No. 12-1045

IN THE
Supreme Court of the United States

EATON CORPORATION,

Petitioner,

v.

ZF MERITOR LLC AND MERITOR TRANSMISSION CORPORATION,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR EIGHTEEN SCHOLARS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

KEVIN J. ARQUIT
Counsel of Record
SIMPSON THACHER &
BARTLETT LLP
425 Lexington Avenue
New York, New York
10017
(212) 455-2000
karquit@stblaw.com
Counsel for Amici Curiae

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TABLE OF CONTENTS

Page

INTEREST OF *AMICI CURIAE* 3

SUMMARY OF ARGUMENT 4

ARGUMENT 5

I. THE COURT OF APPEALS' REJECTION OF A PRICE-COST TEST FOR MARKET SHARE DISCOUNTS CONFLICTS WITH THE STANDARDS ESTABLISHED BY THIS COURT AND THE HOLDINGS OF OTHER CIRCUITS. 5

II. THE COURT OF APPEALS' RECHARACTERIZATION OF EATON'S REBATES AS "PENALTIES" THREATENS TO UNDERMINE THIS COURT'S UNILATERAL PRICING JURISPRUDENCE. 8

III. ABOVE-COST MARKET SHARE DISCOUNTS DO NOT RESULT IN "DE FACTO EXCLUSIVE DEALING" AND DO NOT THREATEN THE VIABILITY OF EQUALLY EFFICIENT COMPETITORS... 13

IV. THE THIRD CIRCUIT'S RULING WILL CHILL THE OFFERING OF MARKET SHARE DISCOUNTS, TO THE DETRIMENT OF CONSUMERS.. 14

CONCLUSION.. 18

CASES

Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group LP, 592 F.3d 991 (9th Cir. 2010) 7
Atl. Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990) 5, 6
Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir. 1983) 7, 13
Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993) 6, 12
Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104 (1986) 6
Cascade Health Solutions v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008) 7, 12
Concord Boat v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000) 7, 12
Healy v. Beer Inst., Inc., 491 U.S. 324 (1989) 15
Herbert Hovenkamp, *The Federal Trade Commission and the Sherman Act*, 62 Fla. L. Rev. 871, 889 (2010) 15
Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986) 5
McKune v. Lile, 536 U.S. 24 (2002) 10
NicSand, Inc. v. 3M Co., 507 F.3d 442 (6th Cir. 2007)7
Pac. Bell Tel. Co. v. linkLine, Commc'ns., Inc., 555 U.S. 438 (2009) 5, 6, 7, 14
Smith Wholesale Co. v. R.J. Reynolds Tobacco Co., 477 F.3d 854 (6th Cir. 2007) 16
Southeast Missouri Hosp. v. C.R. Bard, Inc., 642 F.3d 608 (8th Cir. 2011) 7

Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961) 13
Virgin Atl. Airways Ltd. v. British Airways Plc, 257 F.3d 256 (2d Cir. 2001) 7, 15
Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007)..............................6
ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254 (3d Cir. 2012)..4, 5, 8, 10, 12, 13

OTHER AUTHORITIES

Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 Antitrust L.J. 433, 437-65 (2008) 16
Competitive Impact Statement, *U.S. v. United Regional Health Care Sys.*, No. 7:11-cv-00030 at pp. 14-15 (Feb. 25, 2011).......................................12
Daniel A. Crane, *Bargaining Over Loyalty*, 92 Tex. L. Rev. ___, (forthcoming 2013) 11, 16
Daryl J. Levinson, *Collective Sanctions*, 56 Stan. L. Rev. 345 (2003)...10
Donald Hawthorne & Margaret Sanderson, *Rigorous Analysis of Economic Evidence on Class Certification in Antitrust Cases*, 24 Fall Antitrust 55, 59 (2009)...17

BRIEF *AMICI CURIAE* OF SCHOLARS

This brief *amici curiae* in support of petitioner is respectfully submitted by the following individuals:[1]

- Daniel A. Crane, Frederick Paul Furth, Sr. Professor of Law, University of Michigan
- Kenneth G. Elzinga, Robert C. Taylor Professor of Economics, University of Virginia
- Richard A. Epstein, Laurence A. Tisch Professor of Law, New York University School of Law
- Jerry A. Hausman, John and Jennie S. MacDonald Professor of Economics, Massachusetts Institute of Technology
- Rebecca Haw, Assistant Professor, Vanderbilt Law School

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[1] The parties have consented to the filing of this brief. Counsel of record for all parties received notice at least 10 days prior to the due date of the intention of *amici curiae* to file this brief. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amici* or their counsel made a monetary contribution to its preparation or submission. *Amici* submit their own individual views and not those of their clients or employers.

