UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF TEXAS

MARSHALL DIVISION

PSKS, Inc. d/b/a Kay's Kloset…Kay's Shoes; and Toni Cochran, L.L.C., d/b/a Toni's,

***Plaintiffs*,**

vs.

Leegin Creative Leather Products, Inc.,

***Defendant*.**

Civil Action No. 2-03CV-107-TJW

REPLY IN SUPPORT OF MOTION TO DISMISS

I. INTRODUCTION

PSKS opposes Brighton's motion to dismiss on three grounds: (1) that it need not plead market power to state a rule of reason violation; (2) that it has met the other pleading requirements for a rule of reason violation; and (3) that it need not plead a rule of reason violation in any event because the *per se* standard still applies. It fails in each of its arguments.

First, PSKS must allege market power. PSKS's assertion to the contrary flatly contradicts binding Supreme Court law. *Leegin Creative Leather Products, Inc. v. PSKS, Inc*., 127 S. Ct. 2705, 2712-13 (2007) (equating rule of reason with "an inquiry into market power and market structure").

Second, PSKS has failed to meet the other rule of reason pleading requirements. PSKS's two proposed relevant markets—a consumer market of Brighton-brand products and a wholesale market of brand-name accessories sold to independent retailers—both fail as a matter of law. Courts have consistently rejected single-brand markets, and PSKS cites no authority to the contrary. PSKS's proposed wholesale market is also inadequate; PSKS did not even bother to

argue that its arbitrary limitation to "independent retailers" or its improper grouping of "women's accessories" meets the operative standard for market definition. Likewise, plaintiff's allegations regarding anticompetitive effects are conclusory and fail to meet the *Twombly* pleading standard. *See Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007).

Finally, PSKS's efforts to shoehorn this case back under the per se rule fails. PSKS argues that the mandate rule should not bar its horizontal causes of action because the Supreme Court "pulled the rug out from under it." The Supreme Court did no such thing. The horizontal allegations it is now trying to make were equally available to it the first time around. PSKS chose not to make them. It cannot undo that choice now. Even if it could, its efforts fail as a matter of law. Dual distribution systems such as Brighton's, whether they involve pricing or other restraints, are judged under the rule of reason. And plaintiff has failed to adequately plead a retailer cartel conspiracy under *Twombly*.

II. ARGUMENT

A. PSKS Failed to Allege a Rule of Reason Violation.

1. PSKS has not adequately alleged market power or market definition.

Remarkably, PSKS argues first that it need not allege market power or define a plausible market. But the Supreme Court equated the rule of reason with an "inquiry into market power and market structure designed to assess a restraint's actual effect." *See, e.g.*, *Leegin*, 127 S. Ct. at 2713 (citation and internal brackets omitted). The Fifth Circuit has long held that "market power should be a preliminary hurdle in all restricted distribution (vertical restraint) cases." *Muenster Butane, Inc. v. The Stewart Co*., 651 F.2d 292, 298 (5th Cir. 1981) (citation omitted). Plaintiff is asking this Court to ignore binding precedent. The Supreme Court made clear that resale price maintenance must be analyzed just like other vertical restraints. *Leegin*, 127 S. Ct. at 2722. While the Supreme Court directed lower courts to "devise rules over time for offering

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proof or even presumptions," *id*. at 2720, these must comport with the established rule of reason framework which starts with an analysis of market power. In the year and a half since *Leegin*, that is exactly what other courts have done. *See, e.g., Spahr v. Leegin Creative Leather Products, Inc.*, No. 2:07-CV-187, 2008 WL 3914461, at *8 (E.D. Tenn. Aug. 20, 2008); *Jacobs v. Tempur-Pedic Int'l Inc.*, No. 4:07-CV-02-RLV, 2007 WL 4373980, at *3 (N.D. Ga. Dec. 11, 2007) ["*Jacobs II*"]. Plaintiff cites no contrary authority.

Plaintiff bases its argument on the statement in *Leegin* that "[a] dominant manufacturer or retailer . . . may not be a serious concern unless the relevant entity has market power." Plaintiff is misconstruing *Leegin*. The Supreme Court expressly held that "[a] manufacturer with market power" can abuse resale price maintenance. 127 S.Ct. at 2717. In the passage plaintiff cites, the Court was explaining why a *per se* rule was unnecessary: because there is little reason to worry about manufacturers without market power. *Id.* 2717-20. Moreover, even if *market power* were unnecessary, which it is not, nothing suggests a plaintiff need not plead and prove a *market definition* in which to analyze competitive effects.

