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,	§	
	§	
v.	§	Civil Action No. 2:03-CV-107-TJW
	§	
Leegin Creative Leather Products, Inc.	§	
	§	
Defendant.	§	

PLAINTIFF'S RESPONSE TO DEFENDANT'S MOTION TO DISMISS

I. INTRODUCTION

In *PSKS, Inc. v. Leegin Creative Leather Products, Inc.,* 127 S.Ct. 2705 (2007), the Supreme Court changed the standard by which to judge price fixing agreements between manufacturers and the entities to whom they sell. Instead of applying the *per se* illegal standard that had prevailed, the Supreme Court indicated that a "rule of reason" standard needs to be applied on retrial.

The Court did acknowledge that these type of price fixing agreements could be anticompetitive: "While vertical agreements setting minimum resale prices can have procompetitive justifications, they may have anticompetitive effects in other cases; and unlawful price fixing, designed solely to obtain monopoly profits, is an ever present temptation." *Leegin*, 127 S.Ct. at 2716. Therefore, the Court did not simply reverse the case and enter judgment in favor of the Defendant. Instead, the Court remanded the case to be determined under the new standard, and charged Courts with the following duty: "Resale price maintenance, it is true, does have economic dangers. If the rule of reason were to apply to vertical price restraints, **courts**

would have to be diligent in eliminating their anticompetitive uses from the market." *Id*. at 2719 (emphasis added). The Court then set out a general framework within which trial courts should operate:

> A party alleging injury from a vertical agreement setting minimum resale prices will have, as a general matter, the information and resources available to show the existence of the agreement and its scope of operation. As courts gain experience considering the effects of these restraints by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.

Id. at 2720.

Instead of applying this pleading standard, the defendant seeks to have the Court invent and apply a standard by which the Court, without evidence, can make the determination whether the challenged restraint is in fact pro or anti competitive. The defendant's position is flatly inconsistent with the holding of the Supreme Court and should be rejected.

There is no heightened standard by which to judge an antitrust complaint. As explained in *Apani Southwest, Inc., v. Coca-Cola Enterprises, Inc.,* 300 F.3d 620, 633 (5th Cir. 2002): "a heightened pleading standard may not be applied to antitrust claims * * *." Rule 12(b)(6) provides that a plaintiff must made a "short and plaint statement" providing the "grounds" for his "entitlement to relief." *Bell Atlantic Corp. v. Twombly,* 127 S.Ct. 1955, 1965 (2007). "Factual allegations must be enough to raise a right to relief above the speculative level, * * * on the assumption that all the allegations in the complaint are true (even if doubtful in fact) * * *." Id. This standard "requires a complaint with enough factual matter (taken as true) to **suggest**" that the plaintiff is entitled to relief. *Id.* This standard "does not impose a probability requirement at

the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." *Id.*

As is usual when deciding a motion to dismiss, the Court must accept the well-pleaded facts on the face of the Complaint as true and view them in a light most favorable to Plaintiff. *In re Southern Scrap Material Co., LLC*, 541 F.3d 584, 587 (5th Cir. 2008). With respect to a number of the matters pled by Plaintiff, including composition of the relevant market, those matters are factual issues which a jury must be permitted to decide. *See Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480, 487–88 (5th Cir. 1984)("product market definition generally presents a question of fact to which it is entitled to jury resolution"). It is not appropriate for the Court to disregard allegations pled by Plaintiff as Leegin invites the Court to do in its motion. In its Second Amended Complaint, Plaintiff has alleged an antitrust price-fixing claim under either the rule of reason or per se standard. As such, Leegin's motion must be dismissed.

II. ARGUMENT AND AUTHORITIES

A. PLAINTIFF HAS STATED A RULE OF REASON CASE

1. The Supreme Court did not Require Market Power to be Shown

The Supreme Court was very circumspect when it changed nearly 100 years of law to apply a new standard to the defendant's conduct. In doing so, it recognized that this conduct might still be anticompetitive, and identified certain factors that may need to be considered in reaching a conclusion as to specific conduct. Specifically the court stated: "the number of manufacturers that make use of the practice in a given industry can provide important instruction"; it is subject to greater scrutiny "if many competing manufacturers adopt the practice"; "[i]f there is evidence retailers were the impetus for a vertical price restraint, there is a

greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer"; finally the Court addressed market power:

> [a] dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes **may** not be a serious concern unless the relevant entity has market power. If a retailer lacks market power, manufacturers **likely** can sell their goods through rival retailers. * * * And if a manufacturer lacks market power, there is **less likelihood** it can use the practice to keep competitors away from distribution outlets.

Leegin, 127 S.Ct. at 2719–20 (emphasis added).

This discussion makes it clear that the Supreme Court did not identify any single factor as controlling, or even necessary. Although it did identify market power as a relevant consideration, it did not identify it as a necessary showing to make to prove anticompetitive behavior. Clearly, the Court intended trial courts to hear facts concerning vertical restraints and the effects that these restraints have on competitive markets, and after considering a variety of these situations, then a court may be in a position to "devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones." *Id*. at 2720. By asking this Court to impose a strict market definition requirement at this stage of the process, the defendant is asking this Court to short circuit the path identified by the Supreme Court.

B. The Plaintiff has Identified an appropriate Market

Two primary markets are alleged, the wholesale market in which the Plaintiff purchases its products, and the retail market in which the defendant's goods are sold. Each of these markets need to be evaluated as to their sufficiency.

