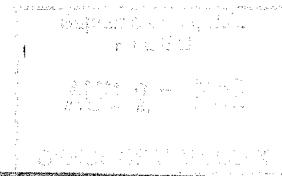


12-171
No.



In the Supreme Court of the United States

ROB BRANTLEY, DARRYN COOKE, WILLIAM and BEVERLEY
COSTLEY, PETER G. HARRIS, CHRISTIANA HILLS, MICHAEL B.
KOVAC, MICHELLE NAVARRETTE, JOY PSACHIE, and JOSEPH
VRANICH, individually and on behalf of all others
similarly situated,

Petitioners,

v.

NBC UNIVERSAL, INC., VIACOM INC., THE WALT DISNEY COMPANY,
FOX ENTERTAINMENT GROUP, INC., TURNER BROADCASTING
SYSTEM, INC., TIME WARNER CABLE INC., COMCAST CORPORATION,
COMCAST CABLE COMMUNICATIONS, LLC, COXCOM, INC.,
THE DIRECTV GROUP, INC., ECHOSTAR SATELLITE L.L.C.,
and CABLEVISION SYSTEMS CORPORATION,

Respondents.

*On Petition for a Writ of Certiorari to the United
States Court of Appeals for the Ninth Circuit*

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Do well-pleaded allegations of industry-wide vertical restraints that generate interdependent, cartel-comparable injuries—increased prices, suppressed distributor competition, and reduced consumer choice—state a Sherman Act Section 1 claim sufficient to survive a motion to dismiss?

PARTIES TO THE PROCEEDING AND
RULE 29.6 STATEMENT

The parties to this proceeding are each named in the caption.

Pursuant to this Court's Rule 29.6, undersigned counsel state that none of the Petitioners has a parent corporation, subsidiaries, or affiliates that have issued shares to the public.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners, a class of television viewers, respectfully petition this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The final and operative Ninth Circuit opinion of March 30, 2012 is reported at 675 F.3d 1192 (9th Cir. 2012), and is reproduced in the appendix hereto ("App."). App. 1-23. The May 4, 2012 order denying the petition for rehearing and rehearing en banc is unreported. App. 64-65.

The prior (now withdrawn) Ninth Circuit opinion of June 3, 2011 was published at 649 F.3d 1078 (9th Cir. 2011). App. 26-41. On July 7, 2011, petitioners moved for rehearing and rehearing en banc. The Ninth Circuit order of October 31, 2011 withdrawing the opinion and reconstituting the panel is published at 661 F.3d 1199 (9th Cir. 2011). App. 24-25. The Oct. 15, 2009 opinion of the United States District Court for the Central District of California granting defendants' motion to dismiss is unreported. App. 42-63.

JURISDICTION

On March 30, 2012, the Ninth Circuit filed its opinion and entered judgment in this case. App. 1-23. On May 4, 2012, the Ninth Circuit denied petitioners' timely petition for rehearing and rehearing en banc. App. 64-65. The jurisdiction of

this Court is invoked under 28 U.S.C. § 1254(1). The district court had jurisdiction over petitioners' claims pursuant to 28 U.S.C. § 1331. The Ninth Circuit had jurisdiction to review the district court's final judgment pursuant to 28 U.S.C. § 1291.

STATUTORY PROVISION INVOLVED

Section 1 of the Sherman Act (15 U.S.C. § 1) provides in pertinent part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is hereby declared to be illegal."

INTRODUCTION

In a Sherman Act case of moment for the future of television viewing in the United States¹, this Court has an opportunity to provide much needed guidance on application of the rule of reason to industry-wide vertical restraints that give rise to the same injuries a cartel would cause. The petitioners seek primarily injunctive relief from a series of contractual restraints imposed by powerful television programmers. The complaint alleges that these vertical restraints suppress competition among and between cable, satellite, and fiber optic distributors of television programming, resulting in increased prices for consumers (the complaint cites

¹ A July 13, 2012 *Los Angeles Times* article entitled "*Give us a la carte channel pricing*" explains the importance of this case for the future of television viewing. See David Lazarus, *Give us a la carte channel pricing*, L.A. Times, July 13, 2012, at <http://articles.latimes.com/print/2012/jul/13/business/la-fi-lazarus-20120713>.

an FCC report estimating the overcharges at about \$100 million annually) and depriving consumers of meaningful choices.

The Ninth Circuit opinion offered a confused, sometimes contradictory, and strict categorical view of vertical restraints. The opinion instructed that such restraints are, even when industry-wide in scope, beyond the reach of the Sherman Act unless they fall under one of two narrow categories: (1) vertical restraints that facilitate horizontal collusion; and (2) vertical restraints or tying conduct that foreclose rivals of the firm imposing the restraint. App. 10-11, 16-17. The ruling is a fundamental misreading of the Sherman Act and the rule of reason that governs its application, a distortion of this Court's teaching in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), and a failure to follow this Court's standards for granting a motion to dismiss as set forth in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).

