Nos. 11-3301 & 11-3426

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IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

ZF MERITOR LLC, et al.,

Plaintiffs-Appellees/Cross-Appellants,

v.

EATON CORPORATION,

Defendant-Appellant/Cross-Appellee.

On Appeal from the
United States District Court for the District of Delaware
Case No. 1:06-cv-00623
The Honorable Sue L. Robinson, U.S. District Judge

BRIEF OF AMICUS CURIAE AMERICAN ANTITRUST INSTITUTE IN SUPPORT OF PLAINTIFFS-APPELLEES

Richard M. Brunell
Director of Legal Advocacy
AMERICAN ANTITRUST INSTITUTE
2919 Ellicott St., N.W.
Washington, DC 20008
(202) 600-9640

Michael Tarringer
CAFFERTY FAUCHER LLP
1717 Arch Street
Suite 3610
Philadelphia, PA 19103
(215) 864-2800

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1, the American Antitrust Institute states that it is a non-profit corporation and, as such, no entity has any ownership interest in it.

TABLE OF CONTENTS

INTEREST OF AMICUS CURIAE 1

FED. R. APP. P. 29(c)(5) STATEMENT 2

INTRODUCTION AND SUMMARY OF ARGUMENT 2

ARGUMENT 6

MARKET-SHARE REBATES STRUCTURED TO PRODUCE EXCLUSIVE DEALING MAY CONSTITUTE MONOPOLISTIC CONDUCT WITHOUT PROOF OF BELOW-COST PRICES 6

A. *LePage's* Forecloses Eaton's Argument That All Challenges to "Pricing Practices" Must Prove Prices Below Cost 6

1. Discounts conditioned on exclusivity may be illegal without below-cost prices 8

2. Many scholars agree that loyalty rebates should be treated as a form of exclusive dealing 11

3. *LePage's* is not limited to multiproduct rebates 13

B. The Policy Rationale for the *Brooke Group* Rule Does Not Apply to Loyalty Rebates 15

1. The issue with loyalty rebates is not prices, but the loyalty conditions required to obtain the rebates 15

2. A cost-based test for exclusionary rebates is unwarranted 17

C. Supreme Court and Other Cases Cited by Eaton Do Not Support Extending Predatory-Pricing Rules to Loyalty Rebates 22

CONCLUSION 28

CERTIFICATE OF BAR MEMBERSHIP 29

CERTIFICATE OF COMPLIANCE 30

CERTIFICATE OF SERVICE 31

TABLE OF AUTHORITIES

Cases

Atl. Richfield Co. v. USA Petroleum Co.,
495 U.S. 328 (1990) 6, 22, 23, 24

Barry Wright Corp. v. ITT Grinnell Corp.,
724 F.2d 227 (1st Cir. 1983) 25, 26

Brooke Group Ltd v. Brown & Williamson Tobacco Corp.,
509 U.S. 209 (1993) .... *passim*

Carter Carburetor Corp. v. Federal Trade Comm'n,
112 F.2d 722 (8th Cir. 1940) 10

Church & Dwight Co. v. Mayer Labs., Inc.,
2011 WL 1225912 (N.D. Cal. Apr. 1, 2011) 9

Concord Boat Corp. v. Brunswick Corp.,
207 F.3d 1039 (8th Cir. 2000) 26, 27

FTC v. Brown Shoe Co.,
384 U.S. 316 (1966) 10

LePage's Inc. v. 3M,
324 F.3d 141 (3d Cir. 2003) .... *passim*

Masimo Corp. v. Tyco Health Care Group, L.P.,
2006 WL 1236666 (C.D. Cal. Mar. 22, 2006) 9

NicSand, Inc. v. 3M Co.,
507 F.3d 442 (6th Cir. 2007) 26

Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.,
555 U.S. 438 (2009) 2, 22, 24, 25

Sprint Nextel Corp. v. AT&T Inc.,
2011 WL 5188081 (D.D.C. Nov. 2, 2011) 24

Standard Fashion Co. v. Magrane-Houston Co.,
258 U.S. 346 (1922)..8, 23

Sullivan v. DB Investments, Inc.,
No. 08-2784 (3d Cir. Dec. 20, 2011)..2

United Shoe Machinery Corp. v. United States,
258 U.S. 451 (1922)..8, 19, 23

United States v. AMR Corp.,
335 F.3d 1109 (10th Cir. 2003)..22

United States v. Dentsply Int'l, Inc.,
399 F. 3d 181 (3d Cir. 2005)..8

United States v. Microsoft Corp.,
253 F.3d 34 (D.C. Cir. 2001)..8, 14

United States v. Standard Oil Co.,
362 F. Supp. 1331 (C.D. Cal. 1972)..10

United States v. United Regional Health Care System,
No. 7:11-cv-00030 (N.D. Tex. Feb. 25, 2011)......................................14

Virgin Atl. Airways Ltd. v. British Airways PLC,
257 F.3d 256 (2d Cir. 2001)..26

Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.,
549 U.S. 312 (2007)..22, 23

ZF Meritor LLC v. Eaton Corp.,
769 F. Supp. 2d 684 (D. Del. 2011)..................................2, 3, 4, 14, 21

Statutes

Clayton Act, § 3, 15 U.S.C. § 14 ....2, 9, 10, 11, 19, 23

Other Authorities

PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW (3d ed. 2006) 9, 21

Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*,123 Harv. L. Rev. 397 (2009) 17, 21

EINER ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS (2d ed. 2011) 11, 15, 16, 18

Einer Elhauge & Abraham L. Wickelgren, *Anti-competitive Exclusion and Market Division Through Loyalty Discounts*, Harvard Discussion Paper No. 707 (September 2011) 16

ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE (2d ed. 2008) 16, 21

Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008) 12

Jonathan M. Jacobson, *A Note on Loyalty Discounts*, ANTITRUST SOURCE, June 2010 .... 11, 15, 21

