(New subsection to be inserted in Ch. 2 after "Jury Instructions: Horizontal Boycotts" on page 166)

2. The "Early Exit" Route in Antitrust Cases

If your client is a defendant, victory at any stage is good, but the earlier the better. The "filter" doctrines—introduced in Ch. 1, enlarged upon earlier in this present chapter, and awaiting greater developments in chapters below—potentially cut in at various procedural stages. Best of all, of course, are those results providing an "early exit," pursuant to a 12(b)(6) motion to dismiss the case for failure to state a valid claim.

Via the *Arista* case in Ch. 1, you already know something about antitrust standing and how that can provoke dismissal, and the standing topic will be explored in detail in Ch. 8. (If you understand the earlier chapters well, you will not be greatly surprised about the details of standing cases coming in Ch. 8.) In this section, we (a) take a closer look at the factual sufficiency of a pleading; (b) learn about the possibility of preclusion of antitrust law by another statutory or regulatory scheme; and (c) have the opportunity to review and assess the correctness of a district court dismissal order.

a. Factual Sufficiency Post-*Twombly*

BELL ATLANTIC CORP. v. TWOMBLY

___ U.S. ___ (2007)

■ JUSTICE SOUTER delivered the opinion of the Court.

…The question in this putative class action is whether a §1 complaint can survive a motion to dismiss when it alleges that major telecommunications providers engaged in certain parallel conduct unfavorable to competition, absent some factual context suggesting agreement, as distinct from identical, independent action. We hold that such a complaint should be dismissed.

I

The upshot of the 1984 divestiture of the American Telephone & Telegraph Company's (AT&T) local telephone business was a system of regional service monopolies called "Incumbent Local Exchange Carriers" (ILECs), and a separate, competitive market for long-distance service from which the ILECs were excluded. More than a decade later, Congress withdrew approval of the ILECs' monopolies by enacting the Telecommunications Act of 1996 (1996 Act) , which "fundamentally restructure[d] local telephone markets" and "subject[ed] [ILECs] to a host of duties intended to facilitate market entry" at the local level. *AT & T Corp. v. Iowa Utilities Bd.* 525 U.S. 366, 371 (1999). In recompense, the 1996 Act set conditions for authorizing ILECs to enter the long-distance market.

"Central to the [new] scheme [was each ILEC's] obligation...to share its network with competitors," *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 402 (2004), which came to be known

as "competitive local exchange carriers" (CLECs), A CLEC could make use of an incumbent's network in any of three ways: by (1) "purchas[ing] local telephone services at wholesale rates for resale to end users," (2) "leas[ing] elements of the [ILEC's] network 'on an unbundled basis,' " or (3) "interconnect[ing] its own facilities with the [ILEC's] network." Iowa Utilities Bd., supra. Owing to the considerable expense and effort required to make unbundled network elements available to rivals at wholesale prices the ILECs vigorously litigated the scope of the sharing obligation imposed by the 1996 Act, with the result that the Federal Communications Commission (FCC) three times revised its regulations to narrow the range of network elements to be shared with the CLECs.

Respondents William Twombly and Lawrence Marcus (hereinafter plaintiffs) represent a putative class consisting of all "subscribers of local telephone and/or high speed internet services...from February 8, 1996 to present." In this action against petitioners, a group of ILECs, plaintiffs seek treble damages and declaratory and injunctive relief for claimed violations of §1 of the Sherman Act.

The complaint alleges that the ILECs conspired to restrain trade in two ways, each supposedly inflating charges for local telephone and high-speed Internet services. Plaintiffs say, first, that the ILECs "engaged in parallel conduct" in their respective service areas to inhibit the growth of upstart CLECs. Their actions allegedly included making unfair agreements with the CLECs for access to ILEC networks, providing inferior connections to the networks, overcharging, and billing in ways designed to sabotage the CLECs' relations with their own customers. According to the complaint, the ILECs' "compelling common motivatio[n]" to thwart the CLECs' competitive efforts naturally led them to form a conspiracy; "[h]ad any one [ILEC] not sought to prevent CLECs...from competing effectively ..., the resulting greater competitive inroads into that [ILEC's] territory would have revealed the degree to which competitive entry by CLECs would have been successful in the other territories in the absence of such conduct."

Second, the complaint charges agreements by the ILECs to refrain from competing against one another. These are to be inferred from the ILECs' common failure "meaningfully [to] pursu[e]" "attractive business opportunit[ies]" in contiguous markets where they possessed "substantial competitive advantages, and from a statement of the chief executive officer (CEO) of the ILEC Qwest, that competing in the territory of another ILEC " 'might be a good way to turn a quick dollar but that doesn't make it right,' "

…

The District Court dismissed the complaint for failure to state a claim upon which relief can be granted. The District Court acknowledged that "plaintiffs may allege a conspiracy by citing instances of parallel business behavior that suggest an agreement," but emphasized that "while '[c]ircumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy[, ...] "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely.' "… The District Court found plaintiffs' allegations of parallel

ILEC actions to discourage competition inadequate because "the behavior of each ILEC in resisting the incursion of CLECs is fully explained by the ILEC's own interests in defending its individual territory." As to the ILECs' supposed agreement against competing with each other, the District Court found that the complaint does not "alleg[e] facts...suggesting that refraining from competing in other territories as CLECs was contrary to [the ILECs'] apparent economic interests, and consequently [does] not rais[e] an inference that [the ILECs'] actions were the result of a conspiracy." [This obviously anticipates *Monsanto/Matsushita,* to be studied in ch. 3.]

