

No. 12-15182

IN THE
**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

◆————◆
MICHAEL MALANEY., *et al.*
Plaintiffs-Appellants,

v.

UAL CORPORATION, UNITED AIR LINES, INC. and CONTINENTAL
AIRLINES, INC.,
Defendants-Appellees.

◆————◆
**On Appeal from a Final Order of the
United States District Court for the Northern District of California
(Case No. 3:10-CV-02858-RS)**

◆————◆
**APPELLANTS' PETITION FOR REHEARING
WITH A SUGGESTION FOR REHEARING *EN BANC***

◆————◆
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Petitioners, a group of airline travelers and travel agents, hereby petition this Court for a rehearing pursuant to Rule 40 of the Federal Rules of Appellate Procedure, and suggest that rehearing be *en banc*, pursuant to Rule 35.

INTRODUCTION

Since 2008, the United States airline industry has become increasingly concentrated through a series of mergers. The number of major U.S. airlines has been reduced from seven to four in only a few years (Delta-Northwest in 2008; United-Continental in 2010; Southwest-Airtran in 2011; and American-US Airways in 2013.) These major competitors have been eliminated because of the airlines' desire to grow through acquisition rather than competition, which § 7 of the Clayton Act, 15 U.S.C. § 18, prohibits. Each airline merger, including most recently, the American and US Airways merger, has been permitted to proceed (by the Department of Justice and the courts) with minor divestitures of slots at airports, if any. In the antitrust context, an overly narrow relevant market definition, such as the one advocated by Defendants in this case, city-pair relevant markets, allows mergers to proceed largely intact, with only minor concessions, if any, by the merging entities. With only minor slot divestitures, the anticompetitive effects of these mergers have been realized¹.

If defining a relevant market is a “necessary predicate” to any antitrust action, then this Court’s decisions on the issue have the potential to impact any antitrust case or major merger, and it is incumbent upon this Court to ensure

¹ “In essence, industry consolidation has left fewer, more-similar airlines, making it easier for the remaining airlines to raise prices, impose new or higher baggage and other ancillary fees, and reduce capacity and service.” *United States v. US Airways Group, Inc.*, et al., Case No. 13-cv-1326, United States District Court for the District of Columbia, Amended Complaint, Dkt. No. 73, at ¶ 4.

that its precedent regarding relevant market definition is clear. *Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962). This case should and must be viewed within this background.

In a decision that not only conflicts with the authority of this Circuit but with authority in numerous other circuit courts and the United States Supreme Court, the panel rubber stamped an erroneous, one-dimensional approach to defining a relevant market. The relevant market analysis validated by the panel is erroneous as a matter of law because cross-elasticity of supply should and must be considered in relevant market definition, rather than the one-sided demand elasticity approach it upheld. Accordingly, Petitioners respectfully request that this Court grant rehearing, or alternatively, rehearing *en banc*.

FEDERAL RULE OF APPELLATE PROCEDURE 35 STATEMENT

Rehearing or rehearing *en banc* is warranted because the panel decision directly conflicts with decisions by this Court and authority of nearly every other United States District Court. It stands in opposition to decades of established law in this Court and the United States Supreme Court, and undermines federal antitrust law. If rehearing is not granted to address these conflicts and ensure uniformity of this Court's precedents, the consequences will be serious and lasting. The decision validates an erroneous, overly narrow approach to defining relevant market in antitrust cases, a mistake which is sure to be repeated in future antitrust litigation. Notwithstanding the incontrovertible fact that a national market for air transportation has been acknowledged and relied upon by airlines in previous actions and that the airlines have admitted that it is easy to enter new markets if it would be profitable to do so (that cross-elasticity of supply in the industry is high), the panel affirmed a decision which rejected Plaintiffs' proposed market definition,

the national market for air transportation as a matter of law, and ignored the authority of this Circuit that cross-elasticity of supply must be considered in relevant market definition.