Louis Kaplow & Carl Shapiro, *Antitrust*, *in* 2 HANDBOOK OF LAW & ECONOMICS 1073 (A. Michell Polinsky & Steven Shavell eds., 2007) 12, 18

Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?,* 2006 UTAH L. REV. 863 .... 12, 22

Barry Nalebuff, *Exclusionary Bundling*, 50 ANTITRUST BULL. (2005) 17

Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 U. CHI. L. REV. 229 (2005) 19

Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard,* 73 ANTITRUST L.J. 311 (2006) 20

Willard K. Tom et al., *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*,
67 ANTITRUST L.J. 615 (2000)..11, 18

THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT (Albert A. Foer ed., 2008) 1

U.S. DEPT. OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008)..........................12

U.S. Justice Dept., Press Release, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009)..12

INTEREST OF AMICUS CURIAE

All parties consent to the filing of this brief. The American Antitrust Institute (AAI) is an independent non-profit education, research, and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining the vitality of the antitrust laws in the United States and around the world. *See* http://www.antitrustinstitute.org. Those goals would be undermined if, as the Eaton Corporation urges, this Court were to adopt a rule that a monopolist is immune from liability for using "market share" rebates to create an anticompetitive exclusive dealing arrangement unless the plaintiff proves the monopolist's prices are below cost. AAI has long maintained that a cost-based safe harbor for discounts linked to market-share requirements would harm competition and consumers. *See, e.g.,* THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT 71-75 (Albert A. Foer ed., 2008).

AAI is managed by its Board of Directors with the guidance of an Advisory Board consisting of over 115 prominent antitrust lawyers, law professors, economists and business leaders.[1] AAI frequently appears as amicus curiae in

[1] AAI's Board of Directors alone has approved this filing for AAI. A member of the Board whose law firm served as local counsel for plaintiffs in this matter was recused. The individual views of members of the Advisory Board may differ from AAI's positions. The law firms of two members of the Advisory Board represent plaintiffs in this matter, and certain other Advisory Board members or their law

cases raising important antitrust issues, including, for example, in *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.,* 555 U.S. 438 (2009), in which it participated in oral argument before the Supreme Court, and in *Sullivan v. DB Investments, Inc.*, No. 08-2784 (3d Cir. Dec. 20, 2011) (en banc).

FED. R. APP. P. 29(c)(5) STATEMENT

No counsel for a party has authored this brief in whole or in part. No party, party's counsel, or any other person or entity—other than AAI or its counsel—has contributed money that was intended to fund preparing or submitting this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

Defendant-Appellant Eaton Corp. ("Eaton") is the dominant manufacturer of Class 8 (heavy-duty) commercial truck transmissions in North America, with a market share in excess of 80% during the relevant period. *See* J.A. 727-28. Plaintiffs-Appellees ZF Meritor LLC and its affiliate Meritor Transmission Corp. (collectively "ZFM") contend that ZF Meritor was forced out of the market as a result of Eaton's long-term exclusionary agreements with four truck manufacturers ("OEMs"), which allowed Eaton to preserve and extend its monopoly power. A jury found Eaton liable under §§ 1 and 2 of the Sherman Act and § 3 of the Clayton Act, but no damages were awarded because the judge excluded the

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firms represent consumers in related litigation against the Eaton Corporation; none played any role in the Directors' deliberations or in the preparation or funding of this brief.

damages opinion of plaintiffs' expert. Eaton appeals from the district court's denial of its motion for judgment as a matter of law, while ZFM cross-appeals from the district court's ruling on damages.

AAI submits this amicus brief to address only one issue in this appeal, namely Eaton's argument that "[a]n antitrust plaintiff challenging a [monopolist's] *pricing practices* must prove below-cost pricing using an accepted price-cost test." Principal Brief of Appellant/Cross-Appellee Eaton Corp. ("Eaton Br.") 23 (emphasis added). According to Eaton, such practices include conditional, share-based rebates that Eaton argues are the central focus of plaintiffs' theory of antitrust liability and the jury's verdict. *Id.* at 29-31. Therefore, plaintiffs' supposed failure to demonstrate that Eaton's prices were below cost is fatal to their claims. *Id.* at 32.

Eaton is incorrect. As an initial matter, the conduct that the jury and lower court found to be monopolistic under the Sherman Act is not limited to Eaton's market-share rebates.[2] But even if the rebates were the only monopolistic conduct

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[2] For example, Eaton's supply contract with the largest OEM (Freightliner) provided numerous benefits in addition to rebates, and could be terminated altogether by Eaton if Freightliner failed to achieve a 92% share penetration target. *See ZF Meritor LLC v. Eaton Corp*., 769 F. Supp. 2d 684, 688 (D. Del. 2011). The agreements also provided Eaton with exclusive or preferred placement in its so-called "databooks" (which contain the options available for truck purchasers), and required the OEMs to offer Eaton's transmissions to truck buyers at preferential prices compared to competitors' offerings. *See id.* The upshot was that the district court concluded that Eaton's agreements with its customers "amounted to de facto

at issue, the Court should reject Eaton's sweeping claims that a market-share rebate program and all exclusionary conduct involving "pricing practices" is per se legal unless a plaintiff proves below-cost prices. Insofar as market-share rebates (also called "loyalty rebates") foreclose competitors, they should be analyzed like exclusive dealing arrangements and be condemned when they help preserve or extend a dominant firm's market power, and the exclusionary conditions are not justified by a countervailing procompetitive benefit.[3] Neither policy nor precedent supports Eaton's claimed above-cost safe harbor.