1. Wholesale Market for Name Brand Women's Accessories

There are two main components of the relevant geographic market the geographic market "in which seller operates, and to which the purchaser can practicably turn for supplies." *Tampa*

Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961). In this case, the seller/manufacturer (Leegin) operates in a national or international market. That factor does not dictate the limits of the market. Instead, the market is limited by the second aspect – the market "to which the purchaser (Plaintiff) can practicably turn for supplies." In this case, the market to which the plaintiff can turn to for supplies is generally identified by the sellers that offer goods at wholesale and who cater to independent dealers operating in the greater Dallas area. The "practicable" suppliers for Kay's Kloset were the wholesale sellers who periodically offer their goods for sale at periodic shows at the Market Center in Dallas.

Indeed, the Market Center's periodic trade shows in Dallas[1] provide a busy hub of activities from which Kay's Kloset and its competitors all draw their supplies. This definition of a market makes perfect sense, in that it is the market into which the defendant sells, and from which the plaintiff purchases. The fact that there might be goods available to others distributed through other channels does not mean that the market must necessarily include other products that it is not practicable for the plaintiff to acquire.

It is not correct to assert that the wholesale market is not relevant in considering this type or restraints. One of the concerns identified by the Supreme Court is the effect that this type of constraint poses for manufacturer cartels. By imposing a fixed margin, manufacturers can easily police competing manufacturer sales and more easily fix wholesale prices.

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[1] The periodic shows for Apparel and Accessories is described on the Market Center website:

> Dallas Apparel & Accessories Market is held every January, March, June, August and October inside FashionCenterDallas®. In addition to the permanent showrooms, you'll also find a complementary blend of temporary exhibitors at this show. Dallas Market Center offers **the most apparel and fashion accessories resources** from leading designers and manufacturers across all categories including women's fashion, menswear and children's products.

http://www.dallasmarketcenter.com/buyers/markets.aspx#ab450

The economic injury of this activity falls not only on the consumer, who is charged more than a competitive price for the goods, but also on those dealers purchasing their goods at wholesale. In this case, there are a number of actions that the defendant has taken that helps to make dealers captive to its own brand, and prevent any new manufacturer from entering the market to compete. Among those activities are imposing minimum stocking requirements; discouraging and prohibiting dealers from stocking any goods that too directly competes against its product line; and aggressively enforcing claims of trademark and tradedress infringement, such that any manufacturer that produces products that bear some resemblance to the products of the defendant likely will face a lawsuit. These activities all discourage competition at the wholesale level, and raise barriers to entering this market to companies that are contemplating doing so.

The general standards for determining what products fall within a market is given by §1.11 of the 1992 Department of Justice Horizontal Merger Guidelines. In those Guidelines, the Department of Justice recognized that a "market" consists of "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price." To make that determination, the Agency utilizes a five percent increase in price lasting for the foreseeable future. Thus, the product market consists of the smallest set of products, including the defendant's products, such that a hypothetical firm selling all of those products with no competition could profitably raise all the prices by five percent. In other words, if a person selling products would find that it would not be profitable to raise prices by five percent because its customers would switch to some other product, then those other products would be considered as being in the same market.

These considerations have recently been considered by another Court in *Babyage.com, Inc., v. Toys "R" Us, Inc.*, 558 F.Supp.2d 575 (E.D.Pa. 2008). In that case, the Court held that relevant product markets were defined by allegations identifying those markets such as "high-end baby and juvenile strollers." In this case, the goods at issue are high end, brand name, fashion accessories, sold in boutiques and specialized stores. Because of these attributes, the defendant's goods compete with goods of a similar nature that are distributed in a similar manner. This necessarily limits the number of actual competitors that the defendant faces.

The defendant has taken the position that women's accessories are fungible goods, such that any price increase by any manufacturer would impact the quantity sold by any other. This notion is nothing short of nonsense. According to the defendants, if Leegin raised the retail price of its $200 handbag by $10.00, the number of $30.00 handbags sold at Walmart would increase. Conversely, if Walmart raised the price of its $30.00 handbag to $31.50, the number of Brighton bags sold would increase. That notion defies sense.

The position that all fashion accessories are "reasonably interchangeable" with Brighton products fails to deal with the nature of the product, as well as how those products are marketed and used. Common sense dictates that something more than a merely functional item is being purchased when women's fashion items are being purchased. By their nature, these items are not purchases primarily for their function, but rather for some ability of the item to project something about the purchaser. For this reason, just as there may be people who would profess not willing to shop at Walmart, there are people who would be unwilling to wear anything other than some product with a designer label. To compare Brighton objects, which bear such a designer's label with items that are interchangeable for that product, at the least, it is necessary that the item to

which it is compared, bear the label of a recognized brand. For these reasons, and as alleged in the Complaint, Brighton products are not interchangeable with non-Brand name products.

2. Retail Market for Brighton Products

The defendant incorrectly asserts that a single brand cannot constitute a separate market. Such is certainly not the case. It should be remembered that:

> product market definition generally presents a question of fact to which it is entitled to jury resolution. * * * Indeed, antitrust law recognizes that economically significant submarkets may exist which themselves constitute relevant product markets. * * * The fact finder may determine a submarket exists by "examining such practical indicia as industry or public recognition of the sub-market as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe,* 370 U.S [294] at 325, 82 S.Ct. at 1524, 8 L.Ed.2d at 535-36.

