# ANTITRUST LAW

## Unit 17: Predation

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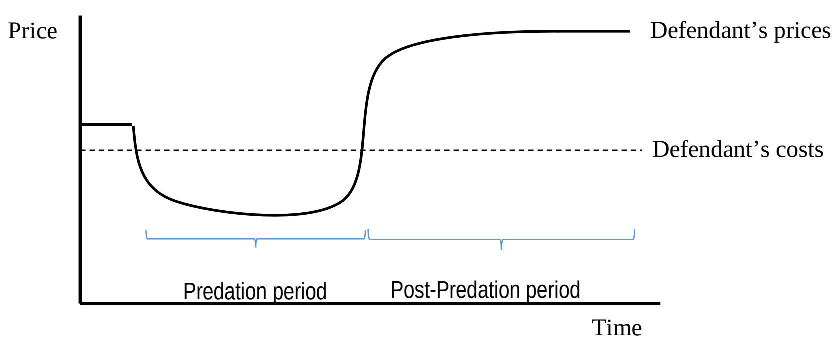
## Table of Contents

# Introduction

## AN INTRODUCTION TO THE LAW OF PREDATION

Predatory pricing has long been a fixture in U.S. antitrust law, but modern courts have almost eliminated it as a viable theory on which to ground an antitrust violation. The idea of predatory pricing is that a company will sacrifice present profits by charging below-cost prices in the near term in order to drive its competitors out of business and thereafter raise its prices to supracompetitive levels in the long term.[1] Under this theory, predatory pricing may be challenged under the antitrust laws as monopolization if already successful or, more likely, as attempted monopolization in the below-cost pricing or predation phase.

The Timeline of Predation




The problem with the theory in application is that low prices benefit customers and are one of the primary means by which companies compete with one another. “[C]utting prices in order to increase business often is the very essence of

1. *See* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 318 (2007) (“In a typical predatory-pricing scheme, the predator reduces the sale price of its product (its output) to below cost, hoping to drive competitors out of business. Then, with competition vanquished, the predator raises output prices to a supracompetitive level.”); Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 117 (1986) (“Predatory pricing may be defined as pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run.”); Transamerica Computer Co. v. IBM, 698 F.2d 1377, 1384 (9th Cir. 1983) (“Predatory pricing occurs when a company that controls a substantial market share lowers its prices to drive out competition so that it can charge monopoly prices, and reap monopoly profits, at a later time.”).

competition."[2] A mistake in finding predatory pricing when only aggressive discounting exists creates the very harm the antitrust laws are designed to prevent.[3] Aggressive procompetitive pricing may result in some firms losing profits or even going out of business, but the antitrust laws do not protect competitors from competition on the merits.[4] As we will see, courts have adopted two requirements for predatory pricing to minimize overinclusive (Type I) enforcement errors: (1) the defendant's prices in the predation period must be below the defendant's costs (so that in some sense the defendant loses money on every sale), and (2) in the postpredation period, the defendant must be able to recoup its investment (with interest) in its predatory conduct, so that overall the conduct makes profits rather than loses them.[5]

**Applicable statutes**

Almost all claims of predatory pricing are made by incumbent competitors facing the defendant's allegedly predatory prices in the predation period. This sounds in attempted monopolization, since actual monopolization has yet to occur. As a result, predatory pricing is usually challenged as attempted monopolization in violation of Section 2 of the Sherman Act. If a group of competitors agree to engage collectively in predatory pricing to drive their other competitors out of business, then predatory pricing can be challenged as horizontal price fixing in violation of Section 1 of the Sherman Act. Finally, predatory pricing may be challenged as illegal primary line price discrimination under Section 2(a) of the Robinson-Patman Act if the alleged predator is selling the same tangible commodity to customers in one geographic market at predatory prices and to customers in a different geographic market at higher prices.[6]

2. *See* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986); *accord* Pacific Bell Tel. Co. v. Linkline Commc'ns, Inc., 555 U.S. 438, 451(2009); *see also* Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 340 (1990) ("Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.").

3. *Matsushita*, 475 U.S. at 594; *accord Pacific Bell*, 555 U.S. at 451; *see* Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.) ("[W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.").

4. *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993); *Atlantic Richfield*, 495 U.S. at 337-38.

5. *See Brooke Group*, 509 U.S. at 222; *accord Pacific Bell*, 555 U.S. at 451; *Weyerhaeuser*, 549 U.S. at 318-19.