The Second Circuit reversed, holding that the District Court tested the complaint by the wrong standard. It held that "plus factors are not *required* to be pleaded to permit an antitrust claim based on parallel conduct to survive dismissal" (emphasis in original). Although the Court of Appeals took the view that plaintiffs must plead facts that "include conspiracy among the realm of 'plausible' possibilities in order to survive a motion to dismiss," it then said that "to rule that allegations of parallel anticompetitive conduct fail to support a plausible conspiracy claim, a court would have to conclude that there is no set of facts that would permit a plaintiff to demonstrate that the particular parallelism asserted was the product of collusion rather than coincidence."

We granted certiorari to address the proper standard for pleading an antitrust conspiracy through allegations of parallel conduct and now reverse.

II

A

…"[T]he crucial question" is whether the challenged anticompetitive conduct "stem[s] from independent decision or from an agreement, tacit or express," *Theatre Enterprises,* 346 U.S., at 540. While a showing of parallel "business behavior is admissible circumstantial evidence from which the fact finder may infer agreement," it falls short of "conclusively establish[ing] agreement or...itself constitut[ing] a Sherman Act offense." *Id.,* at 540-541. Even "conscious parallelism," a common reaction of "firms in a concentrated market [that] recogniz[e] their shared economic interests and their interdependence with respect to price and output decisions" is "not in itself unlawful." [Citations.]

The inadequacy of showing parallel conduct or interdependence, without more, mirrors the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market….

B

This case presents the antecedent question of what a plaintiff must plead in order to state a claim under §1 of the Sherman Act…. In identifying facts that are suggestive enough to render a §1 conspiracy plausible, we have the benefit of the prior rulings and considered views of leading commentators, already quoted, that lawful parallel conduct fails to bespeak unlawful

agreement. It makes sense to say, therefore, that an allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality. Hence, when allegations of parallel conduct are set out in order to make a §1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action.

... A statement of parallel conduct, even conduct consciously undertaken, needs some setting suggesting the agreement necessary to make out a §1 claim; without that further circumstance pointing toward a meeting of the minds, an account of a defendant's commercial efforts stays in neutral territory. An allegation of parallel conduct is thus much like a naked assertion of conspiracy in a §1 complaint: it 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 "entitle[ment] to relief."

…

We alluded to the practical significance of the Rule 8 entitlement requirement in *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336,(2005), when we explained that something beyond the mere possibility of loss causation must be alleged, lest a plaintiff with " a largely groundless claim" be allowed to "take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value." *Id.,* at 347. So, when the allegations in a complaint, however true, could not raise a claim of entitlement to relief, " this basic deficiency should ... be exposed at the point of minimum expenditure of time and money by the parties and the court." 5 Wright & Miller § 1216, at 233-234…

…[I]t is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, but quite another to forget that proceeding to antitrust discovery can be expensive…. That potential expense is obvious enough in the present case: plaintiffs represent a putative class of at least 90% of all subscribers to local telephone or high-speed Internet service in the continental United States, in an action against America's largest telecommunications firms (with many thousands of employees generating reams and gigabytes of business records) for unspecified (if any) instances of antitrust violations that allegedly occurred over a period of seven years.

It is no answer to say [referring to Justice Stevens' dissent] 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. … And it is self-evident that the problem of discovery abuse cannot be solved by "careful scrutiny of evidence at the summary judgment stage," much less "lucid instructions to juries"; the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings. Probably, then, it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous

expense of discovery in cases with no reasonably founded hope that the [discovery] process will reveal relevant evidence to support a §1 claim.

Plaintiffs do not, of course, dispute the requirement of plausibility and the need for something more than merely parallel behavior....So here, the Court of Appeals specifically found the prospect of unearthing direct evidence of conspiracy sufficient to preclude dismissal, even though the complaint does not set forth a single fact in a context that suggests an agreement. It seems fair to say that this approach to pleading would dispense with any showing of a "reasonably founded hope'" that a plaintiff would be able to make a case.

…

III

When we look for plausibility in this complaint, we agree with the District Court that plaintiffs' claim of conspiracy in restraint of trade comes up short. To begin with, the complaint leaves no doubt that plaintiffs rest their §1 claim on descriptions of parallel conduct and not on any independent allegation of actual agreement among the ILECs. [The essence of the complaint], then, is the ILECs' parallel behavior, consisting of steps to keep the CLECs out and manifest disinterest in becoming CLECs themselves, and its sufficiency turns on the suggestions raised by this conduct when viewed in light of common economic experience.

