Westlaw Journal

ANTITRUST

Litigation News and Analysis • Legislation • Regulation • Expert Commentary

VOLUME 21, ISSUE 12 / APRIL 2014

EXPERT ANALYSIS

Streamlining the Rule of Reason: The 6th Circuit Joins the Trend

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Historically, alleged violations of Section 1of the Sherman Act, 15 U.S.C. § 1, have been analyzed under one of two essentially dichotomous methodologies: the rule of reason or the per se rule.

The U.S. Supreme Court has clearly established that the rule of reason is the presumptive standard. The per se rule is applied only when a court can say with confidence that the restraint on trade will always — or almost always — have a net anti-competitive effect.

If there are plausible pro-competitive justifications for a restraint, the per se rule is inappropriate. In addition, if the court has little experience with a restraint, the per se rule should not be applied.

Under the per se rule, there is an irrebuttable presumption of anti-competitive effect. Consequently, the plaintiff must prove only that the defendant engaged in conduct that was unlawful per se.

The Supreme Court's decision in *Chicago Board of Trade v. United States,* 246 U.S. 231 (1918), has long served as the classic template for the rule of reason. The aim of the rule of reason is to determine whether the anti-competitive effects of a restraint outweigh any pro-competitive benefits.

Under the classic articulation of the rule of reason, many facts are relevant but none are dispositive. To prove anti-competitive effect, the plaintiff must convince the court that the defendant's share of a relevant market is significant enough to permit an inference of market power. Market power is, in turn, circumstantial evidence of anti-competitive effect.

The Supreme Court articulated a truncated version of the rule of reason in *National Collegiate Athletic Association v. Board of Regents of the University of Oklahoma*, 468 U.S. 85 (1984). Although the court applied the rule of reason, it found that the restraints at issue — which limited the ability of NCAA schools to negotiate television contracts for broadcasts of their teams' football games — were similar to restraints the court had previously deemed unreasonable.

The high court held that by artificially limiting the number of games the member institutions could televise, the NCAA created a horizontal restraint that prevented the institutions from competing against each other for price. This restraint was similar to ones that had already been deemed unreasonable as a matter of law, such as a classic horizontal limitation on output.

The court held that because the defendant offered no plausible pro-competitive justification for the restraint, the plaintiff could prevail under the rule of reason without having to present evidence relating to the relevant market or the defendant's market share.

The Supreme Court announced a similar abbreviated rule of reason in *Federal Trade Commission v. Indiana Federation of Dentists*, 476 U.S. 447 (1986). In that case, it held that the plaintiff was not obligated to identify the relevant market and market shares because there was direct evidence of anti-competitive effect.

Circumstantial evidence relating to the relevant market and market shares was not needed because there was direct proof that the defendant dentists had failed to provide insurance companies with X-rays that were needed to ensure the appropriateness of the dentists' treatments.

The truncated rule-of-reason analysis introduced in these two cases was dubbed a "quick-look" approach to the rule of reason, although neither decision used the phrase. It was not until *California Dental Association v. Federal Trade Commission*, 526 U.S. 756 (1999), that the Supreme Court used this terminology and further articulated the quick-look standard. In that case, the court said a quick-look rule-of-reason analysis should be applied when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."

California Dental concerned advertising restrictions imposed on dentists by an association of dental societies. In the name of prohibiting false and misleading advertising, the association banned advertising relating to price, as well as advertising relating to the quality of dental services. The FTC and the 9th U.S. Circuit Court of Appeals court applied the quick-look rule-of-reason analysis to conclude that the advertising restraints reduced output and restricted price competition.

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In *California Dental Association v. Federal Trade Commission*, 128 F.3d 720 (9th Cir. 1997), the 9th Circuit concluded that the association's proffered pro-competitive justification that the restrictions prevented false and misleading advertising carried little weight because it was not feasible to disclose all of the information required. In addition, there was no evidence that the rule led to increased transparency in dental pricing.

