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Sixth Circuit *En Banc* Ruling Dismisses Exclusive Dealing Monopolization Suit By Rival

It is axiomatic that the antitrust laws are meant to protect competition, not competitors, and in some circumstances rivals are precluded from bringing antitrust suits because the injury they seek to redress flows from vigorous competition rather than any competition-reducing conduct. In a recent appeal, the Sixth Circuit, sitting *en banc,* was called upon to apply the axiom to a case that had divided one of its panels.

In *NicSand v. 3M,*[1] a distributor of automotive sandpaper alleged that it lost its market-leading position to a competitor that took away business by offering retailers substantial upfront payments in exchange for multi-year exclusive contracts. The Sixth Circuit, sitting *en banc*, affirmed a district court's dismissal of antitrust claims, agreeing with the lower court's determination that the pleading itself demonstrated that the plaintiff had not suffered antitrust injury.[2]

Factual and Procedural Background

The plaintiff, NicSand, alleged that it had developed a niche market supplying "do-it-yourself automotive sandpaper" used to prepare a car for repainting to national retailers. NicSand asserted that it had attained 67% of this alleged market when 3M, its principal rival, began offering substantial up-front discounts to major retailers, including Kmart, Advance Auto Parts, AutoZone and CSK Auto, that had until then stocked their shelves exclusively with NicSand products.

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1 *NicSand, Inc. v. 3M Co.*, No. 05-3431, __ F.3d. __ 2007 WL 3010426 (6th Cir. Oct. 17, 2007).

2 The *en banc* decision departed from an earlier ruling by a panel of that court that had, by a 2-1 vote, reversed the lower court's dismissal order. *NicSand, Inc. v. 3M Co.*, 457 F.3d 534 (6th Cir. 2006), *vacated*, 2007 WL 3010426 (6th Cir. Oct. 17, 2007).

The complaint alleged that, prior to the challenged actions by 3M, five of the six major retail chains that sold automotive sandpaper carried only one brand at a time and negotiated "de facto exclusive"[3] agreements once a year to "simplify planning and reduce costs."[4] The complaint also alleged that significant discounts and other up-front payments had been required to get an exclusive deal with a retailer.[5]

The complaint went on to allege that 3M offered one retailer, Kmart, $300,000 in 1997 to switch from NicSand and enter into an exclusive dealing arrangement for "several years" and that in the following years 3M made similar offers to other retailers — offers that led to NicSand's loss of the retailers' business.[6] NicSand then left the market and filed for bankruptcy.[7] NicSand alleged that following its departure from the market *retailers* raised prices for do-it-yourself automotive sandpaper by up to 70%.[8]

NicSand claimed that 3M's alleged multi-year exclusive agreements combined with the significant up-front payments constituted monopolization or attempted monopolization in violation of Section 2 of the Sherman Act.

The district court dismissed the complaint under Fed. R. Civ. P. 12(b)(6) for lack of antitrust injury. A divided panel of the Sixth Circuit reversed. 3M successfully sought rehearing *en banc* and the panel decision was vacated in light of the grant of rehearing. After supplemental briefing and argument, the Sixth Circuit affirmed the dismissal *en banc* in a 10-4 vote.

The *En Banc* Decision

The *en banc* opinion, written by Judge Sutton, who had been the dissenter in the initial panel ruling, explained the importance of demonstrating antitrust injury in private cases brought under the Sherman Act. The decision noted that antitrust injury is a "threshold, pleading-stage inquiry"[9] and that antitrust injury "is the glue that cements each suit with the purposes of the antitrust laws, and prevents abuses of those laws by claimants seeking to halt the strategic behavior of rivals that increases, rather than reduces, competition."[10] A complaint that fails the antitrust injury test must be dismissed, the majority opinion observed, "lest the antitrust laws become a treble-damages sword rather than the shield against competition-destroying conduct that

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3 Slip op. at 3.

4 *Id.*

5 *Id.*

6 *Id.*

7 *Id.*

8 The court observed that the complaint did not make any allegations about prices charged by 3M or other suppliers to the retailers. *Id.*

9 Slip op. at 4.

10 *Id*. (internal quotations and citations omitted).