We think that nothing contained in the complaint invests either the action or inaction alleged with a plausible suggestion of conspiracy. As to the ILECs' supposed agreement to disobey the 1996 Act and thwart the CLECs' attempts to compete, we agree with the District Court that nothing in the complaint intimates that the resistance to the upstarts was anything more than the natural, unilateral reaction of each ILEC intent on keeping its regional dominance. …Resisting competition is routine market conduct, and even if the ILECs flouted the 1996 Act in all the ways the plaintiffs allege, there is no reason to infer that the companies had agreed among themselves to do what was only natural anyway; so natural, in fact, that if alleging parallel decisions to resist competition were enough to imply an antitrust conspiracy, pleading a §1 violation against almost any group of competing businesses would be a sure thing.

The complaint makes its closest pass at a predicate for conspiracy with the claim that collusion was necessary because success by even one CLEC in an ILEC's territory "would have revealed the degree to which competitive entry by CLECs would have been successful in the other territories." But, this general premise still fails to answer the point that there was just no need for joint encouragement to resist the Act….

Plaintiffs' second conspiracy theory rests on the competitive reticence among the ILECs themselves in the wake of the 1996 Act…. Contrary to hope, the ILECs declined "to enter each other's service territories in any significant way"…. Perceiving the ILECs to be blessed with "especially attractive business opportunities" in surrounding markets dominated by other ILECs, the plaintiffs assert that the ILECs' parallel conduct was "strongly suggestive of conspiracy."

But it was not suggestive of conspiracy, not if history teaches anything. In a traditionally unregulated industry with low barriers to entry, sparse competition among large firms dominating separate geographical segments of the market could very well signify illegal agreement, but here we have an obvious alternative explanation. In the decade preceding the 1996 Act and well before that, monopoly was the norm in telecommunications, not the exception. The ILECs were born in that world, doubtless liked the world the way it was, and surely knew the adage about him who lives by the sword. Hence, a natural explanation for the noncompetition alleged is that the former Government-sanctioned monopolists were sitting tight, expecting their neighbors to do the same thing. In fact, the complaint itself gives reasons to believe that the ILECs would see their best interests in keeping to their old turf. …
…
[W]e do not require heightened fact pleading of specifics, but only enough facts to state a claim to relief that is plausible on its face. Because the plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed.
…

NOTES AND QUESTIONS

1. In the past, courts frequently used the expression that a case will not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.," quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). In a passage not included above, the Supreme Court, however, expressly retired *Conley*'s "no set of facts" language., stating that "[t]he phrase is best forgotten as an incomplete, negative gloss on an accepted pleading standard"). 127 S.Ct. 1955. That much is clear. But are you certain about what the standard is now? Neither (yet) are the lower courts., which are trying to interpret both the meaning and the scope (beyond antitrust) of *Twombly*. *See, e.g., In re Elevator Antitrust Litigation,* 502 F.3d 47, 50 (2d Cir.2007) ("Considerable uncertainty surrounds the breadth of ... *Twombly*."); *Iqbal v. Hasty,* 490 F.3d 143, 157 (2d Cir.2007) (holding that *Twombly* does not require "a universal standard of heightened fact pleading, but rather a flexible 'plausibility standard' "). *See also*, *Cuvillier v. Taylor,* 503 F.3d 397, 401 n. 4 (5th Cir.2007) (acknowledging that *Twombly* "retired" the *Conley* formulation but warning that a case should not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief"); *Assn. of Cleveland Fire Fighters v. City of Cleveland,* 502 F.3d 545, 548 (6th Cir.2007) (describing *Twombly* as a case that "recently clarified the law with respect to what a plaintiff must plead in order to survive a Rule 12(b)(6) motion"); *Ridge at Red Hawk, LLC v. Schneider,* 493 F.3d 1174, 1177 (10th Cir.2007) (noting that after *Twombly*, "the complaint must give the court reason to believe that *this* plaintiff has a reasonable likelihood of mustering factual support for *these* claims").

2. Here is one District Judge's take on what it all means:

…The forced retirement of Conley's phraseology should not be confused with a new pleading standard. Narrowly understood, the Court's language merely forecloses litigants from answering motions to dismiss by responding, "Although I can't make a good faith allegation of illegal conduct now, I bet I'll find something good during discovery." In the Sherman Act § 1 context, this means that where independent, parallel behavior is the only basis for an assertion of "agreement," that is not a ticket for admission to the discovery process. The Court's plausibility requirement in this context was designed to ensure that the plaintiffs had a reason to move the case along to the discovery phase beyond allegations of lawful behavior. But this is nothing new. The retirement of the "no set of facts" language, however, should not be confused with a requirement that the complaint contain more factual specificity than was required before the Court decided Twombly. … Nothing in Twombly has altered Rule 8(a)'s requirement of notice. There is not, and there never was, a magic formula for determining when a complaint lacks enough "factual detail," or when it is composed of "mere legal conclusions." Since 1938, the final call has been housed within the discretion of the district judge, and guided by the Federal Rules' requirement of notice pleading. And Twombly has left that regime intact….