Clarifying application of the rule of reason to industry-wide vertical restraints would come in the context of a signature case that could shape both traditional distribution and Internet distribution for television programming in the United States. The Court would also have the opportunity to clarify standards governing a motion to dismiss under *Twombly* and *Iqbal*.

In *Leegin*, this Court provided helpful reference points to guide litigants in the application of the rule of reason to vertical restraints. Under the rule of reason, the "factfinder weighs all of the circumstances of a case in deciding whether a

restrictive practice should be prohibited as imposing an unreasonable restraint on competition.” 551 U.S. at 885 (citing with approval *Continental Television, Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977)). Applying this approach to resale price maintenance, the Court specified that “the number of manufacturers . . . in a given industry” that make use of resale price maintenance “can provide important instruction” and that an industry-wide restraint “should be subject to more careful scrutiny.” *Leegin*, 551 U.S. at 897.

In affirming dismissal on the pleadings as a matter of law, the Ninth Circuit declined to follow the Court’s roadmap, relying instead on a rigid categorization that sidestepped a meaningful competitive analysis. Under that categorization, any vertical restraint claim will be dismissed as a matter of law unless it facilitates horizontal collusion or forecloses a rival of the firm imposing the restraint. A broad swath of potentially anticompetitive vertical behavior often will fall outside the panel’s narrow exceptions, including most favored nation clauses² and anti-steering clauses³, even when the restraints

² See, e.g., *United States v. Delta Dental of R.I.*, 943 F. Supp. 172, 177 (D.R.I. 1996) (where exclusion was alleged but competitive harm did not depend upon it, most favored nation clause could be unreasonable vertical restraint where it “ultimately results in higher prices . . . for consumers”).

³ Amended Complaint at ¶ 77, *United States v. American Express Co.*, C.A. No. 10-4496 (E.D.N.Y. filed Dec. 21, 2010) available at <http://www.justice.gov/atr/cases/f265400/265401.pdf> (alleging that vertical agreements had “anticompetitive effects by protecting Defendants from competition over the cost of card acceptance by merchants, and

have industry-wide effects comparable to a horizontal cartel. Indeed, under the Ninth Circuit's holding, resale price maintenance, which this Court five years ago warned had "potential anticompetitive consequences" that "must not be ignored or understated" (*Leegin*, 551 U.S. at 894), would now, because of the absence of any foreclosure of rivals, be effectively per se legal except under narrow circumstances.⁴

STATEMENT OF THE CASE

A. Forced Bundling Restraints in the Pay Television Industry

From its nascent years in the mid-twentieth century, the cable television industry has offered cable channels in bundles, forcing consumers to purchase large numbers of channels in order to receive the few they actually watch. The history of cable television is surveyed in *Cablevision Systems Corp. v. Federal Communications Commission*, 597 F.3d 1306 (D.C. Cir. 2010). Television viewers of the past who chafed under the high cost of buying the

restraining merchants from encouraging customers to use lower-cost payment methods").

⁴ The Court in *Leegin* listed a number of scenarios under which resale price maintenance may be anticompetitive that would not necessarily involve either the facilitation of a horizontal cartel or foreclosure of manufacturer competition. Resale price maintenance "could discourage a manufacturer from cutting prices to retailers with the concomitant benefit of cheaper prices to consumers." *Leegin*, 551 U.S. at 892. Or resale price maintenance, when widely pursued in the industry, may deprive "consumers of a meaningful choice between high-service and low-price outlets." *Id.* at 897.

entire bundled package known as expanded basic cable faced two obstacles to effective antitrust relief. First, cable distributors of an earlier era were government-licensed monopolists. *Id.* at 1308. Indeed, as recently as 1992, traditional cable television providers controlled 95 percent of the pay television market. *Id.* at 1309. Untangling a government-sanctioned monopoly was a potentially intractable problem for an antitrust court. Second, given the limited technology available in earlier years, forced tiered bundles were arguably an efficient method of distribution. Today, neither obstacle prevents effective antitrust relief.

B. Well-Pleaded Allegations in the Complaint

As the complaint describes, the government-licensed cable distributor is no longer a monopolist. Consumers can choose among the traditional cable company, two national satellite providers, and telephone companies that distribute programming with fiber optic cables. App. 79 at ¶ 3. In many urban areas, consumers can now choose among four distributors. The second obstacle to antitrust relief is also gone. More sophisticated technology makes it efficient to offer smaller and individually tailored packages to consumers. Distributors have openly declared their readiness to provide such packages. App. 94-97 at ¶ 44. Television distributors outside the United States already provide television programming a la carte or in smaller packages. App. 97-98 at ¶ 45.

Despite an infrastructure conducive to competition, today's distributors cannot compete meaningfully with one another because powerful programmers forbid it in a series of parallel contracts with all distributors. The complaint names five powerful programmers: NBC Universal (now owned by Comcast Cable Communications, LLC, another named defendant), Viacom Inc., The Walt Disney Company, Fox Entertainment Group, Inc., and Time Warner Inc. Each of these five firms owns one or more "must have" channels that allow the firm to dictate bundling and tiering restrictions to distributors, requiring that all of the programmer's channels be carried on bundled tiers as specified by the programmer. App. 76-78 at ¶ 2.

