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High Court's Recent *Linkline* Decision Casts Doubt on Vitality of *LePage's*

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Special to the Legal

The U.S. Supreme Court's February decision in *Pacific Bell Telephone Co. v. Linkline Communications Inc.* raises serious questions as to whether the 3rd U.S. Circuit Court of Appeals' decision in *LePage's Inc. v. 3M*, decided six years ago, is still good law. The Supreme Court's confirmation of the above-cost-pricing defense in monopolization cases under Section 2 of the Sherman Act, based on its prior *Brooke Group* decision, and the rejection of the seminal *Alcoa* decision, appears at odds with the 3rd Circuit's en banc decision in *LePage's*.

In *LePage's*, plaintiffs who sold office products and transparent tape, challenged competitor 3M's bundled rebate and alleged exclusive dealing programs that offered retailers increasing levels of rebates for purchases of products in a number of 3M's diverse product lines from health care to transparent tape to auto products. *LePage's* sued 3M for monopolization under Section 2 of the Sherman Antitrust Act, arguing that 3M's programs were anti-competitive and prevented *LePage's* from gaining or maintaining large volume sales in private label tape. It supported this claim by pointing to its own poor performance — barely surviving at the time of trial and suffering large operating losses in the late 1990s.

On appeal, now-Justice Samuel Alito joined Circuit Judge Morton Greenberg in setting aside the jury's \$68 million trebled verdict against 3M, which had a 90 percent market share, for engaging in exclusionary conduct, including bundled rebates.

Circuit Judge Dolores K. Sloviter in her dissent found the majority's reasoning "novel" stating that it "usurps to the jury's providence to decide facts" and predicted that the ruling [if it stood] would "weaken Section 2 of the Sherman Act to the point of impotence." The 3rd Circuit heard the entire



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case en banc, reversed the majority panel and reinstated the jury verdict. Sloviter wrote the majority's scholarly opinion, with Alito and Greenberg dissenting.

As the antitrust mantra goes, "the antitrust laws were passed for the protection of competition, not competitors." The Supreme Court reminded us back in its 1986 decision in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, in reversing the 3rd Circuit, that "Cutting prices in order to increase business often is the very essence of competition." Therefore, not surprisingly, the federal courts have been often suspicious of antitrust claims brought by competitors that are premised on price-cutting, since it seems counterintuitive

to the intent of the antitrust laws.

The real battle in the *LePage's* case — and the reason it is famous, or infamous, according to some critics — involved 3M's defense resting on the undisputed fact that 3M's pricing was above its costs (however costs are calculated). Sloviter, writing for the majority of the en banc court, described this as "the most significant legal issue in this case." 3M based its above-cost pricing defense upon the U.S. Supreme Court's 1993 decision in *Brooke Group Ltd v. Brown & Williamson Tobacco Corp.*, which — as the 3rd Circuit pointed out — involved the Robinson-Patman Act, not the Sherman Act, Section 2.

In *Brooke Group*, Liggett, a competing cigarette manufacturer, brought a Robinson-Patman Act claim alleging that Brown & Williamson "cut prices on generic cigarettes below cost and offered discriminatory volume rebates to wholesalers." The Robinson-Patman Act — with many exceptions and defenses — prohibits price discrimination. For example, a plaintiff may sue a manufacturer that offers different prices to different retailers. The standard of liability varies based upon a plaintiff's relative market position. A "secondary line competitor" in the example is a plaintiff retailer that does not receive the "better" price. A "primary line competitor" plaintiff, in contrast, is a competitor of the party offering the discounts. Liggett, as a manufacturer suing its competitor for the competitor's pricing policies, was a primary line competitor.

Brooke Group described the standards for a primary line competitor suing under the Robinson-Patman Act. Its relevance to monopolization cases under Section 2 of the Sherman Act is that the Supreme Court expressly declared that the two prerequisites to recovery for primary line competitors under the Robinson-Patman Act and predatory pricing under Section 2 of the Sherman Act are the same. *Brooke Group* found that to establish competitive injury from the low prices, the plaintiff must prove that the prices

complained of are below an appropriate measure of its rival's costs. *Brooke Group* also held that the plaintiff must demonstrate that the competitor had a reasonable prospect, or dangerous probability, of recouping its investment in the below-cost prices.

The Supreme Court in *Brooke Group* pointed out that low prices benefit consumers regardless of how they are set, and, so long as they are above predatory levels, they do not threaten competition. The Supreme Court explained that generally the exclusionary effect of prices above a relevant measure of cost either reflects defendant's lower cost structure — and therefore represents competition on the merits — or is beyond the practical ability of a judicial tribunal to control without creating "intolerable" risks of chilling legitimate price-cutting. In contrast, if defendant is setting prices below its costs, there is less risk that defendant's price-cutting is a legitimate business practice because a business cannot profitably sustain below-cost pricing. But even in those circumstances, the Supreme Court still required plaintiff to also prove that there is a dangerous probability that defendant could recoup its investment in those below cost prices.

As the Supreme Court later recognized in *Bell Atlantic Corp. v. Twombly*, antitrust lawsuits can be expensive. Thus, it is imperative to not discourage competitive behavior like price-cutting by making it too easily punishable under the antitrust laws. Even the prospect of an ultimately unsuccessful lawsuit or government investigation can be enough to deter behavior because of the great costs (discovery and attorney fees) and risks (treble damages) involved.