Domed Stadium Hotel, Inc. v. Holiday Inns, Inc. 732 F.2d 480, 487–88 (5th Cir. 1984).

In this case, the plaintiff has alleged those special factors that could make this product a unique submarket that should be considered separately for antitrust purposes. The Complaint alleges:

> [C]ustomers do not consider other accessories suitable substitutes for their use of Brighton-brand products, nor would they substitute other accessories for Brighton-brand products, nor would they do so even in response to a significant, non-transitory increase in the price of Brighton-brand products. * * *
>
> Brighton-brand products are distinct products characterized by an inelasticity in demand, and little cross-elasticity of demand between Brighton-brand products and demand for competing products.

Second Amended Complaint, ¶¶ 25, 26. These allegations are sufficient to allege that the Brighton brand products should be treated as a separate sub-market for antitrust purposes.

The key to whether a single brand can be its own market lies in whether other brands compete. A court may find that a market composed of a single brand fails 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. *Little Caesar Enterprises, Inc. v. Smith,* 34 F.Supp.2d 459, 476–77 (E. D.Mich.,1998). As discussed previously, the notion that an increase in price of five percent from $200 to $210 for a Brighton handbag would cause consumers to seek other brands as a substitute for Brighton does not make sense.

Given these facts, the Court must accept the facts as pled in Plaintiff's Complaint. Plaintiff has set forth the relevant geographic market as the greater Dallas area and the relevant product market as the wholesale sale of brand-name women's accessories to independent retailers and the retail market for Brighton brand women's accessories. Plaintiff has sufficiently pled the relevant market, and as such Leegin's motion should be denied.

C. Plaintiff has Alleged a Horizontal Conspiracy which is Illegal *Per Se*

1. The Mandate Rule does not Apply Because the Supreme Court did not Decide whether Leegin had Engaged in a Horizontal Price-Fixing Conspiracy

Leegin erroneously argues that the issue of whether Leegin's price-fixing activities are part of a horizontal conspiracy is barred by the mandate rule. Because the Supreme Court specifically did not consider the issue of whether Leegin's price-fixing activities are part of a horizontal conspiracy, that issue is not within the appellate mandate, and is not precluded by the mandate rule.

The mandate rule "is a corollary or specific application of the law of the case doctrine." *U.S v. Pineiro*, 470 F.3d 200, 205 (5th Cir. 2006). The law of the case doctrine states that "an issue of fact or law decided on appeal may not be reexamined * * * by the district court on remand." *Tollett v. City of Kemah*, 285 F.3d 357, 363 (5th Cir. 2002). The mandate rule states that lower courts "must implement both the letter and the spirit of the appellate court's mandate and may not disregard the explicit directives of that court." *General Universal Systems, Inc. v. HAL, Inc.*, 500 F.3d 444, 453 (5th Cir. 2007). The mandate rule, however, applies only to issues

actually decided by the appellate court, so "[a] mandate controls only on all matters within its scope, but a district court on remand is free to pass upon any issue which was not expressly or impliedly disposed of on appeal." *Newball v. Offshore Logistics International*, 803 F.2d 821, 826 (5th Cir. 1986)); *see also Engel v. Teleprompter Corp.*, 732 F.2d 1238, 1241 (5th Cir. 1984)("[T]he district court is obliged to carry out the instructions we have given, and should then be presumed to be free to take any other consistent actions.").

The Supreme Court explicitly stated that it did not consider Plaintiff's allegations regarding a horizontal cartel in determining that the rule of reason would apply to vertical price fixing cases. *Leegin*, 127 S. Ct. at 2725. Curiously, however, Leegin argues that Plaintiff's allegations regarding the presence of a horizontal conspiracy are within the Supreme Court's and the Fifth Circuit's mandate in this case and cannot be litigated in the current case. Frankly, it is difficult to see how allegations and matters the Supreme Court explicitly did not consider in making its ruling would be foreclosed from determination on remand.

The Fifth Circuit's ruling in *Castellano v. Fagozo*, 352 F.3d 939 (5th Cir. 2003) is also instructive as to this point. In *Castellano*, the plaintiff asserted claims for malicious prosecution under state law and various federal constitutional claims related to a wrongful criminal conviction. 352 F.3d at 942. After certain legal rulings, the plaintiff decided to dismiss his state law claims because they would have been redundant of his federal constitutional claims. *Id*. Eventually, on appeal of the case, the Fifth Circuit changed the law regarding the elements of a number of the plaintiff's federal claims such that the malicious prosecution claim previously asserted by the plaintiff was no longer redundant of his federal claims. *Id*. at 960–61. On remand, however, the Fifth Circuit ordered that the plaintiff could re-file and pursue his malicious prosecution claim, despite the fact that he had previously voluntarily dismissed the

claim. *Id.* The Court reasoned that the plaintiff "amended his complaint, purposely abandoning his claim under state law. He did so because our case law said the elements of maliciouis prosecution under state law and under a § 1983 claim were the same." The Court stated that "[w]e have now pulled that legal rug from all the parties," and as such permitted the plaintiff to pursue his state law claims. *Id.*

Similarly, the Supreme Court pulled a rug from under Plaintiff in this case, a rug which had been on the floor for nearly 100 years. Under the law prior to the *Leegin* decision, it did not matter whether a price fixing agreement was vertical or horizontal, it was per se illegal. After *Leegin*, parties like Plaintiff must specify whether their claims relate to a horizontal or a vertical price fixing arrangement. Indeed, Plaintiff is not even changing or stating any new substantive claims. Rather, Plaintiff is simply stating additional facts or bases for the same Sherman Act price fixing claim it has pursued all along. Prior to *Leegin*, these matters were not relevant or pivotal to determining the proper legal standard to apply to Plaintiff's claims as they are now. More importantly, the Supreme Court explicitly stated that it did not consider these matters in making its purely legal ruling. As such, Plaintiff is not precluded by the mandate rule from making allegations of a horizontal conspiracy in the current case.