The large programmers (some vertically integrated into distribution) dominate television offerings. The complaint alleges that, of the roughly 60 channels available in the basic and expanded basic tiers in the Los Angeles area, thirteen are entirely or partly owned by NBC Universal, nine by Viacom, seven by Fox, eleven by Disney, and sixteen by Turner and Liberty Media combined. App. 92-93 at ¶ 42. Each of these powerful programmers has enhanced incentive to insist on carriage of all of its channels because of the dual revenue stream that flows from carriage. Programmers receive payment from the distributor for each channel that is carried and also receive substantial advertising revenues that would disappear if the channel was not carried. This dual revenue source is a major reason that powerful programmers disagree with distributors on the marketing of programming. The distributors, unlike the programmers, derive revenues primarily

from a single source—consumers who buy the television programming. The complaint seeks relief to free distributors of the forced bundling and tiering restraints, allowing them to market in a manner responsive to consumer demand. App. 79 at ¶ 3.

C. Nature of the Restraints and Their Anticompetitive Effects

The complaint does not allege a horizontal conspiracy, but does allege that the vertical bundling restraints are interdependent: each programmer acts “with the knowledge and anticipation that each other major programmer will do likewise.” App. 93-94 at ¶43. If distributors were free to design distribution packages in a manner that maximized consumer subscriptions, the benefit from this increased output would flow to consumers and competition-savvy distributors. Distributors readily acknowledge these restraints and their impact on competition.

The complaint quotes Charles Dolan, Chairman of defendant Cablevision: selling a la carte “would be better for the consumer we do not believe in the long term that selling programming a la carte will be detrimental to either programmers or cable operators.” App. 94-97 at ¶ 44.

The complaint quotes the Chairman and CEO of defendant EchoStar (Dish Network):

Unfortunately, the largest programmers, particularly those that own a big network, have the muscle to

control the way that pay television providers offer programming to consumers. . . . [B]undling of must-have and other content in a single deal is a well-established problem in the industry. . . . [R]estrictions on how . . . [distributors] present their packages curtail the ability of [distributors] to design alternative programming packages.

App. 95 at ¶ 44.

The complaint also quotes the comments of the Broadband Service Providers Association (representing largely telephone companies that distribute television programming through fiber optic lines). The Association advised the FCC that “wholesale programming practices that include tying and bundling of content and the required placement on particular tiers constrain the way [distributors] can package their services to subscribers and their ability to respond to consumer demand in their competitive [distribution] markets.” App. 96 at ¶ 44. Representatives of other distributors agree. App. 79-80, 94-97 at ¶¶ 4, 44.

Each powerful programmer has an independent incentive to require distributors to bundle all of the programmer’s channels, including low-demand channels. This makes sense to the programmer because even low-demand channels can generate significant advertising revenues. When these restraints are imposed industry-wide, the collective impact is a suppression of competition among distributors and reduced output (the large

bundles are costly and unattractive to both distributors and many consumers). If all forced bundling restraints were removed, the market for pay television subscriptions would become responsive to consumer demand. Distributors would be free to “design alternative programming packages” and compete amongst themselves to offer smaller, tailored packages or even a la carte channel offerings.

In 2007, petitioners brought this Sherman Act action alleging that powerful television programmers employ contract provisions that force distributors, and through them consumers, to purchase the entire slate of expanded basic cable offerings. The nature of the restraint is described in paragraph 4 of the complaint:

Competition among distributors for consumer business *has been significantly suppressed and eliminated* because . . . [distributors’] creativity in offering smaller packages or channels on an unbundled basis has been circumscribed by the contract between each distributor and each programmer which prohibits such offerings.

App. 80 at ¶ 4 (emphasis added).

Petitioners crafted the complaint as a rule of reason claim, abjuring any reliance on the modified per se rule that governs tying conduct. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984). Although the forced vertical bundling restraints at issue have similarities to certain types of tying

conduct, a critical distinction is that the industry-wide and interdependent nature of these restraints generates cartel-comparable injury not present in routine tying cases. This unique feature requires a fresh, flexible, fact-based rule of reason analysis, unencumbered by assumptions and limiting doctrine associated with the modified per se rule applicable to traditional tying which normally does not produce cartel-like effects.

D. Proceedings Below

From the outset of this litigation, the parties have disagreed whether a Sherman Act Section 1 complaint alleging industry-wide vertical restraints requires an allegation of foreclosure in the *upstream* market for television programmers. The district court agreed with defendants that such an allegation of foreclosure was required, and dismissed the first amended complaint subject to petitioners' right to amend the complaint. The second amended complaint included such an allegation, but after initial discovery, the two sides entered into a stipulation that anticipated the filing of a third amended complaint omitting any alleged foreclosure injury for rival programmers, and the filing of motions that would allow the district court definitively to resolve the foreclosure issue. Lead counsel for the plaintiffs explained that development of a full record on foreclosure of programmers would, because of the number of firms involved:

be time consuming, enervating and expensive. . . . The foreclosure of

independent programming is not a quantifiable loss, is not what the plaintiffs' claim is about and did not motivate the filing of the case. . . . [P]rogramming foreclosure, which is the essence of a claim by an excluded competitor, has no place analytically in a consumer class action charging deprivation of choice and overcharge."

