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ANTITRUST

Expert Analysis

Market-Share Discounts Scrutinized by Third Circuit

By Elai Katz

The U.S. Court of Appeals for the Third Circuit ruled that a transmission manufacturer's supply contracts with truck makers, which included market-share discounts, could be condemned as unlawful de facto exclusive dealing arrangements. The U.S. Court of Appeals for the Second Circuit decided that indirect purchasers' claims that air carriers conspired in violation of state antitrust laws were preempted by federal aviation laws.

Other antitrust developments of note included charges by the Department of Justice and the state of California that high technology firms agreed to refrain from soliciting one another's employees in violation of federal and state antitrust law, and the U.S. Supreme Court's agreement to tackle "reverse payment" settlements of pharmaceutical patent disputes.

Market-Share Discounts

A heavy-duty truck transmission maker, Meritor Transmission Corp. (along with its joint venture ZF Meritor, LLC, referred to hereinafter collectively as Meritor), brought antitrust claims asserting that its rival, Eaton Corporation, "used its dominant position to induce all heavy duty truck manufacturers to enter into de facto exclusive dealing contracts," foreclosing a substantial share of the heavy-duty transmission market in violation of Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act. Among other allegedly anticompetitive terms, the long-term contracts offered significant discounts if the truck manufacturers bought a high percentage, in some cases above 90 percent, of their requirements from Eaton. Following a four-week trial, the jury returned a verdict for Meritor, finding that Eaton violated the Sherman Act and the Clayton Act.

After the district court denied a motion for judgment as a matter of law or a new trial, Eaton appealed, arguing that Meritor should not have prevailed because modern antitrust jurisprudence has ruled out condemnation of above-cost low prices and Meritor was required to but did not demonstrate at trial that Eaton's pricing practices were below cost.

In a split decision spanning over 200 pages, the Third Circuit affirmed the district court and stated that the challenged contracts were properly evaluated as exclusive dealing claims, rather than under the "price-cost test," and Meritor presented sufficient evidence to support the jury's finding of liability.

The majority rejected Eaton's characterization of the dispute as a "pricing practices" case because the challenged conduct encompassed a variety of practices and contractual provisions, including a requirement to remove Meritor's transmissions from the truck makers' data books in some cases, and a promise to offer Eaton's transmission at a "preferential price," that is, that rivals' products would be priced higher. Accordingly, the majority determined that these arrangements constituted "de facto partial exclusive dealing," where the contract does not impose an express exclusivity obligation and does not cover 100 percent of the buyer's needs.

> The Supreme Court agreed to hear an appeal on the antitrust treatment of settlements of patent disputes between drug companies involving a "reverse payment" to the alleged infringer—the subject of several appellate decisions and much heated debate.

The court acknowledged that the price-cost test applied to market share or volume discounts (unless a bundle of more than one product is offered), but that in this case pricing alone was not the predominant mechanism of exclusion. The majority observed that the precedents do not hold that above-cost prices render

ELAI KATZ *is a partner at Cahill Gordon & Reindel.* BRITTNEY PESCATORE, *an associate at the firm, assisted in the preparation of this article.*

legal an "otherwise unlawful exclusive dealing agreement."

Despite having won affirmance of the finding of liability in its favor, Meritor was unable to recover any damages because the district court excluded its expert's damages testimony. The appellate court affirmed the exclusion of the expert's opinion on damages for having improperly relied on financial projections without knowing their authors, methodology or underlying assumptions. Nonetheless, the Third Circuit majority stated that the trial court should have allowed Meritor to submit alternate damages estimates.

A three-judge panel of the Second Circuit ruled that state law antitrust claims brought by indirect purchases of air freight shipping services against foreign air carriers were expressly preempted by the Federal Aviation Act.

In a 110-page dissenting opinion, Judge Morton Greenberg quoted copiously from the prominent treatise, *Antitrust Law*, authored by Phillip Areeda and Herbert Hovenkamp, where the professors concluded that "as long as the discounted price is above cost and not predatory, it can be matched by an equally efficient rival" and, since exclusionary injury "seems implausible" in most cases, "above-cost single item discounts" should not be illegal. Greenberg underscored the Supreme Court's admonition that courts exercise "caution" before "condemning above-cost pricing practices" and wrote that he would not have allowed the jury to find in Meritor's favor unless it could demonstrate that Eaton's prices, after the discounts, were below cost.