6. *Brooke Group*, 509 U.S. at 221-22; Able Sales Co., Inc. v. Compania de Azucar de Puerto Rico, 406 F.3d 56, 60 (1st Cir. 2005); Fido's Fences v. Canine Fence Co., 672 F. Supp. 2d 303, 310 (E.D.N.Y. 2009); Digene Corp. v. Third Wave Techs., Inc., 536 F. Supp. 2d 996, 1007-08 (W.D. Wis. 2008).

**Elements of a Section 2 attempted monopolization price predation claim**

The Supreme Court has held that no matter what the antitrust offense may be called, it must satisfy all of the requirements of at least one of the statutory prohibitions to be an antitrust violation.[7] Since predatory pricing is usually challenged as attempted monopolization in violation of Section 2 of the Sherman Act, it is convenient to organize the discussion of the elements of a price-predation claim in terms of the elements of a prima facie attempted monopolization claim. Attempted monopolization requires the plaintiff to prove "(1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power."[8]

*Exclusionary conduct.* In a predatory pricing claim, the exclusionary conduct is the defendant's alleged predatory pricing. To ensure that the defendant's pricing is in fact exclusionary in an anticompetitive sense (that is, designed to eliminate or discipline competitors) and not merely aggressively competitive, courts require that the prices charged by the defendant in the predation period must be below "an appropriate measure of cost."[9] Pricing above an appropriate 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."[10] As the *Weyerhaeuser* Court noted, courts should be "particularly wary of allowing recovery for above-cost price cutting because allowing such claims could, perversely, 'chil[l] legitimate price cutting,' which directly benefits consumers."[11]

Curiously, although it has had multiple opportunities, the Supreme Court has assiduously avoided saying what the "appropriate measure of cost" is for the purposes of predation analysis.[12] The marginal cost test was developed by Phillip Areeda and Donald Turner in 1975 in one of the most influential articles in the antitrust literature.[13] The idea is that in a competitive market firms price at the level

7. *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 415 n.4 (2004) (noting that the Second Circuit's "monopoly leveraging" offense fails because it does not require a showing of all of the elements of attempted monopolization).

8. Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 456 (1993).

9. Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 117 (1986); *accord* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 549 U.S. 312, 318 (2007).

10. *Brooke Group*, 509 U.S. at 223; *accord Weyerhaeuser*, 549 U.S. at 319; *Pacific Bell*, 555 U.S. at 451.

11. *Weyerhaeuser*, 549 U.S. at 319 (quoting *Brooke Group*, 509 U.S. at 223-24).

12. In *Brooke Group*, the Supreme Court declined to resolve the conflict among the circuits over the appropriate measure of costs, but utilized the average variable cost standard "[b]ecause the parties in this case agree the relevant measure is average variable cost." *Brooke Group*, 509 U.S. at 223 n.1.

13. Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act,* 88 HARV. L. REV. 697 (1975).

of their marginal costs, and the antitrust laws should not place impediments in the way of firms pricing down to marginal costs. Because of difficulties in ascertaining marginal cost, courts typically use average variable cost as a proxy.[14]

Most federal circuits have adopted some variant of the Areeda-Turner cost test for determining whether low pricing can be exclusionary conduct. Almost all circuits regard pricing below marginal cost or average available cost as "below cost."[15] A more limited number of circuits hold that pricing above marginal cost or average variable cost is, at least presumptively, not "below cost" for predation purposes.[16] The Sixth, Ninth, and Eleventh Circuits appear to permit a finding that pricing above average variable cost but below average total cost is exclusionary when there is also other evidence of an exclusionary effect.[17] Some circuits have held that pricing above average variable cost is conclusively not exclusionary.[18] As the Sixth Circuit explained:

> Although the courts have accepted the marginal or average variable cost standard as an indicator of intent, many allow for consideration of other factors indicative of predation. A leading example of this hybrid approach is that taken by the Ninth Circuit in *Inglis*. There the position was taken that although average variable cost is a generally reliable indicator, there are market situations where a rational firm would find it prudent to sell below its average variable cost. Conversely, it acknowledges that in certain situations, a firm selling above average variable cost could be guilty of predation. Consequently, it focuses "on what a rational firm would have expected its prices to accomplish." Accordingly, it permits the introduction of any evidence, in addition to cost price figures, to illuminate the rationale behind the defendant's pricing policy.[19]

14. *See* United States v. AMR Corp., 335 F.3d 1109, 1116 (10th Cir. 2003); Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 232 (1st Cir. 1983); Northeastern Tel. Co. v. AT&T, 651 F.2d 76, 88 (2d Cir. 1981).