CBT Flint Partners v. Goodmail Systems, 529 F Supp. 2d 1376 (2007).

3. Is the Court interpreting the Rules of Civil Procedure under the lens of cost-benefit analysis? A balancing of Type I and Type II error?

4. Although the Court does not use the phrase, note that much of the opinion here relies essentially on notions of plaintiffs' burden of proof. In addition, however, it rests on the ability of a set of class-action plaintiffs to "force" defendants to settle, even in a case that does not rise to the level of an antitrust violation, in order to avoid the heavy costs of discovery and litigation. Consider in that respect the class of plaintiffs to whom defendants allegedly owe triple damages.

5. Should the possibility of defendants, for financial reasons, being "forced" to settle influence a decision whether to dismiss an antitrust case? More generally, is the litigation-cost issue one that courts should consider in the first place in deciding on a motion to dismiss or for summary judgment?

6. The case is also noteworthy for its insistence on the "contract, combination…or conspiracy" language in §1 of the Sherman Act. This point arises time and again (see, e.g., *City of Tuscaloosa* in ch 3). Yet, mere "parallel conduct" continues to be pled as tantamount to a §1 "contract." In the *Bell Atlantic* case, but for the Supreme Court's reversal, the Second Circuit's reversal of the district court would have sent this case to discovery and, ultimately, trial.

7. The following appeared as footnote 5 in the majority opinion:

Commentators have offered several examples of parallel conduct allegations that would state a §1 claim under this standard. See, *e.g.,* 6 Areeda & Hovenkamp ¶1425, at 167-185 (discussing "parallel behavior that would probably not result from chance, coincidence, independent responses to common stimuli, or mere interdependence unaided by an advance understanding among the parties"). The parties in this case agree that "complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors, and made for no other discernible reason" would support a plausible inference of conspiracy.

Is this a statement about evidentiary requirements, or about the law of §1 itself? How secure can potential defendants feel about alterations in their business conduct, without regard to what their rivals are also doing?

b. Preclusion

The issue raised in *Northwest Stationers* (and again in note 4 after that opinion, in its discussion of the *Silver* case) continues to provoke questions. Specifically, what is the relation between securities regulation and antitrust law? Indeed, the issue is actually much more general in scope, as noted in the *Trans-Missouri* case: what is the relation between antitrust and other regulatory regimes? When is the application of antitrust law precluded? That was the central issue in the Supreme Court's *Credit Suisse* opinion and, as you will see, is also crucial in the *Pennsylvania Avenue* district court case that follows.

Summary: Credit Suisse Securities v. Billing, __ U.S. __ (2007)

In *Credit Suisse,* underwriting firms (i.e., those who would ultimately sell the shares in the client firm's initial public offering of shares, or IPO) tested the market and, in the words of Justice Breyer's opinion, allegedly

> …agreed with one another that they would not sell shares of a popular new issue to a buyer unless that buyer committed (1) to buy additional shares of that security later at escalating prices (a practice called "laddering"), (2) to pay unusually high commissions on subsequent security purchases from the underwriters, or (3) to purchase from the underwriters other less desirable securities (a practice called "tying").

Plaintiffs filed suit under the Sherman Act, alleging that the agreement "to engage in some or all of these practices artificially inflated the share prices of the securities in question." Defendant underwriters, noting that their conduct was fully in accord with federal securities law, argued that "federal securities law impliedly precludes application of the antitrust laws to the conduct in question."

Agreeing, the federal district court dismissed the plaintiff's' complaint. The Second Circuit disagreed, and reinstated the complaint. The Supreme Court then reversed the Second Circuit, finding that there was "conflict" and "clear repugnancy" between the regime established by securities law and antitrust law with respect to plaintiffs' claims. To determine whether there is incompatibility between two legal regimes, Justice Breyer identified four critical factors: (1) an area of conduct squarely within the "heartland" of the other. non-antitrust. regulatory regime; (2) clear and adequate authority to regulate; (3) active and ongoing agency regulation; and (4) a serious conflict between the antitrust and regulatory regimes.

Finding the factors satisfied, the Court gave several reasons for its conclusion. First, the conduct complained of actually furthered the activities of competitive securities markets, in that it helped firms raise capital for new enterprises. Second, the activities complained of were in fact supervised by the Securities and Exchange Commission (SEC). That alone, said the

Court, made the case different from *Silver*. Moreover, the Court found the SEC-administered regulatory scheme clearly superior to antitrust because various factors, including the necessity for expertise in understanding the securities markets and the difficulties of assessing ambiguous and subtly nuanced evidence "suggest that antitrust courts are likely to make unusually serious mistakes" in this area.