To the extent PSKS has tried to allege market power, *i.e.,* a lack of competition, the allegations are wholly inadequate. Merely asserting that Leegin is "dominant" and citing a smattering of unrelated business practices (such as trademark enforcement) is insufficient in the absence of specific facts regarding market structure. (Opening Br. at 12-14.) PSKS has not even bothered to respond on this issue, much less distinguish the authorities cited by Leegin. *See, e.g., Sheridan v. Marathon Petroleum Co., LLC*, 530 F.3d 590, 594-95 (7th Cir. 2008) (dismissal with prejudice where plaintiff failed to allege market share).

2. PSKS's proposed markets are not tenable.

a. ***Courts consistently reject single-brand markets*.**

PSKS argues that its allegations are "sufficient to allege that the Brighton brand products

should be treated as a separate sub-market." (Opp. at 8.) But PSKS does not cite a single case upholding a single-brand market like the one it is proposing here. Nor does PSKS address any of the cases Brighton cited, including *Spahr,* which rejected *exactly* the market plaintiff proposes here. *Spahr*, 2008 WL 3914461, at *8-10. Plaintiffs' argument that Brighton is "distinct" goes nowhere given the overwhelming authority that such allegations are insufficient to justify a single-brand market. "Even where brand loyalty is intense, courts reject the argument that a single branded product constitutes a relevant market." *Green County Food Market, Inc. v. Bottling Group, LLC*, 371 F.3d 1275, 1282 (10th Cir. 2004) (citation omitted).[1] *See also In re Wireless Telephone Servs. Antitrust Litig.*, 385 F. Supp. 2d 403, 420 (S.D.N.Y. 2005) ("[C]onsumer preference for branded products alone cannot demonstrate market power."). Otherwise, every strong brand—Levi's, Rolex, Coke, Ford—would be its own market.

b. ***The proposed wholesale market also fails.***

PSKS's argument in favor of its alternative market—the wholesale market for brand-name women's accessories sold to independent retailers—also makes no sense. Brighton pointed out that the market should not be limited to "independent retailers" because they compete with other types of retailers like department stores, and that the term "independent retailers" was too amorphous to constitute a relevant market. (Opening Br. at 10-11.) Tellingly, PSKS did not respond. There is no reason to assume that independent retailers (whatever they are) constitute a distinct market, *i.e.*, that their customers do not also shop in department stores, particularly given that the complaint is silent on the competition posed by other brands and

[1] Contrary to plaintiff's contention, nothing in *Little Caesar* supports the proposition that a court may reject a single-brand market only if "given a significant increase in price of the preferred brand of five percent for instance, other brands of the product might be selected as substitutes for the preferred brand." (Opp. at 8-9.) Instead, *Little Caesar* confirms that "[c]ourts have consistently refused to consider one brand to be a relevant market of its own when the brand competes with other potential substitutes." *Little Caesar Enters., Inc. v. Smith*, 34 F. Supp. 2d 459, 477 n.30 (E.D. Mich. 1998).

retailers. *See Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430, 437 (6th Cir. 2008) ("Without an explanation of the other [competitors] involved, and their products and services, the court cannot determine the boundaries of the relevant market and must dismiss the case for failure to state a claim.").

Likewise, PSKS wholly failed to justify grouping "women's accessories" into a single product market. Such a grouping is inappropriate because "picture frames do not compete with women's handbags and shoes do not compete with jewelry." *Spahr*, 2008 WL 3914461 at *9 n.3; Opening Br. at 10. Again, PSKS had no response.

Nor does an analysis at the wholesale level make sense to determine the effect on consumers of an alleged effort to raise retail prices. Although the Supreme Court cautioned about the risk of manufacturer cartels, PSKS has not alleged a manufacturer cartel. PSKS argues that other acts discouraged competition at the wholesale level. (Opp. at 6.) That non sequitur offers no explanation why the competitive effect on consumers should not be measured in terms of the *retail* market. Tellingly, PSKS cites no case using a wholesale market definition to analyze the competitive effect of a vertical retail restraint.

c. ***PSKS's geographic limitation is unjustified.***

The test for the geographic market is where the "purchaser *can* practicably turn for supplies." *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961) (emphasis added). Putting aside conclusory allegations, PSKS does not allege that it can only turn to the Dallas market for its supplies. There is no reason alleged for why PSKS could not fly to showrooms in Los Angeles, New York, or Denver, or even order from catalogs. A relevant market cannot be defined based on where a particular plaintiff likes to shop.

3. Plaintiff's Allegations of Anticompetitive Effects Fail.

PSKS alleges that the market for brand-name women's accessories is characterized by

widespread adoption of "practices that … limit[] price competition among competing brands," (SAC ¶ 32), but does not describe what those practices are, which competing brands utilize them, or how the practices limit inter-brand price competition. Such "labels and conclusions" do not pass muster under *Twombly*. 127 S. Ct. at 1964-65.

