UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
LOUISVILLE DIVISION
CIVIL ACTION NO. 3:10-CV-74-H
(Electronically Filed)

SHAMROCK MARKETING, INC. PLAINTIFF

v.

BRIDGESTONE BANDAG, LLC DEFENDANT

MEMORANDUM OF PLAINTIFF, SHAMROCK MARKETING, INC. IN RESPONSE TO MOTION TO DISMISS OF DEFENDANT BRIDGESTONE BANDAG, LLC

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Plaintiff, Shamrock Marketing, Inc ("Shamrock"), respectfully submits this Memorandum in Response to the Motion to Dismiss of Defendant, Bridgestone Bandag, LLC ("Bandag").

INTRODUCTION

Shamrock's Complaint alleges that Bandag has violated the antitrust laws by engaging in a unlawful tying arrangement. The Complaint contains four Counts alleging that the tying arrangement violates Section 1 of the Sherman Act, 15 U.S.C. §1, under both a *per se* and Rule of Reason analysis, as well as Section 2 of the Sherman Act, 15 U.S.C. §2, as an act of monopolization.

Bandag contends that Shamrock's Complaint fails to state a claim for relief under Fed.R.Civ.P., Rule 12(b)(6), "[u]nder the standard of review articulated in *Bell Atlantic Corp. v. Trombly*, 550 U.S. 544 (2007)" (Bridgestone Bandag, LLC's Memorandum In Support of Its Motion to Dismiss at 9-10, hereinafter "Bandag Memorandum"). While so contending, Bandag acknowledges that this Court has held that "*Twombly* is best read as clarifying notice pleading" (Bandag Memorandum at 10, citing *Churchill Downs, Inc. v. Thoroughbred Horsemen's Group, LLC*, 605 F. Supp. 2d 870, 886 n. 23 (W.D. Ky. 2009). Bandag also cites the sentence from *Churchill Downs*, stating: "Under *Twombly*, pleading a §1 violation cannot merely recite the elements of the cause of action, one must provide facts that support them" (Bandag Memorandum at 10, citing *Churchill Downs*, *supra* at 887).

However, Bandag fails to quote the very next sentence from *Churchill Downs* which states: "Those factual allegations however, need not be detailed to survive a motion to dismiss." *Churchill Downs, supra*, at 887. This Court in *Churchill Downs* went on to explain what it regarded as the correct approach to a motion to dismiss antitrust claims in view of *Twombly*:

> The parties' *Twombly* arguments center on whether Plaintiffs have alleged an actual violation. The Court's analysis as to the existence of an antitrust cause of action is limited to only a determination that such a finding is plausible. Certainly if the complaint supports a finding of a *per se* violation such a finding would be plausible. If the complaint does not provide facts supporting a *per se* violation, the complaint must only provide sufficient facts to make finding a violation under a rule of reason analysis plausible. Full analysis under the rule of reason would not be appropriate at this time given the fact intensive nature of that analysis. The Court will proceed with its analysis under *Twombly* by assessing whether Plaintiffs have pleaded facts that support the elements of an antitrust violation.
>
> ...
>
> Facts that make Plaintiffs' theory plausible, even though not conclusive, would meet the *Twombly* pleading standard.

Churchill Downs, supra, at 887.

Applying this Court's approach in *Churchill Downs* to the Complaint in this action requires that Bandag's Motion to Dismiss be denied. As the Court said in *Churchill Downs*, its "analysis as to the existence of an antitrust cause of action is limited to only a determination that such a finding is plausible." *Id*. When Shamrock's Complaint is subjected to that sort of analysis it is more than clear that sufficient facts have been pleaded to make the antitrust claims asserted "plausible." For the reasons that follow, the Court should reject Bandag's contentions to the contrary and deny its Motion to Dismiss in its entirety.

STATEMENT OF FACTS

Inasmuch as Bandag attacks the sufficiency of the allegations of the Complaint to state a claim for relief under Fed.R.Civ.P., Rule 12(b)(6), it is appropriate to review the allegations of the Complaint. Such a review demonstrates that they are sufficient to state the antitrust claims asserted.

The Parties

Shamrock is a family-owned Kentucky corporation which is located in Louisville. It is engaged in the business of supplying "curing envelopes" and other "accessories" to tire retreading shops (Complaint, ¶1).

Bandag is a franchisor of a "proprietary process for the retreading of tires primarily for trucks, buses, and light commercial trucks" (Complaint ¶2 (quoting Bandag's 2006 10-k filed with Securities and Exchange Commission)). As part of this business, Bandag sells to its franchisees "precured tread rubber and related products and equipment" used in its "proprietary process." *Id.* Bandag has over 300 franchisees in the United States who operate tire retreading shops under written franchise agreements (Complaint, ¶¶5, 6).

The "Bandag Process"

These franchisees utilize the "Bandag Process' for tire retreading (Complaint ¶7). The "Bandag Process" is known as a "precured" process because a strip of "precured" tread rubber containing the designed tread design is bonded to the "casing" of a used tire to create a retreaded tire (Complaint, ¶¶8, 9). The used tire is first "buffed" to remove any remaining tread, thus leaving a "casing" suitable for retreading (Complaint, ¶10). After "buffing," an uncured "bonding layer" (or "cushion gum") is applied to the "casing," and the "precured" tread rubber with the desired tread design is applied on top of the "bonding layer" (or "cushion gum") (Complaint, ¶¶11, 12).

