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ANTITRUST UPDATE

This fall issue of the *Antitrust Update* reflects the broad reach of the federal antitrust laws and covers developments in both government enforcement actions and private antitrust litigation. On the enforcement side, we address an important, and long-awaited, standard-setting decision from the Federal Trade Commission. The decision, *In the Matter of Rambus, Inc.*, has several valuable lessons for patent owners who participate in standard-setting organizations (SSOs). On the private litigation side, we discuss the *Twombly* case, which is now on appeal to the U.S. Supreme Court. At stake in *Twombly* is an issue that arises repeatedly in antitrust litigation – the standard for alleging an antirust conspiracy. The result of this Supreme Court appeal is likely to affect the course of many future antitrust cases at the pleading stage.

We also discuss criminal aspects of antitrust regulation. Currently the subject of a petition for *certiorari* before the Supreme Court and, simultaneously, a federal criminal proceeding in Philadelphia is the now infamous *Stolt-Neilsen* matter. The criminal defendant in this matter, a confessed member of an antitrust conspiracy in the parcel-tanker shipping industry, is now fighting on both those fronts to preserve its immunity deal with the Department of Justice.

With a view toward the future of antitrust enforcement, we include in this issue reports on initiatives to repeal or modify the McCarran-Ferguson Act, which currently provides a limited antitrust immunity to the insurance industry, and joint hearings by the DOJ and the FTC on Section 2 of the Sherman Act, governing monopolization and attempted monopolization.

We begin with a discussion of a topic that has generated significant interest in the antitrust and pharmaceutical communities and is the subject of an upcoming FTC investigation – authorized generic drugs.

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FTC to Study Authorized Generics

Richard E. Coe and M. Howard Morse

Earlier this year, the Federal Trade Commission ("FTC") announced that it would serve subpoenas on approximately 80 pioneer or innovator drug companies and more than 100 generic companies as part of a study of so-called "authorized generics." An authorized generic is a generic drug that is marketed and/or distributed by an innovator company – or a third party licensed by the innovator – pursuant to the regulatory approval received by the innovator for the chemically identical brand-name drug. The FTC is currently reviewing public comments on its proposed study and expects to issue subpoenas within the next few months.

The FTC study will consider both (1) the extent to which the introduction of authorized generics leads to lower prices and (2) the extent to which they may reduce the incentive of generic companies to challenge patents before they expire. As discussed more fully in an article by these two authors published in the *Legal Times* on April 10, 2006, Congress gave generic drug manufacturers an incentive to challenge pharmaceutical patents by giving the first generic drug manufacturer to challenge a patent 180 days of so-called "exclusivity," during which the Food and Drug Administration (FDA) may not approve another generic manufacturer. The challenging generic manufacturer does, however, face competition even during this period from the pioneer drug. It will also face generic competition from the manufacturer of the pioneer drug if that firm chooses to launch an authorized generic, either itself or by supplying or licensing another generic manufacturer.

Generic manufacturers have opposed the launch of authorized generics because, when these drugs are launched, they have to share profits during the "exclusivity" period with another competitor. Generic manufacturers' first challenge to the practice of launching authorized generics was to argue that the marketing of authorized generics is prohibited by the legislation governing the approval of prescription drugs, commonly referred to as the Hatch-Waxman Act. This challenge failed in front of the FDA and before a number of federal courts, including the D.C. Circuit.

After losing this legal battle, generic manufacturers resorted to more novel legal arguments. Mylan Pharmaceuticals, a major generic manufacturer, filed suit in California state court against Procter and Gamble Company ("P&G") and the distributor of its authorized generic version of the brand-name drug Macrobid, Watson Pharmaceuticals. Mylan asserted claims under California's antitrust law and consumer protection laws, claiming, among other things, that P&G and Watson engaged in predatory conduct to drive Mylan out of the generic market and failed to disclose that the generic drug was made by P&G.

Generic manufacturers have also advocated for legislation to block authorized generics. They argue that, because authorized generics lower their profits during the exclusivity period, they will have no incentive to challenge patents. Challenges to pharmaceutical patents continue to be filed today, however, despite the expectation that nearly every generic will face an authorized generic. FTC Commissioner Jonathan Leibowitz, who has advocated a close look at authorized generics, has recognized, in recent testimony before the Senate Committee on Aging, that any threat is likely greater for "non-blockbuster" drugs. Authorized generics are not likely to lead to fewer challenges to patents for blockbuster drugs, as evidenced by the large number of generics launched for the highest selling drugs after exclusivity expires when generic profits are much lower.

