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Plaintiffs' Attorneys Wince as Second Circuit Applies Tough *Twombly* Standard to Antitrust Suits

By Thomas A. McCann*

The United States Court of Appeals for the Second Circuit set a high bar this September for plaintiffs alleging industry-wide conspiracies to block competition in violation of U.S. antitrust laws.¹ The appellate court's per curiam decision provides an early insight into the new pleading rules set out by the United States Supreme Court's May 2007 decision in *Bell Atlantic Corp. v. Twombly*.²

The Second Circuit applied *Twombly* to dismiss a highly detailed complaint regarding a price fixing scheme among elevator companies that would have easily passed muster in the pre-*Twombly* era, according to experts in the field.³ The appellate court's strict application of the new pleading rules has corporate defendants breathing a sigh of relief and plaintiff's lawyers scrambling to adapt their pleadings to survive a motion to dismiss.⁴

In the Second Circuit case, a putative class of consumers who purchased elevators and elevator repair and maintenance services filed a complaint in U.S. District Court for the Southern District of

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¹ *In re Elevator Antitrust Litig.*, 502 F.3d 47, 48-9 (2d Cir. 2007).

² *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007).

³ Posting of Anik Banerjee to Antitrust Law Blog, *Second Circuit Applies Twombly To Dismiss Detailed Allegations Of Antitrust Conspiracy*, <http://antitrustlawblog.com> (Oct. 8, 2007) [hereinafter Anik Banerjee].

⁴ *Id.*

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New York alleging that four major elevator companies engaged in a conspiracy in the United States and Europe to monopolize the elevator market.⁵ Specifically, the plaintiffs alleged that the companies conspired to fix prices for the sale and continuing maintenance of their elevators in violation of Section 1 of the Sherman Act;⁶ that the companies tried to monopolize the market for their elevator products in violation of Section 2 of the Sherman Act;⁷ and that they tried to monopolize the maintenance market for their individual elevator products by making it difficult for independent maintenance companies to service each defendant's elevators.⁸

To support these allegations, the plaintiffs asserted that the defendant elevator companies participated in meetings in the United States and Europe to discuss pricing and market divisions, agreed to fix prices for elevators and elevator services, rigged bids for sales and maintenance, exchanged price quotes, "collusively" required customers to enter long-term maintenance contracts, and collectively took actions to drive independent repair companies out of business.⁹ In their complaint, the plaintiffs also made specific reference to government investigations by Italy and the European Union into the defendants' alleged antitrust violations, as a result of which the European Commission raided each defendant's offices and levied "extraordinary fines" on the companies after they admitted wrongdoing.¹⁰

The district court, however, dismissed the complaint. The appellate court upheld the dismissal, holding that the complaint's conspiracy allegations provided "no plausible ground to support the inference of an unlawful agreement."¹¹

The court wrestled with the U.S. Supreme Court's new mandate set down in *Twombly*, acknowledging that there is still "considerable uncertainty" as to how broadly it should be applied.¹² In *Twombly*, a class of plaintiffs alleged that four major telephone

⁵ *In re Elevator Antitrust Litig.*, 502 F.3d at 48-9.

⁶ *See* 15 USC § 1.

⁷ *See* 15 USC § 2.

⁸ *Id.* at 49.

⁹ *Id.* at 51; Anik Banerjee, *supra* note 3.

¹⁰ *In re Elevator Antitrust Litig.*, 502 F.3d at 49, 51.

¹¹ *Id.* at 48-9.

¹² *Id.* at 50.

local exchange carriers colluded to frustrate new competitors from entering the market pursuant to the 1996 Telecommunications Act, which required the established carriers to sell local telephone services at wholesale rates, lease unbundled network services and permit interconnection to the fledgling new competitors.¹³ The plaintiffs' allegations consisted of claims that the defendants agreed not to enter each other's territories and to work jointly against the new competitors.¹⁴ However, the complaint had no independent factual allegations of a negotiated agreement by the defendant companies, such as a specific meeting.¹⁵ After the complaint was dismissed, the Second Circuit revived the lawsuit, saying that an inference could be drawn that an illegal agreement must have taken place at some time if collusion in fact occurred.¹⁶

The U.S. Supreme Court reversed the ruling, holding that to survive a motion to dismiss, it is not enough to make allegations of an antitrust conspiracy that are consistent with an unlawful agreement; to survive, the complaint must contain "enough factual matter (taken as true) to suggest that an agreement [to engage in anticompetitive conduct] was made."¹⁷ While the new standard did not require heightened fact pleading of specific events, it did require enough facts to "nudge the [plaintiffs'] claims across the line from conceivable to plausible."¹⁸ The decision meant that, at least for some types of antitrust violations, courts could no longer apply the general federal pleading standards of *Conley v. Gibson*, where a court cannot dismiss unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief.¹⁹

In reaching its decision, the Supreme Court cited the potentially enormous discovery costs in antitrust cases, and it explained that district courts must "retain the power to insist on some

¹³ *Twombly*, 127 S. Ct. at 1962.

