

Antitrust News & Notes

July 2009

Market Leaders Beware: DOJ Promises “Vigorous” Section 2 Enforcement

By Veronica Lewis and Natalie West

In her first public remarks following her confirmation as the Assistant Attorney General for Antitrust at the Department of Justice (DOJ or Department), Christine Varney announced a significant reversal of the approach to antitrust enforcement under Section 2 of the Sherman Act endorsed by the Bush Administration DOJ. Varney officially withdrew the policy statement regarding the legality of single-firm conduct under Section 2 developed by the Bush DOJ and identified “reinvigorated Section 2 enforcement” as a key priority of the new administration in responding to the current economic crisis.¹

In September 2008, following a series of joint DOJ and Federal Trade Commission (FTC or Commission) hearings that examined and analyzed various issues related to Section 2 enforcement, the DOJ released a 215-page report entitled “Single-Firm Conduct Under Section 2 of the Sherman Act” (the Report), which reflected the Bush Administration’s skepticism regarding the advisability of an active governmental role in policing monopolization.² The Report concluded that

¹ Christine A. Varney, Vigorous Antitrust Enforcement in this Challenging Era, Remarks Prepared for the Center for American Progress at 9 (May 11, 2009), available at www.usdoj.gov/atr/public/speeches/245711.htm.

² U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008),

Also in this Issue

- 3 Recent Developments in the Area of Resale Price Maintenance
- 5 The Contours of *Twombly*’s Pleading Standard Begin to Emerge

because “[d]istinguishing beneficial competitive conduct from harmful exclusionary or predatory conduct often is difficult” and “Section 2 standards . . . should avoid overly broad prohibitions that suppress legitimate competition,” a “disproportionality” test should generally be used to assess whether conduct is unlawful under Section 2.³ The DOJ explained that under its “disproportionality” test:

In the absence of an applicable conduct-specific test, the Department believes that conduct should be unlawful under section 2 if its anticompetitive effects are shown to be *substantially disproportionate* to any associated precompetitive effects.⁴

In order to provide courts, practitioners, enforcement officials, and market leaders with “clear and administrable” liability standards,⁵ the

available at www.usdoj.gov/atr/public/reports/236681.htm.

³ *Id.* at vii, ix.

⁴ *Id.* at ix (emphasis added).

⁵ Press Release, Justice Department Issues Report on Antitrust Monopoly Law (Sept. 8, 2008), available at www.usdoj.gov/atr/public/press_releases/2008/index08.htm.

Report offered guidance on numerous areas, including predatory pricing, tying, bundling and loyalty discounts, unilateral refusals to deal with rivals and exclusive dealing arrangements, and articulated several “safe harbors” that dominant firms could observe to avoid violating Section 2.

Many believed the Report heavily and improperly favored dominant corporations. Indeed, although the FTC participated in the hearing process leading up to the release of the Report, the Commission expressly declined to endorse it, stating that it favored the interests of dominant firms over those of consumers by “adopt[ing] law enforcement standards that would make it nearly impossible to prosecute a case under Section 2.”⁶

Commissioners Harbour, Leibowitz, and Rosch issued a statement expressly criticizing the Report’s adoption of a “disproportionality” test, explaining that “the Department’s baseline test for Section 2 liability would only condemn conduct . . . if the demonstrable anticompetitive effects are ‘disproportionately’ greater than the procompetitive potential. This test distorts the rule of reason standard, which simply asks, whether anticompetitive harm ‘outweighs’ the procompetitive benefits.”⁷ The Report was in effect for only a brief eight months and appeared to have had little or no judicial impact.

In unequivocally withdrawing the Bush Administration’s Section 2 Report, Varney echoed the FTC’s criticism, declaring that the “greatest weakness of the Section 2 Report is that it raised many hurdles to Government antitrust enforcement” and that it “lost sight of an ultimate goal of antitrust laws – the protection of consumer welfare.”⁸ Varney noted that she did not share the prior DOJ’s concern about the difficulty of distinguishing anticompetitive and lawful conduct, explaining “I strongly believe that antitrust enforcers are able to separate the wheat from the chaff in identifying exclusionary and predatory acts.”⁹ Varney stated that the Report relied

too heavily on the market’s ability to self-correct, overly emphasized efficiency justifications for anticompetitive behavior, and understated the importance of redressing exclusionary and predatory acts that ultimately harm consumers through higher prices, reduced product variety, and slower innovation. Varney challenged the previous administration’s deference to market mechanisms for self-correction and insisted that “vigorous antitrust enforcement must play a significant role in the Government’s response to economic crises to ensure that markets remain competitive.”¹⁰

