory pricing."[40] The Ninth Circuit saw no consumer benefit "during this or [the] predation period if the firm raises or maintains the same price level for its finished products."[41] And, it found that if the predator did lower its prices for finished products, then that "would place even greater pressure on competitors, thereby increasing the threat to competition arising from predatory bidding."[42] Accordingly, the Court of Appeals upheld the jury verdict against Weyerhaeuser.

The Supreme Court, in an 8-0 decision written by Justice Thomas, vacated the Ninth Circuit's judgment. The Court found that because there is a "close theoretical connection" between monopoly and monopsony, "[p]redatory-pricing and predatory-bidding claims are analytically similar."[43] As Justice Thomas explained:

> A predatory bidder ultimately aims to exercise the monopsony power gained from bidding up input prices. To that end, once the predatory bidder has caused competing buyers to exit the market for purchasing inputs, it will seek to "restrict its input purchases below the competitive level," thus "reduc[ing] the unit price for the remaining input[s] it purchases. . . ." The reduction in input prices will lead to "a significant cost saving that more than offsets the profit[s] that would have been earned on the output. . . ." If all goes as planned, the predatory bidder will reap monopsonistic profits that will offset any losses suffered in bidding up input prices.[44]

The Court determined that both monopoly and monopsony claims involve the deliberate use of unilateral pricing activities for anticompetitive purposes. It also determined that both types of claims require firms to incur short-term

losses on the chance they might reap supracompetitive profits in the future.

Thus, the Court found that this "kinship" suggested that similar legal standards should apply to both types of claims. More specifically, the Court held that to impose liability for predatory bidding:

> [1.] A plaintiff must prove that the alleged predatory bidding led to below-cost pricing of the predator's outputs. That is, the predator's bidding on the buy side must have caused the cost of the relevant output to rise above the revenues generated in the sale of those outputs; [and]
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> * * *
>
> [2.] A predatory-bidding plaintiff also must prove that the defendant has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power.[45]

Accordingly, the Supreme Court vacated the Ninth Circuit's judgment and remanded for further proceedings.

Litigation over alleged predatory bidding probably is not the stuff around which to build an antitrust practice. Indeed, some believe that the subject lends itself more to intellectual concerns, rather than to practical business considerations. Did the Supreme Court, therefore, take *Weyerhaeuser* merely to reverse a large jury award rendered under an erroneous jury instruction? Or was there more on the Supreme Court's agenda? Perhaps the lurking question here is whether *Weyerhaeuser* foreshadows the Court's eventual approach to analyzing actionable exclusionary conduct for purposes of Section 2 more generally. That debate is just now beginning.[46]