15. *See, e.g.*, Tri State Rubbish v. Waste Mgmt., 998 F.2d 1073, 1080 (1st Cir. 1993); Kelko Disposal v. Browning-Ferris Indus., 845 F.2d 404, 407 (2d Cir. 1988); Stearns Airport Equip. Co. v. FMC Corp., 170 F.3d 518, 532 (5th Cir. 1999); Spirit Airlines, Inc. v. Northwest Airlines, Inc., 431 F.3d 917, 938 (6th Cir. 2005); MCI Commc'ns Corp. v. American Tel. and Tel. Co., 708 F.2d 1081, 1120 n.55 (7th Cir. 1983).

16. *See, e.g.*, Advo, Inc. v. Philadelphia Newspapers, Inc., 51 F.3d 1191, 1198 (3d Cir. 1995); *Stearns*, 170 F.3d at 532.

17. *See, e.g.*, *Spirit Airlines*, 431 F.3d at 938 ("If the defendant's prices were below average total cost but above average variable cost, the plaintiff bears the burden of showing defendant's pricing was predatory.") (quoting D.E. Rogers Assocs., Inc. v. Gardner-Denver Co., 718 F.2d 1431, 1436-37 (6th Cir. 1983)).

18. *See* Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 233-36 (1st Cir. 1983); Henry v. Chloride, Inc., 809 F.2d 1334, 1346 (8th Cir. 1987).

19. *D.E. Rogers Assocs.*, 718 F.2d at 1436 (internal citations omitted; citing William Inglis v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981); *accord Spirit Airlines*, 431 F.3d at 938.

At one point, the Ninth Circuit indicated that, in some circumstances, pricing above average total cost could be exclusionary,[20] but that those cases appear to have been implicitly abrogated by *Brooke Group*.[21]

Significantly, the test of "below cost" is based on the defendant's costs, not the costs of its competitors. All circuits appear to agree that a defendant that prices above its own "costs" (whatever the measure) but below the costs of its less efficient rivals and so drives those rivals out of business is acting competitively, not anticompetitively.[22] The Supreme Court has confirmed that "a firm cannot claim antitrust injury from nonpredatory price competition on the asserted ground that it is 'ruinous'" to a competitor.[23]

Pricing below cost is a necessary but not sufficient condition of exclusory conduct. In addition, for a defendant's price to be exclusionary, even if below the defendant's cost, the defendant's pricing activities must threaten its rivals in a sufficiently material way to either drive them out of the market or discipline them.[24] So, for example, below-cost pricing is not exclusionary if it is occasional, since such pricing is unlikely to drive rivals from the market and to permit the predator to raise prices subsequently.[25] Likewise, pricing is not anticompetitive, even if below cost (however measured), when the company reduces prices to meet lower prices already being charged by one or more competitors.[26]

*Specific intent to monopolize*. The second element of a prima facie case of attempted monopolization is that the defendant engages in its exclusionary acts—here, below-cost pricing—with a specific intent to monopolize the market. We have used the "below cost" test to determine whether the pricing conduct is anticompetitively exclusionary in order to establish the exclusionary act requirement of an attempted monopolization violation. Courts that have addressed the issue—and many do not—typically use the same test to infer the requisite specific intent to

20. *See, e.g.*, *William Inglis*, 668 F.2d at 1035 (noting possibility that pricing above average total cost could be exclusionary); *accord* Transamerica Computer Co. v. IBM, 698 F.2d 1377, 1388 (9th Cir. 1983) (observing that pricing above average total cost may be deemed exclusionary with clear and convincing evidence of predatory intent).

21. Vollrath Co. v. Sammi Corp., 9 F.3d 1455, 1460 (9th Cir. 1993) (noting *Brooke Group's* requirement that to be exclusionary pricing must be "below an appropriate measure" of cost).

22. *See* Tri State Rubbish v. Waste Mgmt., 998 F.2d 1073, 1080 (1st Cir. 1993).

23. Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 338 n.7 (1990).