The panel decision directly conflicts with this Court's decisions in *Rebel Oil Company, Inc. v. Atlantic Richfield Company*, 51 F.3d 1421, 1436 (9th Cir. 1995); *Twin City Sports Service, Inc., v. Charles O. Finley & Co., Inc.*, 512 F.2d 1264, 1271 (9th Cir. 1975); *Equifax, Inc. v. F.T.C.*, 618 F.2d 63, 66 (9th Cir. 1980); and *Calnetics Corporation v. Volkswagon of America, Inc.*, 532 F.2d 674, 691 (9th Cir. 1976), and creates confusion within the Circuit regarding proper relevant market analysis. In *Rebel Oil*, 51 F.3d at 1436, this Court made it clear that a relevant market definition based on demand considerations alone is erroneous:

But defining a market on the basis of demand considerations alone is erroneous. (citations omitted) A reasonable market definition must also be based on "supply elasticity." (citations omitted) Supply elasticity measures the responsiveness of producers to price increases. (citation omitted) If producers of product X can readily shift their production facilities to produce product Y, then the sales of both should be included in the relevant market. (citation omitted).

Malaney I is clearly erroneous because it rejected Plaintiffs' proposed market definition on the basis of demand considerations alone. It makes no finding or analysis and fails to address in any way cross-elasticity of supply, even though the ability of the airlines to enter new markets (that cross-elasticity of supply was high) was brought to the lower court's attention, and then subsequently brought to the attention of the panel before *Malaney II* was decided.

The panel's decision also conflicts with well-settled standing law in the United States Supreme Court and in other Circuits, including a recent 11th

Circuit decision from last year, which cites this Court's decision in *Rebel Oil*. See *Gulf States Reorganization Group, Inc., v. Nucor Corporation*, 721 F.3d 1281, 1286 (11th Cir. 2013).

Rehearing is necessary to ensure the uniformity of the Court's decisions and to correct the irreconcilable differences between the Court's holdings in *Malaney I* and *Malaney II*, and those set forth in *Rebel Oil*, *Twin City*, *Equifax*, *Calnetics*, and in the well-established authority of the Supreme Court and other circuits.

ISSUES FOR REHEARING

1. Whether the panels' rulings in *Malaney I* and *Malaney II* which ignore and fail to address cross-elasticity of supply in defining a relevant market for antitrust purposes, conflict with the standards announced by this Court in *Rebel Oil*, *Twin City Sportservice*, *Equifax*, and *Calnetics*.
2. Whether the panels' rulings in *Malaney I* and *Malaney II* which ignore and fail to address cross-elasticity of supply in defining a relevant market for antitrust purposes, conflict with the standards announced by the Supreme Court and the settled authority of other United States Circuit Courts.

BACKGROUND

In 2010, Defendants UAL Corporation and Continental announced their intention to merge. Plaintiffs brought suit for injunctive relief to enjoin Defendants' merger as illegal under Section 7 of the Clayton Act, 15 U.S.C. § 18. (Op. Br. at 3.) Plaintiffs filed a motion for preliminary injunction. In the briefing on the motion, Plaintiffs argued that the national market for air transportation was the relevant market, that the airlines were actual and potential competitors in the United States market for air transportation, and that the ability of airlines to enter markets where it would be profitable to do so

must be considered in relevant market definition, which was supported by the deposition of former Continental CEO Smisek:

Well, no, no not at all. I mean, there are—competitors can enter your market at 540 miles an hour, so its very easy to enter a market when you are already an airline.

...If I decide I want to fly to Charlotte tomorrow, all I have to do—I would want to sell the seats of the aircraft, but I could take a 737 and point it to Charlotte and there I'd be. So it's actually fairly easy to enter markets.

(APP. SER 39-40) Plaintiffs also argued that a national market for air transportation was consistent with a line of Supreme Court precedent. (APP. SER 13-16.) In the order denying Plaintiffs' motion, the district court held that: "Plaintiffs' third proposed relevant market is the national airline industry taken as a whole, and can be more quickly dispatched than the two previously discussed alternatives. First, '[t]he boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it,' *Brown Shoe*, 370 U.S. at 325, and plaintiffs have not shown how, for example, a flight from San Francisco to Newark would compete with a flight from Seattle to Miami." *Malaney v. UAL Corp.*, WL 3790296, *12 (N.D.Cal. 2010).