At this point, the assembled "casing," uncured "bonding layer" (or "cushion gum"), and "precured" tread rubber, are enclosed in a "curing envelope" made of elastic rubber (Complaint ¶13). The "curing envelope" is sealed and the air inside it is removed to create a vacuum, which has the effect of applying consistent pressure to the "precured" tread rubber, "casing" and uncured "bonding layer" (or "cushion gum") (Complaint, ¶14). After enclosure in the "curing envelope," the entire assembly is placed in an autoclave that has the correct heat and pressure to cause the uncured "bonding layer" (or "cushion gum") to "cure" (or "vulcanize"), which has the effect of permanently affixing the "precured" tread rubber to the "casing" (Complaint, ¶15). When "curing" of the "bonding layer" (or "cushion gum") is complete, the "curing envelope" and its contents are removed from the autoclave, the "curing envelope" is removed, and the result is a retreaded tire ready for use (Complaint, ¶16). "Curing envelopes" are reusable and it is possible for a tire retreading shop to reuse a single "curing envelope" to retread over 200 tires (Complaint, ¶17).

The Franchise Agreement

Bandag's franchise agreement requires the franchisee to purchase all of their "precured" tread rubber from Bandag (Complaint, ¶18). In contrast, the franchise agreement does not require that the franchisees purchase "curing envelopes" from Bandag (Complaint, ¶19). The same is true of other items commonly referred to as "accessories." *Id*. Accordingly, prior to the events forming the basis for this litigation, Bandag franchisees bought "curing envelopes" and "accessories" from suppliers other than Bandag. Shamrock was among the other suppliers of "curing envelopes" and "accessories" from which Bandag franchisees bought these items (Complaint, ¶21).

The "Q-Fund"

This instantly changed on December 4, 2007. On that date, Bandag instituted a significant price increase on the "precured" tread rubber franchisees are required to purchase from Bandag (Complaint, ¶22). Simultaneously, Bandag instituted what it denominated the "Q-Fund" (Complaint, ¶23). Significantly, Bandag franchisees were not given any choice as to whether or not they would participate in the "Q-Fund" (Complaint, ¶24). Instead, under the involuntary terms of the "Q-Fund," a "Q-Fund" account is created for each franchisee (Complaint, ¶25). This "Q-Fund" account is automatically credited with $0.05 per pound of the "precured" tread rubber which the franchisee is required to buy from Bandag. *Id*. This "credit" to the Q-Fund" account is not available to the franchisee in cash (Complaint, ¶26). Instead, it may only be "spent" by applying it to the purchase of "curing envelopes" and certain other designated "accessories" from Bandag. *Id*. Significantly, if the franchisee does not use the "credit" to the "Q-Fund" within 18 months, it is lost. *Id*.

The "Q-Fund's" Economic Coercion

The effect of the "Q-Fund" was to economically coerce Bandag franchisees to purchase "curing envelopes" and the designated "accessories" from Bandag rather than suppliers such as Shamrock. Bandag franchisees are contractually bound to buy their "precured" tread rubber from Bandag. As noted above, at the same time it started the "Q-Fund" on December 4, 2007, Bandag significantly raised the price of "precured" tread rubber to its franchisees. Accordingly, the Bandag franchisees are actually paying the $0.05 per pound of tread rubber into their "Q-Fund" accounts as part of the significant

December 4, 2007 price increase on “precured” tread rubber (Complaint, ¶27). Because they have paid that $0.05 per pound and will lose it if not used in 18 months, the Bandag franchisees are economically coerced to agree to apply the $0.05 per pound of tread rubber “credit” in their “Q-Fund” accounts to acquire “curing envelopes” and other designated “accessories” from Bandag (Complaint, ¶28). The economic coercion not only results from the loss of the already-paid $0.05 per pound if not used in 18 months, but also from the fact that the quantity of tread rubber purchased by franchisees results in a “Q-Fund” credit sufficient to totally or nearly totally offset Bandag’s price for “curing envelopes” and other designated “accessories” (Complaint, ¶29). In short, the significant raise in the price of “precured” tread rubber on December 4, 2007 coupled with the ability to use part of that price increase to buy “curing envelopes” and designated “accessories” from Bandag was, in essence, a forcing of Bandag franchisees to pre-pay for “curing envelopes” and designated “accessories” to be acquired from Bandag.

<u>The “Q-Fund’s” Anti-Competitive Effect</u>

The economic coercion resulting from the above-described structure of the “Q-Fund” has had the anti-competitive effect of excluding competing sellers of “curing envelopes” and designated “accessories” from selling to Bandag franchisees (Complaint, ¶30). Prior to institution of the “Q-Fund,” Shamrock was one such supplier to Bandag franchisees (Complaint, ¶31). After institution of the “Q-Fund” on December 4, 2007, Shamrock’s sales of “curing envelopes” to Bandag franchisees immediately began falling and have dropped by approximately 90% (Complaint, ¶33). Inasmuch as Shamrock’s prices for its “curing envelopes” were and are below Bandag’s prices for its “curing envelopes,” the cause for Shamrock’s immediate and large decline in sales of “curing envelopes” can only be attributed to Bandag’s institution of the “Q-Fund” (Complaint,

¶34). Otherwise, absent the financial need to use up their coerced credits in the "Q-Fund," the franchisees would obviously buy from less expensive vendors such as Shamrock. The result has been that Shamrock has been damaged in its business and property in that it has lost profits on sales it had been making, and would have continued to make, to Bandag franchisees of "curing envelopes" and designated "accessories," and the value of Shamrock's business has severely declined (Complaint, ¶ 35).