- Herbert Hovenkamp, Ben and Dorothy Willie Chair and Professor of Law, University of Iowa College of Law
- R. Glenn Hubbard, Dean and Russell L. Carson Professor of Finance and Economics, Columbia Business School
- Keith Hylton, The Honorable Paul J. Liacos Professor of Law, Boston University School of Law
- William E. Kovacic, Global Competition Professor of Law and Policy, Professor of Law, and Director, Competition Law Center, George Washington University School of Law
- Thom Lambert, Wall Family Foundation Chair in Corporate Law & Governance and Professor of Law, University of Missouri School of Law
- Alan Meese, Ball Professor of Law, William & Mary Law School
- Thomas D. Morgan, formerly Oppenheim Professor of Antitrust and Trade Regulation Law, George Washington University School of Law
- Barak Y. Orbach, Professor of Law and Director, Business Law Program, University of Arizona James E. Rogers College of Law
- William H. Page, Professor of Law and Marshall M. Criser Eminent Scholar, University of Florida Levin College of Law
- Robert S. Pindyck, Bank of Tokyo-Mitsubishi Professor of Economics and Finance, Sloan School of Management, Massachusetts Institute of Technology

- Edward A. Snyder, Dean and William S. Beinecke Professor of Economics and Management at the Yale School of Management
- D. Daniel Sokol, Associate Professor of Law, University of Florida Levin College of Law and Visiting Professor, University of Minnesota
- Robert H. Topel, Isidore Brown and Gladys J. Brown Distinguished Service Professor in Urban and Labor Economics, The University of Chicago Booth School of Business.

INTEREST OF *AMICI CURIAE*

Amici Curiae are law professors and economists at U.S. law schools, business schools, and university economics departments who specialize in antitrust law and economics. They share a common view that antitrust law should not penalize unilaterally established prices unless they are predatory under this Court's jurisprudence. They are concerned that the decision of the Third Circuit could chill beneficial price competition and have adverse effects for consumer welfare.

SUMMARY OF ARGUMENT

This case raises a question of great importance to the business community and the interests of consumers: whether a seller violates the antitrust laws[2] when it incentivizes customers to purchase a specified share of their requirements from the seller by offering admittedly non-predatory "loyalty" or market share rebates. The court of appeals held that loyalty or market share rebates could violate the antitrust laws even though the goods were priced above an appropriate measure of cost. This holding conflicts with a long line of this Court's decisions and the decisions of other circuits. The court of appeals' erroneous and unworkable distinction between discounts and penalties will chill sellers from offering conditional non-predatory discounts and rebates, reward less efficient producers, diminish price competition, and harm consumer welfare. *Amici* respectfully urge this Court to grant *certiorari* and reverse the decision of the court of appeals.

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[2] Meritor brought claims under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act. *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 268 (3d Cir. 2012). The Third Circuit held that the analysis of Eaton's allegedly exclusionary pricing conduct "is the same of all of Plaintiffs' claims." *Id.* at 269 n.9. *Amici* concur and therefore make no distinction between Meritor's separate legal theories.

ARGUMENT

I. THE COURT OF APPEALS' REJECTION OF A PRICE-COST TEST FOR MARKET SHARE DISCOUNTS CONFLICTS WITH THE STANDARDS ESTABLISHED BY THIS COURT AND THE HOLDINGS OF OTHER CIRCUITS.