Plaintiff also maintains that its reliance on higher prices suffices to show anticompetitive effects because it has alleged that Brighton products do not require service. That naked assertion is not enough, not just because it is conclusory, but also because service is far from the only justification for vertical price restrictions. For example, "fine showrooms" or "a reputation for selling high-quality merchandise" are also pro-competitive benefits that may flow from investments enabled by restricting intra-brand competition. *Leegin*, 127 S. Ct. at 2715-16.

Plaintiff's attempt to plead the anticompetitive scenarios enumerated in *Leegin* is equally unavailing. As discussed *infra* in Section II.B.3, plaintiff's retailer cartel allegations fail to meet the *Twombly* standard, and in any event do not reflect the type of cartel contemplated by *Leegin*. To the extent PSKS now asserts that Leegin is a dominant retailer, that allegation was never raised in the complaint, which alleges only that Leegin "operated as a distributor of Brighton-brand products." (SAC ¶ 9.) The complaint does not include even a conclusory assertion that Leegin is a dominant retailer, much less any supporting facts.

B. <u>The Per Se Rule Does Not Apply.</u>

1. The Supreme Court has already determined that plaintiff waived its theory of per se illegality based on dual distribution.

At the Supreme Court, PSKS argued that Brighton's pricing agreements are horizontal agreements—and should be judged under the *per se* standard—because Brighton is itself a retailer. The Supreme Court ruled that "[r]espondent did not make this [horizontal] allegation in the lower courts, and we do not consider it here." 127 S. Ct. at 2725. That was a straightforward

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application of the familiar principle that, if "a certain claim or issue was not raised … below, it is deemed waived." 19 *Moore's Federal Practice* § 205.05[2] (3d ed. 2008). Any further consideration of this per se theory on remand would contravene the Supreme Court's mandate.

PSKS is badly mistaken in arguing that the mandate rule "applies only to issues actually decided by the appellate court." (Opp. at 9-10.) On remand, the mandate rule also bars litigation of issues that were "waived … because they were not raised in the district court." *United States v. Lee*, 358 F.3d 315, 321 (5th Cir. 2004). After all, "[t]rying cases one claim at a time is both unfair to the opposing party and inefficient for the judicial system." *Omni Outdoor Advertising v. Columbia Outdoor Advertising,* 974 F.2d 502, 506 (4th Cir. 1992).

Plaintiff accuses the Supreme Court of "pulling out the rug from under it," as if the doctrine of horizontal per se illegality was unavailable during prior proceedings, and as if plaintiff was prevented from pressing alternative theories of liability. But PSKS could have alleged a horizontal conspiracy when the original complaint was filed in April 2003 or when it was amended in September 2003.

The Supreme Court has overruled outdated or erroneous standards in many antitrust cases. On remand, courts consistently reject litigants' attempts to grasp for previously abandoned or never-raised theories to escape the Supreme Court's mandate. *See, e.g., Continental TV, Inc. v. GTE Sylvania Inc.,* 461 F. Supp. 1046, 1051-52 (N.D. Cal. 1978), *aff'd* 694 F.2d 1132 (9th Cir. 1982) (barring horizontal allegations after Supreme Court overruled per se rule and remanded under rule reason).[2] Plaintiff cites no case where a litigant is allowed to

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[2] *See also Omni,* 974 F.2d at 505 (on remand from the Supreme Court, plaintiff "cannot turn back the clock and resuscitate the monopolization and attempted monopolization theories that it never chose to pursue"); *California Dental Ass'n v. FTC,* 224 F.3d 942, 958-59 (9th Cir. 2000) (barring new evidence on reasonableness of restraint after Supreme Court remanded under rule of reason, where plaintiff initially contemplated litigation under the rule of reason but then pressed only the per se theory in prior proceedings); *cf. Khan v. State Oil Co*., 143 F.3d 362, 364 (7th Cir. 1998) (Posner, J.) (after Supreme Court overruled per se rule and remanded under rule

pursue on remand a liability theory it has never before raised. The law is clear: "[U]nder the mandate rule a remand proceeding is not the occasion for raising new arguments or legal theories." *Volvo Trademark Aktiebolaget v. Clark Mach. Co.*, 510 F.3d 474, 481 (4th Cir. 2007).