Count One

The Complaint alleges that the "Q-Fund" as described above violates federal antitrust law. Count One alleges that the "Q-Fund" constitutes a tying arrangement in *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. §1 (Complaint, ¶37). The relevant geographic market is alleged to be the United States. The tying product is alleged to be "precured" tread rubber which Bandag franchisees are required to purchase from Bandag under the franchise agreements (Complaint, ¶39). The relevant market for this tying product of "precured" tread rubber is for the sale of that product to Bandag franchisees (Complaint, ¶41). That is the appropriate relevant market not only because Bandag franchisees are required by the franchise agreement to purchase all tread rubber from Bandag, but also because Bandag franchisees are "locked-in" to Bandag because the costs of switching to another tire retreading system are excessive compared to the added costs of the "Q-Fund" (Complaint, ¶41). Accordingly, Bandag has 100% of the market for the tying product of "precured" tread rubber, and consequently has economic and market power over that tying product (Complaint, ¶42). The tied products are "curing envelopes" and designated "accessories" (Complaint, ¶40). Bandag's establishment of the "Q-Fund" is an unlawful exercise of this economic and market power over the tying product of "precured" tread rubber to restrain trade in the market for the tied products of "curing envelopes" and designated "accessories" (Complaint, ¶43). In addition, the required not insubstantial amount of interstate commerce in the market for the tied products is present inasmuch as millions of dollars of the tied products of "curing envelopes" and designated "accessories" are affected (Complaint, ¶44).

Count Two

Count Two of the Complaint also alleges a tying arrangement in *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. §1. Count Two asserts an alternate theory that even if the relevant market for the tying product of "precured" tread rubber is not limited to sales to Bandag franchisees on a "lock-in" theory, Bandag's market share of the overall market for sales of "precured" tread rubber is still sufficient to infer the economic and market power over that tying product to support a *per se* tying violation (Complaint, ¶48). Bandag possesses approximately 50% of the overall market for the sale of the tying product of "precured" tread rubber, thus giving it the required economic or market power over the tying product. As in the case of Count One, Bandag has unlawfully exercised that economic and market power over the tying product of "precured" tread rubber to restrain trade in the tied products of "curing envelopes" and designated "accessories" (Complaint, ¶49).

Count Three

Count Three of the Complaint alleges that under both of the approaches to market definition of the tying product stated in Counts One and Two, even if the aspects of the "Q-Fund" complained of are not *per se* violation of 15 U.S.C. §1, there are still violations of that statute under a Rule of Reason analysis (Complaint ¶53). Accordingly, Count Three alleges that the actions of Bandag associated with the "Q-Fund" have unreasonably restrained trade in the market for the sale of "curing envelopes" and other designated "accessories" in that they have excluded Shamrock and other suppliers from sales of these products to Bandag franchisees, and the resulting costs to Bandag franchisees for these items have been increased (Complaint ¶54).

Count Four

Count Four of the Complaint alleges that the aspects of the "Q-Fund" complained of constitute monopolization in violation of Section 2 of the Sherman Act, 15 U.S.C. §2. Count Four incorporates the "lock-in" theory of Count One under which Bandag possesses 100% of the market for the sale of "precured" tread rubber because the market definition is limited to sales of that product to Bandag franchisees. Having 100% of the relevant market, Bandag has monopoly power over that relevant market and the aspects of the "Q-Fund" complained of have been willful and unlawful exercises of Bandag's monopoly power over "precured" tread rubber which have had exclusionary and anti-competitive effects with respect to sales of "curing envelopes" and designated "accessories" (Complaint ¶¶57, 58). This willful and unlawful exercise of monopoly power over "precured" tread rubber has excluded Shamrock and other suppliers of "curing envelopes" and designated "accessories" from sales of those items to Bandag franchisees (Complaint, ¶59).

ARGUMENT

According to Bandag, Shamrock's Complaint should be dismissed because it "fails to state a claim for antitrust relief under the standard of review articulated in *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007)" (Bandag Memorandum at 9-10). In so contending, Bandag acknowledges, however, that this Court has stated that "*Twombly* is best read as clarifying notice pleading," citing *Churchill Downs, Inc. v. Thoroughbred*

Horsemen's Group, LLC, 605 F.Supp. 2d 870, 886, n. 23 (W.D. Ky. 2009) (Bandag Memorandum at 10).

In *Churchill Downs*, this Court explained the Sixth Circuit's interpretation of *Twombly* as follows:

> Since *Twombly* expressly disavowed the previous pleading standard set forth in *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957) courts have wrestled with its appropriate application. The Sixth Circuit has only addressed the issue of *Twombly's* pleading standard and antitrust litigation in a handful of decisions. Those decisions do not suggest a departure from the concept of notice pleading, but instead suggest that *Twombly* is best read as clarifying notice pleading. *See e.g., Bassett v. Nat'l Collegiate Athletic Ass'n,* 528 F.3d 426, 430 (6th Cir. 2008) (stating *Twombly* does not require heightened fact pleading); *Ferron v. Zoomego, Inc.*, 276 Fed.Appx. 473, 475-76 (6th Cir. 2008); *Mich. Div.-Monument Builders of North America v. Mich. Cemetery Assoc.*, 524 F.3d 726, 731 (6th Cir. 2008).

Churchill Downs, 605 F. Supp. at 886, n. 23.

In *Churchill Downs*, this Court also summarized *Twombly* in the following terms:

> *Twombly* requires that "a plaintiff's allegations, [while] 'assumed to be true, must do more than create speculation or suspicion of a legally cognizable cause of action; they must show entitlement to relief.' " *League of United Latin Am. Citizens v. Bredesen*, 500 F.3d 523, 527 (6th Cir. 2007). *Twombly* established that antitrust complaints are held to a "plausibility standard," which requires Plaintiffs plead "enough facts to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." *Id.* at 1965.
>
> Under *Twombly,* pleading a § 1 violation cannot merely recite the elements of the cause of action, one must provide facts that support them. *Twombly,* 127 S.Ct. at 1965. Those factual allegations, however, need not be detailed to survive a motion to dismiss. *Id.* at 1964. "[E]ither direct or inferential allegations respecting all the material elements to sustain recovery under some viable legal theory" is sufficient. *Bredesen,* 500 F.3d at 527 (citing *Twombly,* 127 S.Ct. at 1969). A bare assertion of a conspiracy, however, is insufficient. *Twombly,* 127 S.Ct. at 1966. The facts must give rise to a plausible finding of an agreement that unreasonably restrains trade.