App. 68.

In its final form, the third amended complaint omits any claim of foreclosure of programming rivals, but strongly and repeatedly alleges injury to distributors flowing from the vertically-imposed contractual restraints.⁵ On October 15, 2009, the district court dismissed the complaint with prejudice, ruling that a viable Section 1 complaint must allege foreclosure among *upstream* television programmers. App. 42-63.

Consumer plaintiffs appealed to the United States Court of Appeals for the Ninth Circuit. In an opinion dated June 3, 2011, the Ninth Circuit affirmed the district court's ruling. App. 26-41.

⁵ App. 79 at ¶ 3 (absent the vertical restraints, distributors "would develop ways to differentiate themselves," by offering smaller bundles or a la carte channels); App. 79-80 at ¶ 4 ("competition among distributors . . . has been significantly suppressed and eliminated because their creativity in offering smaller packages or channels on an unbundled basis has been circumscribed" by the restraints); App. 93-94 at ¶ 43 (the restraints have "eliminated competition among and between the distributors"); App. 94-97 at ¶ 44 ("but for programmer coercion . . . [distributors] would offer such unbundled cable channels to consumers").

Petitioners moved for rehearing and rehearing en banc. The panel's decision was withdrawn on Oct. 31, 2011, and a new judge was named to a reconstituted panel. App. 24-25. On March 30, 2012, the Ninth Circuit issued its revised opinion, again affirming the district court's ruling. App. 1-23. The Ninth Circuit's opinion acknowledged language in the complaint alleging competition-stifling injuries to downstream distributors and consumers. App. 4, 17. While not disputing that a horizontal restraint involving the same downstream effects (increased prices, suppressed distributor competition, and deprivation of consumer choice) would constitute injury to competition, the Ninth Circuit nonetheless concluded that the complaint, grounded on a series of parallel vertical restraints, did not adequately plead injury to competition and affirmed dismissal on the pleadings as a matter of law.

The Ninth Circuit opinion recited three areas in which Sherman Act section 1 claims are cognizable: (1) a horizontal conspiracy; (2) a vertical conspiracy involving tying conduct that forecloses rivals from participation in the tied product market; or (3) a vertical conspiracy that facilitates horizontal collusion. App. 10-11, 16-17. Sidestepping the express language in the complaint alleging that the bundling restraints "significantly suppressed and eliminated" downstream distributor competition (App. 79-80 at ¶ 4), the panel wrote that the petitioners "disavow any intent to allege that the practices . . . *foreclosed* rivals from entering or participating in the upstream or *downstream* markets." App. 17 (emphasis added). The Ninth

Circuit reasoned that the complaint failed to identify “*standard-issue threats* to competition” such as exclusion of “sellers of the tied product” or facilitation of “horizontal collusion.” App. 17 (emphasis added). The Ninth Circuit adopted a strict categorical view of the Sherman Act which apparently allows only for garden variety claims of anticompetitive injury. The holding is anathema to the Act and this Court’s venerable interpretations of it.

On May 4, 2012, the Ninth Circuit denied plaintiffs’ petition for rehearing and rehearing en banc. App. 64-65.

REASONS FOR GRANTING THE PETITION

I. This Court Can Provide Needed Clarification of the Rule of Reason Analysis as Applied to Industry-Wide Vertical Restraints with Cartel-Comparable Injuries

The Ninth Circuit opinion is inconsistent with the guidance of *Leegin*, leaving counselors and courts in doubt as to how to approach a series of parallel vertical restraints involving the interdependent and industry-wide conduct of power-wielding firms. This Court can provide meaningful clarification on how standards for dismissal on the pleadings and the rule of reason apply to such vertical restraints when the anticompetitive effects are comparable to a cartel. In doing so, the Court can resolve an important question on how television programming

is distributed to consumers both now and, as the industry adapts to Internet options, in the future.

A. The Rule of Reason Abjures Categorization at the Expense of Fact-Based Analysis

The venerable rule of reason, now just over a century old, has taken on increased importance as the primary method for evaluating vertical and many horizontal restraints. In 1911, the Supreme Court addressed the sweeping words of Section 1 of the Sherman Act—prohibiting contracts, combinations or conspiracies “in restraint of trade”—and concluded that, in light of common law history, the Act reaches only *unreasonable* restraints of trade. *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1 (1911). Over the next century, the Court has shaped this rule. To determine the legality of a restraint, a court must “ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable.” *Chi. Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (Brandeis, J.). “In its design and function the rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer’s best interest.” *Leegin*, 551 U.S. at 886.