Castellano v. Fragozo, 352 F.3d 939 (5th Cir. 2003), lends no comfort to PSKS. In that case, unlike here, the plaintiffs had originally pled and pursued the claim it was seeking to litigate after remand. *See id.* at 960-61. As the Supreme Court found, PSKS, by contrast, has never before raised any theory of horizontal liability. *Leegin*, 127 S. Ct. at 2725. Plaintiff is in the same position as any litigant who did not bother to plead an alternative theory, and belatedly tries to do so only after losing on its chosen theory. *See, e.g., GTE Sylvania*, 461 F. Supp. at 1051-52. More importantly, the *Castellano* appellate panel, as the drafter of the mandate, could exercise its discretion to narrow its mandate and permit continued litigation of the previously asserted claims. The Supreme Court did not choose to do that here. And this court now "lacks 'jurisdiction' to depart from the mandate." 18B Wright, Miller & Cooper, *Federal Practice & Procedure: Jurisdiction 2d* § 4478.3 (2002).

2. Dual distribution systems—even ones involving resale price maintenance—are judged under the rule of reason.

In any event, every federal appeals court — including the Fifth Circuit — that has considered the "dual distribution" arrangement alleged by PSKS (*i.e.*, a manufacturer with some retail stores of its own) has found it to be a *vertical* restriction governed by the rule of reason.[3] (Opening Br. at 20 n.5.) PSKS urges this court to ignore binding precedent and chart a new course, based solely on the conclusory assertion that the "natural checks and balances provided

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of reason, addressing plaintiff's alternative per se theory only because it was raised in prior proceedings and "we cannot say it has been waived").

[3] The one exception to this rule is where the independent retailers themselves imposed the restraint on the manufacturer. *Red Diamond,* 637 F.2d at 1004. PSKS does not argue, nor could it, that retailers foisted this restraint upon Brighton.

by the countervailing interests of manufacturer/consumer against those of the retailer as to retail price and retail margins simply are not present." (Opp. at 16). But that makes no economic sense. A manufacturer with a dual distribution system has the same incentive to minimize independent retailer margins as any other manufacturer. If a dual distribution manufacturer simply wants to raise retail prices, it will raise its *wholesale* prices so that it captures the extra revenue on each sale, not just those at its own stores. A dual distribution manufacturer's efforts to raise retail prices must be driven by the belief that sales will increase by increasing the investment by retailers. That is pro-competitive. *See Leegin*, 127 S. Ct. at 2719.

For this reason, Courts have not seen higher retail prices as a reason to analyze restraints in dual distribution systems differently. "The restrictions *tend to increase retail sales of the product*, and may do so on balance even if they also generate some increase in the price the distributors charge." *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001, 1004 n. 4 (5th Cir. 1981) (emphasis added). The Fifth Circuit held, for this reason, that restrictions imposed by manufacturers "are vertical restrictions" and the fact that "[defendant] also distributed some of its own goods does not alter the situation." *Id.* at 1004. The same result was reached in a recent case involving the same allegations against the same defendant here. *Spahr*, 2008 WL 3914461, at *5-7. *See also Jacobs* v. *Tempur-Pedic Int'l, Inc.*, No. 4:07-CV-0002-RLV, Slip Op. at 4-6 (N.D. Ga. June 21, 2007) ["*Jacobs I*"], submitted herewith as Exhibit A.

Against this unbroken line of authority, plaintiff cites only *United States v. McKesson & Robbins, Inc.,* 351 U.S. 305 (1956). *McKesson* involved the now-repealed Miller-Tydings Act and the McGuire Act. It "did not address or discuss whether the restraints at issue were horizontal or vertical for Sherman Act purposes and its analysis has little, if any, application to the issue before the Court." *Spahr*, 2008 WL 3914461, at *6. *See also Jacobs I*, Slip Op. at 6

(holding *McKesson* did not apply to analysis of dual distribution system under the antitrust laws). Moreover, in the fifty years since *McKesson & Robbins*, in cases actually addressing antitrust analysis of vertical restraints, the Supreme Court itself has consistently treated restraints involving dual distribution as vertical, not horizontal. *See, e.g., White Motor Co. v. U.S.*, 372 U.S. 253, 255, 261 (1963) (restraints by dual distributor manufacturer treated as "vertical"); *U.S. v. Arnold, Schwinn & Co*., 388 U.S. 365, 372, 378, 390 (1967) (in context of dual distribution, restraints on distributors were "a truly vertical arrangement" and "not horizontal restraints").

3. Plaintiff has not adequately pleaded a retailer cartel.

Finally, plaintiff argues that Leegin's activities are horizontal because "they are in furtherance of a retailer cartel." (Opp. at 11.) Not only was this issue waived before the appeal, but to allege a hub and spokes horizontal cartel, the complaint must contain facts showing horizontal agreements *between independent retailers*, not just agreements between retailers and Leegin. *Total Benefits*, 552 F.3d at 435-36 & n.3 (the "critical issue" in hub and spokes conspiracy is "the connecting agreements among the horizontal competitors (distributors)").[4] As explained above, agreements between Leegin and retailers do not become horizontal because Leegin operates retail stores.