The lower court rejected Plaintiffs' proposed market definition as a matter of law, because a "flight from San Francisco to Newark" does not compete with "a flight from Seattle to Miami," because routes in the national market for air transportation are not perfectly interchangeable. The lower court conducted a one-sided relevant market analysis based on cross-elasticity of demand and stopped there. The lower court did not address in any way, cross-

elasticity of supply or the evidence presented that “it’s very easy to enter a market when you are already an airline.”

On the first appeal to this Court, Plaintiffs argued that a national market for air transportation was consistent with a line of binding Supreme Court precedent, including *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). In *Malaney I*, this Court adopted the same one-sided relevant market analysis of the lower court, ignoring cross-elasticity of supply, and held that:

Plaintiffs have failed to demonstrate that the national market in air travel satisfies this standard. As the district court noted, a flight from San Francisco to Newark is not interchangeable with a flight from Seattle to Miami. No matter how much an airline raised the price of the San Francisco–Newark flight, a passenger would not respond by switching to the Seattle–Miami flight.

Malaney v. UAL Corp., 434 Fed.Appx. 620, 621 (9th Cir. 2011) (“*Malaney I*”).

Upon return to the district court, Plaintiffs amended the complaint with additional factual allegations, adding a damages claim, and later filed a supplemental complaint. (II ER 51 and 47.) Defendants filed a motion to dismiss the amended complaint. In opposition to the motion to dismiss, Plaintiffs brought to the attention of the lower court the decision in *In re Air Passenger Computer Reservation Systems*, 694 F.Supp. 1443, 1468 and 1472 (CD Cal. 1988), which held that:

Continental has failed to present any evidence supporting its contention that a city pair or hub constitutes a relevant market in the air transportation industry. In fact, Continental’s own expert (Franklin Fischer) has testified that a city pair cannot be a relevant market absent unusual circumstances, such as slot-constrained airports and the absence of a market for slots at those airports. Plaintiffs’ expert Fischer has also stated that a city or hub cannot constitute a relevant market either. *Id.* at 1468.

The evidence submitted supports [United's] contention that the only relevant air transportation market is the national market. Continental's own expert (Fischer) supports this conclusion... Thus, summary judgment should be granted for failure to establish that the local air transportation markets are relevant markets for antitrust purposes. *Id.* at 1472.

Plaintiffs also relied upon the binding authority of the United States Supreme Court, including *Brown Shoe*, precedents which define relevant market broadly. The lower court granted Plaintiffs' motion to dismiss, holding that:

As both courts have explained, the national market for air transportation does not meet *Brown Shoe's* standard because flights between distant cities are simply not reasonably interchangeable. A passenger would never choose a flight from San Francisco to Newark as an alternative to a flight from Seattle to Miami, regardless of price.

(I ER 007.) No analysis or mention of cross-elasticity of supply has ever been applied to this case by any court. The line of Supreme Court decisions, including *Brown Shoe*, have never been addressed. The plausibility of Plaintiffs' relevant market definition in light of the *In re Air Passenger CRS* was also disregarded by the lower court.

Plaintiffs again appealed to this Court. On appeal, Plaintiffs argued that *Malaney I* was erroneous because it did not consider the authority of this Circuit which requires that cross-elasticity of supply be considered in defining a relevant market. Plaintiffs also noted that airlines have previously acknowledged and alleged the existence of a national relevant market for air transportation for antitrust purposes in not only *In re Air Passengers CRS* but also *Continental Airlines v. American Airlines*, 1993 WL 379396 (S.D. Tex. 1993). The panel refused Plaintiffs' request to take judicial notice of the fact

that in the *Continental* jury instructions, a jury was instructed that they could find a national relevant market for air transportation:

The parties disagree about the relevant geographic market in this case, and you must decide this issue... Defendants claim that the national United States air passenger service market includes all air passenger service within the United States. Defendants also claim that, for purposes of analyzing their national pricing actions, hubs and regions are not relevant markets separate from the national market that contains them...

