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Third Circuit Upholds Finding of Antitrust Liability for Above-Cost Pricing Arrangement

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The Third Circuit has been a source of important and controversial jurisprudence regarding antitrust liability for single-firm conduct. For example, in *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc), *cert. denied*, 542 U.S. 953 (2004), the court found that bundled discounts that had exclusionary effects violated the antitrust laws despite no showing of below-cost pricing. See also *United States v. Dentsply Int'l*, 399 F.3d 181 (3d Cir. 2005). In a recent split decision, the Third Circuit explicitly declined to establish a *per se* rule of non-liability for above-cost pricing. *ZF Meritor, LLC v. Eaton Corporation*, Nos. 11-3301 & 11-3426, 2012 WL 4483899 (3d Cir. Sept. 28, 2012). The Third Circuit further declined to create a rule that requirements contracts covering less than 100% of the buyer's needs are never unlawful exclusive dealing arrangements. While recognizing the Supreme Court's general safe harbor for above-cost discounting, the Third Circuit found that market-share discounts by a monopolist could amount to a *de facto* exclusive dealing arrangement that violates the antitrust laws even when prices remained above-cost. In affirming the jury verdict of liability, the Third Circuit also found that the district court had erred in denying plaintiffs an opportunity to amend its expert report on damages which resulted in no damages being awarded.

This case arose out of the alleged foreclosure of ZF Meritor, LLC and Meritor Transmission Corporation (collectively "Plaintiffs") from over 90% of the market for heavy-duty truck transmissions ("HD transmissions") as the result of Defendant Eaton Corporation's ("Eaton's") long-term agreements with direct purchasers of its HD transmissions. In 2009, a federal jury found that Eaton's conduct violated Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act. In a renewed motion for judgment as a matter of law, Eaton had argued that its conduct was *per se* lawful because its products were priced above-cost. The district court disagreed, reasoning that Eaton had entered into long-term *de facto* exclusive dealing arrangements that harmed competition by foreclosing a substantial portion of the market. Eaton appealed.

Factual Background

In the North American trucking industry, there are only four direct purchasers of HD transmissions, collectively referred to as Original Equipment Manufacturers ("OEMs"). The ultimate consumers of HD transmissions are the buyers who purchase heavy duty trucks from the OEMs. Eaton and Plaintiffs were the only significant suppliers of HD transmissions to the OEMs, with Eaton possessing monopoly power in the market.

Following a decline in demand for new heavy-duty trucks in 2000, Eaton entered into long-term supply contracts with each of the OEMs. Although long-term agreements were not uncommon in the industry, Eaton's agreements were unprecedented in length and coverage. Under the agreements, each with a term of at least 5-years, the OEMs would receive rebates from Eaton if they purchased a specified percentage (generally 90%) of their requirements from Eaton. Some of the agreements also required the OEMs to: i) list Eaton's transmissions as the standard (and therefore lowest cost) component in the OEMs' sales catalogues; ii) "preferential price" Eaton's transmissions against competing transmissions; iii) remove products of Eaton's competitors from the sales catalogues; and iv) provide Eaton an opportunity to match the price and quality of competing products.

Notably, Eaton's average prices were always lower than Plaintiffs' average prices, but Eaton never priced at levels below-cost. By 2007, the Plaintiffs had exited the market due to declining market share.

The Third Circuit's Analysis

On appeal, the Third Circuit examined whether the "price-cost test" should control, or if instead Plaintiffs' exclusive dealing claims should be subject to a rule of reason analysis. Under the price-cost test, a plaintiff must prove the defendant's prices are below-costs. *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, U.S. 209 (1993). In contrast, exclusive dealing arrangements are only unlawful under the rule of reason if the "probable effect" of the arrangement is to substantially lessen competition. *Tampa Elec. Coal Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961). Eaton argued that the OEMs were incentivized to enter into the long-term contracts due to its pricing practices, and therefore the price-cost test should apply. The Third Circuit, however, found that the price-cost test was not dispositive, declining to adopt "Eaton's unduly narrow characterization of this case as a 'pricing practices' case, i.e., a case in which price is the clearly predominant mechanism of exclusion."

