

Whither Antitrust in the Supreme Court?

Susan S. DeSanti

A consideration of “what next?” for the Supreme Court requires first a look at recent Supreme Court opinions, not only to identify the issues just put to rest, at least for the time being, but also to assess the Court’s attitude toward antitrust law. For the most part, the Court’s recent decisions describe antitrust as a costly and mistake-prone doctrine, to be applied (if at all) only by experts capable of a specialized evaluation of the competitive circumstances at issue.

Two decisions in the spring of 2007 illustrate the trend. In *Bell Atlantic Corp. v. Twombly*,¹ Justice Souter’s majority opinion decried the enormous expense of discovery in antitrust cases, which judges have been unsuccessful in managing, according to the Court, and which can lead defendants to settle “even anemic cases” long before summary judgment motions are filed.² For these reasons among others, the Court articulated a new and arguably higher standard for pleading, dismissing an antitrust complaint where plaintiffs had not “nudged their claims across the line from conceivable to plausible.”³ In *Credit Suisse Securities (USA) LLC v. Billing*,⁴ Justice Breyer’s majority opinion stated that in certain securities contexts, “antitrust courts are likely to make unusually serious mistakes”⁵ (note the implication that antitrust courts *usually* make serious mistakes), such that “to allow an antitrust lawsuit [concerning conduct related to the marketing of new securities] would threaten serious harm to the efficient functioning of the securities markets.”⁶ Far better, the Court concluded, to leave these matters in the hands of the securities experts.⁷ The Court declared antitrust law impliedly repealed as “incompatible” with securities law in that context.⁸

These opinions are not ringing endorsements of antitrust law application by federal courts or juries. Regardless of improvements in antitrust doctrine to consider economic complexities before finding liability, the Court finds antitrust still too mistake-prone in particular circumstances and certainly only more costly as a result of its increased complexity. This view suggests the Court will look for antitrust cases that offer the opportunity further to confine antitrust doctrine. Although the Court appears already to have done much of its pruning, opportunities still exist. And perhaps the Court is just in a “pruning” mood; as discussed further below, the Court’s recent patent decisions reflect an interest in restricting the application of patent law as well.

■ **Susan DeSanti** is a partner at Sonnenschein Nath & Rosenthal LLP in Washington, D.C. She was previously Senior Counsel for the Antitrust Modernization Commission and Deputy General Counsel for Policy Studies at the Federal Trade Commission.

¹ 127 S. Ct. 1955 (2007).

² *Id.* at 1967.

³ *Id.* at 1974.

⁴ 127 S. Ct. 2383 (2007).

⁵ *Id.* at 2396.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 2397.

From Implied Antitrust Immunity to State Action?

As noted above, in *Credit Suisse*, the Court held that antitrust law was impliedly repealed in the context of conduct related to marketing new securities that was subject to the securities regulatory regime.⁹ This result may have been presaged in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko LLP*.¹⁰ There, the Court held that Verizon's alleged breach of its duties under the 1996 Telecommunications Act to share its network with competitors did not state a claim under Section 2 of the Sherman Act.¹¹ The 1996 Telecommunications Act contains an explicit savings clause through which Congress mandated that antitrust laws should continue to be applied, despite the regulatory scheme established by the Act.¹² Prevented from implying antitrust immunity for conduct covered by the Act, the Court nevertheless took into account the "existence of a regulatory structure designed to deter and remedy anticompetitive harm" in deciding that Section 2 of the Sherman Act did not outlaw unilateral refusals to deal such as Verizon's.¹³

Credit Suisse raises the question whether the Court similarly will take a more favorable view toward other doctrines that protect regulated activity from antitrust scrutiny.

Some—including the Antitrust Modernization Commission (AMC)—have argued that *Trinko* is best understood simply as a limit on refusal to deal claims under Section 2 of the Sherman Act, not as a decision in which the Court found a way to avoid application of the antitrust laws, despite the explicit savings clause in the 1996 Telecommunications Act.¹⁴ That interpretation becomes more questionable after *Credit Suisse*, a case in which the Court went through contortions to demonstrate that, where both securities and antitrust laws disapproved virtually identical conduct, application of antitrust law would be "practically incompatible" with application of securities law.¹⁵

In addition, *Credit Suisse* raises the question whether the Court similarly will take a more favorable view toward other doctrines that protect regulated activity from antitrust scrutiny. One of the recent cases brought by the Federal Trade Commission could provide a vehicle to answer that question, at least as to the state action doctrine. In *FTC v. Equitable Resources, Inc.*, the Third Circuit is now considering whether a proposed merger of two local gas distribution companies in western Pennsylvania is immune from antitrust scrutiny under the state action doctrine.¹⁶ The FTC challenged the proposed transaction as a merger to monopoly.¹⁷ The parties claimed their conduct was protected by the state action doctrine.¹⁸ Under the Supreme Court's decision in *California Retail Liquor Dealers Association v. Midcal*, private parties may take advantage of the state action doctrine only if their conduct is pursuant to a "clearly articulated and affirmatively expressed" state policy to displace competition, and the policy is "actively supervised" by the state.¹⁹

⁹ *Id.*

¹⁰ 540 U.S. 398 (2004).