Id. 886-87.

A review of Shamrock's Complaint reveals that it clearly satisfies the "plausibility standard" of *Twombly* recognized by this Court in *Churchill Downs*. At the outset, it is worth noting that unlike *Twombly*, this is not a case alleging a horizontal price fixing conspiracy. In *Twombly* the only facts alleged as supporting the "conspiracy" were "parallel" activity by the allegedly conspiring defendants. Because "parallel" activity can be explained by other entirely legal actions, the Court held that merely alleging "parallel" activities did not "plausibly" establish allegations of "conspiracy" among the defendants sufficient to survive a motion to dismiss. *Twombly*, 550 U.S. at 556-57 ("Without more parallel conduct does not suggest a conspiracy . . ."). In contrast, Shamrock does not allege a horizontal price fixing conspiracy, but instead a tying arrangement. It has alleged "facts that support" that violation and make it "plausible." Accordingly Bandag's assertion that the pleading standards of *Twombly* have not been satisfied are without merit.

I. <u>SHAMROCK HAS ANTITRUST STANDING.</u>

Bandag's initial argument is that Shamrock does not have standing to pursue its antitrust claims. However, it is evident that this argument is wholly without merit. As Bandag concedes elsewhere in its brief, "Shamrock competes with Bandag in the sale of envelopes and other retreading accessories" (Bandag Memorandum at 9). These are the allegedly tied products. It is evident from an application of the standing principles this Court recognized in *Churchill Downs* that as a competitor in the market for the tied products Shamrock has standing to pursue a claim for a tying violation.

With respect to standing, in *Churchill Downs* this Court stated that:

> The Sixth Circuit requires the plaintiff show "(1) that the alleged violation tends to reduce competition in some market and (2) that the plaintiff's injury would result from a decrease in that competition rather than from

> some other consequence of the defendant's actions." *Tennessean Truckstop, Inc. v. NTS, Inc.,* 875 F.2d 86, 88 (6th Cir.1989).

Churchill Downs, 605 F. Supp. 2d at 879.

There can be no doubt that both of these aspects of standing are met, when, as here, a competitor in the market for the tied product is challenging a tying arrangement. Clearly, the first element "that the alleged violation tends to reduce competition in some market" is satisfied. Shamrock specifically alleges that prior to the institution of the Q-Fund, "Bandag franchisees bought 'curing envelopes' and 'accessories' from suppliers other than Bandag" and that "Shamrock was among the other suppliers of 'curing envelopes' and 'accessories' from which Bandag franchisees purchased these items" (Complaint, ¶¶20, 21, p. 4). The Complaint also expressly alleges that the competition in the market for these tied products has been reduced: "For competing sellers of 'curing envelopes' and other 'Q-Fund'-designated 'accessories,' the above-described structure and resulting coercive effect of the 'Q-Fund' has had the anti-competitive effect of excluding them from selling their competing 'curing envelopes' and other 'Q-Fund'-designated 'accessories' to Bandag franchisees" (Complaint ¶30, pp. 5-6). The Complaint clearly alleges a "reduction in competition" in the market for the tied products thus satisfying the first element of Shamrock's antitrust standing.

The second element stated in *Churchill Downs* is also plainly satisfied. That requirement is that the "plaintiff's injury would result from a decrease in that competition rather than from some other consequence of the defendant's actions" *Churchill Downs* 605 F.Supp. 2d at 879. In *Churchill Downs* this Court noted that the Sixth Circuit had stated in *In Re Cardizen CD Antitrust Litigation*, 332 F.3d 896, 914 (6th Cir. 2003) that "dismissal is warranted only where it is apparent from the allegations in the complaints that the plaintiffs' injury would have occurred even if there had been no antitrust violation." *Churchill Downs*, 605 F. Supp. 2d at 880. That clearly is not the case here. Shamrock's injury is alleged to be the loss of profits on sales of "curing envelopes" and "accessories" it had been making and would have continued to make to Bandag franchisees but for Bandag's institution of the "Q-Fund's" tying arrangement (Complaint, ¶35). Shamrock's Complaint specifically alleges that "the cause of the immediate and large decline of Shamrock's sales of 'curing envelopes' can only be attributed to Bandag's institution of the 'Q-Fund' inasmuch as Shamrock's prices for its 'curing envelopes' were below Bandag's prices for its 'curing envelopes'" (Complaint, ¶34). Clearly, in view of these allegations it cannot be said that Shamrock's "injury would have occurred even if there had been no antitrust violation."

Shamrock's Complaint meets both of the requirements for antitrust standing contained in this Court's opinion in *Churchill Downs*. The contention of Bandag that Shamrock does not have standing to assert its antitrust claims as a competitor in the market for the tied products who has been injured by Bandag's illegal tying arrangement should be rejected.[1]

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[1] At the conclusion of its standing argument, Bandag includes a paragraph which appears to be directed toward establishing that the "Q-Fund" is not an illegal tying arrangement. However, as this Court indicated in *Churchill Downs*: "To address standing, the Court assumes that an antitrust violation occurred and then determines whether Plaintiffs are 'person[s] injured by reason of a violation of the antitrust laws.'" *Churchill Downs*, 605 F. Supp. At 879.