The dissent also took issue with the majority's characterization of Eaton's long-term contracts as de facto exclusive dealing arrangements because, unlike the leading de facto exclusives cases, Eaton's contracts did not explicitly forbid or have the actual effect of precluding truck manufacturers from buying rivals' transmissions. The dissenting judge added that Eaton's discounts, being above cost, left ample room for rivals to lure customers away by offering better discounts, and that Meritor, assuming it was an equally efficient competitor, was not foreclosed from any market as long as it had an ongoing opportunity to offer competitive discounts.

The dissent noted that rather than having been foreclosed from competing, the record showed that Meritor simply did not offer more competitive prices. Greenberg went on to observe that defeated competitors often fall back on antitrust law in an effort to achieve in court what they were unable to accomplish in the competitive marketplace.

ZF Meritor v. Eaton Corp, Nos. 11-3301, 11-3426, 696 F.3d 254, 2012-2 CCH Trade Cases ¶78,078 (3d Cir. Sept. 28, 2012).

Comment: The Third Circuit remains a vexing jurisdiction for dominant firms that discount aggressively. The 2003 en banc opinion of the court in *LePage's v. 3M*, 324 F.3d 141, left an inexact standard for bundled discounts, and the decision reported immediately above, even if most appropriately limited to its unique facts, leaves ambiguous guidance on above-cost market share discounts without sufficiently articulating what additional factors would expose these pricing practices to treble damages.

Preemption

A three-judge panel of the Second Circuit ruled that state law antitrust claims brought by indirect purchasers of air freight shipping services against foreign air carriers were expressly preempted by the Federal Aviation Act. The foreign air carriers had been subject to federal criminal charges in the United States in connection with a global price-fixing conspiracy.

Because indirect purchasers are unable to obtain money damages under federal antitrust law after the Supreme Court's decision in *Illinois Brick v. Illinois*, 421 U.S. 720 (1977), they typically bring their claims under state law. The Federal Aviation Act, however, expressly prohibits state laws related to a price, route or service of an air carrier. 49 U.S.C. §41713(b)(1).

The plaintiffs argued that the term "air carrier" in the preemption provision did not include "foreign air carriers," which is subject to a separate and mutually exclusive definition within the act. Relying on legislative history, the Second Circuit stated that the preemption provision was employing the ordinary, everyday meaning of "air carrier," which includes both foreign and domestic air carriers. The court noted that this understanding is consistent with Congress's purpose of deregulating airlines.

Other claims brought against the defendant airlines by plaintiffs who were direct purchasers remain in district court.

In re Air Cargo Shipping Services Antitrust Litigation, No. 11-5464-cv, 697 F.3d 154, 2012-2 CCH Trade Cases ¶78,083 (2d Cir. Oct. 11, 2012).

Non-Solicitation

The U.S. Department of Justice and the Attorney General of California brought suits against eBay Inc. alleging that the online retail auction company entered into an unlawful agreement with Intuit, a high tech company also headquartered in Northern California, not to recruit one another's employees. The department's complaint asserted that the agreement eliminated competition over "talent," depriving employees of job opportunities and lowering salaries, constituting a per se violation of §1 of the Sherman Act or a restraint subject to a "quick look" or abbreviated rule of reason review.

In September 2010, the department settled charges that six other high tech firms, including Intuit and Google, committed similar violations.

United States v. eBay Inc., No. 12-cv-5869 (N.D. Cal. Nov. 16, 2012).

Comment: eBay and Intuit are not head-to-head competitors in the sale of high technology services and software, but they do compete with one another as buyers of computer engineering services in the San Francisco Bay area. And, although agreements in restraint of trade among buyers are at times subject to a different, more forgiving standard than agreements among sellers, enforcers have been active in pursuing restraints involving rival employers.