Although Varney did not articulate the precise contours of the DOJ’s new Section 2 enforcement policy, she specifically disavowed the “disproportionality” test, explaining that it “reflects an excessive concern with the risks of over-deterrence and a resulting preference for an overly lenient approach to enforcement. The failing of this approach is that it effectively straight jackets antitrust enforcers and courts from redressing monopolistic abuses, thereby allowing all but the most bold and predatory conduct to go unpunished and undeterred.”¹¹ Varney noted that the “tried and true standards” set forth in previous Supreme Court and circuit court opinions, such as *Lorain Journal v. United States*,¹² *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,¹³ and *United States v. Microsoft*,¹⁴ will form the basis of the Department’s policy towards single-firm conduct. And, she made it clear that the new DOJ will be prepared to take action based upon or lesser showing of anticompetitive effects than would have been demanded by the prior administration. While the Bush DOJ would have found conduct unlawful only if its anticompetitive effects were shown to be “substantially disproportionate” to procompetitive effects, Varney noted that the current DOJ will require no substantial disproportion. She explained the new DOJ will “look closely at both the perceived procompetitive and anticompetitive aspects of a dominant firm’s conduct, weigh these factors, and determine whether on balance

⁶ Press Release, FTC Commissioners React to Dep’t of Justice Report, “Competition and Monopoly: Single Firm Conduct under Section 2 of the Sherman Act” (Sept. 8, 2008), *available at* www.ftc.gov/opa/2008/09/section2.htm.

⁷ *Id.*

⁸ Christine A. Varney, *supra* note 1, at 6.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 8-9.

¹² 342 U.S. 143 (1951).

¹³ 472 U.S. 585 (1985).

¹⁴ 253 F.3d 34 (D.C. Cir. 2001) (en banc).

the net effect of this conduct harms competition and consumers.”¹⁵

Given the Obama Administration’s pledge of broad reforms in the banking, healthcare, technology, telecommunications, and transportation industries, leading firms in these industries may be targeted by the Department. However, Varney’s promise of “vigorous antitrust enforcement” under Section 2 indicates that leading companies in all sectors of the economy should prepare for closer antitrust scrutiny. ■

Recent Developments in the Area of Resale Price Maintenance

By Brian Robison

In 2007, the United States Supreme Court changed the law applicable to minimum resale price maintenance programs when it held that such arrangements are subject to the rule of reason rather than the *per se* rule. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007). In the cases summarized below, we see that defendants are prevailing in minimum RPM programs cases using traditional defenses available in any rule of reason case and using a defense that existed in RPM cases prior to *Leegin*, and we see the types of facts that one court considered sufficient for a plaintiff to survive a motion to dismiss.

Leegin Case Dismissed on Remand at the Pleading Stage

PSKS, Inc. v. Leegin Creative Leather Prods., Inc., No. CV 2:03 CV 107, 2009 WL 938561 (E.D. Tex. Apr. 6, 2009) (slip copy) (Judge T. John Ward)

After the United States Supreme Court held that the rule of reason applied to plaintiff’s claims, the Court remanded the case to the district court for further proceedings. The district court granted plaintiff leave to file a second amended complaint (SAC), and the SAC asserted both rule of reason and *per se* theories of liability. Plaintiff asserted that the minimum resale price program harmed competition in a relevant market under the rule of

reason. Plaintiff also asserted a *per se* claim based upon new allegations that Leegin orchestrated a horizontal conspiracy among retail outlets. Leegin sells its goods through a dual-distribution business model, meaning that Leegin sells handbags in two ways: both as a manufacturer selling downstream to independent retailers and also as a retailer through company-owned retail outlets. Plaintiff alleged that Leegin, acting as a retailer, orchestrated a horizontal conspiracy with retail competitors to enforce the pricing program and to punish plaintiff for price cutting.

The district court granted Leegin’s motion to dismiss both claims. The court held that plaintiff’s rule of reason claim failed due to plaintiff’s failure to allege a relevant product market. Plaintiff’s SAC alleged two relevant product markets: (a) a retail market for Brighton’s women’s accessories and (b) the wholesale sale of brand-name women’s accessories to independent retailers.

The first alleged market failed because plaintiff did not allege facts showing that this single brand, no matter how distinctive or unique, constituted its own product market. The court also rejected plaintiff’s attempt to characterize Brighton’s women’s accessories as a relevant submarket for failure to allege facts showing that this submarket exists.