2. Plaintiff has Alleged that Leegin's Price-Fixing is in Furtherance of a Horizontal Hub and Spoke Conspiracy which is Illegal *Per Se*

Plaintiff has explicitly pled that Leegin's price-fixing activities are in furtherance of a retailer cartel. In particular, Plaintiff pled that "[a]fter Leegin introduced its "Retail Pricing and Promotion Policy" and "Heart Store" programs, and at the insistence of many of its most faithful retail dealers, Leegin made changes to the language of the "Retail Pricing and Promotion Policy", began to enforce the Policy with greater regularity and began to respond to complaints from its retail dealers regarding discounting retailers with greater levels of enforcement."

Second Amended Complaint, ¶ 13. Plaintiff further pleads that Leegin would "following the suggestion and concurrence of retail dealers, from time to time amend the Policy." Plaintiff specifically discusses one such instance occurring at a meeting between Leegin and more than 100 retailers in January of 2003 in which Leegin and its retailers agreed to allow exceptions to the pricing policy, only under certain circumstances. *Id*. at ¶ 14.

Based on these allegations, Plaintiff specifically alleged that Leegin is acting "as the hub in a classic spoke and hub horizontal price fixing conspiracy" (*Id*. at ¶ 15), and that Leegin's "price fixing scheme facilitates the organization and operation of a retail cartel in the sale of [Brighton] goods." *Id*. at ¶ 31. Therefore, Plaintiff has explicitly pled that Leegin's price fixing activities are in furtherance and a part of a horizontal price fixing conspiracy. In addition, Plaintiff has pled specific facts and actions of Leegin and its co-conspirators demonstrating the presence of a horizontal conspiracy.

Plaintiff's allegations are typical of a "hub and spoke" horizontal conspiracy. *See Toys "R" Us, Inc. v. Federal Trade Commission*, 221 F.3d 928, 934–36 (7th Cir. 2000)(holding that an arrangement taking the form of a network of vertical agreements between a dominant distributor and individual manufacturers as well as agreements between the individual manufacturers is a horizontal hub and spoke conspiracy and illegal per se). Plaintiff has alleged and intends to prove that there are a series of agreements between Leegin and independent retailers to fix prices of Brighton goods (spoke); that Leegin's independent retailers have formed a cartel with each other and with Leegin as a retailer to prevent discounting and price competition (wheel); that in response to pressure from retailers involved in the cartel, Leegin has enforced its price fixing agreements against discounters to stamp-out price competition (hub); that retailers have discussed and indeed come to agreements as to the terms of the price fixing agreements and

exceptions thereto (wheel). These allegations set forth a horizontal conspiracy which "is, and ought to be, *per se* unlawful." *Leegin*, 127 S. Ct. at 2717 (citations omitted).

Leegin argues that Plaintiff does not allege that the retailers were the impetus of the price fixing arrangement. Leegin's argument is overly formalistic. Regardless of whether Leegin initially established the pricing policy, Plaintiff has alleged, based on a substantial factual basis, that a cartel of retailers placed pressure on Leegin to enforce the pricing agreements and to officiate disagreements between retailers as to price. Additionally, Plaintiff has alleged instances in which the independent retailers involved in the cartel were involved in discussions, had input and arrived at an agreement with each other and Leegin as to the parameters of the pricing policy itself.[2] Plaintiff's Complaint leaves no question that it alleges the Brighton retail pricing policy was not "adopted independent of retailer pressure" but that retailers, including Leegin itself, precipitated much of the policy, which "facilitates a retailer cartel [and] supports a dominant, inefficient retailer" (i.e. Leegin as Brighton Collectibles). *Leegin*, 127 S. Ct. at 2719–20. As such, Plaintiff has alleged a legally supportable horizontal price fixing conspiracy which would be subject to per se prohibition under the Sherman Act.