"First dollar" or "retroactive" loyalty rebates, such as those in this case, are rebates applied to all the purchases made by a customer during a period, provided a specified market-share threshold is maintained, not just to those in excess of the threshold.[4] Such loyalty rebates are particularly susceptible to exclusionary effects when offered by a dominant firm because they make it costly, if not impossible, for

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exclusive dealing contracts." *Id.* at 697; *see also* Responding Brief and Principal Brief of Appellees/Cross-Appellants ZF Meritor LLC and Meritor Transmission Corp. ("ZFM Br.") 43-44 (highlighting exclusionary conduct beyond market-share rebates).

[3] Notably, although Eaton repeatedly contends that its market-share rebates were procompetitive because they reduced prices charged to the OEMs, nowhere in Eaton's brief does it suggest any procompetitive justification for conditioning the rebates on the OEMs' maintaining near exclusivity.

[4] In this case, the threshold was over 90% for three of the OEMS. *See ZF Meritor*, 769 F. Supp. 2d at 688. Eaton characterizes the rebates as "modest," Eaton Br. at 7, but the dollar value was apparently quite substantial. *See* ZFM Br. at 29 (millions of dollars).

rivals to compete for a portion of the customers' demand beyond that permitted by the specified market-share threshold. A rival must not only match the monopolist's prices on the sales it can reasonably contest, but compensate the customer for its lost rebates on all of the customers' purchases. Thus, as with explicit exclusive dealing arrangements, a rival may be foreclosed from significant portions of the market, and that foreclosure may harm consumer welfare by reducing competitive pressure on the dominant firm. And, as with explicit exclusive dealing arrangements, but unlike predatory pricing, the strategy may be fully profitable for the dominant firm in the short run. Thus, a predatory pricing price-cost test plainly is not appropriate.

Eaton contends that an "accepted" price-cost test is necessary to ensure that price discounting is not chilled and that only equally efficient competitors are protected. However, a rule that makes loyalty rebates by a dominant firm potentially actionable as exclusive dealing, without proof of below-cost prices, will not chill price discounting; at most, such a rule might chill monopolists' imposing exclusionary conditions for obtaining discounts. Moreover, a *Brooke Group* predatory pricing test would allow the exclusion of competitors that are equally efficient at producing part of a customer's demand, as well as rivals that may *become* equally, or more, efficient if they were not foreclosed by the monopolist's

conduct, and higher-cost rivals that nonetheless constrain a monopolist's exercise of market power.

This Court's decision in *LePage's*, which rejected a price-cost test for rebates that effectuated de facto exclusive dealing, forecloses Eaton's argument that an antitrust plaintiff challenging a monopolist's *pricing practices* must prove below-cost pricing. Eaton's effort to limit *LePage's* to bundled rebates does not withstand scrutiny. *LePage's* is consistent with a growing body of legal and economic scholarship and commentary that recognizes loyalty rebates as a form of exclusive dealing, and not predatory pricing. Nothing in the Supreme Court cases prior to *LePage's*, or since, suggests that a predatory-pricing, or other cost-based, test should be applied to loyalty rebates that effectuate exclusive or partial exclusive dealing.

ARGUMENT

MARKET-SHARE REBATES STRUCTURED TO PRODUCE EXCLUSIVE DEALING MAY CONSTITUTE MONOPOLISTIC CONDUCT WITHOUT PROOF OF BELOW-COST PRICES

A. *LePage's* Forecloses Eaton's Argument That All Challenges to "Pricing Practices" Must Prove Prices Below Cost

Eaton's argument that a plaintiff must prove that loyalty rebates result in prices below cost is premised on Supreme Court cases that purportedly demonstrate that any challenge to "pricing practices" requires proof that the prices are predatory, citing in particular *Atl. Richfield Co. v. USA Petroleum Co.*, 495

U.S. 328 (1990) and *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). But this Court in its en banc decision in *LePage's* squarely and correctly rejected this position, which had been urged by 3M. *See LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (3M's "central premise [is] 'that it is not unlawful to lower one's prices so long as they remain above cost.'") (quoting 3M's brief), *cert denied*, 542 U.S. 953 (2004). Indeed, the argument asserted by 3M was virtually identical to the one advanced by Eaton here:

> To prevent courts from imposing liability for conduct that is pro-competitive, the Supreme Court has established a bright-line test in cases where, as here, pricing practices are at issue. Specifically, the Court has held that it is not unlawful to lower one's prices so long as they remain above cost. *Brooke Group Ltd v. Brown & Williamson Tobacco Corp*., 509 U.S. 209, 222 (1993). As we shall demonstrate, LePage's case was all based upon claims about discount prices and rebates, but it offered no proof of below-cost pricing. Thus, 3M's conduct was lawful as a matter of law.

Br. of Appellant/Cross-Appellee 34, *LePage's*, 324 F.3d 141 (No. 00-1368), 2001 WL 34136386.

Yet this Court held that not all antitrust claims involving "pricing practices" are subject to the *Brooke Group* predatory pricing rule. Rather, the Court distinguished between predatory pricing claims, which require proof of below-cost prices, *see LePage's,* 324 F.3d at 151 ("LePage's . . . does not make a predatory pricing claim"), and "pricing practices" like bundled rebates that "effectuat[e]

exclusive dealing arrangements because of the way in which they [are] structured," to which the *Brooke Group* rule does not apply, *id.* at 154.