The court rejected the second alleged market because it was not really a market; plaintiff had identified only a distribution level of the product. Moreover, this distribution level improperly grouped together products that are not interchangeable with one another (handbags, shoes, and jewelry).

Finally, the court rejected the new *per se* claim for three reasons. First, the court held that plaintiff was barred from asserting this claim because it had not done so at the original trial. Second, the court held that dual distribution arrangements are always evaluated under the rule of reason because they involve both vertical and horizontal activity. And finally, the court held that plaintiff had not alleged facts suggesting that a dealer cartel existed. There were no factual allegations of an agreement or horizontal communications to show a rim around the wheel of the supposed hub-and-spoke conspiracy.

This case shows that minimum resale price maintenance programs can fail for many of the same reasons that other antitrust claims can fail under the rule

¹⁵ Christine A. Varney, *supra* note 1, at 13.

of reason. However, because the case did not survive a motion to dismiss, the opinion does not provide guidance on how the pro-competitive benefits of these programs would be weighed against any alleged anti-competitive effects at the summary judgment or trial phases, nor does it apply the factors that the Supreme Court suggested would be helpful in applying the rule of reason to minimum price maintenance programs. *See also Spahr v. Leegin Creative Leather Prods.*, No. 2:07-CV-187 (E.D. Tenn. Aug. 20, 2008) (dismissing direct and indirect purchaser class actions against Leegin for similar reasons: dual distribution arrangements are not *per se* violations, failure to allege valid product markets, and failure to allege anticompetitive effects).

Appellate Court Affirms Summary Judgment Based on the Agency Defense

Valuepest.com of Charlotte, Inc. v. Bayer Corp., No 07-1760 (4th Cir. Mar. 24, 2009).

Aventis entered into agency agreements with distributors. The agreements specified that Aventis retained the title to its pest control product until it was sold to the pest management professionals (PMPs). The agents received commissions for the sales, and Aventis was allowed to set the price at which the product was sold. Another company, Bayer, began to do the same thing. Later, Bayer and Aventis joined forces.

A PMP named Valuepest filed this purported class action against Bayer and others, alleging vertical price fixing in violation of the Sherman Act. The plaintiff alleged that manufacturers had improperly fixed the price of their pest control products in the downstream market. Two weeks after *Leegin* was decided, the district court granted the defendants' summary judgment motion, and earlier this year, the Fourth Circuit affirmed.

The Fourth Circuit held that the agency defense to a minimum RPM claim survived *Leegin*. In a true agency situation, the manufacturer retains title to the goods through the time of sale. Thus, because the manufacturer still owns the goods at the time of sale, the manufacturer has the right to dictate the sales price. In other words, there is no "resale" in this situation; there is only one sale from the manufacturer to the eventual buyer at the manufacturer's

mandated price. Even though the manufacturer uses an agent to assist with the sale, there can be no liability for minimum RPM because the manufacturer remains free to dictate its price.

This decision is important to manufacturers that sell through a true principal-agent relationship because it confirms, at least within the Fourth Circuit, that the agency defense in the *United States v. General Electric Company* case is still viable, even after *Leegin*.

Plaintiff Survives Motion to Dismiss After *Leegin*

BabyAge.com v. Toys R Us, No. 05-CV-6792 (E.D. Pa. May 20, 2008)

Two discount Internet retailers of baby gear (BabyAge.com and The Baby Club of America, Inc.) sued Babies R Us and various baby-gear manufacturers under §§ 1 and 2 of the Sherman Act, alleging price collusion. BabyAge alleged that the defendants conspired to force other retailers to abide by minimum-pricing rules for a range of baby products as part of an illegal price-fixing cartel.

Specifically, plaintiffs alleged that Babies R Us checked prices on the Web sites of retail rivals and reported violations of the manufacturers' minimum-pricing rules. Following those reports, the manufacturers stopped supplying their products to BabyAge and BabyCatalog.com, damaging those competitors' businesses.

The plaintiffs also alleged that Babies R Us canceled orders for some Medela products because Medela was not punishing Internet retailers that discounted below the minimum RPM plans. Plaintiffs also alleged that Medela thereafter terminated Internet discounters to protect Babies R Us's business and margin.

The defendants moved to dismiss the case, citing *Leegin*. Judge Brody denied the motion, stating that a market dominant retailer like Babies R Us could abuse a minimum RPM program in a way that could be anticompetitive. The complaint alleged sufficient facts to suggest a right to relief.