¹⁴ *Id.* at 1962-3.

¹⁵ *Id.* at 1962.

¹⁶ *Id.*

¹⁷ *Id.* at 1965.

¹⁸ *Twombly*, 127 S. Ct. at 1974.

¹⁹ *Conley v. Gibson*, 355 U.S. 41, 45-6 (1957).

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specificity in pleading before allowing a potentially massive factual controversy to proceed.”²⁰

In the elevator litigation, the plaintiffs argued that three parts of their complaint met the Supreme Court’s new “plausibility” standard in *Twombly*: 1) Averments of agreements made between the defendant companies at some unidentified place and time; 2) averments of parallel conduct; and 3) averments suggesting anticompetitive wrongdoing by several of the defendants in Europe.²¹

However, the Second Circuit called the allegations about agreements between the companies merely conclusory and that they amounted to “basically every type of conspiratorial activity that one could imagine.”²² The court went on to agree with the district court that “[t]he list is in entirely general terms without any specification of any particular activities by any particular defendant[; it] is nothing more than a list of theoretical possibilities, which one could postulate without knowing any facts whatsoever.”²³ The court said that simply alleging meetings or agreements at some unidentified time and place, with nothing more, is not enough, implying that plaintiffs must have concrete knowledge of the meetings for the allegation to get past the complaint stage.²⁴

The plaintiffs then alleged that parallel conduct by the companies, such as “similarities in contract language, pricing, and equipment design,” stated enough facts to prove there was an antitrust conspiracy.²⁵ However, the court reasoned that while this alleged conduct was consistent with a conspiracy, it is “just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.”²⁶ The court went on to say that similar contract terms can reflect “similar bargaining power and commercial goals (not to mention boilerplate),” and similar contract wording can reflect “copying of documents that may not be secret.”²⁷ Furthermore, the

²⁰ *Twombly*, 127 S. Ct. at 1967.

²¹ *In re Elevator Antitrust Litig.*, 502 F.3d at 50.

²² *Id.*

²³ *Id.* at 50-1.

²⁴ *In re Elevator Antitrust Litig.*, 502 F.3d at 51.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

court said that similar pricing can mean effective competition just as much as it can mean an anticompetitive conspiracy, and similar equipment design can just reflect state of the art design.²⁸ *Twombly* squarely addressed the problem of alleging parallel conduct, and the U.S. Supreme Court stated that:

[p]arallel conduct. . . gets the complaint close to stating a claim, but without some further factual enhancement, it stops short of the line between possibility and plausibility of entitlement to relief.²⁹

The plaintiffs next asserted that the extensive allegations of misconduct in Europe were enough to prove the plausibility of an antitrust conspiracy among the elevator companies.³⁰ The plaintiffs alleged that the incriminating evidence from Europe reflected the existence of a “worldwide conspiracy”; and that even though the misconduct was not in the United States, the market for elevators is a global one, and the prices charged abroad affect the prices in the United States and vice versa.³¹ Still, the court declared that the plaintiffs pleaded insufficient facts, reasoning that “anticompetitive wrongdoing in Europe, absent any evidence of linkage between such foreign conduct and conduct here – is merely to suggest . . . that ‘if it happened there, it could have happened here.’”³² The court scolded the plaintiffs for including nothing in their allegations about global marketing strategies or fungible products, no assertions that the companies monitored prices in multiple markets, and no proof that the actual prices of elevators or maintenance in the United States were affected by the actions in Europe.³³

Finally, the plaintiffs suing the elevator companies alleged that the defendants unilaterally engaged in “exclusionary conduct” to create or attempt to create a monopoly in the maintenance market for its own elevators.³⁴ The plaintiffs alleged the defendants designed their elevators to prevent servicing by any other providers, including

²⁸ *Id.*

²⁹ *Twombly*, 127 S. Ct. at 1966.

³⁰ *In re Elevator Antitrust Litig.*, 502 F.3d at 51.

³¹ *Id.*

³² *In re Elevator Antitrust Litig.*, 502 F.3d at 52.