> And the threat of antitrust mistakes…means that underwriters must act in ways that will avoid not simply conduct that the securities law forbids…but also a wide range of joint conduct that the securities law permits or encourages (but which they fear could lead to an antitrust lawsuit and the risk of treble damages). And therein lies the problem.
>
> This kind of problem exists to some degree in respect to other antitrust lawsuits. But here the factors we have mentioned make mistakes unusually likely (a matter relevant to Congress' determination of which institution should regulate a particular set of market activities). And the role that joint conduct plays in respect to the marketing of IPOs, along with the important role IPOs themselves play in relation to the effective functioning of capital markets, means that the securities-related costs of mistakes is unusually high. It is no wonder, then, that the SEC told the District Court (consistent with what the Government tells us here) that a "failure to hold that the alleged conduct was immunized would threaten to disrupt the full range of the Commission's ability to exercise its regulatory authority," adding that it would have a "chilling effect" on "lawful joint activities ... of tremendous importance to the economy of the country."

Thus, said the Court, "we must interpret the securities laws as implicitly precluding the application of the antitrust laws to the conduct alleged in this case."

NOTES AND QUESTIONS

1. Recall the *Trans-Missouri* case discussed earlier. There, as already noted, the Court wrote, that mere compliance with another federal statute was no defense against antitrust liability unless the other statute specifically required or authorized the act or practice subject to the antitrust laws. "The [Interstate Commerce] act was not directed to the securing of uniformity of rates to be charged by competing companies, nor was there any provision therein as to a maximum of rates." Thus, the Sherman Act applied. If the conduct here also led to "uniformity of rates" (not to mention possible violations of the antitrust rules against tying), why did the Sherman Act not apply in *Credit Suisse*?
2. How is the Court balancing Type I versus Type II error here? Should this count? Although concurring in the result, Justice Stevens thought not:

> Surely I would not suggest, as the Court did in *Twombly,* and as it does again today, that either the burdens of antitrust litigation or the risk "that antitrust courts are likely to make unusually serious mistakes," should

play any role in the analysis of the question of law presented in a case such as this.

3. The opinion here relates to some of the issues reviewed by then-Judge Breyer on behalf of the First Circuit in *Town of Concord.* Recall *Credit Suisse* when you read *Town of Concord* in Ch.4.

4. Had the Court held that the Sherman Act *did* apply, what would be the best characterization of the practices(s) challenged? Price fixing? Tying? A rule of reason claim? Something else? If the defendants arguably had market power in a relevant product market, what was that market?

c. Reviewing a Securities Case Dismissal

In the case below, you will see the interplay of both factual sufficiency and preclusion issues in the Order whereby a District Court Judge dismisses an antitrust claim. But, is the reasoning of the court's opinion sound? Imagine that you are an attorney for the Plaintiff contemplating appeal? Do you have good grounds? And, even if you would win on appeal, would you likely be doomed at a later stage, such as summary judgment?

PENNSYLVANIA AVENUE FUNDS v. BOREY

W. DIST. WA., NO. C06-1737RAJ, (2008)

■ RICHARD A. JONES, United States District Judge.

I. INTRODUCTION

This matter comes before the court on a motion to dismiss Plaintiff's antitrust claim. The court has reviewed the motion together with all documents filed in support and in opposition, and has heard oral argument. For the reasons set forth herein, the court GRANTS the motion and dismisses Plaintiff's antitrust claim with prejudice.

II. BACKGROUND

This action arises in the wake of a merger that extinguished WatchGuard Technologies Inc. ("WatchGuard") as a publicly traded corporation. Plaintiff Pennsylvania Avenue Funds owned shares of WatchGuard, and seeks to represent a class of all persons who held WatchGuard stock at the time of the merger. … For this motion, it suffices to focus on the actions of two groups of Defendants, to whom the court will refer collectively as "FP" and "Vector." …

[Except where otherwise indicated, facts relied upon by the Court are derived from the Complaint, paragraph citations to which are omitted.]

At some point in the latter half of 2005, WatchGuard's board of directors determined that they should either sell the company or merge with another company. … This led to an acquisition process in which numerous potential purchasers expressed interest in WatchGuard. The Complaint focuses on only a few of those suitors, but Plaintiff admitted at oral argument that as many as 50 suitors expressed some level of interest, consistent with Defendant's statements that 18 private equity funds and 17 strategic partners participated in the process.

Among these suitors, Vector and FP offered formal acquisition bids. At the outset of the "auction" of WatchGuard, FP and Vector were competitors. Each expressed interest in acquiring the company, and each made more than one formal bid, starting as high as $5.10 per share. As of June 26, 2006, FP had made a $4.60 per share bid, and Vector had made a $4.65 per share bid..

… Plaintiff claims that Vector agreed to stop pursuing WatchGuard, and stand aside while FP made a lower bid. FP later lowered its bid to $4.25 per share, WatchGuard's board accepted the bid on July 25, 2006, and …[the merger] closed in October 2006. On August 16, 2006, Vector announced an agreement to fund half of FP's acquisition of WatchGuard in exchange for a 50% interest in WatchGuard after the merger. …

III. DISCUSSION

…

A. Standard of Review on a Motion to Dismiss

… A complaint need not contain detailed factual allegations, but it must provide the grounds for entitlement to relief and not merely a "formulaic recitation" of the elements of a cause of action. *Bell Atlantic Corp. v. Twombly, 127 S. Ct. 1955, 1964-65 (2007).* Plaintiffs must allege "enough facts to state a claim to relief that is plausible on its face."