The Supreme Court reversed the 9th Circuit's ruling, holding that it was not obvious that the restrictions would produce anti-competitive effects. As a result, a more extensive analysis of the anti-competitive effects was required.

The high court further held that although a more extended examination of anti-competitive effects was needed, a full market analysis was not necessarily required. It added that there is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anti-competitive effect and those that call for a more detailed treatment.

The court said that what is needed is "an enquiry meet for the case, looking to the circumstances, detail, and logic of the restraint." It continued by explaining that "[t]he object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one."

Two key federal appellate decisions followed the Supreme Court's ruling in *California Dental*.

In *Polygram Holding v. Federal Trade Commission*, 416 F.3d 29 (D.C. Cir. 2005), competing record companies agreed to restrict advertising and promotions of the recordings of two concerts by the Three Tenors — Jose Carreras, Placido Domingo and Luciano Pavarotti — made at World Cup soccer games. The ostensible purpose of the restraints was to protect the sales of a future Three Tenors recording. The FTC charged the record companies with a violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

In *Polygram*, the FTC used an analytical framework that it first announced in *In re Massachusetts Board of Optometry*, 110 F.T.C. 549 (1988). Under this framework, if the conduct at issue is "inherently suspect" as a restraint, the burden shifts to the defendant to come forward with some plausible and legally cognizable pro-competitive justification.

If the defendant does not proffer such a justification, the restraint is summarily condemned. But if the defendant proffers a justification, the plaintiff can either attack its plausibility or cognizability, or establish that it had a net anti-competitive effect.

On appeal to the D.C. Circuit, the *Polygram* defendants argued that they were not required to proffer competitive justifications unless the FTC first showed that the restraints actually harmed competition. According to the defendants, "proof of actual anti-competitive effect (or market power as its surrogate) is required in any rule of reason case."

The appeals court accepted the FTC's framework, stating that "[i]f based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition then the restraint is presumed unlawful." The burden would then shift to the defendant to either proffer offsetting pro-competitive benefits or show the restraint is unlikely to harm consumers.

The 7th Circuit also endorsed a truncated rule of reason in *In re Sulfuric Acid Antitrust Litigation*, 703 F.3d 1004 (7th Cir. 2012). The court found that even under the rule of reason, the restraint was close enough to a per se illegal practice to shift the burden to the defendants to justify the conduct as pro-competitive — even without proof of a relevant market, market power or anti-competitive effect.

Sulfuric Acid involved agreements between Canadian smelters that were left with sulfuric acid as a waste byproduct and U.S. producers that made sulfuric acid by burning elemental sulfur.

The Canadian smelters wanted to enter the U.S. market to sell their significant surplus of sulfuric acid. Unlike the U.S. producers, the Canadian smelters had no trucks, storage facilities, salespeople or other distribution infrastructure in the United States.

The smelters and U.S. producers entered into agreements that called for the U.S. producers to sell the cheaper Canadian acid and stop producing their more costly acid. The plaintiffs alleged that such an agreement was a per se output restraint. In *Sulfuric Acid*, 743 F. Supp. 2d 827 (N.D. Ill. 2010), the trial court held that the agreements should be analyzed under the rule of reason. Rather than try the case under the rule of reason, the plaintiffs dismissed it and appealed, hoping the 7th Circuit would reinstate their per se case.

Writing for the appeals court, Judge Richard Posner pointed out that most — but not all — rule-of-reason cases require a *prima facie* showing of market power. If a plaintiff proves that the defendants raised prices by restricting output, he has made a *prima facie* case and need not prove market power. Judge Posner also noted that, "even if a challenged practice [did not] quite rise to the level of per se illegality, it may be close enough to shift to the defendant the burden of showing [pro-competitive justifications]."

THE *SOUTHEASTERN MILK* DECISION

As discussed above, courts have applied the "quick-look" approach to the rule of reason when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anti-competitive effect on customers and markets." *California Dental*, 526 U.S. at770.