The Ninth Circuit paid scant attention to this Court’s guidance in determining that the complaint should be dismissed as a matter of law. The opinion

described only two types of vertical restraints that are actionable: vertical agreements “that foreclose competitors from entering or competing in a market” and agreements that “injure competition by facilitating horizontal collusion.” App. 10-11. The Ninth Circuit declared that the complaint raised a “tying” issue (App. 15) and stated that tying can be unlawful only if it results in foreclosure in the “tied product” market. App. 11, 16-17. This rigid and formulaic approach is at odds with the factual analysis required under the rule of reason and with this Court’s repeated admonitions that a competitive analysis “must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing.” *Sylvania*, 433 U.S. at 58-59; accord *Leegin*, 551 U.S. at 887-88 (quoting *Sylvania*).

A case-by-case analysis is the starting point for rule of reason analysis. Commenting on the Act that was to bear his name, Senator Sherman noted that the courts should “determine in each particular case” the “precise line between lawful and unlawful combinations.” 21 Cong. Rec. S2456-60 (daily ed. Mar. 21, 1890). The Court has on occasion permitted short cuts in horizontal cases with cartel implications. *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 109 (1984) (“no elaborate industry analysis is required to demonstrate the anticompetitive character” of restraints on “price and output”). Even cartel cases, however, require “an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint.” *Cal. Dental Ass’n v. FTC*, 526 U.S. 756, 780-81 (1999); accord *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 34-35 (D.C. Cir. 2005) (the Court has “backed away

from any reliance upon fixed categories” and transitioned to a “more nuanced and case-specific inquiry” which is “tailored to the suspect conduct in each particular case”).

This Court has repeatedly embraced the position that “Congress designed the Sherman Act as a ‘consumer welfare prescription.’” *NCAA*, 468 U.S. at 107; *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 367 (1982); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979). “The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade.” *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1958); accord *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 608 (1972) (referring to Sherman Act as Magna Carta of free enterprise; antitrust laws “are as important to the preservation of economic freedom and our free-enterprise systems as the Bill of Rights is to the protection of our fundamental personal freedoms”). As Justice Breyer noted recently, “a basic antitrust assumption” is that “consumers often prefer lower prices to more service” and “providing consumers with a free choice about such matters” is “a basic antitrust objective” embodied in the law. *Leegin*, 551 U.S. at 927 (Breyer, J., dissenting).

In *Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 528 (1983), this Court recognized that “[c]oercive activity that prevents its victims from making free choices between market alternatives is inherently destructive of competitive conditions and may be condemned even without proof of its actual market effect.” It further noted

that “the Sherman Act was enacted to assure customers the benefits of price competition, and our prior cases have emphasized the central interest in protecting the economic freedom of participants in the relevant market.” *Id.* at 538.

Under the Sherman Act, “the essential inquiry remains the same—whether or not the challenged restraint enhances competition.” *NCAA*, 468 U.S. at 104. Wholly apart from labels, the test is whether an alleged restraint produces an anticompetitive effect. *See Leegin*, 551 U.S. at 905-06 (noting that Congress “chose a more flexible option” and that price restraints are to be analyzed “in conformance with traditional § 1 principles, including the principle that our antitrust doctrines ‘evolve with new circumstances and new wisdom’”) (citation omitted); *Cal. Dental*, 526 U.S. at 780-81 (“essential inquiry remains the same—whether or not the challenged restraint enhances competition” which requires an “enquiry meet for the case, looking to the circumstances, details, and logic of a restraint”); *id.* at 793 (Breyer, J., dissenting) (analysis is “not rigid; it admits of some variation according to the circumstances” and “reflects a gradual evolution”).

The Ninth Circuit’s insistence that injury to competition can only be alleged when there is a horizontal agreement or foreclosure of rivals exalts form over substance and attempts to force this case into categories that are ill-suited and not factually analogous, precisely the approach that the Court has repeatedly condemned. *See, e.g., Eastman Kodak v. Image Technical Servs.*, 504 U.S. 451, 466-67 (1992) (“Legal presumptions that rest on formalistic distinctions rather than actual market realities are

generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the ‘particular facts disclosed by the record.’” (citation omitted)).

The gravamen of this antitrust complaint is that each television distributor is forced to cede control of vital aspects of its business to powerful programmers imposing contractual restraints. Here, the “agency” problem is that powerful programmers are, as the result of their “must have” channels, in a position to force an anticompetitive agency relationship on independent downstream distributors, and abuse that agency power to force bundled distribution antithetical to competition, the business interests of distributors, and television consumers.

In the area of vertical restraints, this Court took major steps in offering guidance on the rule of reason’s application in its *Leegin* decision. 551 U.S. at 892-94, 897-99. The Court stressed that “the rule of reason is designed and used to eliminate anticompetitive transactions from the market.” *Id.* at 898. This Court now has an opportunity to clarify how *Leegin* applies to industry-wide and interdependent vertical restraints that have cartel-comparable effects.