Innovator companies have argued that competition from authorized generics lowers prices and benefits consumers. While there have been a number of studies attempting to quantify the consumer benefit, the FTC study should shed more light on this issue as well as on the extent of any disincentive to challenge patents. The FTC currently plans to gather documents related to innovator companies' decisions to launch authorized generics and generic companies' decisions to challenge patents as well as pricing data.

The FTC is studying this issue as part of its broad mandate to examine conduct that may impact competition even though it has acknowledged that the launch of an authorized generic does not raise antitrust issues. Commissioner Leibowitz, who encouraged the agency to study the impact of authorized generics, has said publicly that he is not persuaded by generic companies' claims that authorized generics violate antitrust laws.

Companies should be aware that, although the launch of an authorized generic should not raise antitrust issues, an agreement not to launch an authorized generic may do so. FTC Commissioner Leibowitz has said that an agreement by an innovator company not to launch an authorized generic as part of a settlement of patent litigation "raises interesting questions" and could violate the FTC Act. Such an agreement may have been part of the recent controversy surrounding the patent settlement relating to the blood thinner Plavix between Bristol-Myers Squibb ("BMS"), Sanofi and Apotex that led to the reportedly forced resignations of

BMS's CEO and General Counsel. Those firms reportedly removed a provision from a proposed settlement that would have prohibited the launch of an authorized generic in an effort to obtain government approval of their settlement, which was ultimately rejected by the regulators.

Companies that receive subpoenas from the FTC as part of its study should be aware that even though the study is not aimed at antitrust enforcement, the government could uncover conduct that leads to other investigations. All documents should be reviewed carefully by counsel before they are produced.

FTC's *Rambus* Decision Clarifies Antitrust Risksfor Participants in Standard-Setting Processes

Kenneth M. Vorrasi and Robert A. Skitol

The Federal Trade Commission ("FTC") has finally reached a decision in the *Rambus* case, its long running antitrust proceeding involving standard-setting practices. The FTC held that Rambus, Inc. unlawfully monopolized the markets for four critical technologies involving dynamic random access memory used in computers, known as DRAM. *In the Matter of Rambus, Inc.* Specifically, the August 2006 decision found that Rambus engaged in a "course of deceptive conduct" in connection with standard-setting proceedings of the Joint Electron Device Engineering Council ("JEDEC") that enabled Rambus to assert patent claims against implementers of JEDEC's DRAM standards. The decision (if upheld on appeal) has important lessons for all participants in standard-setting processes, not just those involving computer memory. According to the FTC, participants in standard-setting processes should:

1. avoid misleading conduct regarding their patent portfolios or licensing practices;

2. disclose the existence of patent claims – including patent applications - if there is either an explicit obligation under applicable standard-setting organization ("SSO") rules to do so or if there is an expectation among participants in the SSO that they will do so; and

3. proceed with caution before using information learned during the standard-setting process to file amendments to pending patent applications.

The *Rambus* decision may also encourage collective action by SSO participants to negotiate royalty rates and other license terms on patents covering technology that the SSO is considering.

I. Standard-Setting Can Be Procompetitive and Beneficial to Consumers But Anticompetitive Effects May Result When the Process Is Abused or Distorted

At the outset of its unanimous opinion, authored by Commissioner Pamela Jones Harbour, the FTC acknowledged that standard-setting is generally procompetitive and "can be highly beneficial to consumers." Indeed, "[s]tandards can facilitate interoperability among products supplied by different firms, which typically increases the chances of market acceptance, makes the products more valuable to consumers, and stimulates output." But these benefits cannot be realized "when a firm engages in exclusionary conduct that subverts the standard-setting process and leads to the acquisition of monopoly power."

The FTC focused on patent "holdup" which can occur after a standard incorporating patented technology has been adopted. "[A]s time passes, and the industry commits to greater levels of resources to developing products that comply with the standard, the costs of switching to alternative technologies begins to rise. Industry members may find themselves 'locked in' to the standardized technology once switching costs become prohibitive. Once lock-in occurs, the owner of the standardized technology may be able to 'hold up' the industry and charge supracompetitive rates" to license its technology.

