Legal Backgrounder

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FOUR SUITS DEAL A WEAK HAND TO ANTITRUST PLAINTIFFS

A Review of Cases from the U.S. Supreme Court's 2006 Term

by

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> ***"[A]ntitrust plaintiffs may bring lawsuits throughout the Nation in dozens of different courts with different nonexpert judges and different nonexpert juries. . . .[I]t will prove difficult for those many different courts to reach consistent results. And, . . . it will also prove difficult to assure that the different courts evaluate similar fact patterns consistently. The result is an unusually high risk that different courts will evaluate similar factual circumstances differently."***

As quoted above, the U.S. Supreme Court expressed a remarkable lack of confidence in the ability of the Nation's courts to adjudicate antitrust disputes during its October 2006 term. The Court's four antitrust decisions reflect concern that federal antitrust litigation intrudes excessively into private markets and a strong faith in the benefits delivered by free markets.

The Justices demonstrated significant consensus in curtailing the reach of the federal antitrust laws. Each case cuts back on the scope of the federal antitrust laws. In each case, the high court disagreed with the lower court's judgment and reversed. The Court did not merely fill in the gaps in the law in these cases; nor did it simply distinguish prior cases. Rather, in each case, the Supreme Court overruled, reinterpreted, or extended prior cases.

Weyerhaeuser. On February 20, 2007, the Supreme Court decided *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* Ross-Simmons was a sawmill operator in Longville, Washington. It claimed that Weyerhaeuser drove it out of business by driving "up" the price of red alder sawlogs in the Pacific Northwest. From 1990 to 2000, Weyerhaeuser had invested in state-of-the art technology for its mills, while Ross-Simmons had made little investment. By 2001, Weyerhaeuser was purchasing about 65% of the sawlogs sold in the region. Those logs account for about 75% of a sawmill's costs. When the price of those logs rose from 1998 to 2001, both Weyerhaeuser's and Ross-Mills' profit margins fell. Ross-Mills' business failed in May 2001 and it sued charging Weyerhaeuser with a predatory scheme to drive it out of business. Ross-Mills won in the lower courts.

The Supreme Court held that so long as Weyerhaeuser's downstream sales were profitable, Ross-Mill could not maintain an antitrust claim that Weyerhaeuser had strategically paid too much for the sawlogs. Ross-

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Mills' theory of a predatory strategy made no sense because Weyerhaeuser would not deliberately pay more for saw logs (thus losing profits by increasing its own costs) unless it could recoup the lost profits later by buying them at a price below the competitive price. To prove this, Ross-Mill would have had to have shown that once it left the market, Weyerhaeuser so controlled the market for the purchase of red alder logs that it could demand lower prices than would have been possible when Ross-Mill was in business as a competing buyer. In the *Weyerhaeuser* opinion, the Court extended earlier cases limiting when an antitrust plaintiff might sue a company for setting prices too low in the other direction:

> Predatory-pricing and predatory-bidding claims are analytically similar. * * * Both claims involve the deliberate use of unilateral pricing measures for anticompetitive purposes. And both claims logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future. * * * A rational business will rarely make this sacrifice.

Accordingly, the Supreme Court adopted the same significant limitations for predatory buying cases that it had put in place for predatory selling claims.

Credit Suisse. On June 18, 2007, in *Credit Suisse Securities (USA) LLC v. Billing*, the Court rejected antitrust claims involving aspects of an initial public offering that were already regulated by the federal securities laws. Between March 1997 and December 2000, a group of 60 investors in various IPOs sued 10 leading investment banks for their work as underwriters, forming syndicates that helped execute several hundred IPOs for technology-related companies. The plaintiffs took aim at various commitments that the underwriters demanded of an investor as a condition of participation in the IPO. A federal court of appeals had ruled that the case could proceed.

The Supreme Court held that the plaintiffs could not bring that claim because the federal securities laws preempted it. The Securities and Exchange Commission ("the SEC") had the authority to regulate the area. In fact, the SEC had already disapproved of the practices at issue and the lawsuit, if successful, would not have created a conflict between the securities laws and the antitrust laws with regard to those practices. Nonetheless, the Court found an antitrust challenge to the practices "incompatible" with the federal securities laws because of the federal courts' inability to limit the application of the antitrust laws generally in this area to the specific practices that the SEC had already declared unlawful. The potential applicability of the antitrust laws to other conduct made "an antitrust suit such as this likely to prove *practically incompatible* with the SEC's administration of the Nation's securities laws." (Emphasis supplied.)