Congress meant them to be."[11] The court added that "'[i]t would be ironic indeed if the standards' for establishing antitrust injury 'were so low that antitrust suits themselves become a tool for keeping prices high.'"[12]

The Sixth Circuit emphasized that while it is not the case that one competitor may never sue another, such claims have typically been permitted to proceed only when the defendant had allegedly engaged "in some form of predatory pricing or tying — when the rival has engaged in something more than vigorous price, product or service competition."[13]

In the case before it, the court continued, NicSand conceded that the up-front discounts were not predatory, that is, "3M did not sell automotive sandpaper below cost with the goal of recouping its losses by charging monopolistic prices later."[14] The court observed that, based on NicSand's allegations, when it controlled 67% of the market, it earned significant profit margins and gave "no explanation why it has the right to preserve 38-49% profit margins.[15] The up-front payments were nothing more than "price reductions offered to the buyers for the exclusive right to supply a set of stores under multi-year contracts"[16] and "cutting prices in order to increase business often is the very essence of competition."[17]

The court also stated that multi-year agreements are part of the bargain that provides retailers with lower prices from a new supplier and gives the new supplier the commitment it needs to be able to offer lower prices.[18] The court noted that "retailers cannot be blamed for accepting better prices with 3M for several years, not just one."[19]

With regard to the exclusivity of the supply agreement, the court said that exclusivity was effectively sought by most of the retailers, according to the complaint, and that NicSand could not complain that the exclusivity created barriers that it — as the market leader, not a

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11 *Id.* (internal quotations and citations omitted).

12 *Id*. at 6 (internal quotations from *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*., 509 U.S. 209, 226-27 (1993)).

13 *Id.* at 5.

14 *Id.* at 6.

15 *Id.* The margins were calculated based on detailed cost and sales totals for NicSand pleaded in the complaint.

16 *Id*. at 6 (quoting *Augusta News Co. v. Hudson News Co.*, 269 F. 3d 41, 45 (1st Cir. 2001)).

17 *Id*. at 6 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp*., 475 U.S. 574, 594 (1986)). The NicSand majority also observed that retailers had always demanded up-front discounts and purchase of a prior supplier's stock, indicating that the up-front payments were something that "generically speaking (retailers) already insisted on receiving." *Id.* at 7.

18 *Id.* at 7.

19 *Id.*

new entrant — had to overcome.[20] The court observed that NicSand did not explain why it could not compete for multi-year agreements or match 3M's discounts.[21]

In response to the dissent's suggestion that it has required too much detail in a pleading, the majority observed that the problem is not that the complaint "has too few details but that it has too many" since the details pleaded defeat the claim and antitrust injury and therefore cannot be ignored.[22]

The court concluded that "to allow this litigation to continue on these allegations is to allow one monopolist to sue a competitor for seizing its market position by charging less for its goods."[23]

The Dissent

Judge Martin, joined by three other members of the court, dissented. The dissent concluded that the complaint's allegations "established a right to relief above the speculative level."[24] The dissent noted that upfront payments would have resulted in a loss as to three of the four retailers if those payments had been matched by NicSand.[25] It concluded that this, coupled with the several years' exclusivity period alleged, should suffice at a pre-discovery stage. While acknowledging that, as the majority notes, "NicSand concedes that 3M did not engage in any form of predatory pricing,"[26] the dissent stated that the payments alleged may have resulted in a form of "below cost pricing" that warranted exploration on discovery.[27]

The dissent also emphasized the difference between the allegations of "de facto" exclusive arrangements reached between NicSand and retailers and the legally binding contractual exclusivity that 3M was alleged to have entered into.[28]

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20 *Id.* at 8.

21 *Id.*

22 *Id*. at 11.

23 *Id*.

24 *Id.* at 14.

25 *Id.* at 16-17. Such payments would still have resulted in an overall profit for NicSand under the allegations of the complaint. *Id*. at 16 and n.4.

26 *Id*. at 16.

27 *Id*.

28 *Id*. at 17-18.

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Dean Ringel of Cahill Gordon & Reindel LLP argued this case for 3M on the *en banc* appeal; Elai Katz of Cahill was on the brief.

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Dean Ringel at (212) 701-3521 or dringel@cahill.com; or Elai Katz at (212) 701-3039 or ekatz@cahill.com.