B. Cartel-Comparable Injuries
 Involving Suppressed Interbrand
 Competition and Increased
 Consumer Prices Should Be
 Treated Similarly Regardless of a
 Vertical or Horizontal
 Characterization

The complaint contains well-pleaded allegations, often using the words of the defendant distributors themselves, that the bundling restraints raise prices (App. 80, 93-94 at ¶¶ 5, 43), significantly suppress and eliminate distributor competition (App. 79-80, 93-94 at ¶¶ 4, 43), deprive consumers of choice (App. 93-94 at ¶ 43), with industry-wide and interdependent impact on the market (App. 76-78, 93-94 at ¶¶ 2, 43). “Restrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit.” *NCAA*, 468 U.S. at 107-08. Under the Ninth Circuit’s categorical view of the Sherman Act recognizing only “standard-issue” (App. 17) threats to competition, the facts pleaded in the complaint are sufficient to support a claim if the restraints are characterized as horizontal, but not if they are deemed vertical.

The leading antitrust treatise makes the pivotal point that “horizontal and vertical restraints do not always threaten competition in different ways, or call for different analysis.” 7 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 1503a, at 392 (3d ed. 2010). Indeed, disputes over characterization may obscure analysis

of real anticompetitive effects. Mark Lemley & Christopher Leslie, *Categorical Analysis in Antitrust Jurisprudence*, 93 Iowa L. Rev. 1207, 1265 (2008) (“direct evidence of anticompetitive effects should be sufficient to establish the plaintiff’s prima facie case regardless of whether or the restraint is categorized as horizontal or vertical”). This Court agrees.

In more than a century of Sherman Act jurisprudence, the Court has focused not on rigid characterizations, but on the *impact* of contracts that foster cartel or cartel-like conduct. Most recently, in rejecting per se analysis of resale price maintenance, the Court made clear that a vertical characterization also allows condemnation of a pernicious downstream restraint under the rule of reason. *Leegin*, 551 U.S. at 897. The Ninth Circuit’s decision to dismiss the well-pleaded complaint as a matter of law denies the fact-finder an opportunity to weigh “all of the circumstances of a case in deciding whether a restrictive practice should be prohibited.” *Sylvania*, 433 U.S. at 49, *quoted with approval in Leegin*, 551 U.S. at 885. Indeed, it precludes the gathering and analysis of “all of the circumstances” the rule mandates.

The Ninth Circuit’s categorization would render per se lawful many vertical restraints, even when those restraints occasion cartel-comparable injuries. For example, widespread use of resale price maintenance in a market segment, although not constituting a cartel, may deprive “consumers of a meaningful choice between high-service and low-price outlets.” *Leegin*, 551 U.S. at 897. A dominant retailer “might request resale price maintenance to forestall innovation in distribution that decreases

cost.” *Id.* at 893-94. The competition affected under these uses of resale price maintenance would be downstream competition, which the Ninth Circuit apparently deemed inadequate to state a Section 1 claim under the Sherman Act.

C. The Complaint’s Detailed and Well-Pleaded Allegations of Paradigmatic Anticompetitive Effects Among Distributors and Consumers Preclude Dismissal as a Matter of Law

In *Bell Atlantic v. Twombly*, 550 U.S. 544, 570 (2007), this Court held that to survive a motion to dismiss, an antitrust complaint must contain well-pleaded facts sufficient to “state a claim that is plausible on its face.” In *Ashcroft v. Iqbal*, 556 U.S. 662, 686 (2009), the Court amplified this holding, stating that the Federal Rules “do not require courts to credit a complaint’s conclusory statements without reference to its factual context.” The Ninth Circuit, however, apparently interpreted the Court’s *Twombly/Iqbal* standards as allowing it to recharacterize the complaint and selectively ignore or downplay well-pleaded facts.

Neither case offers such license. Nothing in *Twombly* or *Iqbal* negates this Court’s venerable rule that, in ruling on a motion to dismiss, the court must undertake a fair and accurate reading of the complaint that accepts its well-pleaded facts. “When there are well-pleaded factual allegations, a court should assume their veracity and then determine

whether they plausibly give rise to an entitlement to relief.” *Iqbal*, 556 U.S. at 679.

The Ninth Circuit characterized the complaint as stating a traditional tying violation that would require a foreclosure of upstream programming content. App. 11, 15. In fact, the complaint describes the forced bundling and tiering practices of programming defendants not as a traditional tying violation that forecloses upstream programming rivals, but as bundling conduct directed at suppressing downstream competition. The complaint uses the term “bundling” or variations such as “bundled package” or “forced bundling” 25 times. App. 73-101 (*passim*). These bundling restraints, unlike traditional tying, have their primary effect upon downstream distributors. See App. 79-80 at ¶ 4 (describing the suppression of “competition among distributors for consumer business”). Although the Ninth Circuit acknowledged some of these facts (App. 4, 17), it selectively ignored them in concluding that the complaint alleged no harm to competition (App. 16-17).