24. *See* Wallace v. IBM Corp., 467 F.3d 1104, 1106-07 (7th Cir. 2006).

25. *See, e.g.*, Ramallo Bros. Printing, Inc. v. El Dia, Inc., 392 F. Supp. 2d 118, 140 (D.P.R. 2005); *accord* Midwest Auto Auction, Inc. v. McNeal, No. 11-14562, 2012 WL 3478647, at *13 (E.D. Mich. Aug. 14, 2012).

26. *See, e.g.*, D.E. Rogers Assocs., Inc. v. Gardner-Denver Co., 718 F.2d 1431, 1435 (6th Cir. 1983).

monopolize.[27] The idea is that a firm that is pricing below cost and hence losing profits must be doing it for some reason and, in the absence of a more compelling explanation, courts will presume that the reason is to monopolize the market.

Significantly, most courts will not rely on evocative language by the defendant to prove specific intent. Consequently, phrases such as “kill the competition” do not support an inference of any element of predatory pricing, including specific intent.[28]

*Dangerous probability of success*. The final element in an attempted monopolization claim is that the defendant’s exclusionary conduct is likely to have a dangerous probability of success in monopolizing the target market. In a successful case of predatory pricing, the monopolization occurs in the postpredation period where the defendant was successful in driving out its competitors and the anticompetitive harm arises from the resulting supracompetitive profits that the defendant is able to charge.[29] Moreover, since customers *benefit* from lower prices during the predation period, a net consumer welfare decrease occurs only if the customers lose more in the postpredation period from supracompetitive prices than they gain in the predation period, that is, if the defendant is able to recoup its lost profits in the predation period through its supracompetitive profits in the postpredation period. As the Supreme Court observed in *Brooke Group*:

> Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.[30]

And even if recoupment is possible, due to the time value of money, dollar-for-dollar consumers are better off receiving a discount today for a price increase tomorrow, so some discounting will be required in balancing the consumer benefits in the

27. *See, e.g.*, MCI Commc’ns Corp. v. American Tel. and Tel. Co., 708 F.2d 1081, 1123 & n.59 (7th Cir. 1983).

28. *See, e.g.*, R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!, 462 F.3d 690, 696 (7th Cir. 2006).

29. *See* Felder’s Collision Parts, Inc. v. General Motors Co., 960 F. Supp. 2d 617, 630 (M.D. La. 2013) (“Put differently, in order to establish that a defendant has a dangerous probability of recoupment, the plaintiff must also offer proof that the defendant has a dangerous probability of acquiring monopoly power or already possesses such power.”); Big River Indus., Inc. v. Headwaters Resources, Inc., 971 F. Supp. 2d 609, 619 (M.D. La. 2013).

30. *Brooke Group*, 509 U.S. at 224; *accord Wallace*, 467 F.3d at 1107 (“When monopoly does not ensue, low prices remain—and the goal of antitrust law is to use rivalry to keep prices low for consumers’ benefit.”); United States v. AMR Corp., 335 F.3d 1109, 1115 (10th Cir. 2003) (“Without a dangerous probability of recoupment, competition remains unharmed even if individual competitors suffer.”).

predation period against the consumer losses in the postpredation period to determine if the predatory scheme was in fact anticompetitive.

The recoupment requirement also plays an important role in ensuring that the prices charged in the predation period are in fact *anticompetitively* exclusionary. Assuming that firms are rational, a firm will pursue a price-predation scheme only if it expects that the present discounted value of its net cash flow over the predation and postpredation periods is positive at the defendant's internal discount rate.[31] The idea is that a firm is assumed to act in its own interest, and, if a predation scheme would not have been economically rational, then whatever the defendant was doing must not have been predatory (exclusionary) for the purposes of the antitrust laws.[32]

As a result, beginning with *Brooke Group*, the Supreme Court has required that the defendant have a dangerous probability of success in being able to price supracompetitively in the postpredation period at a level and duration sufficient for it to recoup its investment (with interest) in below-cost pricing in the predatory period.[33] This requirement has two subparts: (1) the defendant's below-cost pricing must be sufficient to drive its competitors out of the market, so that the defendant will have the market freedom to raise its prices to supracompetitive levels, and (2) the defendant needs to be able to sustain its supracompetitive pricing at high enough levels and for a long enough period of time to be able to recoup the losses it incurred during the predation period.[34]

31. *See, e.g.*, Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 590-91 (1986) ("In order to recoup their losses, [predators] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices."); *accord Weyerhaeuser*, 549 U.S. at 318-19 ("The second prong of the *Brooke Group* test—requiring that there be a dangerous probability of recoupment of losses—is necessary because, without a dangerous probability of recoupment, it is highly unlikely that a firm would engage in predatory pricing."); *Brooke Group*, 509 U.S. at 223.