Alternatively, where a defendant successfully challenges a plaintiff's legal theory, rather than the sufficiency of the plaintiff's allegations, the court must also dismiss the complaint. *Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir. 1990)* ("Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory.").

The court's review on a *Rule 12(b)(6)* motion is generally limited to the complaint itself. The court may, however, consider evidence on which the complaint necessarily relies as long as "(1) the complaint refers to the document; (2) the document is central to the plaintiff's claim; and (3) no party questions the authenticity of the copy attached to the *12(b)(6)* motion." The court may also rely on facts subject to judicial notice. *United States v. Ritchie, 342 F.3d 903, 908 (9th Cir. 2003).* Finally, the court may consider a plaintiff's clarifications in briefing and at oral argument.

B. The Court Declines to Decide Whether Securities Law Precludes the Application of Antitrust Law in This Case.

Before considering the sufficiency of Plaintiff's antitrust claim, the court addresses Defendants' contention that securities laws preclude application of antitrust law. In cases like this one, where antitrust and securities regulation may overlap, courts have developed an inquiry to evaluate the extent of the overlap. Where a court finds a "clear repugnancy" between the application of securities law and antitrust law to the defendants' conduct, securities law prevails, and precludes the application of antitrust statutes. *Credit Suisse Securities (USA) LLC, v. Billing, 127 S. Ct. 2383, 2392 (2007).* To determine whether there is a clear repugnancy between the two legal regimes, there are four critical factors:

> (1) an area of conduct squarely within the heartland of securities regulations; (2) clear and adequate SEC authority to regulate; (3) active and ongoing agency regulation; and (4) a serious conflict between the antitrust and regulatory regimes.

Id. at 2397. In shorthand form, the four factors test for SEC "legal regulatory authority," "exercise of that authority," the existence of a serious conflict between antitrust and securities regimes, and "heartland securities activity." Id. at 2393.

The Defendants' attempt to invoke *Credit Suisse* preclusion founders on their inability to show that the SEC has regulatory power over the conduct of FP and Vector. All parties concede that the SEC has sweeping power to regulate *disclosure* of bidding agreements like the one between FP and Vector. No party, however, has put forth a compelling argument that the SEC has authority to prevent bidders like FP and Vector from joining forces. If the SEC's power is limited to requiring disclosure, then the agency's exercise of that power does not conflict with antitrust law, under which disclosure is neither a remedy for anticompetitive conduct nor a defense to the imposition of liability.

Defendants point to no source of authority that permits the SEC to substantively regulate bidding combinations like the one before the court. The Williams Act, which governs tender offers for a significant portion of a company's securities, applies not only to individual bidders, but to "persons act[ing] as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer." Although the Act recognizes that bidders might join forces, the best indication of a power to regulate their conduct is an authorization to issue rules proscribing "fraudulent, deceptive, or manipulative acts or practices" in connection with tender offers. This provision, however, has been interpreted to authorize only disclosure regulations:

> Nowhere in the legislative history is there the slightest suggestion that § 14(e) serves any purpose other than disclosure, or that the term "manipulative" should be read as an invitation to the courts to oversee the substantive fairness of tender offers; the quality of any offer is a matter for the marketplace.

Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 11 (1985). The Supreme Court has interpreted the Williams Act to let the marketplace, not the SEC, govern the substantive fairness of a tender offer. Anticompetitive conduct in the marketplace is the realm of antitrust.

In a separate motion to dismiss Plaintiff's federal securities claims, Vector argued that the Williams Act has no application to the WatchGuard merger. If Vector were right, a question that the court did not resolve in granting that motion, it would only strengthen Plaintiff's assertion that securities laws do not reach the anticompetitive conduct of FP and Vector.

Rather than cite a specific source of preclusive regulatory authority, Defendants rely upon *Finnegan v. Campeau Corp., 915 F.2d 824 (2d Cir. 1990)*, in which the Second Circuit found preclusion of antitrust law in cir-

Goetz & McChesney, *Antitrust Law*, 4th Ed. Preview, ©2008

cumstances similar to the case at bar. In *Finnegan,* two rival bidders initially drove up the price for the target corporation…[but subsequently] agreed that one company would withdraw its latest bid in exchange for a cash payment and two divisions of the target company. Just as in this case, two rival bidders joined forces in a manner that deprived the shareholders of the target company of a potentially higher acquisition price.