In rendering that decision, the Supreme Court extended prior decisions that had only displaced the antitrust laws when they were "clearly repugnant" to some other statutory scheme. The Court changed its test to now ask whether the antitrust laws were only "clearly incompatible" with the other statutory framework. While the actual difference between the linguistic changes from "repugnant" to "incompatible" is not something capable of precise definition, the implication of the change is that the Court believed it necessary in order to decide the case the way it did.

Twombly. On Monday, May 21, 2007, the Supreme Court issued its decision in *Bell Atlantic Corp. v. Twombly* and ordered lower courts to give closer scrutiny to whether an antitrust complaint's allegations support a cause of action. William Twombly and Lawrence Marcus filed an antitrust case on behalf of all subscribers of local telephone and/or high speed Internet service. They alleged that major telecommunications companies had failed to enter each other's territory, one defendant's CEO had made public statements seeming to recognize a benefit from not competing, and the defendants had ample opportunity to meet and enter into an agreement. A court of appeals held that this complaint could proceed.

The Supreme Court held, however, that the complaint was insufficient. Before a charge of conspiracy could proceed into discovery, the Court admonished that a plaintiff must provide enough facts to raise a reasonable expectation that discovery will reveal evidence of an illegal agreement. The plaintiffs had failed to set forth a sufficient factual context to support the allegation of an agreement among the

defendants, a necessary element in the plaintiffs' claim under § 1 of the Sherman Act, 15 U. S. C. § 1. The plaintiffs had alleged the existence of the agreement but not facts which made the existence of the agreement "plausible."

The Court observed that it is not enough to allege facts that make a conspiracy merely "conceivable." "[I]t is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, but quite another to forget that proceeding to antitrust discovery can be expensive." The Court repudiated part of its 1957 decision *Conley v. Gibson*, where it said that "a complaint should not be dismissed . . . 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." (Emphasis supplied.) The Court decided that "this famous observation has earned its retirement."

Leegin. On June 28, 2007, the last day of its 2006 term, the U.S. Supreme Court issued its decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* PSKS, Inc. (PSKS), the owner and operator of a women's apparel store, purchased fine leather goods of the brand name "Brighton" from Leegin Creative Leather Products, Inc. (Leegin), a designer and manufacturer of fine leather goods. The Brighton goods became PSKS's most important brand and at times accounted for nearly fifty percent of its profits.

Leegin refused to sell Brighton goods to retailers who discounted those goods below suggested retail prices. Leegin's policy provided specialty retail stores a sufficient profit margin to provide customers with excellent service and to protect the brand's image and reputation. PSKS had been marking down Brighton goods by twenty percent and refused to cease discounting, contending that nearby retailers were also undercutting Leegin's suggested retail prices. Leegin stopped selling Brighton goods to PSKS. PSKS then sued Leegin alleging violations of the antitrust laws for resale price maintenance and prevailed in the lower courts.

The Supreme Court overturned the judgment for PSKS. To do so, the Court had to overrule its ninety-five year-old decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, (1911). *Dr. Miles* established a *per se* rule against a vertical agreement between a manufacturer and its distributor to set minimum resale prices. In *Leegin*, the Court concluded that, even though some such agreements may have anticompetitive effects, there are sufficient procompetitive justifications for a manufacturer to use resale price maintenance to require a plaintiff to prove the anticompetitive effects rather than presume them.

The Policy Judgments Underlying the Court's Decisions. The Court's decisions clearly reflect a faith in the benefits that flow from allowing businesses and consumers to make investment and purchasing decisions free from government intervention, a concern with the costs of government intervention in the form of antitrust litigation, and a minimal concern with under-deterrence of anticompetitive behavior.

1. The Benefits of the Free Market. The Court's belief in the importance of free markets runs through these decisions. In *Credit Suisse*, for example, the Court cited the potential chilling effect on lawful market activities "of tremendous importance to the economy of the country" from the action before it. The Court's respect for the benefits of the free market took the form of deference to the market's results in *Weyerhaeuser* and *Leegin*. The heart of the predatory purchasing scheme that the Court recognizes in *Weyerhaeuser* lies in the proposition that if successful, the predator will drive prices down. Put another way, the better outcome would be for prices to be "higher." Similarly, in the *Leegin* case, the Court addressed whether the antitrust laws should continue to forbid minimum resale price maintenance, i.e., setting a floor below which a retailer or distributor may not go. Obviously, it would make no sense for a manufacturer to set a price floor unless retailers or distributors might actually price below that floor. As Justice Breyer observed in dissent, "[t]he only safe predictions to make about today's decision are that it will likely raise the price of goods at retail." But, the majority persuasively points out that the mere fact that some prices might rise as a result of the practice is not enough to require its condemnation. Instead, the Court focused on whether minimum resale price maintenance always or almost always tends to "restrict competition" or "decrease output." Indeed, the Court makes clear in its discussion that among the benefits that a free market might deliver, i.e., one in which manufacturers are free to negotiate with retailer to maintain the downstream price for their goods, is one in which "higher-price, higher