II. IN COUNTS I, III AND IV, THE RELEVANT MARKET FOR THE TYING PRODUCT IS PLAUSIBLY ALLEGED TO BE THAT FOR SALE OF PRECURED TREAD RUBBER TO BANDAG FRANCHISEES.

According to its own description of why Shamrock's Complaint fails to state a claim for relief, Bandag first asserts that Shamrock "has failed to meet its threshold obligation to define a plausible relevant market" (Bandag Memorandum at 15). After much preliminary discussion of the elements of tying arrangements and other principles of antitrust law (Bandag Memorandum at 15-19), Plaintiff's finally address their contention that in Counts 1 and 4 of the Complaint, "Plaintiff's single brand market definition improperly conflates 'contract power' with 'market power'" (Bandag Memorandum at 19).[2] Relying primarily upon the Third Circuit's opinion in *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430 (3rd Cir. 1997), Bandag asserts that "Bandag franchisees have voluntarily and contractually bound themselves to purchase tread rubber from Bandag, but, as decided in *Queen City* and elsewhere, such a requirement does not constitute a relevant market for antitrust purposes" (Bandag Memorandum at 22-23).

Bandag then attempts to argue that this is so despite the allegations of paragraph 41 of the Complaint that Bandag franchisees are "locked-in" to purchasing tread rubber from Bandag "because the costs of switching to another tire retreading system are excessive compared to the added costs of the "Q-Fund" (Complaint ¶41; Bandag Memorandum at 23). Correctly, Bandag recognizes that Shamrock contends that this

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[2] Bandag does not address Count III, which incorporates the tying market definitions of Counts I and II and alleges a Rule of Reason violation even if a *per se* violation is not present (Complaint ¶¶52-55).

case is appropriate for application of the "lock-in" theory recognized by the Supreme Court in *Eastman Kodak v. Image Technical Services, Inc.*, 504 U.S. 451 (1992) (Bandag Memorandum at 23, *et seq.*). Incorrectly, however, Bandag asserts that a "lock-in" theory for defining the relevant market for the tying product of tread rubber is not appropriate here.

In *Kodak*, the Supreme Court recognized that a single brand may constitute the market for the tying product when the customer is "locked in" after its initial purchase. Such "locking in" occurs when the costs of switching to another brand are high. *Kodak* at 476-77. If, after the customers are so "locked in," the seller changes its policies to establish a tying arrangement, the market for the tying product may be limited to the single brand of the seller and the seller may be deemed to have the required market power to impose an unlawful tie under Section 1. *Kodak* at 476-77. The *Kodak* Court stated:

> We conclude, then, that Kodak has failed to demonstrate that respondents' inference of market power in the service and parts markets is unreasonable, and that, consequently, Kodak is entitled to summary judgment. It is clearly reasonable to infer that Kodak has market power to raise prices and drive out competition in the aftermarkets, since respondents offer direct evidence that Kodak did so. It is also plausible, as discussed above, to infer that Kodak chose to gain immediate profits by exerting that market power where locked-in customers, high information costs, and discriminatory pricing limited and perhaps eliminated any long-term loss. Viewing the evidence in the light most favorable to respondents, their allegations of market power "mak[e] ... economic sense."

Kodak at 477-78.

According to Bandag, a *Kodak* "lock in" theory is not appropriate because, as in *Queen City*, Bandag franchisees were in "a position at the commencement of the franchise to assess the 'potential costs and economic risks' of the relationship" (Bandag Memorandum at 25). In *Queen City*, however, the franchisee agreement provided that Domino's "may in our sole discretion require that ingredients, supplies and materials used in the preparation, packaging and delivery of pizza be purchased **exclusively** from us or from approved suppliers or distributors." *Queen City*, 124 F.3d at 433 (emphasis added). Consequently, potential Domino's franchisees were advised before becoming franchisees that Domino's had the right to require that "ingredients, supplies and materials" be purchased "exclusively" from Domino's and consequently they could at the outset evaluate the "potential costs and economic risks" of becoming a Domino's franchisee versus becoming a franchisee of another pizza chain. In short, there was no "change in policy," like the imposition of the "Q-Fund," after the franchisees were "locked in." *PSI Repair Servs., Inc. v. Honeywell, Inc.*, 104 F.3d 811, 820 (6th Cir. 1997).[3]

While Bandag attempts to say that the same type of "exclusivity" disclosure was made in the Bandag franchise agreement and disclosure statement, that simply is not the case. Bandag cites to ¶7.6 of its Franchise Agreement (Bandag Memorandum, p. 24). Significantly, it does not quote that paragraph, which reads:

> 7.6 **Product Purchase Requirements**. If certain tire retreading equipment or machinery is a specific requirement for use in the Process, as specified in the Manual(s) for the Dealership, then you agree to purchase or lease it from us. We will sell to you, and you agree to purchase from us, your entire requirements of Materials for use in the Process. Prices are subject to change. All other supplies, equipment, inventory and fixtures

[3] This lack of a "change of policy" also distinguishes the other cases Bandag string cites at pages 21 and 22 of its Memorandum. *Schlotzky's Ltd. v. Sterling Purchasing and National Distribution Co., Inc.*, 520 F.2d 393, 407 (5th Cir. 2008); *Ric-Mik Enterprises Inc. v. Equilon Enterprises, LLC*, 532 F.3d 963, 968 (9th Cir. 2008); *Sheridan v. Marathon Petroleum Company LLC*, 530 F.3d 590, 592 (7th Cir. 2008); *Roy B. Taylor Sales, Inc. v. Hollymatic Corporation*, 28 F.3d 1379, 1381 (5th Cir. 1994); *Maris Distributing Company v. Anheuser-Busch, Inc.*, 302 F.3d 1207, 1222 (11th Cir. 2002); *United Farmers Agents Association, Inc. v. Farmers Insurance Exchange*, 89 F.3d 233, 238 (5th Cir. 1996); *Siemer v. Quizno's Franchise Company LLC*, 2008 WL 904874 (N.D. Ill. 2008) at *11.

