

## STATE ANTITRUST LAW Fills Federal Void

By Jarod Bona and Jeffrey M. Shohet

**A recent predatory pricing decision in California illustrates why corporate counsel must follow state antitrust developments as closely as they follow federal antitrust law. Intentionally or fortuitously, state law often fills in the gaps once occupied by federal law. In *Bay Guardian Company v. New Times Media LLC*, the Court of Appeals of the State of California held that a plaintiff can succeed in a predatory pricing claim without proving harm to competition, a bedrock requirement of federal antitrust claims.**

Predatory pricing involves a claim that a monopolist is unfairly competing by under-pricing its rivals to force them out of the market. In the early days of the Sherman Act, John D. Rockefeller and Standard Oil, for example, handled competition by pricing oil below its cost until all competitors were vanquished. Then Standard Oil raised the price above the level that would exist had competitors still occupied the market.

Predatory pricing cases are rarely tried and those that are tried are difficult to win. Courts are extremely reluctant to impose antitrust liability based upon low prices because vigorous price competition is the hallmark of an efficient market. Predatory pricing schemes benefit consumers in the short run with lower prices. Courts are ill equipped to distinguish pro-competitive price competition from predatory price-cutting, and enforcement mistakes are especially harmful because they chill the very conduct the antitrust laws are designed to encourage. Ironically, the possibility of such enforcement mistakes may serve to actually discourage pro-competitive price competition.

That is why federal law has developed a very difficult

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standard for predatory pricing claims, designed to target for enforcement only those price reductions that are “predatory” in the sense that they have the potential to ultimately reduce competition and raise prices.

Federal law requires that a predatory pricing claimant allege that the prices referenced by a complainant are below an appropriate measure of defendant’s costs, and that there is a “dangerous probability” that the defendant will be able to recoup its “investment” in below-cost prices by charging much higher prices once the competition has been vanquished.

A claimant must satisfy both of these requirements for a federal court to declare the pricing conduct anti-competitive, a necessary condition for an antitrust violation.

### **SUBJECTIVE STANDARD APPLIED**

The California court in Bay Guardian Company didn’t follow this standard. Instead of invoking the traditional anti-competitive impact element, it interpreted California law to incorporate a subjective intent requirement, whereby a claimant need not demonstrate that there is a “dangerous probability,” or any probability, that the party cutting prices below its own cost could eventually “recoup” those losses by raising prices after its competitors leave the market.

Under federal law, and established economic and academic theory, the recoupment element is what makes the predatory pricing anti-competitive because it targets for enforcement only price reductions that have the long run potential to reduce competition and lead to price increases. Without it, the monopolist is merely cutting prices, which benefits competition and consumers.

California’s departure from an anti-competitive impact requirement is significant and potentially dangerous because the necessity of proving actual harm to competition (not just harm to a competitor) is what keeps many antitrust cases from being filed.

In contrast to the objective federal standard, California law makes it easier to progress further into litigation because it requires only an allegation of subjective intent to harm a competitor. Indeed, a plaintiff need not even show intent. California applies a rebuttable presumption of intent if plaintiff can demonstrate actual injury from its competitor’s low prices. Thus, a plaintiff can proceed with a predatory pricing claim under California law merely by showing below-cost pricing and either actual or intended injury to itself.

The problem, of course, is that vigorous price competition, the hallmark of the antitrust laws, often injures less efficient rivals. Indeed, the most basic axiom of antitrust is that it protects “competition,” not “competitors.”

Federal law is moving in a less-interventionist direction by recognizing that deterring behavior like price-cutting in order to successfully prosecute the rare instance of predatory pricing is a bad deal for consumers. California, however, is now moving in the other direction. It offers potential claim-

ants an open invitation to compete in the courts rather than the marketplace by suing their competitors under state law for predatory pricing.

California’s replacement of an objective standard of competitive harm with an intent requirement invites all kinds of mischief, in that intent is a fuzzy concept that might more easily survive a motion to dismiss and lead to expensive discovery. But perhaps even more troubling is that the subjective nature of “intent” makes it more likely that a court will find a material fact in dispute, leading to an actual trial. Indeed, the Bay Guardian Company decision was an appeal of a \$16 million jury verdict.

The increased possibility of a trial introduces an entirely new level of price-cutting deterrence because the likelihood that a jury will make a mistake in a complex antitrust case is very high.

### **FEDERAL LAW NARROWS**

Predatory pricing is not the only area of federal antitrust law that has been narrowed over the last several decades. In several important decisions, federal antitrust claims have faced greater scrutiny, both substantively and procedurally. Substantively, the U.S. Supreme Court and the lower courts have interpreted federal antitrust law more and more narrowly in recent decisions. These decisions express concern for the harm caused by over-enforcement of the antitrust laws to both the litigants and the competitive process, and acknowledge that treble-damage lawsuits can substantially affect behavior (often in unfavorable ways).