1. Discounts conditioned on exclusivity may be illegal without below-cost prices

LePage's is consistent with a long line of Supreme Court and other precedent on exclusive dealing. It is well settled that exclusive dealing arrangements may be illegal without proof of below-cost prices. *See, e.g., United States v. Dentsply Int'l, Inc.*, 399 F. 3d 181, 187 (3d Cir. 2005). It is does not matter whether the exclusive dealing agreement is obtained by a threat to penalize the customer, *see id.* at 190 (Dentsply threatened to sever access to its teeth and other dental products); *United States v. Microsoft Corp.*, 253 F.3d 34, 73 (D.C. Cir. 2001) (en banc) (Microsoft "exclusive deal" with Apple to make Internet Explorer the default browser on Macs under threat by Microsoft to cancel Mac Office), or by the payment of a discount, rebate, or other valuable consideration, *see id.* at 68 (internet access providers agreed to promote Internet Explorer exclusively and keep rival browser shipments below 25% in exchange for valuable promotional treatment)*; Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 346, 351-52 (1922) (retailer received 50% discount off retail prices as part of deal for unlawful exclusive); *United Shoe Machinery Corp. v. United States*, 258 U.S. 451, 457 (1922) (exclusionary lease conditions, including a lower royalty rate for lessees that agreed to use only lessor's machines, held unlawful). Indeed, § 3 of the

Clayton Act expressly makes it illegal for a firm to make a contract for the sale of goods "or fix a price charged therefor, or *discount from, or rebate upon*, such price," on the condition that the purchaser not deal in the goods of a competitor where the effect may be to substantially lessen competition. 15 U.S.C. § 14 (emphasis added). So, if a monopolist pays a distributor an upfront fee or offers a discount for an exclusive dealing contract, antitrust law has never inquired whether the "net" prices to the distributor, after deducting the fee, are below the monopolist's costs. *See* 11 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1807b1, at 133 (3d ed. 2006) ("A discount conditioned on exclusivity should generally be treated no different from an orthodox exclusive dealing arrangement.").

LePage's affirmed that an implicit exclusive dealing arrangement effectuated through "rebates" does not convert it into a predatory-pricing case requiring proof of below-cost prices. *LePage's*, 324 F.3d at 154-55; *see also Masimo Corp. v. Tyco Health Care Group, L.P.*, 2006 WL 1236666, *6 (C.D. Cal. March 22, 2006) (sustaining jury verdict under § 1 of the Sherman Act and § 3 of the Clayton Act, where defendant's market-share discounts amounted to de facto exclusive dealing agreements; no proof of below-cost prices required), *aff'd*, 350 Fed. Appx. 95 (9th Cir. 2009); *Church & Dwight Co. v. Mayer Labs., Inc.,* 2011 WL 1225912, *10 (N.D. Cal. April 1, 2011) (dominant firm's program to provide

rebates for a high share of retailers' shelf space could be actionable even if prices were above cost; harm to competition is not from the pricing, "[r]ather, it is the exclusive display space that [defendant] 'buys' through its rebates"); *Carter Carburetor Corp. v. Federal Trade Comm'n*, 112 F.2d 722, 732 (8th Cir. 1940) (preferential discount available only to service stations that did not take or carry competing lines held to violate § 3 of the Clayton Act; "[t]he condition against handling the goods of competitors was made as fully as though it had been written in and affirmatively agreed to in express terms in the contracts;" no proof of below-cost prices required).

The fact that loyalty rebates do not preclude customers from buying some of their requirements from the monopolist's rival, as here, does not immunize them from liability under § 2. *See, e.g., Dentsply*, 399 F.3d at 185 (unlawful "exclusive" dealing arrangement permitted dealers to continue to purchase "grandfathered" products from competitors); *Microsoft*, 253 F.3d at 68, 70-71 (unlawful "exclusive" dealing arrangement allowed internet access providers to offer competing internet browser to limited extent); *see also FTC v. Brown Shoe Co.*, 384 U.S. 316, 321 (1966) (retailers' agreement to deal *primarily* with Brown in exchange for valuable services "obviously conflicts with the central policy of both § 1 of the Sherman Act and § 3 of the Clayton Act"); *United States v. Standard Oil Co.*, 362 F. Supp. 1331, 1340-41 (C.D. Cal. Oct. 26, 1972) (60% requirements

contract violated § 3 of the Clayton Act), *aff'd*, 412 U.S. 924 (1973); *see generally* Jonathan M. Jacobson, *A Note on Loyalty Discounts*, ANTITRUST SOURCE, June 2010, at 5 (noting that partial exclusivity arrangements that cover all of the market can be more anticompetitive than complete exclusivity agreements that cover less than 100% of the market). Indeed, loyalty rebates that create partial exclusivity generally have less of a legitimate business justification than exclusive dealing agreements with 100% exclusivity. *See id.* at 2 ("Because some competitive product purchases are permitted, the supplier generally is not trying to get its dealer to provide an entirely dedicated focus to the distribution of its products.").

2. Many scholars agree that loyalty rebates should be treated as a form of exclusive dealing

LePage's is also consistent with a growing body of legal and economic scholarship and commentary that recommends treating loyalty rebates as a form of exclusive dealing, and not like predatory pricing. *See* EINER ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS 406 (2d ed. 2011) ("Loyalty discounts can raise the same anticompetitive concerns as exclusive dealing."); Jacobson, *supra*, at 4 ("loyalty discounts are designed to create results essentially the same as exclusive dealing arrangements"); Willard K. Tom et al., *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615, 615 (2000) ("market-share discounts structured to produce total or partial exclusivity should be judged according to the same economic

principles that govern exclusive dealing"); Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?* 2006 UTAH L. REV. 863, 880 (recommending that "retroactive" or "all purchases" loyalty discounts be banned unless justified by significant efficiencies); Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice 6-7 (Sept. 8, 2008), http://www.ftc.gov/os/2008/09/080908section2stmt.pdf (criticizing price-cost test for loyalty discounts); *see also* Louis Kaplow & Carl Shapiro, *Antitrust*, *in* 2 HANDBOOK OF LAW & ECONOMICS 1073, 1203 n.198 (A. Michell Polinsky & Steven Shavell eds., 2007) (explaining that "a variety of seemingly distinct contractual arrangements, without explicit exclusivity, can have very similar economic effects [as exclusivity]," citing *LePage's*).[5]

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[5] The Justice Department's now-withdrawn "Section 2" Report recommended that a predatory pricing test be used for single-product loyalty discounts "in most cases," but noted that "commentators and panelists generally agree that even where a single-product loyalty discount is above cost when measured against all units, such a discount may in theory produce anticompetitive effects, especially if customers must carry a certain percentage of the leading firm's products and the discount is structured to induce purchasers to buy all or nearly all needs beyond that 'uncontestable' percentage from the leading firm." U.S. DEPT. OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 107, 117 (2008) (internal quotation marks omitted). The Department subsequently withdrew the Report as being overly lenient towards monopolistic abuse and inconsistent with Supreme Court precedent. *See* U.S. Justice Dept., Press Release, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), http://www.justice.gov/atr/public/press_releases /2009/245710.pdf.