32. *See* Henry v. Chloride, Inc., 809 F.2d 1334, 1345 n.9 (8th Cir. 1987) ("The thrust of *Matsushita* is that while predatory intentions need not be accomplished, there must be some reasonable expectation on the part of the alleged predator that it will succeed in dominating, if not controlling, the market.").

33. *Brooke Group*, 509 U.S. at 224 (1993) ("The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices."); *accord Pacific Bell*, 555 U.S. at 451 ("Specifically, to prevail on a predatory pricing claim, a plaintiff must demonstrate that: (1) 'the prices complained of are below an appropriate measure of its rival's costs'; and (2) there is a 'dangerous probability' that the defendant will be able to recoup its 'investment' in below-cost prices."); *Weyerhaeuser*, 549 U.S. at 318-19.

34. *See* Stearns Airport Equip. Co., Inc. v. FMC Corp., 170 F.3d 518, 528-29 (5th Cir. 1999) ("To achieve the recoupment requirement of *Brooke Group*, a claimant must meet a two-prong test. First, a claimant must demonstrate that the scheme could actually drive the competitor out of the market. Second, there must be evidence that the surviving monopolist could then raise prices to consumers long enough to recoup his costs without drawing new entrants to the market."); Bailey

Driving competitors out of the market is likely to require deep, sustained losses for an extended period of time. Occasional below-cost sales for example, are unlikely to have this effect and consequently cannot predicate a predatory pricing claim.[35] For the same reason, a firm in a cluster market (such as a grocery store, a department store, or an acute care hospital) is unlikely to be able to drive competitors out of the market if it is pricing only a few of its products below cost. (This is the usual explanation of why Amazon can price its ebooks under wholesale cost without an antitrust problem.)

*Brooke Group* instructs that recoupment cannot be assumed from below-cost pricing and a finding of recoupment will require a rigorous economic analysis of the conditions in the market and the ability of the alleged predator to raise prices in the postpredation period:

> Evidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition. Determining whether recoupment of predatory losses is likely requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market. If market circumstances or deficiencies in proof would bar a reasonable jury from finding that the scheme alleged would likely result in sustained supracompetitive pricing, the plaintiff's case has failed. In certain situations—for example, where the market is highly diffuse and competitive, or where new entry is easy, or the defendant lacks adequate excess capacity to absorb the market shares of his rivals and cannot quickly create or purchase new capacity—summary disposition of the case is appropriate.[36]

Accordingly, courts have held that when entry to the market can be achieved with relative ease, a plaintiff cannot show a dangerous probability of recoupment.[37] The idea is that the postpredation supracompetitive prices necessary for recoupment will induce entry when entry is sufficiently easy, which in turn is likely to drive market prices down to levels where recoupment is not possible. Unless the plaintiff can prove that it is easy to enter as a "knockoff" of the plaintiff's business, analyzing

v. Allgas, Inc., 284 F.3d 1237, 1245 (11th Cir. 2002) ("Determining whether Allgas had the ability to recoup its losses sustained by engaging in its allegedly predatory scheme, therefore, requires a bipartite examination of: (a) whether Allgas possessed sufficient market power to set supracompetitive prices, and (b) whether Allgas could sustain supracompetitive prices long enough to recoup its losses."); Felder's Collision Parts, Inc. v. General Motors Co., 960 F. Supp. 2d 617, 630-31 (M.D. La. 2013).

35. *See, e.g.*, Midwest Auto Auction, Inc. v. McNeal, No. 11-14562, 2012 WL 3478647, at *13 (E.D. Mich. Aug. 14, 2012); Ramallo Bros. Printing, Inc. v. El Dia, Inc., 392 F. Supp. 2d 118, 140 (D.P.R. 2005).

36. *Brooke Group*, 509 U.S. at 226 (internal citation omitted).