service brands" are available. In essence, this recognizes that the "right" or "best" price is that which the market sets through competition, regardless of whether it is lower or higher than some arbitrary benchmark. In the end, the Court flatly rejected the proposition that whether or not resale price maintenance leads to higher prices tells us anything about the "welfare effects" of the practice: "The antitrust laws do not require manufacturers to produce generic goods that consumers do not know about or want."

2. The costs of over-enforcement. The Court stressed in these cases the cost of government intervention in the form of antitrust lawsuits. For example, in *Credit Suisse*, it emphasized the chilling effect of antitrust lawsuits because they cannot be confined to cases where government intervention would do no harm: "[A]ntitrust courts are likely to make unusually serious mistakes in this respect. And the threat of antitrust mistakes . . . means that underwriters must act in ways that will avoid . . . a wide range of conduct that the securities law permits or encourages (but which they fear could lead to an antitrust lawsuit and the risk of treble damages). And therein lies the problem." In *Twombly*, the Court brings to life the "potentially enormous expense of discovery" in antitrust cases and weighs in to make it harder for such cases to proceed because "it is self-evident that . . . the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings. In *Leegin*, the costs of over-enforcement took the form of "burdensome measures" now employed by manufacturers to suggest or influence the downstream pricing of their goods: "The increased costs these burdensome measures generate flow to consumers in the form of higher prices." Finally, in *Weyerhaeuser*, the Court focused on whether a permissive rule would "chill the very conduct the antitrust laws are designed to protect," and went on to give a litany of circumstances in which a buyer would legitimately want to pay more for goods.

3. The costs of under-enforcement. Some under-enforcement following these suits seems a fair prediction. For example, it is reasonable to assume that a court or jury may fail to find for a meritorious plaintiff under the complex and nuanced conditions which would be required to prove that resale price maintenance is anticompetitive under the conditions imposed by the Court in *Leegin*. The Court implicitly recognizes this countervailing factor. In *Credit Suisse*, for example, the Court took comfort that "any enforcement-related need for an antitrust lawsuit is unusually small" (but not absent) due to government and private enforcement of the securities laws. But other than recognizing the anticompetitive potential of the practices at issue, the Court did not discuss extensively the likelihood or consequences of under-enforcement.

4. The policy call. The Court's faith in the benefits delivered by the free market explains how it weighed the competing costs of cutting back on antitrust enforcement. It emphasized the benefits of the free market and focused on the dangers to those market benefits from too much enforcement: prophylactic chilling of procompetitive conduct (*Credit Suisse*); reduced economic efficiency and higher prices (*Leegin*); and deterrence of competition to purchase supplies (*Weyerhaeuser*). For good measure, it considered the additional cost of litigation of meritless suits. In contrast, the Court did not identify any significant loss to the performance of the markets from under-enforcement of the antitrust laws. Therein lies the policy judgment of the Court that the costs of under-enforcement are outweighed by the costs of over-enforcement, namely, that the markets perform generally better with less antitrust intervention.

What comes next? The four cases decided this past term will themselves have a substantial impact on antitrust litigation and business practices.[1] Additionally, if the Court's policy call against antitrust intrusion in free markets takes hold in the lower courts, we might well expect to see further retrenchment in the area of antitrust litigation. Finally, that policy judgment may lead the Court to look for additional opportunities where it may further restrict the scope of the antitrust laws.

[1]For a further discussion of the scope and impact of the Court's *Twombly* and *Leegin* decision, readers may wish to consult the following papers: *Supreme Court Overrules Dr. Miles: Vertical Agreements Setting Minimum Resale Prices Are to Be Judged By the Rule of Reason*, available at http://www.akingump.com/docs/publication/993.pdf; and *Supreme Court Ruling Portends Changes in Motions Practice*, http://www.akingump.com/docs/publication/979.pdf.