3. Because Leegin is also a Retailer of Brighton Goods, It's Retail Pricing Policy Should be Treated as a Horizontal Price-Fixing Arrangement

In the late 1990's, Leegin began to participate in the market as a retailer and began to sell Brighton-brand products through retail outlets owned by Leegin. Over the years, and during the

[2] Leegin argues that the meeting of retailers discussed in paragraph 14 of Plaintiff's Second Amended Complaint only pertains to a minor exception to the policy, and should be of minimal importance. On the contrary, the jury could certainly infer that because these retailers arrived at a consensus as to an exception to the pricing policy, they discussed the pricing policy in more detail, discarded various other proposals for exceptions to the policy, and indeed agreed to maintain the policy as a whole, with the exception agreed upon by the consensus. The Court cannot disregard this reasonably inference, neither at this stage in the context of a motion to dismiss, nor at any stage prior to trial. Therefore, Leegin's attempt to minimize the effect this allegation is futile.

time of enforcement of Leegin's pricing policy, Leegin's retail stores became very profitable and its retail operations grew exponentially. Currently, Leegin itself owns over 100 retail outlets called Brighton Collectible Stores throughout the United States and in the greater Dallas area. Plaintiff discusses Leegin's dual role as a manufacturer and a retailer in paragraphs 8, 22, 28 and 29 of its Complaint. With respect to Leegin's dual roles in the distribution of Brighton products, Plaintiff allege that:

> [Leegin] has engaged in a price fixing scheme for the Brighton line of products that is illegal *per se*. At all times pertinent hereto, Defendant operated as a retailer of Brighton-brand products, and agreed with other retailers of Brighton-brand products on the price at which these goods would be sold to the consuming public. Those agreements constitute horizontal cartel activities and constitute *per se* violations of the Sherman Antitrust and Clayton Acts.

Second Amended Complaint, ¶ 29.

On pages 19 and 20 of its Motion to Dismiss, Leegin cites a number of cases in support of its argument that its participation in the market as a manufacturer and a retailer is a "dual distribution" arrangement which should be treated as a vertical restraint and governed by the rule of reason. It is true that the cases cited by Leegin in this section treat non-price restrictions adopted in a dual distribution arrangement as vertical restraints governed by the rule of reason. It cannot be denied, however, that none of the cases cited by Leegin in this section of its brief concern a price restriction employed within a dual distribution arrangement, i.e. price-fixing agreements between a manufacturer/retailer and other independent competing retailers of the same product.

The explanation for the lack of case law on this issue is quite logical in one regard. Prior to the *Leegin* decision, both vertical and horizontal minimum price arrangements were per se illegal. Therefore, any price-fixing arrangement in a dual distribution configuration, whether it

was treated as vertical or horizontal, was subject to the per se rule. Nevertheless, it cannot be ignored that the cases cited by Leegin in its brief all concern non-price restrictions, not minimum price-fixing as alleged in this case, in the context of a dual distribution structure.

Leegin argues that the Court should ignore this distinction and should simply extend the principles applied with respect to non-price restrictions in a dual distribution arrangement to Leegin's price fixing arrangements in its dual distribution system. Leegin, therefore, argues that like non-price restrictions, price restrictions in a dual distribution system should be treated as vertical and governed by the rule of reason. Some basic principles underlying the *Leegin* decision by the Supreme Court, and touted by Leegin in its brief as procompetitive explanation for resale price maintenance, however, advise against extending the holdings of the cases cited by Leegin to apply to the current case.

As the Supreme Court has stated on multiple occasions, the economic interests of the manufacturer and the consuming public are generally aligned with respect to price and are opposed to the interests of the retailer. *See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 56 n.24 (1977)("Generally a manufacturer would prefer the lowest price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues."). This principle was one of the key economic and procompetitive justifications for resale price maintenance and the Supreme Court's decision to apply the rule of reason in vertical price fixing cases. *See Leegin*, 127 S. Ct. at 2118–19 ("Respondent's argument, furthermore overlooks that, in general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins * * *. A manufacturer has no incentive to overcompensate retailers with unjustified margins. The retailers, not the manufacturer gain for higher retail prices."). Indeed, in the current Motion to Dismiss, Leegin has touted this factor,

that manufacturers and consumers are aligned in interest as to price against retailers, as a procompetitive justification for its own price-fixing activities.

This principle, which has been fundamental to the Supreme Court's analysis of all vertical restraints including resale price maintenance, is antithetical to Leegin's argument that resale price maintenance in a dual distribution system should, like any other non-price restraint in a dual distribution setting, be treated as a vertical restraint. Leegin, who is both a manufacturer and a retailer, has steadfastly engaged in price-fixing with competing independent retailers, an activity which maintains retail prices at higher levels and protects retail margins. As both the Supreme Court and even Leegin recognize, these higher retail prices operate to the economic benefit of the retailer, not the manufacturer and not the consumer. This is especially true when the other purported procompetitive benefits of resale price maintenance for the manufacturer, i.e. increased retailer services and market entry, are not and could not be a factor based upon the type of products sold and the relevant market. Nevertheless, it can generally be said that in a dual distribution setting, the natural checks and balances provided by the countervailing interests of manufacturer/consumer against those of the retailer as to retail price and retail margins simply are not present. This is especially so when, as in this case, the manufacturer is not a small retailer but a dominant retailer of the manufacturer's goods.

This relationship between Leegin's retail operations and its manufacturing and wholesale operations cannot be ignored. Leegin's price-fixing activity eliminates competition based on price, an undeniable benefit to Leegin as a proprietor of its numerous Brighton Collectible Stores. As the Supreme Court has stated in describing a particular restriction as horizontal as opposed to vertical, "the use of the term 'horizontal' was 'appropriate to capture the fact that dealer interests opposed to those of the manufacturer were being served.'" *Bus. Elec. Corp. v.*

Sharp Elec. Corp., 485 U.S. 717, 730 n.4 (1988)(quoting & P. Areeda, Antitrust Law § 1457d, p. 174 (1986)). Because the interests of retailers, not manufacturers, are promoted by higher retail margins and higher retail prices, it is appropriate, when a manufacturer engaged in dual distribution utilizes resale price maintenance, to treat the resale price maintenance as a horizontal as opposed to a vertical restriction.