According to the FTC, "[a]ntitrust scrutiny of possibly deceptive conduct" enabling holdup conduct of this sort "is especially warranted when the standard-setting body has determined to carry out its work in an environment ostensibly characterized by cooperation, rather than rivalry." Indeed, "[i]n a consensus-oriented context, participants in the standard-setting process are likely to be less wary of deception; they are less likely to detect and take countermeasures to counteract it, and anticompetitive effects therefore are more likely to result" than in the competitive marketplace.

II. Ex Ante Disclosure of Potential Patent Claims Enables Participants to Make More Informed Decisions in the Course of Their Standards Development Activities

The disclosure of patents and patent applications that contain claims that may be essential to implement a proposed standard "enable[s] SSO members to evaluate potential standards with more complete information about the likely consequences, before the standard is finalized." The FTC observed that such disclosure:

> enables SSO participants to make their choices with more complete knowledge of the consequences – including the potential that those practicing the standard may be liable for patent infringement, unless they negotiate licenses and pay royalties. If the SSO members prefer a given technology, notwithstanding the prospect of royalties, they can vote to incorporate it into the standard. If, in light of likely royalty payments, members prefer an alternative technology, they can vote against inclusion of the patented technology.

Similarly, the FTC said that requiring contributors of patented inputs to commit *ex ante* to licensing terms (*e.g.*, reasonable and non-discriminatory, or RAND, terms) "may further inform SSO members' analysis of the costs and benefits of standardizing patented technologies."

III. Deceptive Conduct Engaged In During the Course of Standard-Setting May Be Exclusionary and Lead to Adverse Competitive Effects

The FTC concluded that deceptive conduct during standard-setting can be exclusionary and thus form the basis for a monopolization holding. Relying on its 1983 *Policy Statement on Deception*, adopted in the consumer protection context, the FTC held that, for conduct to be deceptive, a firm must engage in a willful "misrepresentation, omission, or practice that was material in that it was likely to mislead others acting reasonably under the circumstances and thereby likely to affect their conduct or decisions." The FTC held that, in the standard-setting context, "deceptive behavior that hides the price of a patented technology is not 'competition on the merits,' and deception that thwarts informed choice is not competition on the 'basis of efficiency'" and may thus become illegal monopolization.

In a competitive marketplace, while deception may not be the basis of an antitrust claim, deceptive conduct engaged in during standard-setting may hide critical information. According to the FTC, "[t]he risk of competitive harm is heightened in the face of exclusionary conduct that does not constitute competition on the basis of efficiency and that interferes with the cooperative nature of the standard-setting process. Exclusionary conduct such as deception may distort the selection of technologies and evade protections designed by SSOs to constrain the exercise of monopoly power, with substantial and lasting harm to competition."

The FTC found Rambus' conduct to be deceptive due to its:

1. concealment of patents and patent applications until after the standards were adopted;

2. evasive and misleading statements about its patent portfolio; and

3. use of information learned from the JEDEC proceedings to fashion amendments to patent applications that covered key parts of the proposed standards.

Based on these facts, the FTC found that Rambus' overall course of conduct was deceptive, and concluded that "[t]his sort of deception is not competition on the merits. . . . [D]istorting choices through deception obscures the relative merits of alternatives and prevents the efficient selection of preferred technologies." The message for SSO participants generally is to pay close attention to the patent-related representations they make during the SSO processes. The decision teaches that materially misleading representations and omissions in this context can form the basis of an antitrust claim.

The FTC acknowledged that, standing alone, the practice of amending patent applications to add claims based on information learned during standard setting is not necessarily deceptive. But this conduct may be unlawful when it is done with a concomitant (undisclosed) intent to seek royalties for use of technology included in a standard after the standard has been adopted and parties are locked in. Importantly, the FTC recognized that, after a member has withdrawn from a

standard-setting proceeding, it is not necessarily unlawful for it to monitor the standard-setting activities and act upon information learned. It stated that "we do not mean to suggest that a firm that never participated in a standard-setting process – or that did so without deception, then resigned from the SSO – would be at risk of . . . liability if it monitored the standard-setting process from the outside and developed a patent portfolio covering standards it believed would be adopted."