The district court highlighted the following points as particularly important in holding that plaintiffs had stated a claim. First, plaintiffs alleged facts to support six separate product markets. Second, plaintiffs were not required to allege "what the price points [for high-end baby goods]

are, which manufacturers do and do not make high-end products, and which retailers do and do not sell them” at the pleading stage. Third, plaintiffs alleged facts suggesting that this behavior did not constitute merely parallel conduct: the pricing agreements were contrary to each manufacturer’s economic self-interest but served the interests of Babies R Us, which possessed significant power over each manufacturer and threatened each manufacturer to induce each of them to impose the pricing restriction. Finally, plaintiffs adequately alleged facts showing an anticompetitive effect: minimum pricing agreements had increased prices above competitive levels, reduced output by blocking sales that could have been made, and reduced quality in that Babies R Us’s frequent customer service problems represented a larger portion of the reduced volume of sales transactions.

This case illustrates how a plaintiff can state a rule of reason claim against a minimum RPM program in light of the factors that the *Leegin* opinion suggested should be used by lower courts in applying this new standard. It also serves as a warning to those companies with a dominant share of the market as to what price monitoring and reporting behavior might be viewed as suspect by courts in an antitrust case. ■

The Contours of *Twombly*’s Pleading Standard Begin to Emerge

By Brian Robison and Craig Zieminski

The Supreme Court changed the landscape of motions to dismiss with its 2007 decision, *Bell Atlantic Corp. v. Twombly*,¹⁶ in which the Court discarded the lenient pleading standard that had been used for decades in deciding motions to dismiss for failure to state a claim. Under the former standard, a court would dismiss a complaint for failure to state a claim only if it appeared “beyond doubt that the plaintiff [could] prove no set of facts in support of his claim which would entitle him to relief.”¹⁷ This standard limited a defendant’s ability to defeat a meritless claim at the pleading stage, as a savvy plaintiff

could satisfy its pleading burden by merely reciting the generic elements of a cause of action.¹⁸ In *Twombly*, the Supreme Court held that a complaint must state “enough facts to state a claim to relief that is plausible on its face,” as opposed to merely alleging a “conceivable” right to relief.¹⁹ Applying that standard to the Section One antitrust claim before the Court, it held “that stating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made . . . not merely parallel conduct that could just as well be independent action.”²⁰

While the judicial community quickly grasped the significance of *Twombly*, it has been slow to develop the contours of this new doctrine. Early judicial opinions and legal commentary questioned whether *Twombly* applied outside the antitrust arena and how to draw the line between ‘conceivable’ and ‘plausible.’ Two recent decisions have shed light on both of these questions by applying *Twombly* in a non-antitrust context and elaborating on the new pleading standard.

In *Ashcroft v. Iqbal*, the Supreme Court dismissed a federal detainee’s claim for various constitutional violations, holding that the complaint failed to meet the pleading standard set by *Twombly*.²¹ The Court rejected the plaintiff’s argument that *Twombly* was limited to antitrust disputes: “Our decision in *Twombly* expounded the pleading standard for all civil actions, and it applies to antitrust and discrimination suits alike.”²² The plaintiff, a detainee in the wake of the September 11th attacks, alleged that top-ranking government officials had implemented a race-based policy with respect to the apprehension and detention of persons “of high interest” during the government’s investigation of the attacks.²³ In order to succeed on his claims, the plaintiff would need to prove that the government officials “adopted and implemented the detention policies at issue not for

¹⁸ See *Twombly*, 550 U.S. at 561.

¹⁹ *Id.* at 570.

²⁰ *Id.* at 557.

²¹ 556 U.S. ____, 128 S.Ct. 2931 (2009), available at www.supremecourtus.gov/opinions/08pdf/07-1015.pdf (last accessed June 11, 2009).

²² *Id.* at 20 (citations and quotations omitted).

²³ *Id.* at 3-5.

¹⁶ 550 U.S. 544 (2007).