You may consider how readily airlines shift from selling in one location to selling in another. Evidence that airlines tend to shift readily among different locations in response to price changes may be considered by you in determining whether the different locations are in the same geographic market.

[Y]ou may conclude that a relevant market exists only for the entire United States, or you may conclude that relevant markets exist both for the entire United States and for particular hubs within or regions of the United States.

Id. at *2. [Emphasis added.]

Despite authority in this Circuit to the contrary regarding definition of relevant market and consideration of cross-elasticity of supply, the panel, affirming the decision of the lower court, held that “*Malaney I* is not Clearly Erroneous”:

Appellants argue *Malaney I*, in affirming the district court’s denial of a preliminary injunction, fails to account for the cross-elasticity of supply within the passenger airline industry. *See Equifax, Inc. v. F.T.C.*, 618 F.2d 63, 66 (9th Cir. 1980) (recognizing it is “well settled that cross-elasticity of supply is a valid basis for determining that two commodities should be within the same market”); *Twin City Sportservice, Inc. v.*

Charles O. Finley & Co., 512 F.2d 1264, 1271 (9th Cir. 1975)5 (similar). We disagree.

Appellants have not pleaded any specific facts establishing relevance of supply interchangeability to the product market inquiry in this case. *Malaney v. UAL Corp.*, Memorandum Decision, January 16, 2014 (9th Cir. 2014). (“*Malaney II.*”) Though CEO Smisek’s statements regarding ease of entry into markets were brought to the attention of the panel, they were ignored. (Reply Br. at 5.) The panel’s decision finds that *Malaney I* is not “clearly erroneous” without analyzing the previous panel’s holding against the weight of the authority in this Circuit. *Malaney I* and *Malaney II*, without question, rejected Plaintiffs’ proposed market definition based on demand considerations alone.

ARGUMENT

1. The Panel’s Decision Conflicts with the Authority of this Circuit Requiring Consideration of Cross-Elasticity of Supply in Defining a Relevant Market

The panel’s decision upheld a standard for defining a relevant market for antitrust purposes that conflicts with the standard articulated by this Court in *Rebel Oil*, *Twin City Sportservice*, *Equifax, Inc.*, and *Calnetics*, and will create confusion within the Circuit. Specifically, the panel held that *Malaney I*, the previous panel’s decision which rejected Plaintiffs’ proposed market definition based on demand considerations alone, was not “clearly erroneous.” Under *Rebel Oil*, and the other authority of this Circuit, the court is required to consider cross-elasticity of supply in relevant market definition. Failure to do so, in the face of binding authority to the contrary, is clear error.

In addressing the issue of relevant market in *Rebel Oil*, this Court held that:

Rebel’s expert relied on “demand elasticity”—that is, whether a price rise in self-serve, cash-only gasoline would cause self-serve consumers to shift their demand to full-service gasoline...***But defining a market on the basis of demand considerations alone is erroneous.*** *Virtual Maintenance, Inc., v. Prime Computer, Inc.*, 11 F.3d 660, 664 (6th Cir. 1993) (citing Areeda & Hovenkamp, ¶ 518.1 at 543), *cert. dismissed*, 512 U.S. 1216, 114 S.Ct. 2700, 129 L.Ed.2d 829 (1994). ***A reasonable market definition must also be based on “supply elasticity.”*** *Id. Twin City Sportservice, Inc., v. Charles O. Findley & Co.*, 512 F.2d 1264, 1274 (9th Cir. 1975.) Supply elasticity measures the responsiveness of producers to price increases. Sullivan & Harrison, § 6.02. ***If producers of product X can readily shift their production facilities to produce product Y, then the sales of both should be included in the relevant market.*** Areeda & Turner ¶ 521a, at 354. The affidavit of Rebel’s expert fails to account for the fact that sellers of self-serve gasoline can easily convert their full-serve pumps, at virtually no cost, into self-serve, cash-only pumps, expanding output and thus constraining any attempt by ARCO to charge supracompetitive prices for self-serve gasoline. The ease by which marketers can convert their full-serve facilities to increase their output of self-serve gasoline requires that full-serve sales be part of the relevant market; ***it is immaterial that consumers do not regard the products as substitutes***, that a price differential exists, or that prices are not closely correlated. Areeda & Turner ¶ 521 at 354....*See Thurman Indus.*...875 F.2d at 1374 (***a relevant market includes those sellers who have the “actual or potential ability” to compete and deprive the defendant of significant amounts of business***).