³³ *Id.*

³⁴ *Id.*

the other defendants; refused to sell to competitors the parts, tools, software programs and blueprints necessary to repair their elevators; and obstructed competing companies' attempts to purchase elevator parts.³⁵ However, the appellate court dismissed this section of the complaint as well, reasoning that the Sherman Act allows companies in an entirely private business to deal with whatever third parties they choose, and that refusing to do so is not an antitrust violation.³⁶ The only exception the court recognized was that companies are prohibited from terminating "a prior (voluntary) course of dealing with a competitor," because "the unilateral termination suggest[s] a willingness to forsake short-term profits to achieve an anticompetitive end."³⁷ The court implies that only this type of conduct would violate § 2 of the Sherman Act because it would drive businesses out of a pre-existing market and raise prices for repair work that had previously been offered for a lower price.³⁸ The court said a plaintiff would have to prove the terminations were part of a "scheme of willful acquisition. . . of monopoly power."³⁹ However, because the plaintiffs alleged no such terminations, they failed to state a claim.⁴⁰

The Second Circuit's exacting interpretation of the *Twombly* standard has driven home the tough new playing field for antitrust lawsuits, according to plaintiffs' lawyers.⁴¹ The case also shows that the *Twombly* standards may affect a much broader range of antitrust suits than previously thought.⁴² J. Douglas Richards, the attorney who argued and lost the *Twombly* case before the U.S. Supreme Court, has contended that the impact of the holding, even in antitrust conspiracy cases, would be very small, and that to survive a defendant's motion to dismiss, a plaintiff need only point to a meeting that could have occurred shortly before the alleged antitrust

³⁵ *Id.*

³⁶ *Id.*

³⁷ *In re Elevator Antitrust Litig.*, 502 F.3d at 53.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ Anik Banerjee, *supra* note 3.

⁴² Steve Lash, *Reach of Antitrust Ruling Debated*, CHI. DAILY L. BULL., Nov. 15, 2007, at A1.

violation, such as price fixing.⁴³ However, many defense attorneys have “declared open season on plaintiffs,” aggressively citing *Twombly* to dismiss a wide range of business cases where plaintiffs’ claims are short on facts and long on inferences of illegal meetings.⁴⁴ The Second Circuit’s elevator litigation ruling provides further ammunition to the defense bar in dismissing expensive antitrust cases early.⁴⁵

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ Anik Banerjee, *supra* note 3.

Antitrust Modernization Commission Declares Antitrust Need Not be Modernized, But Does Suggest a Few Tweaks

By Thomas A. McCann

In 2002, the United States Congress created the Antitrust Modernization Commission to wage a comprehensive review of U.S. antitrust laws to determine whether they need to adapt to keep pace with the changing business world.⁴⁶ After conducting 18 hearings over 13 days, hearing testimony from 120 witnesses and receiving comments from 126 people and organizations, the commission released its much awaited 540-page report in April 2007, concluding on balance that U.S. antitrust law is fundamentally sound and that no significant changes are required.⁴⁷

Despite recommending no wholesale changes to the current antitrust enforcement system, the commission did make several suggestions for improvement, and the courts are just beginning to apply some of the commission's more progressive ideas to the antitrust cases on their dockets.⁴⁸

The U.S. House Committee on the Judiciary specifically asked the Commission to analyze three main issues: (1) whether U.S. antitrust law must be changed to address the role of intellectual property; (2) whether enforcement priorities should change to reflect the global economy; and (3) whether the state attorneys general should play more of a role in antitrust enforcement.⁴⁹ The commission responded "no" to all three questions.⁵⁰

⁴⁶ Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, § 11054(h), 116 Stat. 1856, 1857 (2002).

⁴⁷ Charles Freed, *The Antitrust Modernization Commission: "If It Ain't Broke..."*, ANTITRUST, Summer 2007, at 7.

⁴⁸ Cascade Health Solutions v. PeaceHealth, No. 05-35627, (9th Cir. Sept. 4, 2007).

⁴⁹ Freed, *supra* note 47, at 7.