> for use in the Process must comply with requirements prescribed periodically in the Manual(s).

Bandag Franchise Agreement, ¶7.6, p. 9; Ex. 3 to Bandag Memorandum. The capitalized term "Materials" is defined in ¶1 of the Franchise Agreement as "Bandag tread, cushion gum, repair gum, repairs (patches) and certain other proprietary materials we make or distribute, including certain equipment used in the Process." *Id*. at p. 1. There is nothing in this paragraph which in any way indicates that "curing envelopes" and "accessories" must, as in *Queen City*, be purchased "exclusively" from Bandag. That the provision was interpreted in that fashion is confirmed by the fact that, until the institution of the "Q-Fund," Bandag franchisees had purchased these "curing envelopes" and "accessories" from a variety of suppliers, including Shamrock (Complaint, ¶¶19, 20, and 21). Indeed, Bandag states in its Memorandum that "envelopes are not included among the 'Materials' which franchisees must purchase from Bandag under the terms of the Franchise Agreement" (Bandag Memorandum, n. 8, at p. 6).

Bandag also points to Section 8 of the "Franchise Disclosure Document" to support its assertion that this case is analogous to *Queen City's* "exclusive" disclosure to prospective franchisees (Bandag Memorandum at 24). However, again Bandag neglects to quote from Section 8 of the "Franchise Disclosure Document." Bandag summarizes Section 8 as reserving the "right for Bandag to require franchisees to purchase other supplies, equipment and inventory meeting standards and specifications determined by Bandag" (Bandag Memorandum at 24). However, reserving a right to meet "standards and specifications" set by Bandag is a far cry from the disclosure of "exclusivity" involved in *Queen City*. Bandag's argument based on the "Franchise Disclosure Document" accordingly fails.

The recent analysis of the Court in *Burda v. Wendy's International, Inc.*, 659 F.Supp. 2d 928 (S.D. Ohio 2009) is directly on point and persuasive. In *Burda*, the Court quoted the following language from Wendy's franchise agreement:

> Franchisee shall purchase all food items, ingredients, supplies, materials, and other products used or offered for sale at the Restaurant solely from suppliers . . . who demonstrate, to the continuing reasonable satisfaction of Franchisor, the ability to meet Franchisor's then-current standards and specifications for such items; who possess adequate quality controls and capacity to supply Franchisee's needs promptly and reliably; and who have been approved in writing by Franchisor prior to any purchases by Franchisee from any such supplier, and have not thereafter been disapproved. If Franchisee desires to purchase any products from an unapproved supplier, Franchisee shall submit to Franchisor a written request for such approval. Franchisee shall not purchase from ay supplier until, and unless, such supplier has been approved in writing by Franchisor.

Burda, 659 F. Supp. 2d at 935. The Court held that there was "no language in this section that would put a potential franchisee on notice that [Wendy's] would be able to eliminate all competition by naming an exclusive supplier . . .". *Id*. The Court went on to state that "[i]nstead that language suggests that supplier competition was welcome so long as prospective suppliers met [Wendy's] 'standards and specification,' and 'possess[ed] adequate quality controls and capacity to supply Franchisee's needs' . . .". *Id*. 935-36. Finally, the Court pointed out that "[i]ndeed, Plaintiffs have alleged that the market for the tied products – the buns and food supplies – was competitive prior to the alleged tie." *Id*. at 936. Accordingly, the Court held that allegations of the naming of an exclusive supplier would "satisfy the 'change of policy' requirement" for a *Kodak* "lock in" theory. *Id*.

In *Burda*, Wendy's, citing and quoting *Queen City*, also argued that where "the defendants' 'power' to 'force' the plaintiffs to purchase the alleged tying product stems not from the market, but from the plaintiffs' contractual agreement to purchase the tying product, no claims will lie." *Id*. at 936. The same argument is made here that Shamrock has "conflate[d] 'contract power' with 'market power'" (Bandag Memorandum at 19-23). The *Burda* court rejected this argument:

> Defendants' arguments miss the mark. As set forth in the foregoing section, the Court finds that Plaintiffs have adequately plead market power under a *Kodak* lock-in theory. To reach this conclusion, the Court found that UFA § 6.12 did not contain language putting a potential franchisee on notice that Defendants would be able eliminate all competition by naming an exclusive supplier or that they could impose a surcharge on approved suppliers, especially in light of the allegations that the market for these supplies was competitive prior to the alleged tie. This finding distinguishes the instant case from *Queen City Pizza, Inc.*, the case relied upon by Defendants.

Burda, 659 F. Supp. 2d at 936.

Significantly, in so holding the Court rejected Wendy's reliance on *Queen City* because of the above-quoted express provision of Domino's franchise agreement which allowed Domino's in its "sole discretion" to require that "ingredients, supplies and materials" be purchased "exclusively" from Domino's or "approved suppliers or distributors." On this point, the *Burda* court stated:

> Unlike the *Domino's* franchisees, Plaintiffs in the instant case are not claiming that market power was contractually established because UFA § 6.2 required them to purchase buns and food supplies from exclusive suppliers. Thus, *Queen City Pizza, Inc.* is inapposite and does not provide grounds for dismissal. Instead, as set forth above, Plaintiffs have asserted a *Kodak* type lock-in theory of market power, specifically alleging that at the time Burda entered into his franchise agreements, he could not have reasonably anticipated being required to purchase buns and food supplies from exclusive suppliers.

Burda, 659 F. Supp. 2d at 937.