Rebel Oil, 51 F.3d at 1436.

Instead of following the standard in *Rebel Oil*, the panel in *Malaney I* and *Malaney II* validated a one-sided, demand consideration approach to relevant market definition—an approach which is described in *Rebel Oil* as “erroneous.” It is impossible to reconcile the holding of the panel in *Malaney I* that, “No matter how much an airline raised the price of the San Francisco–Newark flight, a passenger would not respond by switching to the Seattle–Miami flight” with

the mandate of this Circuit in *Rebel Oil*, “If producers of product X can readily shift their production facilities to produce product Y, then the sales of both should be included in the relevant market... *it is immaterial that consumers do not regard the products as substitutes.*” *Id. at 1436.* [Emphasis added.]

Cross-elasticity of supply in the context of this case is the ability of airlines to easily enter markets where it would be profitable to do so. This was admitted in the testimony of CEO Smisek and brought to the attention of the lower court and the panel, but disregarded. The issue of supply elasticity has never been addressed by any court in this case.

Rebel Oil is not the only 9th Circuit case requiring consideration of cross-elasticity of supply in relevant market definition. In its decision, the panel also either misapprehended or overlooked:

a. *Twin City Sportservice, Inc., v. Charles O. Finley & Company, Inc.*, 512 F.2d 1264 (9th Cir. 1975) (holding that, “A like analysis applies when the market is viewed from the production rather than the consumption standpoint...Where the degree of substitutability in production is high, cross-elasticities of supply will also be high, and again the two commodities in question should be treated as part of the same market...While the majority of decided cases in which the rule of reasonable interchangeability is employed deal with the “use” side of the market, the courts have not been unaware of the importance of substitutability on the “production” side as well.”)

b. *Calnetics Corporation v. Volkswagon of America*, 532 F.2d 674 (9th Cir. 1976), (holding that, “In defining the product market, the district court explicitly refused to consider the cross-elasticity of production facilities or capacity. (citation omitted) VW and Subsidiary argue that *this refusal rendered the ensuing market definition...clearly erroneous...The district court’s*

failure to consider production cross-elasticity was inconsistent with the views of the Supreme Court and of this circuit.) [Emphasis added.]

c. *Equifax, Inc., v. Federal Trade Commission*, 618 F.2d 63 (9th Cir. 1980), (holding that, “It is well settled that cross-elasticity of supply is a valid basis for determining that two commodities should be within the same market. “)

Based on *Rebel Oil*, *Twin City Sportservice*, *Equifax, Inc.*, and *Calnetics*, there should have been no question that it was erroneous to define a relevant market from demand considerations alone, and that supply elasticity must be considered. Rehearing is not only required to reconcile the conflict between the panel’s rulings in *Malaney I* and *Malaney II* and these Circuit precedents, but also to correct the errors of law that underlie the panel’s decision.

2. The Panel’s Decision Misapprehends or Overlooks that Cross-Elasticity of Supply was Brought to the Attention of the Lower Court, But was Improperly Disregarded

Testimony from the deposition of Continental CEO Smisek, which acknowledges that airlines can enter markets easily (in other words, cross-elasticity of supply), was brought to the attention of the district court and the panel (APP SER 39-40), but was overlooked or misapprehended. Continental’s CEO admitted that:

Well, no, no not at all. I mean, there are—competitors can enter your market at 540 miles an hour, so its very easy to enter a market when you are already an airline.