⁵⁰ *Id.*

The commission concluded there is no need to change the antitrust laws to deal with “industries in which innovation, intellectual property, and technological change are central features.”⁵¹ The commission recommended that in analyzing the competitive effects of new economy industries, enforcers simply should give due weight to market dynamics, just like any traditional antitrust case.⁵² The commission further concluded that globalization should not affect U.S. antitrust enforcement, but instead recommended that there be greater cooperation among international antitrust authorities and greater coordination of different nations’ antitrust laws, including a call for a centralized pre-merger notification system.⁵³ The commission finally recommended that there be no change in the role of the state attorneys general, but advised that they should stick to local antitrust violations and there should be more coordination between the federal and state enforcement agencies.⁵⁴

Notwithstanding the report’s “don’t change a thing” tenor, the commission did make one novel recommendation regarding “bundling” violations under § 2 of the Sherman Act.⁵⁵ That section of the Sherman Act “forbids ‘monopolization’ and ‘attempted monopolization’ (as well as combinations and conspiracies to monopolize) of any part of the trade or commerce of the United States.”⁵⁶ In addition to traditional schemes to acquire monopoly power, courts have recognized that companies can also utilize “bundled discounts” to drive away competition, using schemes in which they offer a discount or rebate to customers if they buy a package of products in an effort to deter entry into the market, to use it as predatory pricing or as a form of illegal “tying,” which violates antitrust law.⁵⁷ However, the commission recognized that bundling is exceedingly common in today’s economy, from cell phone products

⁵¹ ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS, at 32 (2007) [hereinafter AMC REPORT], available at <http://www.amc.gov>.

⁵² *Id.*

⁵³ AMC REPORT, *supra* note 51, at 232.

⁵⁴ *Id.* at 187.

⁵⁵ Freed, *supra* note 47, at 7; *See also* 15 USC § 2.

⁵⁶ AMC REPORT, *supra* note 51, at 84; *See also* 15 USC § 2.

⁵⁷ Freed, *supra* note 47, at 7.

to car/home/life insurance packages, and it can significantly lower costs for consumers.⁵⁸

The commission report proposed an “objective, cost-based approach” for determining the legality of companies offering “bundled” discounts.⁵⁹ First, a court should take the entire discount or rebate of the product bundle and deduct it just from the price of the product on which the defendant competes with the plaintiff.⁶⁰ If, after that calculation, the price of the defendant’s product is still above its incremental cost of production, the defendant wins.⁶¹ Even if the plaintiff establishes that prices are below the defendant’s incremental cost of production, the defendant still wins unless the plaintiff can prove that the defendant is able to recoup its losses from the pricing scheme, and that the scheme causes harm to competition.⁶²

The Ninth Circuit recently applied this cost-based test to an antitrust case involving the healthcare market.⁶³ The appellate court chose to follow the commission’s recommendation and to reject the more ambiguous approach adopted by the Third Circuit, an approach that did not consider whether the bundled discounts constituted competition on the merits, but simply concluded that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line.⁶⁴ The Third Circuit standard would not require a cost-based analysis and would allow the jury to find bundled discounts exclusionary merely upon a showing that a competitor could not offer the same bundle as the defendant.⁶⁵

PeaceHealth and McKenzie are two hospital care providers in Lane County, Oregon. PeaceHealth provides basic care and more advanced “tertiary care” services while McKenzie provides only basic care service. PeaceHealth has more than 90 percent of the

⁵⁸ AMC REPORT, *supra* note 51, at 95.

⁵⁹ *Id.* at 89, 99.

⁶⁰ *Id.* at 99.

⁶¹ *Id.*, *See also* Freed, *supra* note 47, at 7.

⁶² *Id.*

⁶³ *See* Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).

⁶⁴ *Cascade Health Solutions*, 502 F.3d at 910; *See also* LePage’s Inc. v. 3M, 324 F.3d 121 (3d Cir. 2003).

⁶⁵ *Id.*

county's market for advanced care and about 75% for basic care.⁶⁶ McKenzie alleged in its complaint that PeaceHealth offered insurers 35 to 40 percent discounts on advanced care if the insurers made PeaceHealth their exclusive preferred provider.⁶⁷ Further, McKenzie alleged that it could offer basic care services at a lower cost than PeaceHealth, but because of the bundled discounts, McKenzie was driven out of the market for those services.⁶⁸ The district court instructed the jury to apply the Third Circuit standard, and the jury awarded the plaintiff \$5.4 million, which the court trebled to \$16.2 million.⁶⁹

In vacating the district court's judgment, the Ninth Circuit analyzed both tests and came out on the side of the Antitrust Modernization Commission. The court said that while bundling can be anticompetitive in certain situations, the majority of businesses, both big and small, use bundles to instill customer loyalty, lower net prices to consumers, increase demand in lieu of advertising, encourage use of a new product, or enter a new market.⁷⁰ The court said that the Third Circuit prohibited some competitive business behavior and that "we think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct. . . unless the discounts result in prices that are below an appropriate measure of the defendant's costs."⁷¹

The court then considered several tests to determine which bundling schemes were bad and adopted the commission's "discount attribution" standard.⁷² The court reasoned that this standard makes the defendant's bundled discounts legal unless the discounts have the potential to exclude a hypothetical equally efficient producer of the competitive product, i.e. it that pretends that the actual plaintiff is equally efficient to the defendant.⁷³ The court provided this example of how the test works:

⁶⁶ *Cascade Health Solutions*, 502 F.3d at 902.