¹¹ *Id.* at 415–16.

¹² *Id.* at 406.

¹³ *Id.* at 412.

¹⁴ ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 340–41 (2007) [hereinafter AMC REPORT], available at http://www.amc.gov/report_recommendation/amc_finalreport.pdf.

¹⁵ *Credit Suisse Sec. (USA) LLC v. Billing*, 127 S. Ct. 2383, 2393 (2007).

¹⁶ Opening Brief of Appellant, *FTC v. Equitable Res., Inc.*, No. 07-2499 (3d Cir. July 6, 2007) [hereinafter Appellant Opening Brief].

¹⁷ *Id.* at 36.

¹⁸ Reply Brief of Appellant at 1–2, *FTC v. Equitable Res., Inc.*, No. 07-2499 (3d Cir. Aug. 17, 2007) [hereinafter Appellant Reply Brief].

¹⁹ 445 U.S. 97, 105 (1980).

The merging parties in *Equitable Resources* argued the transaction had been approved by the Pennsylvania Public Utility Commission (PPUC) under a “clearly articulated” state policy to displace competition,²⁰ and the PPUC would “actively supervise” the merged entity’s rates, costs, earnings, terms of service, and service quality.²¹ The district court agreed,²² and the FTC appealed the district court’s decision to the Third Circuit.²³

The FTC’s arguments in *Equitable Resources* parallel those made in the FTC Staff’s State Action Report.²⁴ The FTC asserts that *Midcal* requires a showing that the state has authorized the specific type of anticompetitive conduct that has been challenged.²⁵ In particular, according to the FTC, “The [district] court should have assessed whether the Pennsylvania legislature had clearly articulated any policy to displace the antitrust laws with respect to anticompetitive acquisitions by public utilities.”²⁶ (The AMC similarly recommended that, for the state action doctrine to immunize conduct by entities that are not sovereign states, courts should require that those entities act pursuant to a clearly articulated state policy “deliberately intended to displace competition *in the manner at issue.*”²⁷)

In *Equitable Resources*, the FTC further argues that the second part of the *Midcal* test—active state supervision—also requires a more targeted inquiry: whether the state will supervise the particular conduct likely to cause antitrust competitive injury.²⁸ The FTC alleges the PPUC does not regulate the particular conduct likely to cause anticompetitive effects—that is, certain customers’ loss of discounts and high quality service.²⁹

Whoever wins or loses in the Third Circuit, a petition for certiorari may be filed. The last time the FTC was before the Supreme Court on a state action issue, in *FTC v. Ticor Title Insurance Co.*,³⁰ the agency succeeded in persuading the Court that alleged horizontal price fixing by defendant title insurance companies did not merit state action immunity, because active state supervision was absent.³¹ Among other things, the Court in *Ticor* noted that “state-action immunity is disfavored, much as are repeals by implication [of the antitrust laws].”³² After *Credit Suisse*, however, repeals by implication of the antitrust laws no longer seem disfavored; does state action immunity remain disfavored? Leaving aside the particular facts in *Equitable Resources*, the Court’s shift toward a more benign view of regulation and a more skeptical view of antitrust law suggests the FTC would likely have a more difficult time today persuading the Court to adopt the FTC’s position than it did in *Ticor*.

²⁰ Appellant Reply Brief, *supra* note 18, at 3.

²¹ *Id.* at 20.

²² *FTC v. Equitable Res., Inc.*, 512 F. Supp. 2d 361, 371 (W.D. Pa. 2007).

²³ Appellant Opening Brief, *supra* note 16.

²⁴ FEDERAL TRADE COMM’N STAFF, REPORT OF THE STATE ACTION TASK FORCE (Sept. 2003), available at <http://www.ftc.gov/os/2003/09/stateactionreport.pdf>.

²⁵ Appellant Opening Brief, *supra* note 16, at 9.

²⁶ *Id.*

²⁷ AMC REPORT, *supra* note 14, at 24 (emphasis added).

²⁸ Appellant Opening Brief, *supra* note 16, at 30.

²⁹ *Id.* at 30–31.

³⁰ 504 U.S. 621 (1992).

³¹ *Id.* at 638.

³² *Ticor*, 504 U.S. at 636.

From Tying to Bundled Discounts?