Despite the price-depressing effect of the conduct, the *Finnegan* court concluded that securities law precluded the application of antitrust law. The court noted that the Williams Act contemplates concerted action by groups of acquirors. It also noted that Congress empowered the SEC to "regulate agreements between bidders by virtue of its authority to define fraudulent, deceptive or manipulative practices and to prescribe means to prevent such practices." To support its finding of substantive regulatory authority, the court pointed to regulations promulgated under the Williams Act governing procedures for tender offers. Although the cited regulations did not impact the anticompetitive conduct alleged in *Finnegan,* the court nonetheless concluded that because the SEC had the power to regulate "bidders' agreements," and had "implicitly authorized them by requiring their disclosure," antitrust suits aimed at concerted action by acquirors would "conflict with the proper functioning of the securities laws."

Several considerations prevent this court from reaching the same conclusion as the *Finnegan* court. *Finnegan* came almost two decades before the Supreme Court's decision in *Credit Suisse.* Although nothing in *Credit Suisse* suggests a sea change in preclusion analysis, the Court emphasized that preclusion depends on showing SEC regulatory authority and enforcement over "all of the activities" that a plaintiff challenges as anticompetitive. In *Credit Suisse,* which examined "anticompetitive charges" levied on participants in initial public offerings of stock, the Court pointed to SEC regulations on "virtually every aspect of the practices in which [the defendants] engaged." The Court looked not only at SEC regulations that "defined in detail" what conduct was permissible, but at actions by the SEC and private litigants to enforce those regulations. The *Finnegan* court provides no similar analysis of SEC regulatory authority or enforcement over efforts by competing bidders to join forces in a contest for corporate control. More importantly, however, Defendants have not convinced the court either that the SEC possesses authority over the anticompetitive conduct that Plaintiff alleges, or that it has exercised that authority. For that reason, the court declines to decide whether securities law precludes Plaintiff's antitrust claim.

C. Plaintiffs Have Not Stated a Claim Under Sec. 1 of the Sherman Act.

The court now turns to an application of antitrust law to Plaintiff's allegations. … Courts presumptively do not apply the *per se* rule, instead applying a "rule of reason" analysis that requires an examination of the economic effect of the challenged conduct and the market in which it occurs. *Texaco Inc. v. Dagher, 547 U.S. 1, 5 (2006).*

Before conducting its analysis, the court emphasizes that it accepts for purposes of this motion that Vector and FP agreed to fix the merger price for FP, and that the result is that WatchGuard shareholders received less money than if Vector and FP had continued to compete. Plaintiff has adequately alleged "price fixing in a literal sense," and the court's task is to determine whether Defendants engaged in "price fixing in the antitrust sense." *Texaco, 547 U.S. at 6.*

1. Plaintiff Has Not Alleged Conduct that is Per Se Unlawful.

… When applying the *per se* rule, a court ignores the "reasonableness of [the challenged] restraint in light of the real market forces at work" in the case before it, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2713 (2007)*, and declares the challenged practice unlawful. Because application of the *per se* rule means that the court will not engage in nuanced analysis of the defendants' anticompetitive conduct in context, "the *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue . . . ." *Id. at 2713.*

Plaintiff stands at a disadvantage in invoking the *per se* rule, because no court has applied the rule to a price-fixing agreement in a contest for corporate control. Indeed, neither party cites authority in which a court has considered the issue. This court notes, however, that in at least two cases the parties have cited, competitors for corporate control agreed to cease competition in exchange for economic considerations. The court has already examined the Second Circuit's decision in *Finnegan.* In another case, rival bidders "effectively ended the bidding" for the target corporation by agreeing to a "carve-up" of the target. *In re Lukens Inc. S'holders Litig., 757 A.2d 720, 726 (Del. Ch. 1999).* These cases demonstrate that the price fixing practice that Plaintiff challenges is not uncommon, and yet it appears that no court has considered whether it is *per se* unlawful, much less applied a *per se* rule.

Where no precedent mandates a *per se* analysis, the court must determine, "in the first instance, the economic effects" of price fixing among rivals for control of a target corporation, to determine whether the practice is *per se* unlawful. *Leegin Creative, 127 S.Ct. at 2714.* The court cannot consider the particular effects of Defendants' conduct in the case before it, but must instead consider whether conduct like the Defendants', *in general,* has "manifestly anticompetitive effects" and "lack[s] any redeeming virtue." So long as there are "plausible arguments that a practice enhances overall efficiency and makes markets more competitive," application of the *per se* rule is not appropriate. *Per se* treatment is appropriate only when the challenged practice "facially appears to be one that would always or almost always tend to restrict competition and decrease output ...." *Broad. Music, Inc. v. Columbia Broad. System, Inc., 441 U.S. 1, 19-20 (1979).*

Price fixing among rival bidders in a contest for corporate control is not, in general, anticompetitive. Plaintiff admits as much by agreeing that when potential rivals agree to join forces *before* entering a contest for corporate control, they have acted lawfully. ("Plaintiff is not alleging joint bid-

ding or other joint venture ... that would be permissible under the antitrust laws.") Putting aside Plaintiff's admission, it is apparent that bidders who join forces can promote rather than suppress competition. For example, in a corporate auction involving numerous well-heeled bidders, less wealthy bidders cannot compete. By joining forces, and thus combining resources, poorer contestants can gain access to the contest, thus increasing competition. Similarly, where the acquisition of a corporate asset imposes risks that are too great for a single potential acquiror to bear, bidders who join forces can spread risk between themselves, thus promoting competition. In either scenario, a competitor who initially enters a control contest alone might well join forces with a rival when escalating prices exceed its resources or risk tolerance.