At the heart of Meritor's case lies a claim that Eaton excluded Meritor by offering truck manufacturers preferential rebates if they met specified market share penetration targets. *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 265 (3d Cir. 2012). Meritor made no showing that these rebates resulted in Eaton pricing below cost. *Id.* at 267 ("Although Eaton's prices were generally lower than Plaintiffs' prices, Eaton never priced at a level below its costs."). While recognizing that "when price is the clearly predominant mechanism of exclusion" the plaintiff is required to show pricing below an appropriate measure of cost, *id.* at 275, the court of appeals nonetheless held that Meritor was excused from showing that Eaton's market share discounts resulted in below-cost pricing. *Id.* at 281.

This Court has long required a plaintiff challenging unilaterally set prices as exclusionary to show that the prices were below an appropriate measure of cost "regardless of how those prices are set." *Pac. Bell Tel. Co. v. linkLine, Commc'ns., Inc.*, 555 U.S. 438, 451 (2009) (citing *Atl. Richfield Co. v. USA Petroleum Co.,*495 U.S. 328, 340 (1990)). Beginning with *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), this Court has confronted a string of cases in which the plaintiff challenged the defendant's prices as exclusionary.

Although the defendants' pricing structures varied and the plaintiffs often tried to distinguish their circumstance from "simple" predatory pricing, this Court uniformly required the plaintiff to show that defendant was pricing below an appropriate measure of cost.

To recap the cases briefly, in *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104 (1986), plaintiff argued that a merger between the nation's second and third largest beef packers would result in slightly above-cost or below-cost pricing. *Id.* at 114-15, 117-18. This Court rejected plaintiff's challenge, holding that evidence of below-cost prices would be necessary to establish liability. *Id* at 118-19. Next, in *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), an independent gasoline marketer challenged defendants' alleged maximum vertical price-setting scheme. This Court rejected plaintiff's Sherman Act Section 1 and 2 claims since plaintiff made no showing of predatory pricing. *Id.* at 339-40. In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), plaintiff brought a primary line price discrimination case under the Robinson-Patman Act rather than the Sherman Act, but this Court nonetheless required plaintiff to meet the price-cost test. *Id.* at 222. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007) involved a claim of predatory overbidding. This Court rejected the claim because plaintiff had not shown that alleged overpayments for inputs resulted in below-cost pricing of defendant's outputs. *Id.* at 325-26. Most recently, in *linkLine*, 555 U.S. at 438, an independent DSL service alleged a "price squeeze" theory of liability, and this Court rejected it because plaintiff failed to allege that AT&T was

pricing its DSL services at retail below cost. *Id.* at 452. In sum, this Court has consistently required a showing of below-cost pricing when a plaintiff challenges a unilaterally established pricing structure, regardless of its form.

Although this Court has not yet heard a case involving market share discounts, many of the circuits have. Consistent with this Court's precedents, a number of circuits have held that a plaintiff challenging market share or other loyalty discounts as exclusionary must prove below-cost pricing. *Southeast Missouri Hosp. v. C.R. Bard, Inc.*, 642 F.3d 608, 610-13 (8th Cir. 2011); *NicSand, Inc. v. 3M Co.*, 507 F.3d 442, 447-48, 455 (6th Cir. 2007); *Virgin Atl. Airways Ltd. v. British Airways Plc*, 257 F.3d 256 (2d Cir. 2001); *Concord Boat v. Brunswick Corp.*, 207 F.3d 1039, 1062-63 (8th Cir. 2000); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983).[3] The Third Circuit's decision is inconsistent with these cases and this Court's longstanding precedent.

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[3] The Ninth Circuit recently rejected an antitrust challenge to a market share discount scheme. *Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group LP*, 592 F.3d 991 (9th Cir. 2010). That decision did not squarely address the applicability of the price-cost test. However, on the related issue of bundled discounts, the Ninth Circuit has applied a version of the price-cost test. *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 909 (9th Cir. 2008).

II. THE COURT OF APPEALS' RECHARACTERIZATION OF EATON'S REBATES AS "PENALTIES" THREATENS TO UNDERMINE THIS COURT'S UNILATERAL PRICING JURISPRUDENCE.