¹⁷ *Id.* at 561 (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)).

a neutral, investigative reason but for the purpose of discriminating on account of race”²⁴ The Court held that plaintiff had failed to satisfy the pleading requirement of *Twombly*. It explained, “[t]he plausibility standard is not akin to a probability requirement, but it asks for more than a sheer possibility that a defendant has acted unlawfully.”²⁵ Although the Federal Rules require only a short and plain statement of the plaintiff’s entitlement to relief, they do “not unlock the doors of discovery for a plaintiff armed with nothing more than conclusions.”²⁶ Applying this standard, the Court determined that the plaintiff had failed to allege sufficient facts regarding the government officials’ allegedly discriminatory purpose.²⁷

In addition, the United States District Court for the Northern District of California recently dismissed an antitrust conspiracy claim in a decision requiring a substantial amount of factual support to consider a claim “plausible” and not merely “conceivable.”²⁸ In this case, plaintiffs alleged that a group of title insurance companies was using its rate-setting ability in certain states to fix prices for title insurance in non-rate-setting states.²⁹ The title insurance group was legally permitted to meet in certain states and jointly file insurance premium rate schedules with those states’ insurance authorities.³⁰ Plaintiffs alleged that the group used this opportunity to fix insurance premiums in other states, such as California, that do not permit rate-setting.³¹ The Northern District of California granted the defendants’ motion to dismiss, stating that

²⁴ *Id.* at 13.

²⁵ *Id.* at 14.

²⁶ *Id.*; see also *Twombly*, 550 U.S. at 559 (“It is no answer to say that a claim just shy of a plausible entitlement to relief can, if groundless, be weeded out early in the discovery process through careful case management given the common lament that the success of judicial supervision in checking discovery abuse has been on the modest side.” (internal citation and quotations omitted)).

²⁷ *Iqbal*, 556 U.S. ___, at 17.

²⁸ *In re Calif. Title Ins. Antitrust Litig.*, No. C 08-01341 JSW (N.D.Cal. May 21, 2009) (order granting motions to dismiss and granting leave to amend) (on file with authors).

²⁹ *Id.* at 2-3.

³⁰ *Id.*

³¹ *Id.*

“there are no factual allegations to support [the plaintiffs’] conclusion.”³² Nor would the Court infer a conspiracy based on the allegations concerning the defendants’ opportunity and motive to conspire or the market characteristics facilitating such a conspiracy.³³ The Court noted the absence of details concerning “where or when those meetings took place . . . which [d]efendants may have attended [the] meetings . . . the types of employees that may have attended such meetings . . . whether those employees reported back to their parent organizations . . . [or] a temporal link between the release of rates in the rate-setting organizations in other states and the release of rates in California.”³⁴

As a precedent, *Twombly* is still in its infancy. However, early decisions indicate that the Supreme Court’s new pleading standard may be a broad and powerful tool for eliminating causes of action without incurring the expense of discovery. ■

Antitrust News & Notes is published by the Antitrust Practice Group of Vinson & Elkins LLP. This newsletter is not intended to be legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information only. Results described herein may be subject to reconsideration or appeal. Prior results do not guarantee a similar outcome. Application of the information reported herein to particular facts or circumstances should be analyzed by legal counsel.

³² *Id.* at 6.

³³ *Id.*

³⁴ *Id.* at 8.

Antitrust News & Notes

Antitrust Practice Contacts

Name	Office	Email	Phone
Alden L. Atkins	Washington	aatkins@velaw.com	202.639.6613
J. David Bickham, Jr.	Austin	dbickham@velaw.com	512.542.8570
Bruce A. Blefeld	Houston	bblefeld@velaw.com	713.758.3610
Lauren J. Harrison	Houston	lharrison@velaw.com	713.758.4430
Neil W. Imus	Washington	nimus@velaw.com	202.639.6675
Jeffrey S. Johnston	Houston	jjohnston@velaw.com	713.758.2198
William E. Lawler III	Washington	wlawler@velaw.com	202.639.6676
Cathy A. Lewis	Washington	clewis@velaw.com	202.639.6537
Veronica S. Lewis	Dallas	vlewis@velaw.com	214.220.7757
Dionne C. Lomax	Washington	dlomax@velaw.com	202.639.6610
Jason M. Powers	Houston	jpowers@velaw.com	713.758.2522
Harry M. Reasoner	Houston	hreasoner@velaw.com	713.758.2358
James A. Reeder, Jr.	Houston	jreeder@velaw.com	713.758.2202
Brian E. Robison	Dallas	brobison@velaw.com	214.220.7770
Kathleen B. Spangler	Houston	kspangler@velaw.com	713.758.2853
Walter B. Stuart	Houston	wstuart@velaw.com	713.758.1086
William R. Vigdor	Washington	wvigdor@velaw.com	202.639.6737
David R. Woodcock, Jr.	Austin	dwoodcock@velaw.com	512.542.8637

Vinson & Elkins LLP Attorneys at Law Abu Dhabi Austin Beijing Dallas Dubai Hong Kong
Houston London Moscow New York Shanghai Tokyo Washington www.velaw.com