The most recent direction regarding how courts are to view resale price maintenance utilized in a dual distribution system is *United States v. McKesson & Robbins, Inc.*, 351 U.S. 305 (1956). The underlying facts of *McKesson* arose in the context of the Miller-Tydings and McGuire Acts, by which Congress, for a period in the last century, exempted certain resale price maintenance agreements from the regulation of the Sherman Act. Although both the Miller-Tydings and McGuire Acts exempted certain vertical price maintenance agreements, both Acts expressly stated that this exemption did not apply to agreements "between retailers, or between persons, firms or corporations in competition with each other." *McKesson*, 351 U.S. at 311 n.14. Such agreements were still per se illegal under the Sherman Act. As the *McKesson* Court stated, these provisions in the Miller-Tydings and McGuire Acts regarding "firms or corporations in competition with each other" were intended to "expressly continue[] the prohibitions of the Sherman Act against 'horizontal' price fixing by those in competition with each other at the same functional level." *Id*. at 313 (quoting *Schwegmann Bros. v. Calvert Corp.*, 341 U.S. 384, 389 (1951)).

In *McKesson*, the defendant, a manufacturer and wholesale distributor, had entered price fixing agreements with other competing wholesale distributors of products manufactured by the defendant. The essential question in the case was whether these agreements fit within the Miller-Tydings and McGuire Acts' exemption from the antitrust laws of certain vertical price fixing

agreements. Because of the defendant's participation in the market as a wholesaler and not just a manufacturer, the court held that the agreements in question were between "firms [or] corporations in competition with each other," and thus fit squarely within the Miller-Tydings and McGuire Acts' express continuation of the Sherman Act's per se prohibition of horizontal price fixing. *Id*. To determine whether the agreements were within the Sherman Act's per se prohibition of horizontal price fixing agreements, the Court stated that "**without regard to categories or labels, the crucial inquiry is whether the contracting parties compete with each other.**" *Id*. (emphasis added).

This interpretation and application of the Sherman Act to price fixing agreements between firms competing at the same level has never been overturned. As in *McKesson*, Leegin participates in the market on two levels: manufacturing and retail. As a retailer, it competes with the independent retailers to which it distributes Brighton goods for resale. Although it competes with them on the retail level, Leegin has entered price fixing agreements with these independent retailers of Brighton goods. Leegin contends that these agreements should be viewed as vertical arrangements. According to *McKesson*, however, the crucial question as to whether such agreements fall within the Sherman Act's longstanding per se prohibition of horizontal price fixing is whether they are between parties which compete with each other at the same operative level. This question is undeniably answered in the affirmative.

With regard to a dual distributor who enters into price fixing agreements with competitors in the same market, *McKesson* plainly states that such price fixing agreements come within the Sherman Act's traditional per se prohibition of horizontal price fixing. This is consistent with economic theory cited by the Supreme Court and indeed by Leegin regarding the conflicting economic interests of retailers versus manufacturers and consumers regarding retail

price and retailer margins. In addition to the fact that these price fixing agreements were in furtherance of a retailer cartel, *McKesson* also dictates that they be treated as horizontal price fixing arrangements subject to per se prohibition. Therefore, Plaintiff has pled a horizontal price fixing arrangement, and Leegin's motion must be denied.

D. Plaintiff Has Alleged Several Anticompetitive Effects

Leegin argues that Plaintiff has failed to set forth any anticompetitive effects or scenarios which could result from Leegin's price-fixing activities. In doing so, Leegin attempts to suggest that the Supreme Court's decision in this case was an absolute endorsement of resale price maintenance as procompetitive and acceptable under all circumstances. Contrary to Leegin's arguments, the Supreme Court's opinion is not an absolute pardon of resale price maintenance activities at all.

The Supreme Court specifically stated that "[w]hile vertical agreements setting minimum resale prices can have procompetitive justifications, they may have anticompetitive effects in other cases * * * ." *Leegin*, 127 S. Ct. at 2716. In fact, the Supreme Court recognized that "[R]esale price maintenance, it is true, does have economic dangers," and that courts "have to be diligent in eliminating their anticompetitive uses from the market." *Id*. at 2719. The Supreme Court then set forth four particular scenarios at a minimum in which resale price maintenance could be utilized as an anticompetitive restraint. Contrary to Leegin's arguments, it its Complaint Plaintiff has set forth at least two of these specific anticompetitive scenarios as well as some additional anticompetitive effects tenement to Leegin's price-fixing activities which are sufficient to support a claim under the Sherman Act.

1. Plaintiff has Alleged that Leegin's Price-Fixing Activities are in Furtherance of a Horizontal Cartel

As stated above, the Supreme Court set forth at lest four specific scenarios in which resale price maintenance can be used to achieve particularly anticompetitive objectives. Those include (1) when it is used to "facilitate a manufacturer cartel;" (2) when it is "used to organize cartels at the retailer level:" (3) when it is used by a powerful retailer; and (4) when it is used by a powerful manufacturer. *Leegin*, 127 S. Ct. at 2716–17. In addition to other anticompetitive scenarios and effects, Plaintiff has specifically pled at least two of these anticompetitive scenarios in its Complaint.