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In cases like the ones involving the NCAA and the dental societies, the record established a clear anti-competitive effect. Therefore, the plaintiff did not have to prove a relevant market and market shares.

In others, such as *Polygram* and *Sulfuric Acid*, the restraint was close enough to a per se illegal restraint to require the defendant to proffer pro-competitive justifications, even without proof of a relevant market and market power. The 6th Circuit's decision in *In re Southeastern Milk Antitrust*

Litigation, No. 12-5457, 2014 WL 25811 (6th Cir. Jan. 3, 2014), broadens the plaintiff's threshold showing under the quick-look approach, at least for purposes of defeating summary judgment.

Southeastern Milk concerned a merger between Suiza Foods and Dean Foods, the two largest milk processors in the country. Both processors purchased their raw milk from other entities. Dairy Farmers of America was Suiza's primary supplier. It was also Suiza's business partner and owned almost 34 percent of a Suiza subsidiary.

To avoid antitrust issues and with input from the Justice Department, Suiza and Dean Foods spun off certain assets and entered into various agreements.

Suiza purchased DFA's ownership interest in the Suiza subsidiary in exchange for cash and six of Suiza's dairy processing plants. Suiza also entered into two contractual arrangements with DFA to provide raw milk to the merging companies' processing plant, assuring DFA of long-term supply contracts.

The six processing plants that Suiza spun off were transferred to a new partnership called National Dairy Holdings, which DFA partially owned. NDH also added five plants that Dean Foods had spun off. NDH became the second-largest milk bottler in the Southeast, competing with the newly merged Dean Foods and Suiza.

The 6th Circuit affirmed the lower court's application of the rule of reason, explaining that it is the "default position."

DFA was a 50 percent owner of NDH, and it could veto any agreement that would substantially affect the operations, contracts or capital expenditures of NDH. It also had veto power over any acquisition, expansion or disposal of NDH's facilities.

Two milk retailers sued Dean Foods, NDH and DFA in the U.S. District Court for the Eastern District of Tennessee. The retailers alleged a conspiracy to reduce output and divide markets. The relationship of DFA to both Dean Foods and NDH was a key part of the alleged conspiracy, the retailers claimed.

DFA had a lucrative supply contract with Dean Foods, and it had a controlling ownership interest in NDH. The retailers alleged that Dean Foods and NDH conspired to reduce NDH's output through DFA's ownership and control of NDH. They claimed that the conspiracy was part of DFA's effort to protect and foster its supply contracts with Dean Foods.

Undertaking a traditional rule-of-reason analysis, the District Court determined that to show an antitrust violation, the plaintiffs had to establish an anti-competitive effect in relevant geographic and product markets. The court granted the defendants' summary judgment motion because the retailers could not prove an anti-competitive effect in a geographic market. *In re Southeastern Milk Antitrust Litig.*, No. 08-MD-1000, 2012 WL 1032797 (E.D. Tenn. Mar. 27, 2012).

On appeal, the plaintiffs contested the trial court's decision to apply the rule of reason. They also argued that it was error for the court not to apply the "quick-look" approach, which would have obviated the need to prove the geographic market.

The 6th Circuit affirmed the lower court's application of the rule of reason, explaining that it is the "default position."

The appeals court described the per se rule as the "less common method of determining whether the restraint is unreasonable," stating that "[t]he per se rule should only be used when the restraint has 'such a predictable and pernicious anti-competitive effect,' that there is limited potential for pro-competitive benefit."

The court also examined whether the restraint was horizontal or vertical. It pointed out that horizontal restraints are more threatening to competition and thus are subject to per se treatment more regularly, while vertical restraints have more redeeming qualities and therefore can generally be examined under the rule of reason.

The plaintiffs' essential allegation was that "Dean Foods agreed to buy the raw milk it needed from DFA, thus creating a vertical relationship, in exchange for DFA's hampering NDH's ability to effectively compete." Because the restraint derived from a fundamentally vertical relationship, the 6th Circuit concluded that the lower court properly tested the allegations under the rule of reason.