Patent Settlements

The Supreme Court agreed to hear an appeal on the antitrust treatment of settlements of patent disputes between drug companies involving a "reverse payment" to the alleged infringer—the subject of several appellate decisions and much heated debate. The petitioner, the Federal Trade Commission (FTC), and others have labeled these "pay-for-delay" settlements because, as they see it, the brand name drug maker pays the generic drug company to defer entry into a market dominated by the branded drug. The FTC presented the question as whether "reverse-payment agreements are per se lawful unless" there was a sham or "fraud (as the [U.S. Court of Appeals for the Eleventh Circuit] held), or instead are presumptively anticompetitive and unlawful (as the Third Circuit has held)."

FTC v. Watson Pharmaceuticals Inc., No. 12-416 (cert. granted Dec. 7, 2012).

Comment: Reverse payment settlements arise under the byzantine regulatory structures and incentives put in place by the Hatch-Waxman Act, which was intended to accelerate the introduction of generic drugs. As such, these agreements should be viewed through the lens of the legislative construct that created them rather than being evaluated as conventional monopoly sharing arrangements.

Natural Gas Merger

The FTC announced the closing of an investigation into the combination of natural gas production, storage and pipeline facilities in Cook Inlet, Alaska, which supplies Anchorage and surrounding areas. The commission asserted that the proposed acquisition of Marathon Oil Company assets by Hilcorp Alaska, an energy exploration and production company, would lead to substantially increased market concentration in natural gas production and delivery and complete control of proprietary storage capacity in south-central Alaska.

Nevertheless, the commission decided not to challenge the transaction and to defer to Alaskan regulators. State authorities believed that the merger would alleviate concerns about energy security and local energy supply shortages and addressed competition concerns by negotiating a consent decree that included an agreement not to raise prices for five years.

The FTC noted that the likely anticompetitive effects of the proposed merger were confined to consumers in Alaska, contributing to the commission's decision to exercise prosecutorial discretion.

Hilcorp Alaska/Marathon Oil, FTC File No. 121-0113 (Nov. 7, 2012).

Cartels

The European Commission (EC) imposed fines on several electronics manufacturers for participating in global cartels fixing prices and restricting output of cathode ray tubes (CRT), which had been used in television screens and computer monitors. The commission described the decade-long conspiracies as textbook cartels, engaging not only in price fixing but also customer allocation, capacity and output coordination and audits to monitor compliance with the conspiracy.

The commission noted that the manufacturers—including Philips, Samsung and LG—were motivated by a desire to manage the decline of the CRT market, as those screen components were being replaced by new technologies—liquid crystal display (LCD) and plasma screens.

The fines totaled nearly $2 billion (€1.47 billion), reportedly the largest fine in the EC's history. Chungwa, a Taiwanese tube manufacturer, received full immunity for being the first to disclose the conduct to the commission and others received 10 percent to 40 percent reductions for their cooperation.

Antitrust: Commission fines producers of TV and computer monitor tubes, €1.47 billion for two decade-long cartels, IP/12/1317 (Dec. 5, 2012).

Interchange Fee Settlement

A district court preliminarily approved a class action settlement resolving claims brought by retail merchants that Visa and MasterCard conspired to fix interchange or "swipe" fees and imposed anticompetitive rules preventing merchants from steering consumers toward using lower fee cards or cash.

The settlement agreement would require payment of over $7 billion, in the form of cash and reduced interchange fees, and modifications to the merchant rules. Among the rule changes in the settlement agreement, merchants will be permitted to impose surcharges for some categories of cards. Over a dozen members of the class opposed the settlement and sought to appeal the preliminary approval order.

In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, No. 05-MD-1720 (E.D.N.Y. Nov. 9, 2012).

Pre-merger Notification

The owner of a restaurant chain paid an $850,000 fine to settle charges that it made an acquisition of around 9 percent of the stock of another restaurant chain in violation of the Hart-Scott-Rodino Act's pre-merger notification and waiting period requirements. The Department of Justice and FTC asserted that the buyer improperly invoked the investment-only exemption, which permits acquisitions of not more than 10 percent of an issuer if made solely for the purpose of investment, because the restaurant owner sought representation on the issuer's board, among other things, immediately after the acquisition.

United States v. Bilgari Holdings, No. 12-cv-01586 (D.D.C. Sept. 25, 2012).

Comment: The FTC has consistently taken a narrow approach to the investment-only exemption, making the United States one of the only jurisdictions where many acquisitions of less than 10 percent are potentially subject to pre-merger reporting obligations.

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