First, Plaintiff has explicitly pled that Leegin's price-fixing activities are in furtherance of a retailer cartel. In particular, Plaintiff plead that "[a]fter Leegin introduced its "Retail Pricing and Promotion Policy" and "Heart Store" programs, and at the insistence of many of its most faithful retail dealers, Leegin made changes to the language of the "Retail Pricing and Promotion Policy", began to enforce the Policy with greater regularity and began to respond to complaints from its retail dealers regarding discounting retailers with greater levels of enforcement." Second Amended Complaint, ¶ 13. Plaintiff further pleads that "following the suggestion and concurrence of retail dealers, from time to time amend the Policy," and discussed one such instance occurring at a meeting between Leegin and more than 100 retailers in January of 2003. *Id*. at ¶ 14. Plaintiff discussed how Leegin "frequently intervened to reconcile pricing disputes between competing retailers of Brighton who were competing," and stated that "[i]n this manner, Brighton would act as the hub in a classic spoke and hub horizontal price fixing conspiracy." *Id*. at ¶ 15; (See also, *Infra* Section C.2). Plaintiff therefore alleges that "[Leegin] and its retail dealers have deliberately set up an unlawful retail pricing policy which [Leegin] enforces to unreasonably restrain prices." *Id*. at ¶ 22.

In addition, the fact that Leegin is itself a retailer, and indeed a dominant retailer, of Brighton goods is further indication that its price-fixing activities have been in furtherance of a retailer cartel and are typical of a horizontal arrangement. (See *Infra* Section C.3). As Plaintiff explicitly alleges in its Complaint:

> [Leegin] has engaged in a price fixing scheme for the Brighton line of products that is illegal *per se*. At all times pertinent hereto, Defendant operated as a retailer of Brighton-brand products, and agreed with other retailers of Brighton-brand products on the price at which these goods would be sold to the consuming public. Those agreements constitute horizontal cartel activities and constitute *per se* violations of the Sherman Antitrust and Clayton Acts.

Second Amended Complaint, ¶ 29. Plaintiff sets forth precisely the anticompetitive effects which result from this horizontal arrangement which are unique to the circumstances of this case. Plaintiff states that "[b]y enforcing independent retailers to agree not to discount, [Leegin] can insulate the retail stores it owns or controls from price competition and protect retailers who have cartelized from price competition from more innovative and efficient retailers. *Id*. at ¶ 22.

Leegin's attempts to ignore and indeed disbelieve these allegations at this stage in an attempt to dismiss the Complaint on the pleadings are improper and have no merit. Plaintiff has explicitly pled that Leegin's "price fixing scheme facilitates the organization and operation of a retail cartel in the sale of [Brighton] goods." *Id*. at ¶ 31. Leegin's pricing policy "reduces competition in order to increase price" and as such "is, and ought to be, *per se* unlawful." *Leegin*, 127 S. Ct. at 2717 (citations omitted). Plaintiff has stated specific facts, including the occurrence meetings between Leegin and more than 100 of its retailers, the fact that Leegin has officiated disputes between retailers regarding the price of Brighton goods which are typical of a classic hub and spoke horizontal conspiracy. Moreover, the fact that Leegin is a dominant retailer of Brighton goods would indicate that Leegin was itself acting as a retailer in its policing

and enforcement of its pricing policy and furthering its interests as a retailer of Brighton goods. *See Leegin*, 127 S. Ct. at 2719 (citing *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 56 n.24)(discussing that with respect to price, interests of manufacturers and consumers are generally aligned and are different from interests of retailers).

Plaintiff has alleged, with substantial factual support, that Leegin's resale pricing policy is in furtherance of a horizontal retailer cartel, which was specifically discussed by the Supreme Court as an scenario in which resale price maintenance is particularly anticompetitive. As such, Plaintiff has clearly stated at least one anticompetitive scenario to defeat Leegin's motion to dismiss.

2. Plaintiff has Alleged that Leegin has Market Power

In addition to the fact that Leegin's price-fixing activities are in furtherance of a retailer cartel, Plaintiff has alleged, again with substantial support, that Leegin as a manufacturer has market power. Plaintiff has alleged that Leegin has a measure of market power as a result of its highly differentiated product line. Second Amended Complaint, ¶¶ 16–17. Plaintiff has also discussed Leegin's position as a dominant manufacturer in the relevant wholesale market. *Id*. at ¶ 18. Plaintiff has plead specific actions Leegin has taken to maintain and even increase its market power, including "(a) broadly and vigorously asserting tradedress/trademark infringement cases aginst other manufacturers who sough to offer competing products; (b) requiring retailers to carry minimum levels of product, so as to limit and foreclose the ability of those retailers to offer competing goods; (c) refusing to sell to retail dealers that carry certain competing product lines; and (d) exercising its dominant position in the Dallas market to discourage traffic to other distributors at certain times." *Id*. at ¶ 19. As a whole, Plaintiff alleges that Leegin's price-fixing scheme allows Leegin to "exercise[] its market power to limit or discourage the sales by stores of

products by new entrants." *Id*. at ¶ 31. Plaintiff's allegations regarding Leegin's relative power within the relevant market are set forth more fully in previous sections of this brief. (See *Infra* Sections I.A, B).