IV. Disregard of SSO Policies May Be Deceptive

The FTC held that if an SSO requires the disclosure of relevant patent claims, "then non-disclosure – followed by adoption of a standard incorporating the intellectual property, and royalty demands against those practicing the standard – may be considered a material omission and may constitute deceptive conduct."

It was not clear whether Rambus was under an obligation to disclose its patents or patent applications to JEDEC. The Administrative Law Judge determined that JEDEC's policies and rules did not impose an affirmative duty to disclose. Similarly, the U.S. Court of Appeals for the Federal Circuit – examining the same facts in patent infringement litigation against a DRAM supplier (Infineon) – held that Rambus did not breach a duty to disclose intellectual property to JEDEC.

The FTC acknowledged that JEDEC's rules and policies were ambiguous and did not expressly require disclosure. Nonetheless, the FTC found – based on the "totality of circumstances . . . in which the standard-setting occurred" – that "JEDEC's policies and practices . . . gave JEDEC's members reason to believe that the standard-setting process would be cooperative and free from deceptive conduct."

Thus, when under an obligation to disclose relevant intellectual property, an SSO participant should do so accurately, completely, and in accordance with the intent or spirit of the organization's policies and practices. Even where there is no explicit disclosure obligation, participants should not provide misleading information about their patent portfolios. As the FTC said, "If an SSO chooses not to require such disclosure, SSO members are still not free to lie or to make affirmatively misleading misrepresentations."

V. Collective Negotiation of License Terms Does Not Necessarily Violate the Antitrust Laws

The FTC recognized that SSO participants may want to negotiate license terms for patented technologies before a standard has been adopted. It stated that "under certain circumstances, members of an SSO may even collectively negotiate these types of *ex ante* licenses, without necessarily running afoul of the antitrust laws." The FTC favorably cited a speech FTC Chairman Deborah Majoras given in September 2005, in which she stated that "joint *ex ante* royalty discussions that are reasonably necessary to avoid hold up do not warrant *per se* condemnation" under the antitrust laws and should be evaluated under the rule of reason.

Although this was not an issue in the *Rambus* case, such joint negotiation has been debated vigorously within the antitrust bar as well as throughout the standard-setting community. Some commentators argue that *ex ante* joint negotiation would constitute a buyers' cartel and should be *per se* illegal. Prior to this decision, most of the support for permitting joint negotiation of license terms came from speeches and academic commentary. The statement here in an FTC decision provides significant further support for the position that *ex ante* joint negotiation of license terms can be procompetitive and should therefore not be *per se* condemned under the antitrust laws.

Stolt-Nielsen Amnesty Saga Continues

Mary E. Kohart and Meredith Rubin

Antitrust lawyers around the country are still waiting to see what the end game holds for Stolt-Nielsen and, more broadly, for the Department of Justice's ("DOJ") Amnesty Program. Stolt-Nielsen was at one time an amnesty program participant, until the DOJ took the position that their amnesty agreement was violated – a position that Stolt-Neilsen continues to dispute. Indeed, as of this writing, the federal criminal prosecutions are proceeding against both Stolt-Nielsen and one of its executives, Mr. Richard Wingfield, while the defendants' lawyers seek *certiorari* from the Supreme Court in an effort to reinstate the district court's decision to enjoin the indictments. The criminal case has been assigned to Bruce Kauffman, a federal judge in

Philadelphia, who was not involved in the defendants' earlier civil suit seeking to enjoin the indictments. Defendants Stolt-Nielsen and Wingfield may move to quash the indictments based on their amnesty agreement but, so far, have not done so. If they do, antitrust lawyers will be watching carefully to see if Judge Kauffman will conclude, like his district court colleague, Judge Timothy Savage, that the Stolt-Nielsen defendants may not be convicted of antitrust violations because of its amnesty agreement with DOJ.

The DOJ Amnesty Program for antitrust offenders permits a conspirator which self-reports its violations to receive complete immunity from prosecution. The program has two hooks: first, the corporation must be the first conspirator in the door at the Antitrust Division. Any later corporations who self-report or otherwise cooperate with the DOJ may receive some benefit because of their conduct but will not receive complete immunity. Second, the self-reporting corporation must cease its illegal conduct and must fully cooperate with the DOJ's investigation of the reported cartel behavior.