The parties debate whether the agreement between Vector and FP was a "joint bid" or an example of "bid rigging." The court declines to use either label, because the question before the court is whether the agreement between FP and Vector violates the Sherman Act. Semantics play no part in resolving this question.

Price agreements between competitors in a corporate control context are not *per se* illegal. The examples above show that the practice is not invariably anticompetitive. Plaintiff alleges that the circumstances of this case are quite different than the examples above, but this is irrelevant in determining whether the *per se* rule applies. *Nat'l Collegiate Athletic Ass'n v. Bd of Regents of Univ. of Okla., 468 U.S. 85 (1984) ("Per se* rules are invoked when surrounding circumstances make the likelihood of anticompetitive conduct so great as to render unjustified further examination of the challenged conduct."). Indeed, Plaintiff's effort to show that the agreement between Vector and FP was anticompetitive in the context of the contest for control of WatchGuard only emphasizes that the court must apply a particularized rule of reason analysis, rather than the *per se* rule. *Broad. Music, 441 U.S. at 19 n.33.*

2. Plaintiff's Allegations Do Not Withstand a Rule of Reason Analysis.

Under the rule of reason, a plaintiff asserting a Sec. 1 claim must, at the threshold…allege both the existence of a relevant market and "that the defendant has power within that market." *Newcal Indus., Inc. v. Ikon Office Solution,* 513 F.3d 1038 (9th Cir., 2008). A plaintiff can prove market power by direct or circumstantial evidence. *Rebel Oil Co. v. Atlantic Richfield Co*., 51 F.3d 1421, 1434 (9th Cir. 1995). In either case, the plaintiff must show that the defendants control enough of the market that their anticompetitive conduct actually injures competitors or consumers.

Plaintiff's description of the alleged relevant market as "the market for corporate control of WatchGuard and other technology companies," is fatal to its Sherman Act claim. There is no allegation from which the court could reasonably infer that Vector and FP have power in this market. Plaintiff alleges that in 2006 alone, "nearly $159 billion has poured into private equity funds." Plaintiff offers no allegations from which the court could

infer that the combined resources of FP and Vector are more than a minuscule fraction of this market.

Construing the Complaint in the light most favorable to Plaintiff, Plaintiff may be alleging that the relevant market is the "market for corporate control of WatchGuard" alone. Assuming for the sake of argument that such a narrow definition of a relevant market is appropriate, Plaintiff still has failed to show that FP and Vector have market power. Plaintiff errs in focusing on the conclusion of the contest for control of WatchGuard, in which Vector and FP were the only bidders remaining. Vector and FP had an apparent stranglehold on this submarket, to be sure, but only because dozens of other suitors who expressed interest in WatchGuard refused to make bids. There is no inference that Vector and FP had market power among these suitors. There is also no inference that these potential acquirors declined to enter the fray because of the anticompetitive conduct of Vector and FP. Instead, the inference is that most suitors refused to bid because WatchGuard was not an attractive asset. The result was a contest for corporate control in which it appeared that there were only two bidders, but the appearance is a mirage. Any acquiror who believed that WatchGuard was worth more than FP's bid could have made a topping bid. The agreement between FP and Vector would have had no effect on such a bid. Moreover, had WatchGuard's shareholders believed that the FP bid was too low, they retained power to reject the merger by voting it down. In short, the court cannot infer that Vector and FP had market power even in the contest for control of WatchGuard. The illusion of market power arose not from Defendants' anticompetitive conduct, but from the lack of market interest in WatchGuard.

The court must dismiss Plaintiff's antitrust claim, because Plaintiff has not alleged the existence of a relevant market in which FP and Vector had market power.

…

NOTES AND QUESTIONS

1. Are you satisfied that the trial court judge here has applied both *Credit Suisse* and *Twombly* correctly? Had neither case been decided previously, would the outcome of this case have been different??

2. On p. 14 above, the court accepts, as it must, Plaintiff's allegation that there was an effect on price. How does this square with the conclusion that Defendants had no market power?

3. No mention is made of the standing issues that were so important in *Arista*. Does Plaintiff have antitrust standing?

4. Where is the contract, combination or conspiracy that causes Plaintiff injury here? The court states, "Vector agreed to stop pursuing WatchGuard, and stand aside while FP made a lower bid." Could Vector not stop bidding on its own; if so, what is the point of an agreement? Or was the agreement Vector's later purchase of 50% in Watch Guard? By that time, FP's deal with Watch Guard was a *fait accompli*. Does the court say the two decisions were related?

5. Assuming *arguendo* that the judge's dismissal of the Rule of Reason claim were reversed, how would this case be likely to fare at the next opportunity for an early exit, *i.e,* summary judgment?