In *LePage's*, 3M argued that *Brooke Group's* below-cost pricing and recoupment prerequisites should apply because plaintiff was asserting an antitrust claim premised on its rebates to retailers, i.e., price-cutting. And since 3M was pricing above its costs, it believed that it was acting competitively and legally under *Brooke Group's* dictates. The issue then became how to apply *Brooke Group*.

The 3rd Circuit, sitting en banc, however, rejected 3M's argument, holding that *Brooke Group* was immaterial to the Section 2 case. The court reviewed the Sherman Act Section 2 jurisprudence beginning with Judge Learned Hand's often-cited decision in *United States v. Aluminum Co. of America (Alcoa)*, which described an expansive view of Section 2 liability even for above-cost pricing. The *LePage's* court stressed that *Brooke Group* was primarily concerned with the Robinson-Patman Act, not the Sherman Act. The *LePage's* court also emphasized that *Brooke Group* involved oligopoly pricing rather than

pricing by an unconstrained monopolist. The future was bleak for *Brooke Group*, thought the 3rd Circuit in 2003: "Nothing in any of the Supreme Court's opinions in the decade since the *Brooke Group* decision suggested that the opinion overturned decades of Supreme Court precedent."

Indeed, noted the 3rd Circuit, the 1993 decision had only been cited four times by the Supreme Court in the 10 years since it was decided, and only once in an antitrust decision, which the court explained was inapplicable. Moreover, said the *LePage's* court, "nothing that the Supreme Court has written since *Brooke Group* dilutes the Court's consistent holdings that a monopolist will be found to violate § 2 of the Sherman Act if it engages in exclusionary or predatory conduct without a valid business justification." The court flat out rejected *Brooke Group's* below-cost pricing and recoupment requirements and, instead, preferred Hand's *Alcoa* opinion, which it believed "enunciated certain principles that remain fully applicable today."

Other circuits have not had the same view about *Brooke Group's* vitality. Most recently, the 9th Circuit in *Cascade Health Solutions v. PeaceHealth* in relying on that decision, held that "the exclusionary conduct element of a claim arising under § 2 of the Sherman Act cannot be satisfied by reference to bundled discounts unless the discounts result in prices that are below an appropriate measure of defendant's costs."

Earlier this year, however, the U.S. Supreme Court in *Linkline* confirmed the continued vigor — rather than the demise predicted by the 3rd Circuit — of *Brooke Group*. Indeed, by doing so, it undercut the necessary premise of the 3rd Circuit's decision in *LePage's* to refuse the below-cost prerequisite for exclusionary conduct allegations based on price reductions.

Linkline was a price-squeeze case where plaintiff alleged that AT&T — which sold at both the wholesale and retail level — was raising prices at the wholesale level and reducing prices at the retail level. Plaintiff competed with AT&T at the retail level, but had no choice but to purchase from AT&T at the wholesale level. This had the effect of "squeezing" AT&T's competitors because their input costs went up (at the wholesale level), but they had to reduce their output prices to compete with AT&T's lower retail prices. The 9th Circuit had held that plaintiff could state a price squeeze claim under Section 2 of the Sherman Act even though there was no allegation that AT&T was pricing below its costs.

The Supreme Court divided the price squeeze claim into two antitrust claims and analyzed them separately. The claim based

on raising prices at the wholesale level was unavailable under the court's recent precedent in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*. The court then analyzed the claim that AT&T was improperly cutting retail prices. Undercutting the 3rd Circuit's prediction about the future path of antitrust jurisprudence, Chief Justice John Roberts for the court (joined by a majority, including Alito) cited *Brooke Group* and stated: "To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low." Notably, the Supreme Court did not limit its admonition to predatory pricing claims (as opposed to other pricing-related claims of exclusionary conduct), or even Section 2 claims, it instead broadly specified "a Sherman Act claim."

The Supreme Court in *Linkline* then discussed with approval *Brooke Group's* below-cost pricing and recoupment requirements, before finally concluding that "recognizing a price-squeeze claim where the defendant's retail prices remain above cost would invite the precise harm we sought to avoid in *Brooke Group*: Firms might raise their retail prices or refrain from aggressive price competition to avoid potential antitrust liability."

The Supreme Court went on to reject the 3rd Circuit's favored Hand opinion from *Alcoa*: "Given developments in economic theory and antitrust jurisprudence since *Alcoa*, we find our recent decisions in *Trinko* and *Brooke Group* more pertinent to the question before us." Therefore, it would appear that the Supreme Court's *Linkline* decision, by confirming *Brooke Group's* vitality and the necessity of alleging below-cost pricing and recoupment for price-cutting based antitrust claims under the Sherman Act, has effectively undercut the foundations upon which *LePage's* was decided. Ultimately, *Linkline* stands for the proposition that whenever an antitrust claim is premised upon cutting prices, plaintiff cannot use that price-cutting behavior to support its claim unless it can plead and later demonstrate that the prices were cut below some appropriate measure of defendant's costs and that defendant has a dangerous probability of being able to recoup its losses from cutting prices below its costs. The question of what is the appropriate measure of costs, however, is one that will likely percolate among the circuits before the Supreme Court finally decides to take it up again. Stay tuned. •