Most corporations which have participated in the Amnesty Program have also been able to obtain complete immunity for officers, directors and employees who join the corporation in cooperating with the DOJ's investigation. The program offers tremendous benefits to corporations which have found themselves participating in illegal cartels and, as expected given the program's "winner take all" feature, it has been a hugely successful prosecutorial tool for cracking both international and domestic cartels.

Stolt-Nielsen entered the DOJ's Amnesty Program by a letter agreement, dated January 15, 2003. The agreement gave Stolt-Nielsen, as well as any of its cooperating officers, directors and employees, immunity from prosecution for any offense they may have committed prior to the date of the letter. In exchange, Stolt-Nielsen agreed voluntarily to incriminate itself and others in an antitrust conspiracy in the parcel-tanker shipping industry. After executing the letter, Stolt-Nielsen turned over documents and other evidence that were used by the DOJ to indict, and receive guilty pleas from, its two corporate co-conspirators and several of their top executives. The guilty pleas included fines totaling $62 million and, for the individuals, prison time.

Despite the foregoing, and a mere four months after Stolt-Nielsen signed its amnesty agreement, DOJ threatened to prosecute Stolt-Nielsen and Mr. Wingfield for their roles in the conspiracy. DOJ informed Stolt-Nielsen that it considered the amnesty agreement voided because it had learned through the post-amnesty agreement investigation that Stolt-Nielsen had not, as the DOJ had understood, stopped participating in the cartel by March 2002 but, instead, had continued its wrongdoing until approximately June 2002. While the DOJ did not formally revoke Stolt-Nielsen's conditional leniency under the agreement until March 2004, Mr. Wingfield was arrested and charged with criminal antitrust violations in June 2003.

Stolt-Nielsen and Wingfield responded to these developments by filing a civil action in the Eastern District of Pennsylvania, seeking enforcement of their rights under the amnesty agreement. They argued that the amnesty agreement gave them immunity for all criminal conduct through January 15, 2003, and, consequently, included their alleged participation in the conspiracy through June 2002. They then sought and obtained a preliminary injunction that enjoined the DOJ from indicting or prosecuting Stolt-Nielsen and Mr. Wingfield for any violations of the Sherman Act in the parcel tanker industry up to and including January 15, 2003. The trial judge consolidated his findings of fact and legal determinations with the merits trial, as allowed under Fed. R. Civ. P. Rule 65.

The government appealed to the Third Circuit. The Third Circuit panel that heard the case consisted of Judges Alito, Ambro and the Hon. Jane A. Restani, the Chief Judge of the Court of International Trade who was sitting by designation. After argument, Judge Alito was elevated to the United States Supreme Court where, we presume, he will not consider the petition for *certiorari*. The two remaining judges concluded that the district court's injunction should be vacated. The Court determined that it could not enjoin the executive branch from filing an indictment. To do so would be inconsistent with the separation of powers outlined in the U.S. Constitution. Significantly, however, the Court of Appeals made clear that a defendant who believed he was denied the benefit of his bargain under an amnesty agreement with prosecutors had the right to seek to interpose the agreement as a defense to conviction. Despite this language, the Court of Appeals made clear that the defendant was not limited to raising the agreement as a defense barring conviction at trial, but instead the defendant could do so either in a pre-trial motion that could be heard before trial or as a trial defense.

As of this date, no defense motion by Stolt-Nielsen has been filed. It is possible that the defendants are trying to avoid rendering their Supreme Court appeal moot by making such a motion. Whatever the outcome of the Stolt-Nielsen amnesty saga, it appears that the DOJ's Amnesty Program is here to stay – the program's benefits are simply too substantial to ignore. Yet, the experience of Stolt-Neilsen serves as a reminder that a company's assurance of full cooperation with the DOJ and each and every represen-

tation of fact made in connection with that cooperation are not matters to be taken for granted.

Antitrust Changes May Be on the Horizon for the Insurance Industry

James J. Dougherty

For over half a century, the insurance industry has been subjected to less antitrust scrutiny at the federal level than most other lines of interstate commerce. Much of this relative freedom from federal antitrust oversight is attributable to the McCarran-Ferguson Act (the "Act"). Enacted in 1945, the Act provides that the states, rather than the federal government, will regulate the "business of insurance." 15 U.S.C. § 1012. There are certain notable exceptions to this antitrust immunity, such as insurer conduct that constitutes an agreement to boycott. Nevertheless, as a consequence of the Act, insurance companies generally have had more freedom than those in other industries to gather and exchange price data.