...If I decide I want to fly to Charlotte tomorrow, all I have to do—I would want to sell the seats of the aircraft, but I could take a 737 and point it to Charlotte and there I’d be. So it’s actually fairly easy to enter markets.

(APP. SER 39-40.) Though this information was before the lower court and this panel, the panel in *Malaney II* held that, “Appellants cobble together bald factual allegations with a citation to out-of-circuit authority to allege that cross-elasticity of supply is relevant to the passenger airline industry.” Smisek’s testimony has never been addressed by the lower court or a panel of this Circuit.

3. The Panel’s Decision Conflicts with the Authority of Nearly Every Other United States Circuit Court and the United States Supreme Court

The panels’ holdings in *Malaney I* and *Malaney II* conflict with precedent in a number of other Circuit Courts and the United States Supreme Court, including the following:

a. In a recent 11th Circuit decision, *Gulf States Reorganization Group, Inc. v. Nucor*, 721 F.3d 1281 (11th Cir. 2013), the court cited and relied on this Circuit’s decision in *Rebel Oil* (at 1286) regarding cross-elasticity of supply and held that, “[Plaintiff’s] definition of the product market is too restrictive...it refuses to acknowledge that...manufacturers could (and likely would) enter the fray...That would, in turn, increase the supply, and lower the price...**[Plaintiff] ignores this “actual or potential” economic construct, U.S. Anchor Mfg., 7 F.3d at 995, and its failure to account for cross-elasticity of supply is fatal...**” *Id.* at 1287. [Emphasis added.]

b. *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962), (“The cross-elasticity of production facilities may also be an important factor in defining a product market...)

c. *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660, 665 (6th Cir. 1993) (“**Defining a market, or “submarket,” on the basis of demand considerations alone is erroneous because such an approach fails to consider the supply side of the market.** Philip E. Areeda & Herbert Hovenkamp,

Antitrust Law, ¶ 518.1g at 471 & n. 26 (Supp.1990) (citing *United States v. Central State Bank*, 817 F.2d 22 (6th Cir.1987)). ***The relevant product market cannot be determined without considering the cross-elasticity of supply.***)

[Emphasis added.]

d. *U.S. v. Empire Gas Corp.*, 537 F.2d 296, 303 (8th Cir. 1976), (“The cross-elasticity of supply would seem to be as important as the demand factor in determining relevant product market.”)

e. *Larry V. Muko, Inc., v. Southwestern Pennsylvania Bldg. and Const. Trades Council*, 670 F.2d 421, 434 (3rd Cir. 1982) (“A market definition must look at all relevant sources of supply, either actual rivals or eager potential entrants to the market.”)

f. *Spectrofuge Corp., v. Beckman Instruments, Inc.*, 575 F.2d 256, 282 (5th Cir. 1978), (“The fact that a company limits its competitive activity...cannot control the definition of the relevant market. (citations omitted)..The [] Court reasoned that limiting the relevant market...ignored...the low cost involved...in supplying peripheral products compatible with equipment manufactured by...competitors (cross-elasticity of supply).”)

g. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986), (“[T]he capability of other production facilities to be converted to produce a substitutable product is referred to as the cross-elasticity of supply. The higher these cross-elasticities, the more likely it is that similar products or the capacity of production facilities now used for other purposes are to be counted in the relevant market.”)

The panel’s departure from well-established precedent in this Circuit, and in other circuits and the United States Supreme Court, threatens consequences far beyond this case. The panel’s decision validates an erroneous, one-sided

analysis of relevant market definition, which accounts for demand elasticity but ignores supply elasticity.

CONCLUSION

For the reasons set forth above, the Court should grant rehearing or rehearing *en banc*.

Respectfully submitted:

January 30, 2014

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**CERTIFICATE OF COMPLIANCE PURSUANT TO CIRCUIT RULES
35-4 AND 40-1**

I certify that pursuant to Circuit Rule 35-4 or 40-1, the attached petition
for panel rehearing/petition for rehearing en
banc:

Proportionately spaced, has a typeface of 14 points or more and contains
4,181 words

January 30, 2014

s/ Joseph M. Alioto

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