“The Sherman Act reflects a legislative judgment that ultimately competition will not only produce lower prices, but also better goods and services.” *Nat’l Soc’y of Profl Eng’rs v. United States*, 435 U.S. 679, 695 (1978). An assumption that competition best allocates resources in the free market “recognizes that all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers.” *Id.* In affirming dismissal of the complaint, the Ninth

Circuit concluded that petitioners did not adequately allege “injury to competition.” App. 22. Yet key language in the complaint alleges, in part by citing the words of defendant distributors, that competition among distributors is eliminated and suppressed by the programmer-imposed bundling restraints. App. 79-80, 93-94 at ¶¶ 4, 43. These allegations are amplified by detailed claims that the industry-wide forced bundling restraints result in an increase in prices, citing the FCC’s report that overcharges of \$100 million annually (App. 80, 93-94 at ¶¶ 5, 43), deprivation of consumer choice (App. 93-94 at ¶ 43), and reduced output due to the aggregate impact of the industry-wide restraints (App. 76-78 at ¶ 2) and the interdependent nature of the programmers’ conduct (App. 93-94 at ¶ 43). The loss of output from the restraints is another key Sherman Act measure of anticompetitive impact. *See, e.g., NCAA*, 468 U.S. at 104-10. From the standpoint of addressing the Sherman Act’s goals, it is difficult to imagine a more comprehensively pleaded complaint addressing paradigmatic anticompetitive injuries. The Ninth Circuit’s conclusion that the complaint failed to plead “injury to competition” is simply wrong.

D. The Ninth Circuit
 Mischaracterized the Complaint
 and Misstated the Law Governing
 Tying

The Ninth Circuit concluded that “tying arrangements, without more, do not necessarily threaten an injury to competition.” App. 16. “[T]he complaint does not allege the types of injuries to

competition that are typically alleged to flow from tying arrangements.” *Id.* In particular, the Ninth Circuit concluded that there was no allegation of “standard-issue threats to competition”—that the bundling restraints “foreclosed rivals from entering or participating in the upstream or downstream markets.” App. 17. Later, the Ninth Circuit stated that the complaint failed to allege any effect “on Distributors’ competition as to cost and quality of service.” App. 22. Both statements are incorrect.

This transparent misreading of the complaint is all the more puzzling because the Ninth Circuit itself acknowledged on two occasions the complaint’s allegations of foreclosure injury to distributors: the bundling restraints “impair competition among Distributors for consumer business” (App. 4); and the restraints “limit[] the manner in which Distributors compete with one another” (App. 17). These allegations are on point because the theory of the complaint and the basis for the relief being sought is that *downstream* competition among distributors (not *upstream* competition among programmers) has been “significantly suppressed and eliminated.” App. 79-80 at ¶ 4. The Ninth Circuit’s selective misreading of and disregard for the language of the complaint goes well beyond any license this Court has granted in *Twombly* or *Iqbal*.

United States v. Loew’s Inc., 371 U.S. 38 (1962) is a bundling case in which television stations were compelled by powerful movie distributors to buy bundles of low-demand movies in order to obtain high-demand movies for screening. The Court found the bundling conduct violated Section 1 of the Sherman Act, resting its conclusion on the

foreclosure effect on upstream programming rivals. *Id.* at 48-49. The complaint here also focuses on foreclosure, but alleges that the exclusionary effects occur at the downstream, distributor level. Although downstream foreclosure was not the focus in *Loew's*, nothing in the Court's opinion suggests that foreclosure is harmful only when upstream rivals are excluded.

Loew's also provides a basis for assessing the non-foreclosure effects of the bundling conduct. Nobel laureate economist George Stigler wrote an article analyzing *Loew's* and disagreed with the foreclosure analysis. Instead, Stigler concluded that the bundled licensing of movies allowed the seller to price discriminate and extract higher prices from the purchasing television stations. George J. Stigler, *United States v. Loew's Inc., A Note on Block Booking*, 1963 Sup. Ct. Rev. 152, 153. Stigler's price discrimination insights were the basis for this Court's observation in *Jefferson Parish* that tying can "either harm existing competitors or create barriers to entry of new competitors in the market for the tied product, *and can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie.*" 466 U.S. at 14-15 (emphasis added) (internal citation omitted); see also *id.* at 13 n.19.

The Ninth Circuit cited the Court's language (App. 11), but omitted the italicized words that address non-foreclosure injuries from tying. Justice O'Connor's concurring opinion in *Jefferson Parish* also acknowledged that tying can be harmful beyond its exclusionary or foreclosing impact. 466 U.S. at 35

(O'Connor, J., concurring) (the "purpose of tying law" is "to identify and control those tie-ins that have demonstrable exclusionary impact in the tied product market, *or that abet the harmful exercise of market power that the seller possesses in the tying product market*") (emphasis added) (internal citation omitted).⁶ Stigler's analysis was more recently amplified and explained in an award-winning article by a Harvard Law School professor. Einer R. Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 Harv. L. Rev. 397 (2009).