In addition to the vertical nature of the restraint, the appeals court noted that the plaintiffs did not allege facts that placed the restraint into one of the limited categories that are clearly and unquestionably illegal per se.

Furthermore, it held that the rule of reason should be applied even to horizontal restraints that do not fit into the existing per se categories, reaffirming the 6th Circuit's "automatic presumption in favor of the rule-of-reason standard."

In this case, there was a factual dispute as to whether the restraint was obviously anti-competitive, and the defendants produced evidence that the agreement at issue had pro-competitive effects.

On summary judgment, the factual dispute as to the net competitive effect of the restraint militated in favor of a finding that the rule of reason should be applied. Finally, the court noted that the Justice Department had reviewed and sanctioned the agreement, which presumably would not happen if the agreement was illegal per se.

After upholding the trial court's decision to apply the rule of reason, the 6th Circuit addressed whether the plaintiffs were required to establish the relevant geographic market.

The court acknowledged that the rule of reason generally requires plaintiffs to establish that the restraint had an anti-competitive effect on the relevant geographic and product markets. However, the 6th Circuit observed that other courts have begun to view the rule of reason as something broader than a fixed analysis.Instead, it said, the rule of reason exists on a continuum between the per se rule and the traditional rule-of-reason analysis, and the extent of the inquiry is tailored to the alleged conduct on a case-by-case basis.

The 6th Circuit's opinion could open the door for district courts to fashion a structured set of burdens and burden-shifting tailored to the facts of a particular case.

The 6th Circuit noted that it had "characterized 'quick look' analysis as a third type of category resulting from the blurring of the line between per se and rule-of-reason cases." The District Court had not distinguished between the two forms of rule of reason: the full rule of reason and the "quick look" version of the rule.

Under the quick-look version, the plaintiffs had raised a genuine issue of fact sufficient to defeat summary judgment, without establishing a relevant geographic market.

Construing the facts and record in the plaintiffs' favor, the 6th Circuit held that the alleged conduct obviously had anti-competitive effects. In such a situation, the District Court should have at least considered the fact that a detailed market analysis might not have been required.

Although the 6th Circuit technically left it to the lower court to decide whether the quick-look inquiry was appropriate in *Southeastern Milk*, it appears to have set a low threshold for application of the "quick-look" paradigm.

Southeastern Milk did not seem to present a situation in which "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anti-competitive effect on customers and markets" under *California Dental*.

Indeed, the advertising restrictions in *California Dental* seem far more anti-competitive than the ownership arrangement in *Southeastern Milk*. Nonetheless the Supreme Court in *California Dental* held that a more complete rule-of-reason analysis was appropriate.

In *Southeastern Milk*, it did not appear that DFA orchestrated an express agreement between NDH and Dean Foods to reduce competition. Rather, the allegation appeared to be based on an inference drawn from the possible conflict that arose from the defendants' ownership arrangement. Furthermore, the *Southeastern Milk* defen-dants proffered pro-competitive justifications for their conduct.

The 6th Circuit's opinion usefully advances the quick-look protocol by asserting that like the quick-look rule itself, burdens and presumptions in such cases exist along a continuum. As a result, district courts may soon begin to tailor burdens and burden-shifting paradigms on a case-by-case basis.

For example, the plaintiff's showing that the restraint in question has an anti-competitive effect would shift the burden to the defendants to proffer pro-competitive justifications. If the defendants succeed in this "justification proffer," then the burden would shift back to the plaintiff to prove that the proffered justifications are pretextual or not cognizable.

If the plaintiffs are able to do so, the case is over. If they are not, the ultimate burden of persuasion rests with the plaintiffs to prove that the anti-competitive effects out-weigh the pro-competitive benefits. In such a situation, the plaintiffs would probably have to prove a relevant market and defendants' market shares to establish an inference of anti-competitive effect.

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