In recent years, however, it seems the insurance industry has become more of a target for antitrust challenges. For example, insurance companies and brokers are currently the subject of a large multi-district antitrust proceeding in New Jersey, involving 38 different complaints. *In re Insurance Brokerage Antitrust Litigation*, MDL No. 1663 (D.N.J.). Earlier this month, the district court in that action denied, in part, a motion to dismiss the federal antitrust claims, finding that the McCarran-Ferguson exemption did not apply.

Now, the Act itself has become the subject of criticism, and this criticism has led to an investigation by the Senate Judiciary Committee into the efficacy of repealing the Act. Over the summer, the Judiciary Committee heard testimony from representatives of a number of groups ranging from the National Association of Insurance Commissioners advocating that the Act be left intact to the New York State Attorney General's Office calling for its outright repeal.

Donald C. Klawiter, testifying on behalf of the American Bar Association, laid out the case for replacing the Act with a series of safe harbors "to make clear that certain types of conduct by insurers are pro-competitive and beneficial to the American economy." Specifically, the ABA proposed the following safe harbors:

- Insurers should be authorized to cooperate in the collection and dissemination of past loss-experience data so long as those activities do not unreasonably restrain competition.
- Insurers should be authorized to cooperate to develop standardized policy forms to simplify consumer understanding, to enhance price competition, and to support data collection efforts.
- Insurers should be authorized to participate in voluntary joint-underwriting agreements to cooperate in making rates, policy forms and other insurance functions so long as these activities do not unreasonably restrain competition.
- So long as the residual market mechanism is approved and actively supervised by a state regulatory agency, insurers participating in residual market mechanisms should be authorized, in connection with such activity, to cooperate in making rates, policy forms and other insurance functions.
- Insurers should be authorized to engage in any other collective activities that Congress specifically finds do not unreasonably restrain competition in insurance markets.

Currently pending in the Senate is a bill introduced by Senator Patrick Leahy (D-VT) that would repeal the antitrust exemption created by the Act, but the repeal would apply only to medical malpractice insurance. No bill seeking to repeal or completely modify the Act has yet been introduced. However, with the Act coming under increasing scrutiny, significant changes that will affect the insurance industry may only be a matter of time. In the meantime, even in the absence of a repeal or modification of the Act, insurance companies will continue to be susceptible to some types of antitrust challenges, as is evident by the on-going proceeding in New Jersey district court.

Pleading Issue Comes to a Head with *Twombly*

Amy B. Miner

For years, courts have struggled to determine what allegations of an unlawful conspiracy under Section 1 of the Sherman Act are sufficient to survive a motion to dismiss. In deciding the proper pleading standard, courts have had to balance the competing considerations of the Federal Rules

of Civil Procedure, which do not require a heightened pleading requirement for antitrust conspiracy claims, and the burdensome costs associated with defending insubstantial allegations of a conspiracy.

Recently, in *Twombly v. Bell Atlantic Corporation*, the Second Circuit examined these competing considerations and came to what defendants view as a remarkable – and unwarranted – conclusion: it found that pleading a *plausible* conspiracy is sufficient to survive dismissal of a Section 1 claim. The U.S. Supreme Court has since granted the defendants' petition for *certiorari* and will review the Second Circuit's decision on the appropriate pleading standard.

In *Twombly*, the plaintiffs, purchasers of local telephone or high speed internet services, alleged that the defendants, four "descendents of … AT&T .. and its wholly-owned subsidiaries, Bell Operating Companies," had entered into a conspiracy to prevent competitive carriers from entering into defendants' respective markets and to refrain from "competing … in each others' respective territories." Plaintiffs' conspiracy claim was based on a theory of conscious parallelism. The district court dismissed plaintiffs' complaint because it failed to satisfy the "plus factors" requirement. The court described "plus factors" as "evidence that the parallel conduct would have been against defendants' economic interests" absent an agreement or evidence of a "strong common motive."