⁶⁷ *Id.* at 903.

⁶⁸ *Id.* at 907.

⁶⁹ *Id.* at 901, 904-5.

⁷⁰ *Id.* at 906.

⁷¹ *Cascade Health Solutions*, 502 F.3d at 913.

⁷² *Id.* at 916.

⁷³ *Id.* at 916-17.

A [is] a firm that makes both shampoo and conditioner. A's incremental cost of shampoo is \$1.50 and A's incremental cost of conditioner is \$2.50. A prices shampoo at \$3 and conditioner at \$5, if purchased separately. However, if purchased as a bundle, A prices shampoo at \$2.25 and conditioner at \$3. Purchased separately from A, the total price of one unit of shampoo and one unit of conditioner is \$8. However, with the . . . discount, a customer can purchase both products from A for \$5.25, a discount of \$2.75 off the separate prices, but at a price that is still above A's variable cost of producing the bundle. Applying the discount attribution rule. . . we subtract the entire discount. . . , \$2.75, from the separate per unit price of the competitive product, shampoo, \$3. The resulting effective price of shampoo is thus \$0.25. If a customer must purchase conditioner from A at the separate price of \$5, a rival who produces only shampoo must sell the shampoo for \$0.25 to make customers indifferent between A's bundle and the separate purchase of conditioner from A and shampoo from the hypothetical rival.⁷⁴

The court said the pricing scheme has the effect of excluding any potential rival who produces only shampoo, and does it at an incremental cost above \$0.25.⁷⁵ Thus, the bundling excludes potential competitors that could produce shampoo more efficiently (i.e., at an incremental cost of less than \$1.50).⁷⁶

The court also approved of the scheme because it "provides clear guidance for sellers that engage in bundled discounting practices. A seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the rule we have outlined."⁷⁷

Going back to the other facets of the Antitrust Modernization Commission, the body advocated leaving well enough alone. The commission rejected any wholesale changes to the current enforcement system, which is quite harsh by international standards,

⁷⁴ *Id.* at 917.

⁷⁵ *Id.*

⁷⁶ *Cascade Health Solutions*, 502 F.3d at 917.

⁷⁷ *Id.* at 918.

with treble damages, and jail terms for major violations.⁷⁸ The commission said “[o]n balance, the current scheme appears to be effective in enabling plaintiffs to pursue litigation that enhances the deterrence of unlawful behavior and compensates victims.”⁷⁹ The commission did recommend that Congress enact legislation that would permit non-settling defendants to obtain a more equitable reduction of the judgment against them and allow for contribution among non-settling defendants.⁸⁰

The commission was critical of the current merger review process, advocating stricter rules and a tighter timeline for getting the process done.⁸¹ The commission also was critical of antitrust exemptions and immunities granted by the federal government.⁸² The report pounded home that Congress must stop granting special industry exemptions and reevaluate existing exemptions to see if the reasons for them, such as societal goals, still outweigh the harm to competition.⁸³ The Commission also recommended that federal antitrust agencies have full merger enforcement authority over regulated industries and should exclusively conduct the analysis, instead of having it redone and second-guessed by the industry’s regulatory authority.⁸⁴

The Antitrust Modernization Commission’s long-awaited report was short on pizzazz but did provide a useful top-down review of the antitrust regime in the United States.⁸⁵ Courts are already applying the body’s recommendations in the bundling arena, and its other recommendations are likely to influence policy both in Congress and the federal agencies involved in antitrust enforcement.⁸⁶ It’s still too early to tell, but many experts in the

⁷⁸ AMC REPORT, *supra* note 51, at vi.

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.* at 15.

⁸² *Id.* at 435.

⁸³ AMC REPORT, *supra* note 51, at 334.

⁸⁴ *Id.* at 342.

⁸⁵ Freed, *supra* note 47, at 8.

⁸⁶ *Id.*

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antitrust field say the report's \$4 million price tag was still worth the price.⁸⁷

⁸⁷ *Id.*