3. *LePage's* is not limited to multiproduct rebates

Eaton seeks to distinguish *LePage's* by arguing that it is "limited to the special case of bundled rebates extending across *multiple* product markets." Eaton Br. at 36. In fact, the Court in *LePage's* was concerned with "intra-product" rebates—i.e., those offered by 3M on its Scotch-brand tape, which was in the same product market as LePage's private-label transparent tape—as well as with 3M's rebates on non-tape products. *See LePage's*, 324 F.3d at 156 ("3M bundled its rebates for Scotch-brand tape with other products it sold," which exploited its monopoly power because "Scotch-brand tape is indispensable to any retailer in the transparent tape market."). In any event, Eaton offers no *rationale* for why bundled rebates across multiple products should be distinguished from loyalty rebates with respect to a single market; both involve "pricing practices" under Eaton's rubric, and both may be used to effectuate exclusive (or partial exclusive) dealing. And when rivals realistically can only compete for part of the customers' business, as is often the case when there is a dominant firm, the mechanism by which loyalty rebates exclude rivals is very similar to that of bundled rebates: to win a customer's business, a rival not only has to match the monopolist's terms on the volume (or products) for which the rival can compete, but must also

compensate the customer for lost rebates on volume (or products) the rivals cannot replace.[6]

This similarity between bundled rebates and loyalty rebates has led some commentators who advocate the "discount attribution" price-cost test for bundled rebates, to advocate a similar test for loyalty rebates whereby the discounts are attributed to the "contestable" portion of the monopolist's sales. Indeed, Eaton seems to indicate that such a test could be an appropriate test. *See* Eaton Br. at 28-29 (citing Department of Justice action that employed the test).[7] However, the discount attribution price-cost test for loyalty rebates, while useful in some

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[6] In some respects, the rebates here look very much like bundled discounts. *See ZF Meritor,* 769 F. Supp. 2d at 688 (noting that "rebates were conditioned on share penetration across all product lines, and failure of any one line would lead to a loss of rebates across all lines."). Eaton itself notes, "Plaintiffs never developed a full line of heavy-duty truck transmissions." Eaton Br. at 3-4.

[7] The fact that the Justice Department recently brought a case involving loyalty discounts in which it analyzed the anticompetitive effects using the discount-attribution test does not mean that the Department takes the position that such a test is a *required* element of a plaintiff's case, or that it believes the test is an appropriate tool in all cases. *See* Competitive Impact Statement 15, *United States v. United Regional Health Care System*, No. 7:11-cv-00030 (N.D. Tex. Feb. 25, 2011) ("measuring the contestable volume may in some cases be impractical"); *cf.* Competitive Impact Statement 18, *United States v. Microsoft Corp.*, 56 F.3d 1448 (D.C. Cir. 1995) (where a volume discount by a monopolist is structured "in such a way that buyers, who must purchase some substantial quantity from the monopolist, effectively are coerced by the structure of the discount schedule (as opposed to the level of the price) to buy all or substantially all of the supplies they need from the monopolist . . . the volume discount structure would unlawfully foreclose competing suppliers from the marketplace . . . and thus may be challenged").

circumstances, is inadequate for some of the same reasons as in the bundled rebate context, and for additional reasons. *See* Jacobson, *supra*, at 7-8; *infra* at 17-22.

B. The Policy Rationale for the *Brooke Group* Rule Does Not Apply to Loyalty Rebates

Eaton maintains that the *Brooke Group* rule requiring below-cost pricing for predatory pricing claims "reflects the fundamental principle that price competition in the form of discounts, rebates, and price reductions is generally pro-competitive," and that "[a]n alleged monopolist's above-cost rebates cannot harm competition, because any equally efficient competitor can simply match them." Eaton Br. at 24. Accordingly, Eaton argues that a price-cost test is essential to ensure that procompetitive conduct is not chilled.

1. The issue with loyalty rebates is not prices, but the loyalty conditions required to obtain the rebates

The flaw in Eaton's argument is that there is a fundamental difference between unconditional price cuts, which provide unambiguous benefits for buyers, and bundled or loyalty "discounts," which impose exclusionary conditions on purchasers in order to obtain certain "price" benefits. As Professor Elhauge notes, "unlike with predatory pricing, what requires justification in the case of loyalty and bundled discounts is not the pricing, but the loyalty or bundled condition attached to the pricing." ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS, *supra*, at 413; Jacobson, *supra*, at 2 ("a loyalty discount is not a simple price cut. . .

. By conditioning the discount on a percentage requirement, the supplier is inducing the customer to take more from the supplier and also to take *less* from rivals."); *cf.* Brief for the United States as Amicus Curiae at 12, *3M Co. v. LePage's Inc.*, 542 U.S. 953 (2004) (No. 02-1865) ("U.S. *LePage's* Br.") ("[T]he bundling of rebates (as distinct from price reductions that may result) is not necessarily procompetitive.").

Indeed, loyalty (and bundled) rebates do not necessarily involve lower prices at all. Professor Elhauge explains:

> Without some comparison to but-for prices [i.e., those prices that would be charged in the absence of the loyalty condition], any loyalty discount or rebate could equally be called a disloyalty penalty imposed on buyers who refuse to restrict purchases from the seller's rivals. Rather than call them either loyalty discounts or disloyalty penalties, it would be more neutral to call them price differences conditioned on loyalty . . . .

ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS, *supra*, at 404;[8] *see also* ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE 682 (2d ed. 2008) ("Although loyalty discounts may initially result in lower prices to some customers, they may actually lead to higher prices

[8] Professor Elhauge also explains that, even in the absence of exclusion of rivals, loyalty rebates can lead to higher prices when they involve a commitment by the incumbent to maintain a higher "list" price for customers that do not agree to the loyalty condition. In that event, both the incumbent and the rivals have less of an incentive to cut prices to "disloyal" buyers. *See* Einer Elhauge & Abraham L. Wickelgren, *Anti-competitive Exclusion and Market Division Through Loyalty Discounts*, Harvard Discussion Paper No. 707 (September 2011), *available at* http://ssrn.com.

for others, especially those who do not qualify for (or decline to accept) the discounts, when compared to prices that were available before the program was implemented."). Furthermore, even if a loyalty rebate program results in lower prices in the short term for buyers who accept the terms,[9] lump-sum loyalty rebates are much less likely to be passed on to the ultimate consumers than unconditional price cuts. *See* Barry Nalebuff, *Exclusionary Bundling*, 50 ANTITRUST BULL. 321, 347 (2005); *cf. LePage's*, 324 F.3d at 163 (noting that 3M's rebate programs did not benefit the ultimate consumers).[10]

2. A cost-based test for exclusionary rebates is unwarranted

A predatory-pricing test cannot be justified on the basis that if prices are above the monopolist's cost, an equally efficient competitor can match them. In the first place, a firm with a small market share may be an equally-efficient competitor for part of the market, yet it may not be able to match the monopolist's loyalty rebates because it cannot realistically compete for all of a customers' business for which the customer receives a rebate—just as an equally efficient single-product firm cannot match a monopolist's bundled rebates because it does

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[9] Over the long term, buyers collectively will be harmed by the elimination of competition among suppliers, but buyers may agree to the terms because of a collective-action problem. *See* Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397, 456 (2009).

[10] ZFM cites evidence that Eaton's rebates were not, in fact, passed on to the OEMs' customers. *See* ZFM Br. at 24.

not offer the range of products on which the monopolist provides a rebate. *See LePage's*, 324 F.3d at 155 (firm that does not manufacture an equally diverse group of products may be foreclosed). A traditional *Brooke Group* test would exclude equally efficient competitors in these circumstances.[11]

Second, loyalty rebates, like bundled rebates, may prevent a rival from *becoming* an equally efficient competitor by denying it the economies of scale it needs to be equally (or more) efficient. *See* ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS, *supra*, at 411 ("Rivals that are equally efficient (in the sense of having a long run cost curve that is as low as the defendant) might be unable to achieve a price as low as the defendant's costs precisely because the foreclosure has relegated them to the high cost portion of their cost curve."); *cf.* Kaplow & Shapiro, *supra*, at 1203 ("Anticompetitive exclusion most plausibly arises [from exclusive dealing] when [a monopolist] requires its dealers to purchase only from itself, these dealers constitute a large proportion of the market, and profitable entry or continued survival requires the rival to achieve a scale greater than is possible if sales must be limited to dealers not subject to exclusive-dealing contracts.").

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[11] When a rival cannot compete against an unconditional above-cost price cut, one can assume that is because its costs are higher than the monopolist's. However, when a rival cannot compete against a loyalty discount linked to market share, it says nothing about rival efficiency because of the added "tax" the rival must assume if it is to compete for part of the customer's business beyond that permitted by the market-share threshold. *See* Tom et al., *supra*, at 628 (providing example of negative prices).

Even Judge Posner, a prominent advocate of an "equally efficient competitor" standard, recognizes that exclusion of a competitor that is "less efficient" because it is prevented from attaining economies of scale is an antitrust problem. In discussing *LePage's*, Judge Posner commented:

> There is a difference from the standpoint of economic welfare between efficiency based on lower labor or materials costs, superior management, better quality, and other firm-specific attributes, and efficiency based on scale, which is attainable by any firm that is able to increase its output to the efficient scale. Economies of scale are a market rather than a firm attribute. To the extent that the loyalty rebates raised LePage's average costs by shrinking its output and thus preventing it from achieving the available economies of scale, this was not a consequence of 3M being a more efficient company in a sense relevant to antitrust policy.

Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 U. CHI. L. REV. 229, 240 (2005); *see also* U.S. *LePage's* Br. at 13 n.10 ("Firms with equal costs at any common level of output may have different costs because they produce different levels of output, perhaps as a result of allegedly exclusionary conduct, which calls into question their comparative efficiency.").

Third, antitrust law ordinarily has not immunized anticompetitive conduct by monopolists when it excludes only less efficient rivals. *See, e.g., United Shoe,* 258 U.S. at 462 (discriminatory royalty clause providing lower royalty for lessees who agreed to use only lessor's machines violated § 3 of Clayton Act; "[n]o matter how good the machines of the United Company may be, or how efficient its service, it is not at liberty to lease its machines upon conditions prohibited by a

valid law"); *Microsoft*, 253 F.3d at 79 (Sherman Act protects "nascent, albeit unproven, competitors" from monopolistic abuse). And this is good policy because even less efficient competitors can provide important checks against the exercise of market power. *See* Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 328 (2006) ("The fundamental problem with applying the equally efficient entrant standard to [exclusionary] conduct is that the unencumbered (potential) entry of less-efficient competitors often raises consumer welfare."); Elhauge, *supra*, at 463-64 ("The equally efficient rival test seems oddly focused on the competitive virtue of the rival, rather than on the effects of the defendant's conduct on consumer welfare and efficiency.").