37. *See, e.g.*, Affinity LLC v. GfK Mediamark Research & Intelligence, LLC, 547 F. App'x 54, 55 (2d Cir. 2013) (unpublished).

barriers to entry may first require a definition of the relevant market.[38] Likewise, there is an inference that the lower the defendant's market share in the relevant market during the predation period, the less likely the defendant will be able to sustain below-cost pricing for the length of time necessary to drive its rivals out of the market.[39]

### Predatory pricing claims under other statutes

*Sherman Act § 1*. An agreement among competitors to fix prices at any level is a per se violation of Section 1 of the Sherman Act.[40] A particular case is where the conspirators attempt to gain a joint monopoly through below-cost pricing. Nothing more is needed for a Section 1 violation.

Although a conspiracy to fix below-cost prices violates Section 1 simply as a horizontal price-fixing conspiracy, a private plaintiff should have to allege and prove both below-cost pricing and a dangerous probability of recoupment in order to have antitrust standing to pursue a predatory pricing conspiracy claim.[41] The idea is that antitrust standing requires that the plaintiff's injury be the proximate result of a competition-reducing aspect of the defendant's conduct, and in predatory pricing cases the competition-reducing conduct is below-cost pricing that can likely be recouped. So while a conspiracy to fix a below-market but above-cost price violates Section 1 of the Sherman Act, it should not give rise to a private antitrust claim.

*Robinson-Patman Act § 2(a)*. Section 2(a) of the Robinson-Patman Act, which amended Section 2 of the Clayton Act, provides in pertinent part:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition

38. *See* Big River Indus., Inc. v. Headwaters Resources, Inc., 971 F. Supp. 2d 609, 519-20 (M.D. La. 2013).

39 *See* Vollrath Co. v. Sammi Corp., 9 F.3d 1455, 1461 (9th Cir. 1993) (sustaining a judgment notwithstanding the verdict where the defendant "controlled only 10% of the market" so that there was "no danger of monopoly power, and there certainly would be no hope of recouping losses from below-cost pricing").

40. United States v. Socony Vacuum Oil Co., 310 U.S. 150, 223 (1940) ("Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se.").

41. *See* Energy Conversion Devices Liquidation Trust *ex rel.* Madden v. Trina Solar Ltd., No. 13-14241, 2014 WL 5511517 (E.D. Mich. Oct. 31, 2014).

> with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . . .[42]

Note that, by its terms, Section 2(a) applies only to person "in commerce" and to discriminations in the course of such commerce[43] and then only to tangible commodities. Price discrimination in services is not covered by Section 2(a).

Section 2, "when originally enacted as part of the Clayton Act in 1914, was born of a desire by Congress to curb the use by financially powerful corporations of localized price-cutting tactics which had gravely impaired the competitive position of other sellers."[44] In 1936, Congress passed the Robinson-Patman Act to expand Section 2's coverage to also prohibit powerful buyers (at the time, especially the large emerging chain stores such as A&P) from using their clout to obtain lower prices for goods than smaller buyers could demand.[45]

The Supreme Court has identified three types of competitive injuries prohibited by Section 2(a):

- *Primary-line injury*, where competition is injured at the level of the discriminating seller and its direct competitors.[46]
- *Secondary-line injury*, where competition is injured at the level of the discriminating seller's "favored" and "disfavoured" customers.[47]
- *Tertiary-line injury*, where competition is injured at the level of the customers of the favored and disfavoured purchasers.[48]

Where the prerequisites of the Robinson-Patman Act are satisfied (including the "in commerce" and tangible commodities requirements), predatory pricing can cause primary line injury in violation of Section 2(a).

In *Utah Pie v. Continental Baking Co.*,[49] the Supreme Court found that the evidence of geographic price discrimination at trial presented a jury question as to whether the defendants violated Section 2(a). Utah Pie, a small family-run business

42. 15 U.S.C. § 13(a).

43. *See, e.g.*, Able Sales Co., Inc. v. Compania de Azucar de Puerto Rico, 406 F.3d 56 (1st Cir. 2005); Bailey v. Allgas, Inc., 284 F.3d 1237, 1244 n.13 (11th Cir. 2002).

44. FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 543 & n.6 (1960) (citing H.R. Rep. No. 63-627, at 8 (1914); S. Rep. No. 63-698, at 2-4 (1914)); *accord* Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164, 175 (2006).

45. *See Volvo*, 546 U.S. at 175.