On appeal, the Second Circuit found that by applying a "plus factors" pleading requirement, "the district court applied an incorrect standard for evaluating defendants' motion to dismiss." In reversing the district court's dismissal of plaintiffs' complaint, the Second Circuit emphasized that it was deciding a motion to dismiss, not a summary judgment motion, and began its analysis with a discussion of the pleading requirements under the Federal Rules of Civil Procedure. Although the Second Circuit acknowledged that a heightened pleading standard applies to "certain kinds of claims," it declined to find that "antitrust complaints merit a more rigorous pleading standard." Thus, according to the Second Circuit, the rule of notice pleading in a Section 1 case is "relatively straightforward" and requires plaintiff simply to allege "(1) the defendants were involved in a contract combination, or conspiracy that (2) operated unreasonably to restrain interstate trade, together with the factual predicate upon which those assertions are made."

In addressing the specific issue of the district court's "plus factors" requirement, the Second Circuit opined that although such factors are appropriate in considering a motion for summary judgment, they have no place in deciding a motion to dismiss. The court explained that a plaintiff may survive a motion to dismiss simply by alleging "the existence of a conspiracy and a sufficient supporting factual predicate on which that allegation is based." The "factual predicate" need only include an allegation of conspiracy among the realm of "plausible" possibilities. And, therefore, "plus factors" are only necessary to survive a summary judgment motion and "are not required to be pleaded to permit an antitrust claim based on parallel conduct to survive dismissal."

In reaching this conclusion, the Second Circuit declined to be persuaded by the decision of other courts to dismiss actions for failure to plead "plus factors." The court simply reiterated its belief that "[a]t the pleading stage" defendants need only have "'fair notice' of the claim … not whether the conspiracy can be established at trial."

The Second Circuit's decision, by endorsing a more liberal pleading standard for antitrust conspiracies, is welcome news to plaintiffs. It also has negative practical implications for defendants. Indeed, as the Second Circuit itself acknowledged, permitting a more lenient pleading requirement for antitrust conspiracy claims could impose "colossal" costs that would induce "defendants to pay plaintiffs to settle what would ultimately be shown to be meritless claims" and that "the success of such meritless claims [will] encourage[] other[] [lawsuits] to be brought." The Second Circuit further recognized that "the overall result may well be a burden on the courts and a deleterious effect on the manner in which and efficiency with which business is conducted." Despite its recognition of these troubling concerns, the Second Circuit expressed the view that it was the role of Congress or the Supreme Court to "recalibrate" the balance between these concerns and the notice pleading requirements of the Federal Rules.

By granting the petition for *certiorari*, the Supreme Court will have the opportunity to address the issue of the appropriate pleading standard in the context of a Sherman Act conspiracy claim. For antitrust practitioners and their clients, the Supreme Court's decision in *Twombly* promises to be a significant one. It has the potential to influence not only the frequency with which antitrust complaints are filed but also the frequency with which courts dispose of such complaints at the pleading stage.

Sherman Act Section 2 Hearings

D. Alicia Hickok

In June, the Department of Justice and the Federal Trade Commission convened joint hearings on Section 2 of the Sherman Act, which prohibits the illegal acquisition, maintenance, or use of monopoly power. The hearings are entitled *Consumer Benefits and Harms: How Best to Distinguish Aggressive, Pro-Consumer Competition From Business Conduct To Attain or Maintain a Monopoly*. Predatory pricing was one of the featured Section 2 topics at the hearings.

Three cases were the center of the predatory pricing discussion: *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*; *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*; and *Confederated Tribes of Siletz Indians of Or. v. Weyerhaeuser Co.*, a case in which *certiorari* has been granted and briefing before the United States Supreme Court is in progress.

In the 1993 *Brooke Group* decision, the Supreme Court confirmed that a price is "predatory" only if it is below a specified (but so far undefined) measure of cost, and a firm cannot be considered liable for predatory pricing under the antitrust laws unless below-cost pricing is proven. In *Spirit*, which concerned an airline's complaint that Northwest Airlines had added capacity and discounted prices to passengers for routes also flown by the plaintiff, the Sixth Circuit found that predatory conduct could exist despite an overall price that exceeded average variable cost. And, in *Weyerhauser*, the Ninth Circuit refused to apply *Brooke Group* to the predatory bidding/buying conduct at issue, a determination that is being challenged by Weyerhauser in the Supreme Court. *Weyerhauser* focused on whether Weyerhauser had sought to gain monopsony control over the supply of alder logs in order to prevent other sawmills from being able to process them efficiently.