Again, the Supreme Court in *Leegin* specifically stated that when employed by a dominant manufacturer or retailer, resale price maintenance can be anticompetitive. *Leegin*, 127 S. Ct. at 2720. Plaintiff has alleged that Leegin is a dominant manufacturer in the wholesale market of name brand women's accessories sold through independent retailers and is a dominant retailer in the retail market for Brighton women's accessories in the greater Dallas area. As the Supreme Court has stated, therefore, Leegin may use resale price maintenance to achieve anticompetitive objectives and the relevant market is vulnerable to such uses by Leegin. This is another example of a specific anticompetitive scenario Plaintiff has explicitly pled in its Second Amended Complaint.

3. Plaintiff has Alleged Several other Anticompetitive Effects

In addition to the two anticompetitive scenarios specifically discussed in the *Leegin* opinion, Plaintiff alleges several other anticompetitive effects in its Complaint. First, Plaintiff alleges that "[b]rand-named women's accessories, and especially the area of handbags, can be characterized by the wide-spread adoption of practices that have the effect of limiting price competition among competing brands" such that "the effect of price fixing practices of [Leegin] results in consumers paying more and harm to those consumers." Second Amended Complaint, ¶ 32. As the Supreme Court stated, "the number of manufacturers that make use of the practice in a given industry can provide important instruction" regarding the anticompetitive effects of a resale price maintenance scheme. *Leegin*, 127 S. Ct. at 2719.

Plaintiff has also alleged that the alleged procompetitive benefits of resale price maintenance are not present in the market in question. For instance, as Plaintiff has alleged:

- Brighton products do not require services which would likely be underprovided without a price restriction and on which discounting retailers could free-ride;
- Leegin's price-fixing scheme actually hinders entry into the market; and
- Any services desired by Leegin could be required directly, and price-fixing is not the most efficient means of procuring these services.

Second Amended Complaint, ¶ 31. In the absence of the purported procompetitive benefits, Leegin's price-fixing scheme simply does nothing more than stabilize prices above competitive levels. Indeed, "resale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands." *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n.18 (1977)(quoting *White Motor Co. v. U.S.*, 372 U.S. 253, 268 (1963)). It is exactly this lack of price competition and maintenance of prices at artificially high and anticompetitive levels Plaintiff alleges is a primary anticompetitive effect of Leegin's price-fixing activities. Second Amended Complaint, ¶ 27.

Leegin criticizes Plaintiff's discussion of higher prices as an anticompetitive effect of its price-fixing activities. Leegin argues that the Supreme Court has noted that higher prices may be a secondary effect of the purported procompetitive benefits of resale price maintenance. Leegin argues that an allegation of higher prices alone is not a sufficient anticompetitive effect to support a claim under the Sherman Act. Notwithstanding the merits of this particular argument, Leegin again has ignored the fact that Plaintiff has set forth numerous and substantial anticompetitive scenarios in its Complaint. Plaintiff is not relying on the existence of higher

prices alone as an anticompetitive effect, but has pled the maintenance of higher consumer prices as one of a number of anticompetitive effects from the price-fixing activities of Leegin. Moreover, if the higher prices created by resale price maintenance are not accompanied by any of the purported procompetitive benefits of resale price maintenance, increased prices is certainly a detrimental anticompetitive effect of resale price maintenance practices.

In its Complaint, Plaintiff has set forth numerous anticompetitive effects and scenarios related to Leegin's price-fixing activities. Leegin would have the Court simply ignore these substantial and explicit allegations. Of course, the Court cannot do this at this stage, and must accept the well-pleaded facts on the face of the Complaint as true and view them in a light most favorable to Plaintiff. *In re Southern Scrap Material Co., LLC*, 541 F.3d 584, 587 (5th Cir. 2008). Plaintiff has set forth sufficient anticompetitive scenarios and affects from Leegin's price-fixing practices. As such, Leegin's motion to dismiss must be denied.

IV. CONCLUSION

Plaintiff has adequately pled an antitrust price fixing case under the Sherman Act under either the rule of reason or per se standard. Contrary to Leegin's arguments, Plaintiff has pled tenable product and geographic markets, has alleged that Leegin's price-fixing activity is pursuant to and in furtherance of a horizontal cartel and has set forth several anticompetitive scenarios and effects caused by Leegin's price-fixing. Therefore, and for the reasons set forth above, Plaintiff's Second Amended Complaint should not be dismissed, and Leegin's motion must be denied.

Dated: February 9, 2009 Respectfully submitted,

D. Neil Smith, State Bar No. 00797450
NIX, PATTERSON & ROACH, L.L.P.
205 Linda Drive
Daingerfield, TX 75638
Telephone: (903) 645-7333
Facsimile: (903) 645-4415

and

/s/ Robert W. Coykendall
Ken M. Peterson, Kansas State Bar No. 07499
Robert W. Coykendall, Kansas State Bar No. 10137
MORRIS, LAING, EVANS, BROCK
& KENNEDY, CHARTERED
300 North Mead, Suite 200
Wichita, Kansas 67202-2722
Phone: (316) 262-2671
Facsimile: (316) 262-5991

ATTORNEYS FOR PLAINTIFF

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 9th day of February 2009, a true and correct copy of the above **Plaintiff's Response to Defendant's Motion to Dismiss** was filed with the clerk of the court by using the CM/ECF system which will send a notice of electronic filing to all counsel who have registered for receipt of documents filed in this matter.

/s/ Robert W. Coykendall
Robert W. Coykendall