As the Supreme Court in *Linkline* recently reiterated, courts are ill suited to “act as central planners, identifying the proper price, quantity, and other terms of dealing.” For example, in *Leegin Creative Leather Products v. PSKS, Inc.*, the Supreme Court in 2007, overturning one-hundred years of precedent, made it more difficult for antitrust plaintiffs to challenge vertical minimum resale price maintenance agreements between manufacturers and retailers.

Procedurally, federal antitrust plaintiffs now have a higher burden to survive a motion to dismiss following the U.S. Supreme Court’s 2007 decision in *Bell Atlantic Corporation v. Twombly*. *Twombly* is an antitrust decision that applies more broadly to all federal claims, requiring that plaintiffs allege a factual basis for a claim to relief that is “plausible” on its face.

In the antitrust context, this means, for example, that plaintiffs cannot allege mere conclusions of anticompetitive harm, or mere parallel conduct to allege a conspiracy. Practically speaking, *Twombly* and its progeny provide federal judges with a stronger tool to clear their docket of weak cases.

These changes in federal antitrust law have created a void that elevates state antitrust law. As federal antitrust claims succeed less often, plaintiffs will increasingly turn to state antitrust statutes, like the predatory pricing statute in California, to pursue claims that cannot survive the federal

standards. At the same time, states themselves recognize the void left by federal law, and many are likely to develop their own antitrust law, both legislatively and judicially, to fill that void. This has happened before.

In a series of decisions in the 1960s, 70s, and 80s, the Supreme Court held that under federal antitrust law, indirect-purchaser plaintiffs alleging price-fixing could not recover damages by arguing that the direct purchasers of the price-fixers “passed-on” the overcharges to the indirect purchasers. At the same time, the price-fixers could not prevail against the direct purchasers by arguing that they “passed-on” any overcharges to indirect purchasers. So, regardless of whether any overcharges were actually passed-on, the direct purchasers could recover the entire amount (trebled) of the overcharges from a price-fixing scheme, and the indirect purchasers were out of luck.

Notably, however, the Supreme Court later confirmed that under state antitrust law, indirect purchasers could recover any part of the overcharges that were “passed-on” by the direct purchasers. Recognizing this void in antitrust law (and the ability to exploit it), many states raced to pass legislation allowing indirect purchasers to recover under state antitrust law. Defendants, of course, were saddled with the possibility of redundant damages for lawsuits in both state and federal court.

Interestingly, the California Supreme Court, in July 2010, went even further in *Clayworth v. Pfizer*, holding that not only can indirect purchasers sue defendants to recover overcharges under California law, but that defendants are prohibited from defending themselves against direct purchasers by arguing that these purchasers “passed-on” the charges to the indirect purchasers. Thus, defendants are subject to redundant damages under the same state law!

Another example is the developing body of federal and state law relating to resale price maintenance following the U.S. Supreme Court’s decision in *Leegin*. As noted above, the *Leegin* court departed from longstanding precedent and held that under federal antitrust law, plaintiffs challenging vertical minimum resale price maintenance agreements are subject to the much tougher rule of reason standard instead of the *per se* standard. Following this controversial decision, at least one state has enacted a “repealer” statute expressly rejecting the *Leegin* approach and returning to the pre-*Leegin* “*per se*” standard for vertical price-fixing under state law.

#### **MORE WORK**

Not enough time has passed to determine whether this is a trend or an isolated example, but companies considering these type of agreements must survey the state antitrust landscape before they can properly evaluate the risks.

The California decision in *Bay Guardian Company* is a good illustration of how state antitrust law can and will fill

in the void left by a diminished federal antitrust law. This could happen substantively, or procedurally when plaintiffs with less or weaker evidence decide to sue under state law in state courts that apply a more liberal standard than the federal courts after *Twombly*. Laws and procedures that permit plaintiffs to go further into litigation attract lawsuits because the settlement value typically increases as each hurdle in the process is passed.

One subject that may be ripe for state antitrust intervention is loyalty discounts. These discounts can take many forms, but generally, they encourage customers to purchase more of a product by rewarding those who buy multiple units. They may include one type of product or several products (bundled discounts). Their structure could vary from straight volume discounts to market-share discounts that are based upon the percentage of a customer’s requirements purchased from a single seller.

The antitrust treatment of loyalty discounts is a matter of great controversy in both the United States and Europe. Federal antitrust law is still in flux, but the general trend is that courts are making it more difficult for loyalty discount claims to succeed. If this trend continues, the controversial nature of these discounts make it very likely that some states may seek to carve-out their own standards.

While recent developments have been good news for companies intent on using the antitrust laws to protect themselves from their more aggressive rivals, they add costs and burdens to the system that may outweigh and in some cases run contrary to their intended benefits. Whatever competitive benefit they achieve, they certainly place considerable burdens on company counsel who must now, more than ever, keep abreast of the antitrust laws of the various states, as well as federal antitrust law.



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