Burda held that the Complaint before it sufficiently alleged the required "change of policy" under *Kodak* and therefore that "Plaintiffs have sufficiently plead an antitrust claim under a *Kodak* lock-in theory. . .". *Id*. at 936. The same sort of "change of policy" is evident from the allegations of the Complaint here with respect to Bandag's involuntary institution of the "Q-Fund" after the entry of franchise agreements (Complaint, ¶¶20-30). As in *Burda*, Shamrock has alleged that the market for "curing envelopes" and "accessories" was competitive "prior to the alleged tie" resulting from the "Q-Fund" (Complaint ¶20). As in *Burda*, this Court should hold that Shamrock has adequately alleged that the tying product market is that for sale of precured tread rubber to Bandag franchisees and that the institution of the "Q-Fund" was a "change of policy" under a *Kodak* "lock in" theory.

III. IN COUNTS II AND III, THE RELEVANT MARKET FOR THE TYING PRODUCT IS ALTERNATIVELY PLAUSIBLY ALLEGED TO BE THAT FOR THE SALE OF ALL PRECURED TREAD RUBBER.

As the above reflects, in Counts I, III, and IV, the market for the tying product is alleged to be that for sale of precured tread rubber to Bandag Franchisees. As an alternative to the *Kodak* "lock-in" theory, which supports a market for precured tread rubber limited to Bandag franchisees, Counts II and III contain allegations that, alternatively, the market for the tying product is that for the sale of precured tread to all purchasers (Complaint ¶¶47, 52). Using such a market for the tying product, Count II alleges that there is a *per se* violation of Section 1, while Count III alleges a Rule of Reason violation of Section 1.

Bandag never seriously deals with the allegations of Counts II and III, which are based on this broader definition of the market for the tying product of precured tread rubber. It is specifically alleged that "Bandag possesses approximately 50% of the market for the sale of the tying product – 'precured' tread rubber – to all purchasers, and, consequently, it has economic and market power over that tying product" (Complaint,

¶48). Bandag never denies this allegation, but instead attempts to deal with Counts II and III in the very brief footnote 16 of its Memorandum (Bandag Memorandum at 23).

Bandag deals with Count III first in its footnote 16. As to Count III, Bandag totally misses the mark when it contends that in "Count III, Plaintiff alleges that the relevant market is all envelopes and accessories listed on Q-Fund." While, as with all of Shamrock's tying claims, curing envelopes and accessories are the tied product, in Count III, as in the other Counts, the tying product is precured tread rubber. By incorporating by reference the allegations of Counts I and II, Count III alleges that whether the market for precured tread rubber consists of sales to Bandag franchisees (Count I) or to all purchasers (Count II), there is a tying arrangement which violates Section 1 under a Rule of Reason analysis (Complaint ¶¶52-53). Bandag never comes to terms with these allegations.[4]

After giving Count III such abbreviated treatment, Bandag's footnote 16 does the same with Count II. While footnote 16 correctly recognizes that Count II alleges a tying product market consisting of "all precured tread rubber" it then argues that it "competes with every company that produces replacement tires – whether such tires are retreads or new tires," and that "[a]ccordingly Defendant disagrees with the proposed market definition set forth in Count II" (Bandag Memorandum, fn 16, p. 23). Even if Bandag is correct about with whom it competes, something Shamrock does not concede, this does not render implausible Shamrock's proposed market definition of the tying product as being that for sale of precured tread rubber to all purchasers. Bandag has offered no

[4] Bandag's footnote 16 does contend that "as explained below" the "curing envelopes" and "accessories" are not "reasonably interchangeable" and therefore "not a valid market." Shamrock deals with this contention, *infra*, p. 24.

rational reason to support its conclusory statement in footnote 16 to the contrary. The Court should, consequently, reject Bandag's summary contention that a relevant market for the tying product consisting of sales to all purchasers is not plausible.[5]

IV. THE COMPLAINT SUFFICIENTLY ALLEGES THAT BANDAG HAS ECONOMICALLY COERCED ITS FRANCHISEES TO PURCHASE THE TIED PRODUCT.

According to Bandag,

> Absent coercion, there can be no tying. Bandag has never forced or coerced its franchisees to purchase the tied product. The Bandag franchisees are free to purchase curing envelopes or other Q-Fund products from Shamrock or any other manufacturer.

Bandag Memorandum at 29. According to Bandag: "Plaintiffs' failure to allege a single fact supporting the conclusory allegation of coercion is fatal." *Id*. at 28.

A review of Shamrock's Complaint reveals that this assertion of Bandag is not valid. The Complaint does indeed allege specific facts with respect to how the "Q-Fund" does economically coerce Bandag franchisees into purchasing the tied products of "curing envelopes" and "accessories" from Bandag. The Complaint specifically alleges that "Bandag franchisees had no choice over whether or not they would participate in the Q-Fund" (Complaint, ¶24). The price of the tying product – tread rubber – was increased significantly and a portion of that increase was involuntarily "credited" to the franchisee's "Q-Fund" account (Complaint, ¶¶22-24). Significantly, the franchisee could not take the "Q-Fund" credit in cash by electing to simply have the price of the tread

[5] Bandag's footnote 16 also says that "even of Count II's market definition were plausible, Count II should be dismissed because Shamrock "lacks standing" and the "elements of conditioning or coercion" are not "adequately pleaded" (Bandag Memorandum, fn 16, p. 23). Shamrock has dealt with standing, *supra*, p. 11, *et seq.*, and deals with Bandag's contention regarding "conditioning or coercion" in the next section of this Memorandum.