In *Illinois Tool Works, Inc. v. Independent Ink*,³³ the Court explained not only that one could not assume market power from the mere existence of a patent, but also that “[o]ver the years, this Court’s strong disapproval of tying agreements has substantially diminished.”³⁴ The Court may consider this language a sufficient signal for the lower courts to develop tying law in the direction the Court wishes.

For bundled discounts, however, the current law is in conflict. In *LePage’s Inc. v. 3M Co.*,³⁵ the Third Circuit held the bundled discounts at issue violated Section 2 of the Sherman Act. There, the plaintiff contested bundled rebates that the defendant offered when customers made purchases across a number of the defendant’s product lines.³⁶ The Third Circuit described the “principal anti-competitive effect” of the rebates as their potential “to foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.”³⁷ The Third Circuit’s decision has been widely criticized as focusing simply on harm to the single product competitor without considering whether the conduct in question constituted harm to competition.³⁸

The criticisms of *LePage’s* alerted the Ninth Circuit to the controversy, and the court therefore invited amicus briefs on the proper antitrust evaluation of the bundled discounts at issue in *Cascade Health Solutions v. PeaceHealth*.³⁹ In that case, the Ninth Circuit ultimately adopted the first part of a three-part test for bundled discounts advocated by the AMC.⁴⁰ The first part of that test requires a factfinder to allocate the full amount of the discounts given on the entire bundle to just the competitive product and determine whether the resulting price is below the defendant’s incremental cost to produce the product.⁴¹ If it is, then the Ninth Circuit would find the bundled discount to constitute exclusionary conduct under Section 2.⁴² Application of this test, however, would result in liability only if the bundled discounts had the potential to exclude a hypothetical equally efficient producer of the competitive product(s).⁴³

Thus, two courts of appeals have conflicting approaches to bundled discounts, and the stage is set for a Supreme Court ruling to choose the proper approach. The Ninth Circuit’s cost-based approach is more in line with the Court’s cost-based tests for predatory pricing,⁴⁴ a type of exclusionary conduct that, like bundled discounts, may be defined as “pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing compe-

[T]wo courts of appeals have conflicting approaches to bundled discounts, and the stage is set for a Supreme Court ruling to choose the proper approach.

³³ 547 U.S. 28 (2006).

³⁴ *Id.* at 35 (2006).

³⁵ 324 F.3d 141 (3d Cir. 2003) (en banc).

³⁶ *Id.* at 144–45.

³⁷ *Id.* at 155.

³⁸ *E.g.*, AMC REPORT, *supra* note 14, at 97.

³⁹ 502 F.3d 895 (9th Cir. 2007).

⁴⁰ *Id.* at 919 (citing AMC REPORT, *supra* note 14, at 99–100).

⁴¹ *Id.*

⁴² *Id.* The AMC would ask two further questions before a finding of liability could be reached: (1) whether the defendant is likely to recoup the short-term losses from offering the bundled discounts, and (2) whether the bundled discounts had or are likely to have an adverse effect on competition. AMC REPORT, *supra* note 14, at 99–100.

⁴³ *PeaceHealth*, 502 F.3d at 919.

⁴⁴ *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222, 224 (1993).

tition in the long run.”⁴⁵ As the AMC acknowledged, however, the cost-based test the Commission proposed and the Ninth Circuit adopted could generate false negatives—that is, the standard “would permit bundled discounts that could exclude a less efficient competitor, even if the less efficient competitor had provided some constraint on pricing of the competitive product.”⁴⁶ Nonetheless, the Court would likely agree with the Commission that the danger of such false negatives was outweighed by “the difficulties of identifying [circumstances in which a less efficient competitor had provided some constraint on pricing], the lack of predictability and administrability in any standard that would capture such instances, and the undesirability of a test that would protect less efficient competitors,”⁴⁷ and would likely adopt the Ninth Circuit or another cost-based standard for the antitrust analysis of bundled discounts.

Further Pruning Patent Law?

In April of this year, in *KSR International Co. v. Teleflex, Inc.*,⁴⁸ the Court issued a unanimous decision on “obviousness” under patent law, the most important decision on this issue in four decades. The Court addressed when a patent application should be rejected, or an existing patent should be invalidated, because the underlying subject matter is “obvious,” a term of art in patent law. Under the Patent Act, a patent may not issue where “the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made *to a person having ordinary skill in the art to which said subject matter pertains.*”⁴⁹ The Supreme Court found that the Court of Appeals for the Federal Circuit had adopted and applied too rigid a test for obviousness, resulting in an erroneous ruling that upheld the patent in question as non-obvious.⁵⁰

The Court remanded the case and reminded the Federal Circuit to take another look at Supreme Court precedent on “obviousness.” In addition, the Court stated: “[T]he results of ordinary innovation are not the subject of exclusive rights under the patent laws. Were it otherwise patents might stifle, rather than promote, the progress of useful arts,” which the Constitution specifies that patents should promote.⁵¹ As the FTC noted in its 2003 report, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, patents on obvious subject matter can preclude innovation that competition might otherwise have encouraged.⁵² The Court’s ruling in *KSR* now leaves greater room for competition to encourage “ordinary innovation.”