The court of appeals recognized that "Eaton's rebates were part of Plaintiff's case," 696 F.3d at 277, but found this fact not dispositive on whether the price-cost test should apply. The court justified this holding based on the assertion that Eaton employed coercive measures other than price discounts to incentivize loyalty. Since "[p]laintiffs do not allege that price itself functioned as the exclusionary tool," *id.* at 281, the court believed that the price-cost test should not apply. The court of appeals erred in asserting that price was not "the exclusionary tool."[4]

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[4] The Third Circuit also invoked what it characterized as Eaton's contractual right to cease selling transmissions to OEMs that did not meet market share targets, a purported right that Eaton never exercised. 696 F.3d at 282-83. The mere possibility that Eaton, the "dominant supplier" might exercise this right, the court said, helped transform the firm's unilateral price practices into "*de facto* partial exclusive dealing," because "no OEM could satisfy customer demand without some Eaton products." *Id*. at 283.

Amici do not contend that every Section 2 monopolization claim requires use of the price-cost test. But whenever a unilaterally determined pricing structure is the alleged mechanism of exclusion, that test should apply. The Third Circuit allowed Meritor to escape the price-cost test by glossing over the *mechanism* of exclusion and resting simply on the *effect*. When the court of appeals explained the "exclusionary tools" it saw in the record, it simply characterized the operation of the market share rebates as coercive: "Significantly, there was considerable testimony that the OEMs did not want to remove ZF Meritor's transmissions from

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The court's invocation of Eaton's contractual right to cease dealing with OEMs as evidence of "de facto exclusive dealing" provides too easy an escape hatch from this Court's unilateral pricing precedents. Actual exclusive dealing agreements may prevent a monopolist's rivals from themselves engaging in merits-based competition, as discounts that induce customers to breach their contracts and ignore exclusivity provisions constitute tortious interference with contract. Absent such an agreement, however, rivals are free, as they were here, to offer their own discounts and hence induce customers to switch. The Third Circuit's test would result in a finding of "*de facto* partial exclusive dealing" whenever a manufacturer offered above-cost market share discounts and reserved the right to choose its customers in the future.

their data books, but that they were essentially forced to do so or risk financial penalties or supply shortages." 696 F.3d at 277. The "financial penalties" were nothing other than the loss of the market share rebates. In short, the market share rebate pricing structure was precisely the alleged mechanism of exclusion.

In allowing the jury to find Eaton liable for threatening "penalties," the court of appeals misunderstood basic economics and opened a loophole in this Court's predatory pricing jurisprudence through which plaintiffs will be able to drive at will. As this Court and scholars have long recognized, distinctions between penalties and rewards are often slippery and depend entirely on some preconceived baseline. *E.g. McKune v. Lile,* 536 U.S. 24, 46 (2002) ("The answer to the question whether the government is extending a benefit or taking away a privilege rests entirely in the eye of the beholder."); Daryl J. Levinson, *Collective Sanctions*, 56 Stan. L. Rev. 345, 376 & n.154 (2003) (observing that whether something is a punishment or a reward depends on the baseline). Meritor made no claim that Eaton was threatening customers with any financial "penalty" *other than* the loss of the rebates they would have received by complying with the loyalty conditions. One can characterize the withdrawal of a rebate the customer otherwise would

have received as a "penalty," but it is economically indistinguishable from a reward a customer receives from complying with the seller's condition.[5] A dollar awarded for loyalty and a dollar withdrawn for disloyalty are equivalent.

The distinction drawn by the court of appeals between loyalty rewards and disloyalty penalties threatens to undermine this Court's predatory pricing jurisprudence. In every case in which the defendant offers the buyer a better price for buying more, the plaintiff could characterize the offer as the threat of a higher price for buying less. If this Court's unilateral pricing precedents are going to retain their force, the economic substance of the offered price rather than its label as a "penalty" or "discount" must control.

