Caveat Venditor: Supreme Court Declines To Clarify Law on Market Share-Based Price Discounts

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On April 29, 2013, the U.S. Supreme Court refused to review the Third Circuit?s 2012 ruling in *ZF Meritor, LLC v. Eaton Transmission Corporation*, which held that a dominant supplier of heavy duty truck transmissions violated the antitrust laws by offering above-cost loyalty discounts to its customers. Though the Court is not shying away from antitrust issues this term (it will soon rule on the legality of ?reverse payment? patent infringement settlements, and it has already spoken on the scope of state action immunity as detailed ***here***), its unwillingness to add another antitrust case to its docket leaves the business community with little clarity about a ubiquitous pricing practice. Instead, firms with market power are left with an inconsistency between the Third Circuit?s treatment of a monopolist?s aggressive but above-cost pricing discounts and numerous other federal circuits? treatment of the same conduct.

Price Cutting by Dominant Firms ??Good? Competition or ?Bad? Exclusion?

It is common for sellers to encourage larger purchases of their products by offering discounts, rebates or other attractive pricing terms to their most loyal customers. One example is a market share discount, which activates the discount only after the customer buys a certain percentage of its total requirements from the seller. That this type of business practice is often beneficial should be clear: customers receive lower prices and obtain sufficient volume to meet much of their demand, while sellers increase output, reduce selling costs, and heighten customer loyalty.

Several federal courts have recognized the procompetitive potential of market share-based discounts ? even when offered by a dominant firm. Appellate Courts in the First, Second, Sixth, Eighth, and Ninth Circuits have upheld such discounts so long as the reduced pricing is not below-cost. The Supreme Court, too, has for decades required that challenges to unilaterally set prices must show that those prices are below some measure of cost.

The Third Circuit Remains a Thorn in Large Companies? Sides

The Third Circuit has somewhat deviated from these holdings; indeed, its *Meritor* ruling was its third decision in less than 10 years that found above-cost vertical restraints imposed by a dominant supplier to violate antitrust law. In the *Meritor* case, a divided panel imposed antitrust liability on Eaton, a long-time dominant manufacturer and seller of truck transmissions. Eaton?s smaller rival Meritor (who entered the market in 1989 and exited it in 2007) challenged Eaton?s offer of conditional rebates to four large OEM customers on their purchases of heavy duty truck transmissions. Following a steep reduction in demand for trucks in 1999-2000, Eaton and each of the four OEMs entered into long term agreements with durations of at least five years. Under the agreements, Eaton offered substantial price reductions, engineering and technical support if the OEMs met certain purchasing targets of between 70 and 97.5% of their requirements. Eaton and the OEMs agreed to additional contract terms, such as: (i) Eaton transmissions? placement as the ?preferred? or ?standard? product option in some, but not all, of the OEMs? advertising; (ii) the requirement that OEMs grant Eaton ?preferential pricing? against competitors? equivalent transmissions; and (iii) the implementation of a ?competitiveness? clause, which allowed Eaton the opportunity to match the price or quality of competitors? transmissions before an OEM sold competing products.

Eaton defended its conduct as lawful, aggressive behavior that reduced prices to customers and increased output following a market drop, noting in particular that its prices were always lower than Meritor?s and always above Eaton?s own costs. The Third Circuit nonetheless held that Eaton engaged in anticompetitive conduct, because its lower prices were not the ?predominant? mechanism for excluding Meritor from OEM sales. The court instead determined that Eaton?s long-term agreements as a whole were anticompetitive and allowed Eaton to engage in *de facto* exclusive dealing (even though Eaton?s contracts did not require that OEMs purchase exclusively from it). Moreover, the Third Circuit did not delineate a clear standard for what constitutes ?*de facto* exclusive dealing? in its opinion. Although the *Meritor* ruling created a clear split between the Third Circuit and numerous other circuits, the Supreme Court denied certiorari without comment.

Moving Forward in the Face of Uncertainty

The Supreme Court?s refusal to review the *Meritor* decision means that the Third Circuit?s less permissive view of dominant firm pricing conduct remains intact for now, and suggests that Pennsylvania, New Jersey and Delaware federal courts will likely be the preferred venues for challenges to such conduct. National sellers with large market shares should account for the Third Circuit?s ruling when deciding whether and how best to craft loyalty discount programs. Key threshold questions remain crucial, such as whether the seller possesses market power and whether its reduced prices are above or below-cost. However, sellers would be well-served to assess their loyalty program as a whole by analyzing aspects such as (i) its business justification; (ii) its duration; (iii) customers? ability to terminate agreements under the program; and (iv) non-price aspects that may increase customers? switching costs.

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