Showing a continued interest in patent law, the Supreme Court this fall granted certiorari in *Quanta Computer, Inc. v. LG Electronics, Inc.*,⁵³ another case that will test the scope of the exclusive rights granted under the patent laws. That case involves whether and, if so, when, a patentee may bring an infringement suit to enforce restrictions on a patented article after an authorized sale. LG had granted Intel a license to make and sell specialized components using certain LG

⁴⁵ *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 117 (1986).

⁴⁶ AMC REPORT, *supra* note 14, at 100.

⁴⁷ *See id.*

⁴⁸ 127 S. Ct. 1727 (2007).

⁴⁹ 35 U.S.C. § 103 (emphasis added).

⁵⁰ *KSR*, 127 S. Ct. at 1739.

⁵¹ *Id.* at 1746.

⁵² FED. TRADE COMM’N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, *Executive Summary* 3, ch. 4 at 4–6, ch. 5 at 2–4 (2003), available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>.

⁵³ 128 S. Ct. 28 (2007).

patents. The license agreement, however, specifically disclaimed any express or implied license for acts of infringement that might occur when a third party to which Intel sold its LG-patented products combined them with other, non-Intel components; indeed, the license required Intel to notify purchasers of this limitation.⁵⁴

Under Supreme Court cases, the patent exhaustion doctrine, also known as the first-sale doctrine, prohibits a patentee who sells a machine embodying the invention (either directly or through an authorized licensee) from bringing a patent infringement suit against the purchasers for using the machine for its only reasonable use or for reselling the machine to others. In *LG Electronics*, the district court held, among other things, that LG could not enforce certain of its patent claims against Quanta, a manufacturer that had combined LG-patented Intel products with non-Intel products, because those claims were “exhausted” by the license that LG had granted Intel to sell products embodying LG’s patents.⁵⁵ In reaching its decision, the district court emphasized that the relevant licensed Intel components were essential to LG’s patented invention and had no reasonable use that did not practice LG’s patents.⁵⁶ The Federal Circuit reversed the district court’s holding on this point, on the ground that the patent-exhaustion doctrine does not apply to “an expressly conditional sale”—that is, a sale that is subject to an express limitation on the right to use or to resell the patented invention.⁵⁷

The Solicitor General recommended that the Court grant certiorari to review the Federal Circuit’s decision, arguing that the Federal Circuit’s expansion of the circumstances in which a patentee may use a patent infringement suit (as opposed to a suit for breach of contract) to enforce restrictions on a patented article after an authorized sale “is difficult to reconcile with the reasoning of this Court’s cases.”⁵⁸ Among other things, the Solicitor General noted, “The Federal Circuit’s approach also has the potential to erode downstream competition by permitting patentees to avoid antitrust scrutiny of restrictions on the use and resale of products embodying their inventions—restrictions that would be enforceable as a matter of patent law in the Federal Circuit.”⁵⁹ This would contrast with current practice, under which a patentee may negotiate contractual restrictions with downstream purchasers but the patentee does not automatically have the right to apply such restrictions as a matter of patent law.

This case provides yet another opportunity for the Court to limit the Federal Circuit’s expansive interpretation of the scope of patents and thus to facilitate competition. To allow a patentee automatically to apply any condition on all downstream purchases of the patented product would add uncertainty to those purchases at best, and could impose anticompetitive restrictions to competition involving the patented product *as a matter of patent law* at worst. Given the Court’s recent patent decisions, such as *KSR*, there is reason to believe that the Court understands the competition implications of the Federal Circuit’s approach to the doctrine of patent exhaustion and has granted certiorari in *LG Electronics* to undo the Federal Circuit’s method of avoiding the application of that doctrine. Overruling the Federal Circuit on this issue would be the best outcome for competition and consumers. ●

⁵⁴ *LG Elecs., Inc. v. Bizcom Elecs., Inc.*, 453 F.3d 1364, 1368 (Fed. Cir. 2006).

⁵⁵ *LG Elecs., Inc. v. Asustek Computer, Inc.*, 248 F. Supp. 2d 912, 917–18 (N.D. Cal. 2003).

⁵⁶ *Id.*

⁵⁷ *Bizcom Electronics*, 453 F.3d at 1370.

⁵⁸ Brief for the United States as Amicus Curiae at 17, *Quanta Computer, Inc. v. LG Electronics, Inc.*, No. 06-937 (U.S. Aug. 24, 2007), available at <http://www.usdoj.gov/atr/cases/f225500/225544.htm>.

⁵⁹ *Id.* at 18.