46. *See, e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 220-22 (1993).

47. *See, e.g.*, *Volvo*, 546 U.S. at ___; Falls City Indus. v. Vanco Beverage, Inc., 460 U.S. 428 (1983); FTC v. Morton Salt Co., 334 U.S. 37 (1948).

48. *See, e.g.*, Perkins v. Standard Oil Co., 395 U.S. 642 (1969).

49. 386 U.S. 685 (1967).

in Salt Lake City, brought a treble damages action against three nationwide companies—Pet Milk Company, Carnation Milk Company and Continental Baking Company—alleging that they had injured Utah Pie by selling frozen fruit pies to retailers in the Salt Lake City market at lower prices than they sold in other markets. Utah Pie began making and selling frozen pies in Salt Lake City in competition with the defendants in 1957, undercutting their prices and quickly gaining a 66% share of sales. The defendants responded by lowering their prices in Salt Lake City while continuing to charge higher prices for frozen pies of "like grade and quality" (in the words of the Robinson-Patman Act) in other cities that were closer to their own production facilities. The jury found against the defendants on the Section 2(a) count and the defendants appealed. The Tenth Circuit reversed, finding the evidence inadequate to support a jury finding of injury to competition.[50] In a 6-2 decision, the Supreme Court reversed in an opinion written by Justice White, holding that the evidence of the defendants' "predatory intent" and the "drastically declining price structure" in Salt Lake City was sufficient for the jury to the requisite injury to competition.[51]

*Utah Pie* has received much criticism for permitting an inference of competitive injury on what was arguably an intent to gain sales from a competitor through aggressive pricing.[52] Moreover, Utah Pie was not driven out of business and indeed retained its leading market share (although it did drop to 45%), expanded its sales, and made profits throughout the period between 1958 and 1961 in which the defendants were allegedly illegally pricing.

In 1993, in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,[53] its next primary-line Robinson-Patman, the Supreme Court acknowledged the criticisms and walked back from *Utah Pie*:

> *Utah Pie* has often been interpreted to permit liability for primary-line price discrimination on a mere showing that the defendant intended to harm competition or produced a declining price structure. The case has been criticized on the grounds that such low standards of competitive injury are at odds with the antitrust laws' traditional concern for consumer welfare and price competition.

50. Continental Baking Co. v. Utah Pie Co., 396 F.2d 161 (10th Cir. 1968), *rev'd*, 386 U.S. 685 (1967).

51. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 696, 702 (1967).

52. *See, e.g.*, ROBERT. BORK, THE ANTITRUST PARADOX 386-87 (1978); RICHARD POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 221 (2d ed. 2001); Ward S. Bowman Jr., *Restraint of Trade by the Supreme Court: The Utah Pie Case*, 77 Yale L.J. 70 (1967). *See generally* American Academic Suppliers, Inc. v. Beckley-Cardy, Inc., 922 F.2d 1317, 1322 (7th Cir. 1991 (Posner, J.) (observing that "[c]ritique and interpretation of *Utah Pie* have become a cottage industry"); A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1404 (7th Cir. 1989) (Easterbrook, J.) (noting that "[n]ary a voice has been heard in support of *Utah Pie* in years" and that there has been "universal academic disdain" for the case).

53. 509 U.S. 209 (1993)

> We do not regard the *Utah Pie* case itself as having the full significance attributed to it by its detractors. *Utah Pie* was an early judicial inquiry in this area and did not purport to set forth explicit, general standards for establishing a violation of the Robinson-Patman Act. As the law has been explored since *Utah Pie*, it has become evident that primary-line competitive injury under the Robinson- Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act.[54]

The Court then held that the same two requirements—pricing below an "appropriate measure" of the defendant's cost and recoupment—applied equally to predatory pricing cases under Section 2 of the Sherman Act and Section 2(a) of the Robinson-Patman Act.[55]

Still there are differences between the two statutes in their application. The Robinson-Patman Act, for example, applies only to persons "in commerce" in the course of such commerce, while the Sherman Act has the full jurisdictional reach of the Commerce Clause. This can be a meaningful difference.[56] The Robinson-Patman Act applies only to tangible commodities, while the Sherman Act applies to all tangible and intangible goods and services. This, too, imposes a significant restriction on the reach of a primary-line Section 2(a) claim. The Robinson-Patman Act applies only to cases where the predatory pricing is part of a price discrimination, while the Sherman Act covers pure price predation independently of any discrimination. But this may not be much of a difference. Although the canonical primary-line Robinson-Patman Act case is where the defendant charges a predatory price in one geographic region and contemporaneously charges a higher price for the same product in another geographic region,[57] but not all of the cases appear to involve contemporaneous geographic price discrimination.[58] This suggests that the requisite price discrimination can be temporal—the charging of some price in the prepredation period and then the charging of a lower, predatory price in the predation period.