Price-Cost Test

Acknowledging that above-cost prices are generally not anticompetitive, the Third Circuit nonetheless did not find it dispositive in this case. The Court noted that under the price-cost test, "when price is the clearly predominant mechanism of exclusion…so long as the price is above-cost, the procompetitive justifications for, and the benefits of, lowering prices far outweigh any potential anticompetitive effects." Nonetheless, in this case, the Court found that price was not the predominant mechanism of exclusion. Despite Eaton's rebate pricing, "Plaintiffs [did] not allege that price itself functioned as the exclusionary tool." Instead, Plaintiffs alleged that they were foreclosed from a substantial share of the market as a result of Eaton's use of its monopoly power to force the OEMs to remove Plaintiffs' products from the sales catalogues and to meet the market share penetration targets of 90% or more for Eaton's products.

Exclusive Dealing

The Third Circuit observed that exclusive dealing arrangements "are of special concern when imposed by a monopolist." Here, the Court found that, although the long-term agreements between Eaton and the OEMs contained no express exclusivity provision and did not cover 100% of the OEM's purchase requirements, the trial jury still could have concluded that the long-term agreements were *de facto* partial exclusive dealings. Plaintiffs had presented evidence that both the rebates and Eaton's continued business with the OEMs were conditioned on the OEMs meeting market share targets, and that the market share targets were large enough to foreclose competition in a substantial share of the market. In affirming the district court's finding of liability, the Third Circuit reasoned that "exclusive dealing arrangements can exclude equally efficient rivals, and thereby harm competition, irrespective of below-cost pricing."

The Third Circuit further concluded that, having found that there was "sufficient evidence from which a jury could determine that the [long-term agreements] functioned as unlawful exclusive dealing agreements… that there was [also] likewise sufficient evidence that Plaintiffs suffered antitrust injury" as a result of Eaton's foreclosure of rivals, including Plaintiffs, from a substantial share of the market.

Damages

At the trial level, no damages were awarded despite the finding of antitrust liability. The district court had excluded Plaintiffs' expert's damages testimony and had denied Plaintiffs an opportunity to present alternate damages calculations. Plaintiffs cross-appealed the district court's damages rulings.

The Third Circuit upheld the district court's initial determination that the Plaintiffs' expert's damages estimate was not sufficiently reliable, as required by *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993). The Third Circuit found that the district court had not abused its discretion in determining that the expert could not rely on Plaintiffs' strategic business plan for its damages calculations without knowledge of the qualifications of the individuals who had prepared the relevant data contained in that business plan. However, the Third Circuit found that the district court erred in not allowing Plaintiffs' expert to amend the expert report on damages. The Plaintiffs had proposed an amended damages calculation that would not rely on the business plan, but rather would use market share estimates based on an econometric model. Importantly, the new calculation would have used methodology and alternate reliable data already contained in the expert's original report.

Dissent

The vigorous dissent argued that Eaton was entitled to judgment as a matter of law in all aspects of the case, suggesting that "the general principle that above-cost pricing practices are not anticompetitive… is a cornerstone of antitrust jurisprudence that applies regardless of whether the plaintiff focuses its claim on the price or non-price aspects of the defendant's pricing program." The dissent urged that "courts ought to exercise a great deal of caution before condemning above-cost pricing practices." Responding to the majority's discussion on exclusive dealings, the dissent argued that the long-term agreement's market share targets did not reflect the actual foreclosure effect of the agreements, nor did they act as express purchase requirements.

The dissent interpreted the record in the case to demonstrate that Eaton maintained its market dominance "for myriad reasons, including its capability of offering the OEMs a full product line, favorable pricing, its long-standing, positive reputation, and various market forces that favored an established market player." The dissent concluded that "[w]hat I find most troubling is that firms will play it safe by not formulating discount programs and that the result of this case will be an increase of prices to purchasers and the stifling of competition."

The case has been remanded to the district court for further proceedings consistent with the majority's opinion. This case might well end up being proffered to the Supreme Court, which would then have the opportunity to decide whether above cost pricing should be a safe harbor in all circumstances.

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