Endnotes

1. 127 S. Ct. 2705 (2007).
2. 127 S. Ct. 1955 (2007).
3. 127 S. Ct. 2383 (2007).
4. 127 S. Ct. 1069 (2007).
5. 127 S. Ct. 2705 (2007).
6. 220 U.S. 373 (1911).
7. In *State Oil Co. v. Kahn*, 522 U.S. 3 (1997), the Supreme Court held that the rule of reason applied to "maximum" resale price maintenance agreements--where the ceiling price, above which a retailer may not sell, is set. The Court noted that such restrictions have the potential to "stimulate interbrand competition." *Id.* at 14.
8. The Supreme Court upheld the practice of a supplier announcing its "suggested" retail prices and unilaterally refusing to deal with retailers who fail to adhere to them in *United States v. Colgate & Co.*, 250 U.S. 300 (1919). However, the supplier must act unilaterally, as Colgate's safe harbor does not extend to an agreement between market participants at different distribution levels.
9. *PSKS, Inc. v. Leegin Creative Leather Prods., Inc.*, No. 2:03-CV-107, 2004 U.S. Dist. LEXIS 30414 (E.D. Tex. Mar. 25, 2004).
10. *PSKS, Inc. d/b/a Kay's Kloset v. Leegin Creative Leather Prods., Inc.*, No. 04-41243, 2006 U.S. App. LEXIS 6879 (5th Cir. Mar. 20, 2006).
11. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 28 (2006).
12. 127 S. Ct. 763 (2006).
13. *Leegin*, 127 S. Ct. at 2713 (quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977)).
14. *Id.* at 2714-17.
15. *Id.* at 2721.
16. *Id.* at 2716 ("Minimum resale price maintenance alleviates the problem because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer's retailers compete among themselves over services.").
17. *Id.* at 2714.
18. *Id.* at 2719, 2725.
19. *Id.* at 2727-37.
20. *Id.* at 2725, 2731.
21. Brief for New York and 36 Other States as Amici Curiae Supporting Respondent, No. 06-480, 127 S. Ct. 28 (2007).
22. *PSKS, Inc. d/b/a Kay's Kloset v. Leegin Creative Leather Prods., Inc.,* No. 04-41243, 2007 U.S. App. LEXIS 20957 (5th Cir. Aug. 30, 2007).
23. 127 S. Ct. 1955 (2007).
24. 355 U.S. 41 (1957).
25. *Id.* at 45-46.
26. 127 S. Ct. at 1969.
27. *Id.* at 1959.
28. *Id.* at 1960.
29. *Id.* at 1968.
30. 127 S. Ct. 2383 (2007).
31. *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).
32. Justice Breyer wrote the majority opinion, with Justice Stevens concurring. Justice Thomas dissented. Justice Kennedy took no part in the consideration or decision of the case.
33. 127 S. Ct. at 2392.
34. *Id.* at 2396.
35. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007) (*Weyerhaeuser II*), *rev'd sub nom. Confederated Tribes of Siletz Indians of Oregon v. Weyerhaeuser Co.*, 411 F.3d 1030 (9th Cir. 2005) (*Weyerhaeuser I*).
36. 509 U.S. 209 (1993).

37. *Weyerhaeuser II*, 127 S. Ct. at 1074 (ellipses and bracketed matter in original) (quoting *Brooke Group*, 509 U.S. at 222, 224.).

38. *Weyerhaeuser II*, 127 S. Ct. at 1073 (internal quotations omitted; bracketed matter in original). *See also Weyerhaeuser I*, 411 F.3d at 1036 n.8 (quoting the jury instruction).

39. Strictly speaking, Ross-Simmons tried the case on the theory that Weyerhaeuser engaged not only in buy-side price predation, but also in non-price anticompetitive conduct that included exclusive dealing arrangements and misrepresentation to state officials. *Weyerhaeuser I*, 411 F.3d at 1034. *See also* Brief for Appellee-Respondent at 2, *Weyerhaeuser II*, No. 05-381, 2006 WL 2950594 (Oct. 12, 2006) (asserting that "[t]his is *not* a predatory pricing case . . . [, but] was pled and tried as a garden-variety monopolization case in which the defendant was accused of multiple acts of anticompetitive conduct") (emphasis in original). However, as the Ninth Circuit and the Supreme Court framed the appellate issues, the non-price conduct effectively dropped out of the case, and the lawsuit took on more cabined a quality than Ross-Simmons argued was warranted by the evidence. *See id.* at 7-18 (setting out the full array of anticompetitive conduct by Weyerhaeuser that Ross-Simmons asserted the evidence proved).

40. *Weyerhaeuser I*, 411 F.3d at 1037 (footnote omitted).

41. *Id.* at 1037-38.

42. *Id.* at 1038 (footnote omitted).

43. *Weyerhaeuser II*, 127 S. Ct. at 1076.

44. *Id.* at 1075-76 (bracket matter in original; footnote omitted) (quoting Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669, 672 (2005)).

45. *Id.* at 1078.

46. *See* Thomas A. Lambert, *Markets and the Law: Weyerhaeuser and the Search for Antitrust's Holy Grail*, 2007 CATO SUP. CT. REV. 277 (2006-2007) (arguing that the Weyerhaeuser court implicitly adopted a requirement of exclusion of an equally efficient rival as a precondition for unlawful exclusionary conduct) .

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