Each of the panelists at the joint hearings observed as outdated the notion that predatory pricing would be an irrational business strategy. As well, there was general agreement that the old adage – repeated in *Brooke Group* – that predatory pricing was rarely tried and even more rarely successful was an over-generalization. One panelist took issue with the phrasing itself, noting that murder may also be "rare" – the real question is whether it is significant. Another drew parallels to historic instances of predatory pricing that left long-lasting imprints of deterred entry on industries such as telecommunications and tobacco.

Two of the economists on the panel, Dr. Kenneth Elzinga and Dr. Janusz Ordover, noted that predatory pricing is more likely to occur in industries that have certain economic characteristics, including ease of exit but not of entry. They were clearly influenced in their views by the experience in *Spirit*, in which the core issue – as the Sixth Circuit articulated it – was whether "even if the jury were to find that Northwest's prices exceeded an appropriate measure of average variable costs, the jury must also consider the market structure in this controversy to determine if Northwest's deep price discounts in response to Spirit's entry and the accompanying expansion of its capacity on these routes injured competition by causing Spirit's departure from this market and allowing Northwest to recoup its losses and to enjoy monopoly power as a result." As Dr. Ordover explained, the difficult issue is how to assess predation: is the "price" at issue an average weighted price, or a price offered to a given class of passengers? Several economists have now challenged the effectiveness of using costs as the measure of whether conduct has anticompetitive or procompetitive effects.

Dr. Ordover stressed that the real task of a predatory pricing policy has to be to allow businesspeople to know what they can and cannot do. A lawyer cannot counsel a client: "Thou shall not signal that you are going to be a tough guy."

The panel was also sensitive to the difficulties of a proper injunctive remedy for predatory pricing. As Dr. Elzinga put it, "I'm suspicious of having antitrust become a price regulatory regime." He advocated regulating access instead, a recommendation that concerned Dr. Ordover – at least as to some industries – because it suggested undoing any value of sunk costs a firm would invest in developing new technology.

The panelists at the joint hearings also reacted against the idea that all buyer-side conduct was being lumped together as "predatory." In order to separate out the conduct that might be subject to *Brooke Group*, the panel sought to distinguish predatory bidding – an attempt to control the price of supply in order to guarantee a company control over the supply – from exclusionary conduct that was directed at a competitor, whether that conduct was "raising rivals' costs" or other conduct that is not purely price conduct, the goal of which was to control the *output* – *i.e.*, to give the company monopoly power.

There was a fair degree of skepticism as to whether there should be much concern at all with monopsony-directed pricing, absent some additional monopoly-directed exclusionary conduct. Everyone agreed that conduct that was purely directed toward acquiring supplier power has rarely been challenged. Dr. Rick Warren-Boulton pointed out that

economists are concerned with a loss to welfare, and that loss can be experienced either downstream or upstream. The harm on either side – to producers/suppliers or to consumers – is what the antitrust laws target. His perspective was not shared by others on the panel, and they hotly disputed whether there could be *any* harm that the antitrust laws should address unless it could be measured as consumer harm. The Antitrust Modernization Commission has been having the same debate.

Dr. Steve Salop criticized the government for "spending an awful lot of time deciding what you should not do, and you are not doing a heck of a lot, and so I think that in the exclusionary conduct area, the agencies ought to get involved and start looking for exclusionary conduct cases rather than protecting monopolists." The panel was generally in agreement that the governmental agencies had been too hands-off in enforcement of exclusionary conduct, and the panelists recognized that conduct directed at rivals tended to be remedied by private litigation rather than by government enforcement. They were split, however, as to whether the remedy *should* be damages, and not some sort of structural adjustment (such as ordering Weyerhauser to divest operations), which would argue for governmental enforcement.

Overall, panelists at the joint hearings raised significant questions as to whether *Brooke Group* is either too vague or too simplistic a test to account fully for the types of conduct that are currently being weighed by the courts. The biggest concern of all – whether voiced in terms of "clarity" or "administrability" – was that the law develop in a way that lawyers can convey it to their clients in terms of what they can do, and what they cannot do, consistent with the antitrust laws.

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