To be sure, the *Brooke Group* below-cost pricing test does not necessarily protect less efficient rivals against predatory pricing, but *Brooke Group* was largely premised on the difficulty of fashioning a rule that would not chill *unconditional* price-cutting. *See Brooke Group*, 509 U.S. at 223 ("As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to

control without courting intolerable risks of chilling legitimate price-cutting.").[12] Treating loyalty rebates that create exclusive or partial exclusive dealing arrangements under a rule of reason—like ordinary exclusive dealing arrangements by a monopolist—does not impinge on legitimate price cutting activity by a monopolist. The monopolist can always cut prices without the loyalty condition. *See* Jacobson, *supra*, at 9 ("[L]oyalty discounts generally involve no cost-saving or similar customer benefit that cannot be achieved with equal effectiveness through simple price reductions without associated loyalty conditions.").[13]

Finally, a cost-based test for loyalty rebates is not advisable because cost-based tests are so difficult to apply in practice. *See* GAVIL ET AL., *supra*, at 672 ("Determining whether a dominant firm's prices are 'below cost' . . . has proven to be a challenging task."); 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 740d, at 198 (3d ed. 2006) ("The difficulties of measuring costs

[12] As Professor Elhauge notes, "Pure above-cost pricing should be allowed, but that is not because excluding less efficient rivals cannot be anticompetitive. Rather, it is because a firm cannot avoid setting some price, and the systematic effects of banning above-cost price cuts that exclude less efficient rivals would harm consumers and efficiency. . . . The same analysis does not extend to exclusionary conditions that lack any redeeming justification and are thus eminently avoidable and can be banned without systematic ill effects." Elhauge, *Tying, supra*, at 464 n.198.

[13] Insofar as there are volume-based efficiencies, a dominant firm is also ordinarily free to offer uniform volume discounts. Loyalty rebates have little, if anything, to do with volume-based efficiencies, however, because the discounts do not reward volume, but "market share." *See ZF Meritor*, 769 F. Supp. 2d at 688 n.1.

are notorious."); *see, e.g., United States v. AMR Corp.*, 335 F.3d 1109, 1120-21 (10th Cir. 2003) (rejecting all four tests of variable costs proposed by the government). This difficulty not only makes it hard for courts and juries to determine a monopolist's costs, increases expenses for litigants, and undercuts the usefulness to businesses of cost-based safe harbors, but it also makes it exceedingly difficult for a plaintiff to succeed. As Professor Lande notes, using a cost-based test "would snare the parties into the expensive, unpredictable, daunting quagmire" of predatory pricing litigation "that almost always ends in a finding of legality." Lande, *supra*, at 880; *see id.* at 869 ("the world of predatory pricing has become a monopolist's paradise" despite the view of many respected scholars that predatory pricing is not rare). In other words, adopting a cost-based test for loyalty rebates is likely to lead to "false negatives" (anticompetitive conduct going unremedied and undeterred) and increased costs of judicial administration, which are not justified by the risk of "false positives" (deterring procompetitive conduct).

C. Supreme Court and Other Cases Cited by Eaton Do Not Support Extending Predatory-Pricing Rules to Loyalty Rebates

Eaton contends that "the Supreme Court has mandated the use of a price-cost test in cases involving a broad range of theories of liability, including classic predatory pricing (*Matsushita* and *Cargill*), maximum resale price maintenance (*Atlantic Richfield*), market manipulation through discounting (*Brooke Group*), predatory bidding (*Weyerhaeuser*), and price squeezes (*linkLine*)." Eaton Br. at

26. Moreover, it repeatedly quotes *Atlantic Richfield* as standing for the proposition that "'pricing practices' may not be challenged as anticompetitive absent below cost pricing, '*regardless of the type of antitrust claim involved*.'" *E.g., id.* at 38 (quoting *Atlantic Richfield*, 495 U.S. at 340, adding emphasis). This is a significant misreading of the cases.

Of course, *Matsushita* and *Brooke Group* are predatory pricing cases, while *Weyerhaeuser* applies predatory pricing rules to predatory bidding by buyers, which is the obverse of predatory pricing by sellers. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007). However, the other cases cited by Eaton do not support extending predatory pricing rules to exclusionary loyalty rebates or contradict the Supreme Court precedent treating discounts conditioned on exclusivity as exclusive dealing arrangements without regard to whether the resulting prices are above cost. *See Standard Fashion,* 258 U.S. 346; *United Shoe*, 258 U.S. 451; *supra* at 8-11.

Cargill and *Atlantic Richfield* stand for the uncontroversial proposition that competitors do not suffer antitrust injury (and hence lack standing under the Clayton Act) from a rival's low, but not predatory prices. But just as basic is the proposition that competitors *do* suffer from antitrust injury when they are foreclosed from a market as result of exclusive dealing or other exclusionary conduct. *See LePage's*, 324 F.3d at 158 ("The foreclosure of markets through

exclusive dealing contracts is of concern under the antitrust laws."); *Sprint Nextel Corp. v. AT&T Inc.*, __ F. Supp. 2d __, 2011 WL 5188081, *7 (D.D.C. 2011) ("Where a defendant, by means of anticompetitive conduct, restricts or forecloses a competitor plaintiff's access to a necessary input, courts have found that the resulting loss is injury of the type that the antitrust laws were designed to prevent.") (collecting cases). Nothing in the jurisprudence of antitrust injury suggests that standing should be denied to a competitor when its injury arises from the exclusionary conditions associated with loyalty rebates.[14]

linkLine held that a "price squeeze" by a vertically integrated monopolist against the monopolist's downstream rival (charging a "high" wholesale price to the rival and a "low" retail price to common customers) is not actionable if the monopolist has "no antitrust duty to deal" with the rival. *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.*, 555 U.S. 438, 445-46 (2009). *linkLine* did note that "[r]ecognizing a price-squeeze claim where the defendant's retail price remains above cost would invite the precise harm we sought to avoid in *Brooke Group*: Firms might raise their retail prices or refrain from aggressive price competition to avoid potential antitrust liability." *Id.* at 451-52. However, *linkLine* is distinguishable because a price squeeze excludes rivals through prices themselves,