Amici take no position on *how* the cost-price test should be applied to market share discounts. Some courts and scholars would apply the test exactly as it

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[5] Some commentators have theorized that loyalty discounts offered by dominant firms are merely disguised penalties because the seller raises its price above the profit-maximizing monopoly level and then offers a discount back down to the monopoly level for buyers who comply with the condition. Such assumptions are not economically plausible, since they involve the seller exceeding the profit-maximizing monopoly price whether or not the buyer accepts the condition. *See* Daniel A. Crane, *Bargaining Over Loyalty*, 92 Tex. L. Rev. ___, (forthcoming 2013).

is used in ordinary predatory pricing cases—by asking whether the revenues generated by the allegedly exclusionary contracts exceeded the incremental costs of performing those contracts. *See. e.g.*, *Concord Boat*, 207 F.3d at 1062-63. Others would modify the price-cost test in the market share discount context. For instance, the Justice Department has taken the view that conditional discounts have an exclusionary effect if they result in pricing below an appropriate measure of cost after discounts given on incontestable business are relocated to contestable business. Competitive Impact Statement, *U.S. v. United Regional Health Care Sys.*, No. 7:11-cv-00030 at pp. 14-15 (Feb. 25, 2011), available at http://www.justice.gov/atr/cases/f267600/267653.pdf; *see also Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 909 (9th Cir. 2008) (adopting discount attribution standard in bundled discount context). Further, administration of the price-cost test raises important questions—not yet decided by this Court—about the identification of the "appropriate measure of cost." *Brooke Group*, 509 U.S. at 222 n.1 (declining to decide what is appropriate measure of cost in predatory pricing cases).

How to administer the price-cost test in the loyalty discount context raises complex questions, but not for this case. Meritor made no claim that Eaton's market share discounts resulted in below-cost pricing under *any* definition. 696 F.3d at 265. It just wanted to avoid the price-cost test. Hence, the issue this Court would decide if it granted *certiorari* is only whether plaintiffs should be allowed to avoid price-cost tests altogether by recharacterizing unilaterally determined pricing incentives as

"penalties," "coercive measures," or the like. Consistent with its decisions going back to *Matsushita*, the Court should make clear that whenever a plaintiff challenges a seller's unilaterally determined price as exclusionary, it must show that the price is below an appropriate measure of cost, no matter what gloss the plaintiff puts on the effect of defendant's pricing structure.

III. ABOVE-COST MARKET SHARE DISCOUNTS DO NOT RESULT IN "DE FACTO EXCLUSIVE DEALING" AND DO NOT THREATEN THE VIABILITY OF EQUALLY EFFICIENT COMPETITORS.

In holding that Meritor's failure to meet the price-cost test was not fatal to its complaints about Eaton's market share discounts, the court of appeals characterized the discounts as creating a "de facto exclusive dealing arrangement." 696 F.3d at 275. That characterization was erroneous. Exclusive dealing arrangements are unlawful when they foreclose a substantial share of the relevant market to rivals. *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961). As Justice Breyer observed while on the First Circuit, "virtually every contract to buy 'forecloses' or 'excludes' alternative buyers from some portion of the market, namely the portion consisting of what was bought," *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236 (1st Cir. 1983), but that does not mean that the contract "forecloses" in a sense relevant to antitrust law. To extend Justice Breyer's point, if all customers decided to buy from Firm A rather than Firm B because Firm A's product and pricing were superior,

one could say that A had entirely "foreclosed" the market to B and was engaging in "de facto exclusive dealing." But, of course, "foreclosure" would just be another way of acknowledging that B lost out to A because its products and prices were inferior.

One important function of the price-cost test is to ensure that less efficient firms who lose sales because customers prefer their rival's offerings are not able to turn their defeat in the market into an antitrust claim. If a seller offers aggressive but above-cost prices, equally efficient rivals will not be excluded from matching and hence attracting customers. The price-cost test brings discipline to antitrust cases by preventing less efficient rivals from resting on a characterization of the effect of the defendant's prices (i.e., "exclusivity," "foreclosure") without regard to the fact that a non-predatory price was the mechanism of "exclusion."

Above-cost prices do not result in "de facto exclusive dealing." The Third Circuit's holding to the contrary should be reversed.

