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In Secret Rebate Case, If It Walks Like A Duck, Allegations That It Will Also Quack Are Plausible

On May 24, 2011, United States District Court, Central District of California, denied a motion to dismiss allegations of a "price squeeze" implemented through the granting of secret rebates to the plaintiff's customers, finding that the complaint stated a plausible claim under California Business and Professions Code section 17045. Drawing on "judicial experience and common sense", District Judge Dean D. Pregerson held that the allegations of the first amended complaint are sufficiently "plausible" on their face to withstand challenges under *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, (2007). *Western Pacific Kraft, Inc. v. Duro Bag Manufacturing Company*, Case No. CV 10-06017 DDP (SSx), 5/24/11.

Plaintiff Western Pacific Kraft, Inc. ("WPK") is a wholesaler of paper bag products to smaller wholesale distributors. Defendant Duro Bag Manufacturing Company ("Duro") is the largest manufacturer of paper bags in the country, and the largest seller of paper bags in California. Duro was WPK's supplier, and also its principal competitor. For twenty years or more, Duro would reduce its prices to WPK, where WPK informed Duro that it had to meet competition from competing sources.

On October 9, 2010, however, Duro informed WPK that it would no longer do so. Instead, it raised the prices it charged WPK, while at the same time lowering the prices it charged WPK's customers. WPK only became aware of the discriminatory pricing when asked by its existing customers to meet the competition from Duro's lower prices.

WPK filed a complaint in federal court, alleging violations of California Business and Professions Code section 17045. Section 17045 has been a feature of California law since 1913, and was added to the California Unfair Practices Act in 1941. It prohibits the "secret payment" of rebates and unearned discounts, or secretly extending to certain purchasers special services or privileges not extended to all purchasers buying on like terms and conditions. However, additional elements of a violation are that there also be (a) injury to a competitor, and (c) a showing that such payment tends to destroy competition. It has been held to be applicable to competition at either the seller or the purchaser level, or both. *ABC International Traders, Inc. v. Matsushita Elec. Corp.*, 14

Cal. 4th 1247 (1997). In *Diesel Elec. Sales & Serv., Inc. v. Marco Marine San Diego, Inc.*, 16 Cal. App. 4th 202 (1993), the Court of Appeal, Fourth District, held that Section 17045 must be "liberally construed".

The first amended complaint alleged that as a result of the price discriminations, which were unknown to WPK, Duro's course of conduct "effectively put it out of business". It alleged that Duro had injured WPK and destroyed competition by providing secret rebates, refunds, or discounts to its customers.

As is much in vogue, Duro moved to dismiss, citing *Twombly*, and *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009). In discussing the applicable legal standards, the District Court recited the litany of quotes from *Twombly* that, while a complaint need not include "detailed factual allegations", it must offer "more than an unadorned, the–defendant–unlawfully–harmed–me accusation." *Iqbal* at 1949. While "conclusory allegations", "labels and conclusions", including "formulaic recitation of the elements," or "naked assertions" are insufficient, the court will assume the veracity of "well-pleaded factual allegations". Because this is somewhat of a subjective exercise, courts are to draw on their "judicial experience and common sense" in evaluating the two schools of thought. When is an allegation "well-pleaded" and "factual", as opposed to being a "legal conclusion"? This may be difficult to parse prior to at least initial discovery.

Nevertheless, the court is to use its "common sense". To paraphrase Lewis Carroll's famous logical fallacy of officers marching, where at least one of the officers "waddles", and has been heard to even utter the phrase, "quack", a degree of common sense may tell us whether the allegation is, in context, "plausible on its face". Is one of the officers really a duck?

The central attack by Duro was that the allegations of the first amended complaint do not plead sufficient factual allegations to show that Duro's price discriminations were "secret". Duro argues that this is so because it advised WPK that it would no longer grant "meeting competition" price reductions. However, as the court reasoned, WPK alleged a "price squeeze" in which Duro simultaneously raised its net prices to WPK, while at the same time lowering net prices charged to its former customers. The court held that on a motion to dismiss on *Twombly* grounds, the allegations were sufficient that the prices attributable to secret rebates were "secret". This was on the basis of the allegations that the rebates were never disclosed to WPK. Here we have a "hint" of a possible concerted refusal to deal.

Duro also contended that the first amended complaint failed to establish that WPK could have been harmed by the secret rebates, assuming they were "secret" at all. The court disagreed, as a fair reading of the first amended complaint was that as a result of the price discriminations and rebates, "virtually all of the plaintiff WPK's major customers began buying paper products directly from defendant Duro". Thus, it alleged that as a result of the secret discriminatory pricing, it had been effectively run out of business. Perhaps not surprisingly, and as it would have been endorsed by Lewis Carroll, these allegations were sufficient to satisfy the three prongs of 17045. First, the price

discriminations were "secret". Second, by effectively putting WPK out of business, WPK was harmed as a competitor. Third, the elimination of WPK as a competitor would have reduced consumer search opportunities, and thus would have contracted the available consumer choices, and thereby allocatively inefficiently injuring the competitive process.

The motion to dismiss, interestingly, did not attack the first amended complaint on *DuPont Cellophane* grounds. It did not argue that paper bags, like cellophane, may have been substitutable with an array of packaging materials, and that "paper bags" or "paper bags in California", were an insufficient allegation of a properly defined relevant market for an evaluation whether the allegations of antitrust injury were sufficiently "plausible". *See United States v. E.I. DuPont de Nemours & Co.*, 353 U.S. 586 (1957). Thus, the court has held that through an application of "common sense" as determined by the district court, there can be life after *Twombly*. While further developments could determine that we have but an impersonation of a duck, the allegations are sufficient to allow the connection between the waddles, the quacks, and a judicial determination that in fact, we are dealing with something like a duck.

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