[14] *Atlantic Richfield* actually confirms that not all "pricing practices" are subject to a price-cost test because the above-cost maximum resale prices at issue in *Atlantic Richfield* were nonetheless per se illegal and challengeable by consumers, restricted dealers or the government. *See Atl. Richfield*, 495 U.S. at 345.

whereas the exclusion from a loyalty rebate results from the exclusionary conditions linked to the rebates. Moreover, it is clear that the basis of the decision was that AT&T had no antitrust duty to deal with linkLine in the first place, which the Court emphasized numerous times in the opinion. *See, e.g., id.* at 450 ("*Trinko* thus makes clear that if a firm has no antitrust duty to deal with its competitors at wholesale, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous."). Indeed, the Court was doubtful that even a *Brooke Group* predatory pricing claim could be brought in these circumstances: "For if AT&T can bankrupt the plaintiffs by refusing to deal altogether, the plaintiffs must demonstrate why the law prevents AT&T from putting them out of business by pricing them out of the market." *Id.* at 456-57. In short, *linkLine* provides no support for extending predatory pricing rules to loyalty rebates or other exclusive dealing arrangements.

Nor does then-Judge Breyer's opinion in *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983), support requiring a price-cost for loyalty rebates. It is true that *Barry Wright* involved a loyalty discount: the putative monopolist, Pacific, "agreed to sell its product (mechanical snubbers) to Grinnell at a specially low price and Grinnell agreed to take nearly all its snubber requirements from Pacific." 724 F.2d at 228. The plaintiff challenged the low prices as predatory pricing, which the court rejected in the absence of a showing of

prices below cost. However, the plaintiff *also* challenged the arrangement as anticompetitive exclusive dealing, and the court pointedly did not apply a cost test to the exclusive-dealing theory. *See id.* at 236-238 (finding no violation because of insufficient foreclosure and legitimate business justifications). If anything, *Barry Wright* recognizes that a challenge to exclusionary conditions required to obtain discounts *does not* require proof of prices below cost.

Virgin Atlantic is similar. In that case, the Second Circuit applied the *Brooke Group* predatory pricing test to plaintiff's predatory pricing theory, but not to plaintiff's claim that British Airways' incentive agreements with corporate clients and travel agents violated § 1. *See Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 263-65 (2d Cir. 2001). The latter claim was dismissed where the plaintiff failed to show an adverse effect on the relevant market, which is not surprising given that the agreements covered tiny percentages of the bookings in the relevant markets. *See id.* at 261-62 (maximum of 3.79%).

The other appellate cases cited by Eaton are also inapposite. *NicSand* dismissed a challenge to exclusive dealing agreements obtained in exchange for up-front payments where plaintiff never alleged below cost prices *or* that the exclusive agreements had adverse anticompetitive effects. *See NicSand, Inc. v. 3M Co.*, 507 F.3d 442, 454 (6th Cir. 2007) (en banc). Likewise, the Eighth Circuit in *Concord Boat* held that plaintiffs' claim involving market-share discounts was

wanting in part because defendant's prices were not below cost, but also because the loyalty conditions had not "foreclosed a substantial share" of the market. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1059 (8th Cir. 2000). Indeed, the court did not consider the question of below-cost prices in analyzing the discount program as exclusive dealing under § 1 of the Sherman Act.

CONCLUSION

Loyalty rebates are not equivalent to price discounts. They are policies that link the price paid by a buyer to the maintenance of the supplier's market share. Such arrangements impose a penalty on buyers for giving business to the supplier's rival. Like bundled rebates, they can effectuate exclusive (or partially exclusive) dealing arrangements. As such, loyalty rebates should be condemned when they foreclose a significant share of the market and thereby help to preserve or extend a dominant firm's market power, and the exclusivity conditions are not justified by a countervailing procompetitive benefit. Eaton has offered no good reason in law or policy that *LePage's* should be repudiated and an antitrust plaintiff should be required to prove the resulting prices are below the supplier's cost.

Respectfully submitted,

/s/Michael Tarringer
MICHAEL TARRINGER
CAFFERTY FAUCHER LLP
1717 Arch St.
Suite 3610
Philadelphia, PA 19103
(215) 864-2800

RICHARD M. BRUNELL
Director of Legal Advocacy
AMERICAN ANTITRUST INSTITUTE
2919 Ellicott St., N.W.
Washington, DC 20008
(202) 600-9640

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CERTIFICATE OF BAR MEMBERSHIP

In accordance with Local Rule of Appellate Procedure 28.3(d), I certify that I am a member of the bar of the United States Court of Appeals for the Third Circuit.

/s/Michael Tarringer
Michael Tarringer
Cafferty Faucher LLP
1717 Arch Street
Suite 3610
Philadelphia, PA 19103
Phone: 215-864-2800

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/s/Michael Tarringer

Michael Tarringer
Cafferty Faucher LLP
1717 Arch Street
Suite 3610
Philadelphia, PA 19103
Phone: 215-864-2800

CERTIFICATE OF SERVICE

I, Michael Tarringer, hereby certify that counsel for Amici Curiae is a Filing User of the Court's CM/ECF system, and that, on this 7th day of February, 2012, this Brief of Amici Curiae American Antitrust Institute in Support of Plaintiffs-Appellees was served on counsel of record by filing it on the Court's CM/ECF system. I further certify that ten hard copies of this Brief were delivered to the Office of the Clerk for the United States Court of Appeals for the Third Circuit.

/s/Michael Tarringer
Michael Tarringer
Cafferty Faucher LLP
1717 Arch Street
Suite 3610
Philadelphia, PA 19103
Phone: 215-864-2800