Although the complaint refers to the price discrimination impact of the bundling restraints (App. 97-98 at ¶ 45) and petitioners' filings in the Ninth Circuit emphasized the non-foreclosure injuries from bundling, the Ninth Circuit ignored these anticompetitive effects, instead persisting with an approach that is not at the heart of the anticompetitive injury—foreclosure of upstream rivals under conventional tying law. Given the significant legal and public policy issues of this case, the Ninth Circuit's refusal to address these non-foreclosure harms is perplexing; disregarding their import in the context of a motion to dismiss is a fundamental error of law.

⁶ In his dissenting opinion in *Fortner Enterprises, Inc. v. United States Steel Corp.* (*Fortner I*), 394 U.S. 495, 513-14 (1969), Justice White explained two ways in which tying might have anticompetitive price discrimination effects: "[T]ying arrangements may be used . . . as a counting device to effect price discrimination [requirement ties]; and they may be used to force a full line of products on the customer so as to extract more easily from him a monopoly return on one unique product in the line."

Respondents are free to dispute facts asserted in the complaint (even if many of the pleaded facts were based on statements of defendant distributors). Respondents are also free to contest the economic theories that explain the anticompetitive injuries (even if the complaint's claims are based on theories that have a substantial pedigree in past decisions of this Court and in the economic literature). However, the appropriate forum for resolution of such issues would *not* be on a motion to dismiss, but on a full record after facts and economic theories are thoroughly tested in discovery.

E. The Ninth Circuit Erroneously
Disregarded Allegations of
Increased Prices and Loss of
Consumer Choice

The Ninth Circuit concluded that a combination of pricing effects and deprivation of consumer choice does not establish an injury to competition. App. 18. However wrong that proposition is, it is also incomplete. The complaint alleges much more, including detailed allegations of how the bundling restraints suppress and eliminate competition among distributors, have interdependent effects among programmers, and have aggregate or industry-wide effects on both distributors and consumers. These additional allegations are ignored as the Ninth Circuit proceeded to dissect individual allegations in piecemeal fashion. In doing so, the Ninth Circuit fell into a common trap—reading individual allegations in isolation while ignoring the impact of the

allegations as a whole. In the context of a summary judgment motion on the question of whether a Sherman Act Section 1 conspiracy existed, Judge Posner wrote that a “trap to be avoided . . . is to suppose that if no single item of evidence presented by the plaintiff points unequivocally to conspiracy, the evidence as a whole cannot defeat summary judgment.” *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 655 (7th Cir. 2002).

Although the loss of consumer choice, standing alone, may not signal an injury to competition, it is an integral part of a careful analysis of anticompetitive impact. “A restraint that has the effect of reducing the importance of consumer preference in setting price and output is not consistent with this fundamental goal of antitrust law.” *NCAA*, 468 U.S. at 107. The Ninth Circuit relied on this Court’s observation in *Leegin* that price increases from vertical restraints may be the result of additional procompetitive services provided by dealers. App. 18 (citing *Leegin*, 551 U.S. at 895-97). This reliance is misplaced.

The Court in *Leegin* was confronting the question whether to replace the per se rule with the rule of reason, an analysis quite different than whether to conclude, as a matter of law, that an allegation of price-increasing effects cannot survive a motion to dismiss under a rule of reason standard. Moreover, *Leegin* was addressing the potential procompetitive effects from resale price maintenance, which are related to enhanced dealer services which *increase* consumer choice. The complaint here emphatically alleges that the industry-wide forced bundling restraints have the

dubious distinction of *both raising prices and decreasing consumer choice*.

The Ninth Circuit repeatedly referred to the complaint as seeking “to compel programmers and distributors of television programming to sell each cable channel separately.” App. 3; *see also* App. 18, 28. Such statements imply that plaintiffs are seeking a highly regulatory decree. Nothing could be further from the truth. The complaint seeks to eliminate forced bundling contractual restraints “so the market responds to the forces of competition.” App. 80 at ¶ 6. Freed of the forced contractual restraints, “distributors would develop ways to differentiate themselves” through either “a la carte or smaller user friendly packages.” App. 79 at ¶ 3. The objective of the complaint is not to substitute court regulation for the forced bundling restraints, but to remove the bundling restraints so that *competition* will determine market outcomes.

CONCLUSION

The rule of reason has become the metric of choice for assessing allegedly anticompetitive vertical restraints. The Court has an opportunity to provide much needed clarification on how the Sherman Act applies to industry-wide and interdependent vertical contracts that have cartel-comparable effects on an industry of great interest to consumers. The outcome of this case could greatly affect television viewing in the United States, potentially increasing output, lowering prices, and generating greater choices for consumers. The exercise of this Court’s supervisory hand is also

warranted because the Ninth Circuit's selective and highly inaccurate reading of the complaint warrants intervention. At stake is whether the Sherman Act applies only to "standard-issue" threats to competition, or whether the Act is sufficiently flexible and comprehensive to address novel but genuine anticompetitive harm. This Court has an opportunity to steer the hand of justice not only in this case but in future cases implicating the standards for granting a motion to dismiss. For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully Submitted,

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