IV. THE THIRD CIRCUIT'S RULING WILL CHILL THE OFFERING OF MARKET SHARE DISCOUNTS, TO THE DETRIMENT OF CONSUMERS.

If allowed to stand, the Third Circuit's ruling will have a chilling effect on sellers offering non-predatory market share or other loyalty discounts. Without the assurance that their discounts are protected by a price-cost safe harbor and faced with the threat of a treble damages lawsuit, sellers will be reluctant to offer such discounts. *See linkLine*, 555 U.S. at 453 (recognizing that abandoning the price-

cost test for price squeeze claims would leave firms without a clear safe harbor). Already, some *amici* have counseled firms that are reluctant to provide market share discounts because of potential liability.

A general chilling of market share discounts would harm the interests of consumers. Foregone discounts means higher prices. *See Virgin Atl.*, 257 F.3d at 265 ("Rewarding customer loyalty promotes competition on the merits."). Even if sellers shifted from market share to volume as the basis for granting discounts, the effects on consumer welfare could be negative. This Court has recognized the procompetitive benefits of volume discounts. *E.g.*, *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 339 (1989). In some circumstances, market share discounts can benefit consumers in ways that volume discounts cannot. *Amici* offer three examples.

First, market share discounts may have the effect of shifting risks of changing market circumstances from buyers to sellers in ways that volume discounts do not. *See* Herbert Hovenkamp, *The Federal Trade Commission and the Sherman Act*, 62 Fla. L. Rev. 871, 889 (2010). If the market in which input purchasers sell their products weakens more than expected, the input purchasers might not be able to meet a contractually specified volume threshold and hence might lose a volume-based discount. However, if to obtain the seller's lowest price they must buy a specified percentage of their needs from seller—say 80%—they can continue to claim the best price even in a weak market.

Second, market share discounts may be used to guarantee the supplier a minimum volume of sales when the individual requirements of a set of

customers are unpredictable. Daniel A. Crane, *Bargaining Over Loyalty*, 92 Tex. L. Rev. ___ (forthcoming 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2223982. If a seller anticipates that a set of buyers with a predicted aggregate demand will respond to the loyalty discount offer by buying a specified percentage of their requirements from the seller, then the seller can plan for a known sales volume even though the market shares within the set shift due to competition between the purchasers. Offering volume discounts would not achieve this effect, since the requirements of any individual buyer could not be determined ex ante.

Third, market share discounts may enable even relatively small buyers who might not qualify for a volume discount to enhance their bargaining position with suppliers and exact pricing concessions. This occurs because the buyer is able to exchange its freedom to pursue variety in its purchases for a lower price. By foregoing its variety preferences and focusing primarily on a single seller, the buyer effectively elasticizes the demand facing the seller and hence can obtain a better price. Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 Antitrust L.J. 433, 437-65 (2008). Significantly, even relatively small purchasers with little buying power can deploy loyalty to secure better prices. *Id.* at 449; *see also Smith Wholesale Co. v. R.J. Reynolds Tobacco Co.,* 477 F.3d 854, 864-65 (6th Cir. 2007) ("Market-share discounts theoretically level the playing field by allowing competing purchasers of like commodities to participate on equal terms, regardless of size, because such discounts depend not on volume

purchases, but on the percentage of purchases of a particular category of products."); *see also* Donald Hawthorne & Margaret Sanderson, *Rigorous Analysis of Economic Evidence on Class Certification in Antitrust Cases*, 24 Fall Antitrust 55, 59 (2009) (reporting that a medical device manufacturer's market share discounts for pulse oximeters allowed small hospitals to achieve lower prices than they could under pure volume discounts).

Amici do not claim that market share discounts are always superior to volume discounts or other discounting mechanisms. Economic theory and real-world evidence show that a variety of different pricing mechanisms could be optimal, depending on the circumstances. Hamstringing the seller's ability to choose the optimal discounting mechanism will reduce consumer welfare overall. The Third Circuit's decision eliminating the cost-price safe harbor for non-predatory market share discounts should be rejected.

CONCLUSION

Amici urge the Court to grant the petition and reverse the judgment of the court of appeals.

Respectfully submitted,
KEVIN J. ARQUIT
Counsel of Record
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, New York 10017
(212) 455-2000
karquit@stblaw.com
Counsel for Amici Curiae

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