Plaintiff argues that its conclusory allegations of a conspiracy suffice. But the entire point of the Supreme Court's recent *Twombly* decision is precisely the opposite. The Supreme Court rejected an antitrust claim because the horizontal conspiracy was alleged without the level of detail—who, what, when, where, how—that permitted the conclusion that the alleged conduct was inconsistent with unilateral conduct. Rule 8 "requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 127 S. Ct. at

[4] "The rim of the wheel is the connecting agreements among the horizontal competitors (distributors) that form the spokes." *Total Benefits*, 552 F.3d at 435 n.3.

1965. *See also Total Benefits*, 552 F.3d at 436 ("An antitrust plaintiff must provide factual allegations suggesting, *not merely consistent* with [a claim of conspiracy].") (emphasis added). PSKS's allegation is that retailers individually agreed to accept Leegin's pricing policy. Leegin initiated the program and solicited agreements from retailers not to discount. (SAC ¶ 9.) The alleged January 2003 meeting, which involved the pricing policy only to the extent of approving a minor *exception* to it, took place years after the program began, and indeed after Leegin began to enforce the long-standing policy against PSKS. There is no allegation that retailers agreed to the alleged RPM among themselves. These allegations suggest not a retailer cartel, but that Leegin's interests were the driving force behind the program. PSKS has not even identified any particular conspiring retailer that participated in the scheme, much less why each did so, or when and where the conspiracy began. *See Twombly*, 127 S.Ct. at 1971 n.10 (dismissing complaint that "furnishes no clues as to which of the four [defendants] (much less which of their employees) supposedly agreed, or when and where the illicit agreement took place").

Even if these allegations were consistent with a retailer cartel, they are just as consistent with independent decisions by retailers and thus do not state a claim. A plaintiff cannot state a claim for an antitrust conspiracy with allegations of "parallel conduct that could just as well be independent action." *Id.* at 1966. *See also Wellnx Life Sciences, Inc. v. Iovate Health Sciences Research, Inc.*, 516 F. Supp. 2d 270, 290 (S.D.N.Y. 2007) (dismissing hub and spokes allegation because "it is plausible that the publishers individually agreed to abide by Iovate's terms").

The Supreme Court was clear in *Leegin* as to what was meant by a "retailer cartel": "A group of retailers might collude to fix prices … and then to *compel* a manufacturer to aid the unlawful arrangement with retail price maintenance." *Leegin,* 127 S.Ct. at 2717 (emphasis added). That is not what is alleged here. In dismissing similar allegations against this same

defendant, the *Spahr* court explained:

> There is no allegation by plaintiffs here that retailers have agreed to fix prices and then compelled the manufacturer, Leegin, to utilize resale price maintenance. In fact, plaintiffs have affirmatively alleged the opposite*, i.e.*, that Leegin coerced retailers and forced upon retailers the resale price maintenance agreements.

Spahr, 2008 WL 3914461, at *12.

Toys-"R"-Us v. FTC is inapposite. 221 F.3d 928 (7th Cir. 2000). There, a dominant retailer coerced toy manufacturers to boycott competing retailers. *Id.* at 936. The allegation of a hub and spoke conspiracy was based on the fact that "the only condition on which each toy manufacturer would agree to [the dominant retailer's] demand was if it could be sure its competitors were doing the same thing." *Id*. at 933, 936. In contrast, nothing in the complaint here suggests that the (unidentified) conspiring retailers did not individually accept Leegin's policy without collusion with other retailers.

C. <u>Plaintiff Has Abandoned All State Law Claims</u>.

Plaintiff does not deny that its state law claims have already been waived. They should be dismissed forthwith.

D. <u>The Complaint Should Be Dismissed *With Prejudice*</u>.

Leave to amend need not be granted here because the plaintiff has already had years of discovery and more than a year to consider how to amend its complaint in light of *Leegin*. Nor has plaintiff made any proffer of how it could amend its complaint to avoid these fundamental legal deficiencies.

III. CONCLUSION

For all of the foregoing reasons, Leegin respectfully requests dismissal of PSKS's Second Amended Complaint with prejudice.

Respectfully submitted,

February 19, 2009

/s/ Collin Maloney

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing document was served on all parties via United States mail and/or electronic delivery this 20 day of February, 2009.

/s/ Collin Maloney