rubber reduced by the amount of the "Q-Fund" portion of the increase in the price of tread rubber (Complaint, ¶26). To the contrary, the franchisee can only "spend" the involuntarily paid "Q-Fund" credit by applying it solely to the purchase of "curing envelopes" and "Q-Fund" designated "accessories" from Bandag. *Id*. Significantly, if the "Q-fund" credit already paid by the franchisee is not so spent within a designated time it is lost. *Id.*

In effect, by increasing the price of tread rubber, and then crediting the franchisee's "Q-Fund" with a portion of the increase which can only be "spent" on "curing" envelopes" and "Q-Fund" designated "accessories," Bandag has forced its franchisees to pre-pay all or a significant part of the price for acquiring "curing envelopes" and "Q-Fund"-designated "accessories" from Bandag. Having already involuntarily prepaid all or a significant part of the price of these items to Bandag, the franchisees are unquestionably economically coerced into purchasing these items from Bandag rather than another supplier, such as Shamrock. These facts are specifically alleged in paragraphs 27, 28 and 29 of the Complaint:

> 27. Because a Bandag franchisee (1) must purchase all of its "precured" tread rubber from Bandag; and (2) Bandag simultaneously increased the price of its "precured" tread rubber at the time of introduction of the "Q-Fund," Bandag franchisees have paid to Bandag the $0.05 per pound of "precured" tread rubber "credit" to their "Q-Fund" account.
>
> 28. Because they have so paid the $0.05 per pound of tread rubber "credit" into their "Q-Fund" accounts, and they will lose that "credit" if it is not utilized in a specified time period, the Bandag franchisees are economically coerced to agree to apply the $0.05 per pound of tread rubber "credit" in their "Q-Fund" accounts to acquire "curing envelopes" and other "Q-Fund"-designated "accessories" from Bandag.
>
> 29. The economic coercion also results from the facts that the $0.05 per pound of tread rubber has already been paid in full by franchisees by Bandag's raise in the price of the required purchases of "precured" tread rubber, and due to the quantity of "precured" tread rubber purchased by

> franchisees, it is sufficient to totally or nearly totally offset Bandag's price for "curing envelopes" and other "Q-Fund"-designated accessories.

In view of these allegations, Bandag's assertion is invalid that Shamrock has "fail[ed] to allege a single fact supporting the conclusory allegation of coercion is fatal" (Bandag Memorandum, p. 28). Shamrock's Complaint spells out with more than sufficient detail how Bandag's "Q-Fund" has operated to economically coerce franchisees into buying the tied products from Bandag rather than Shamrock and other suppliers. Bandag's contention to the contrary should be rejected.

V. BANDAG'S OTHER CONTENTIONS ARE INSUFFICIENT TO SUPPORT DISMISSAL OF THE COMPLAINT.

While the contentions addressed above are the principal arguments Bandag raises to support its claim that dismissal of the Complaint under Rule 12(b)(6) is appropriate, it also appears to rely somewhat on two other contentions. First, that "Plaintiffs putative market of 'curing envelopes' and 'other Q-Fund' designated 'accessories' is flawed," and second, that "Plaintiff has failed to allege two separate products" (Bandag Memorandum, pp. 25-26, 30-31). Neither of these contentions will support dismissal of the Complaint.

As noted, the first contention is that the market for the tied products of "curing envelopes" and other Q-Fund designated "accessories" is "flawed." According to Bandag, "these Q-Fund-approved products clearly belong to different markets – they are not reasonably interchangeable with each other and they are not substitutes from each other" (Bandag Memorandum at 26). Bandag's argument misses the point that "curing envelopes" and "accessories" are alleged to be the tied products that the Q-Fund forces franchisees to buy from Bandag. There is no requirement in tying law that there be only one tied product, and Bandag points to no authority for such a proposition. Yet Bandag takes the position that the tied products must all be "reasonably interchangeable" with each other. In short, Bandag's imposition of such a "reasonably interchangeable" requirement for tied products would limit illegal tying to situations where there is only a single tied product. That is not and should not be the law. The Court should reject Bandag's argument of a requirement of "reasonable interchangeability" of all of the tied products.

Bandag's second contention is that "Plaintiff has failed to allege two separate products." According to Bandag the "tread rubber and envelopes are not two distinct products, but instead, components of one unified product – retread tires" (Bandag Memorandum at 31). However, Bandag quotes the following from the Sixth Circuit's decision in *PSI Repair Services Inc. v. Honeywell, Inc.*, 104 F.3d 811, 817 (6^{th} Cir. 1997): ". . . [t]he Sherman Act is not triggered merely by the presence of component parts, but only when there is sufficient demand for these parts such that it would be efficient for a firm to provide them separately" (Bandag Memorandum at 30). Of course, this is true here because Shamrock and other suppliers provided "curing envelopes" and "accessories" without providing tread rubber. This alone is fatal to Bandag's contention that two separate products are not alleged. Furthermore, Bandag's contention that "curing envelopes" and "accessories" are "components" of retread tires is plainly in error. These items are reusable materials used in the manufacturing of retread tires. As such, they do not end up as part of the retreaded tire they are used to manufacture. They simply are not "components" of the retreaded tire and because that is the case they must be regarded as two separate products.

Bandag's contentions with respect to both of the above-addressed arguments are without merit. Accordingly, they do not support a dismissal of the Complaint.

CONCLUSION

For the reasons expressed above, each of Bandag's contentions that Shamrock's Complaint should be dismissed for failure to state a claim are without merit. Shamrock's Complaint clearly satisfies the *Twombly* requirement of pleading antitrust claims that are "plausible." The Court should deny Bandag's Motion to Dismiss in its entirety.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing has been served upon all counsel of record through the CM/ECF system if they are registered users, and, in addition to the following, by U.S. Mail, on this the 26th day of May, 2010:

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