Perhaps more fundamentally, the Robinson-Patman Act applies whenever competition may be substantially lessened by the primary line price discrimination, while Section 2 more narrowly focuses on competitive jury through exclusionary conduct. So, for example, the Robinson-Patman Act would apply in a "price

54. *Id*. at 221 (internal citations omitted).

55. *Id*. at 222, 224.

56. *See, e.g.,* Able Sales Co., Inc. v. Compania de Azucar de Puerto Rico, 406 F.3d 56 (1st Cir. 2005) (reversing judgment for the plaintiff for lack of "in commerce" subject matter jurisdiction). *See generally* Gulf Oil Corporation v. Copp Paving Company, Inc., 419 U.S. 186 (1974) (discussing subject matter jurisdiction limitations of Section 2(a) in the context of a secondary line price discrimination case).

57. *See, e.g., Utah Pie*, 386 U.S. at ___.

58. *See, e.g.,* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

disciplining case," while Section 2 of the Sherman Act may not.[59] A price disciplining case is where a larger firm punishes smaller competitors for failing to follow the larger firm's lead in maintaining high prices by temporarily aggressively attacking them with below-cost pricing but without any design to force them out of the market. If a sufficiently high share is a condition of monopoly and if the larger firm does not have a monopoly share—so that there is no monopolization—and is not intending on obtaining one, there would be no dangerous probability of success of monopolization and hence no attempted monopolization. On the other hand, if control of prices in the market even in the absence of a monopoly share is sufficient for monopolization, then a price disciplining case could be reached under Section 2. The issue has not been adjudicated. In any event, predatory pricing claims under the Robinson-Patman Act are common when it does not appear that the defendant's conduct is intended to drive competitors from the market.

Finally, it is arguable in theory—but probably not in application—that the Robinson-Patman Act reaches conduct that that is less probable to be anticompetitive. As the *Brooke Group* Court acknowledged, a Robinson-Patman Act violation requires only a "reasonable probability" of injury to competition, while a Section 2 attempted monopolization violation requires a "dangerous probability of success" in obtaining a monopoly.[60]

*Robinson-Patman Act § 3*. Section 3 of the Robinson-Patman Act provides in part:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce . . . or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor in such part of the United States; or, to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.[61]

The provision creates a criminal offense and violators may be fined not more than $5,000 or imprisoned not more than one year, or both.[62] Section 3 can only be enforced criminally. In *Nashville Milk Co. v. Carnation Co.*,[63] the Supreme Court held that Congress did not make Section 3 part of the Clayton Act (as it did with

59. *See* Bailey v. Allgas, Inc., 284 F.3d 1237, 1244 n.13 (11th Cir. 2002) ("Based on the difference in language between the Sherman Act and the Robinson-Patman Act, the United States Supreme Court has held competitive injury under the Robinson-Patman Act 'must extend beyond the monopoly setting.' *Brooke Group*, 509 U.S. at 229. As a result, the Robinson-Patman Act can be violated when primary-line injury occurs in an oligopoly setting. *Id*.").

60. *Id*. at 222.

61. 15 U.S.C. § 13a.

62. *Id*.

63. 355 U.S. 373 (1958).

Section 2) and hence Section 3 was not one of the "antitrust laws" for which the Clayton Act created a private right of action.[64]

In all likelihood, courts today would interpret Section 3 to incorporate the *Brooke Group* requirements of below-cost pricing and recoupment as implicit in "destroying competition or eliminating a competitor." In *United States v. National Dairy Prods. Corp.*,[65] the district court had dismissed the Section 3 count of the indictment on the grounds that the statute's prohibition against "unreasonably low prices" was unconstitutionally vague and indefinite. The Supreme Court, on a direct appeal under the Criminal Appeals Act, reversed and remanded for trial, holding was reasonably definite in prohibiting selling "below cost" with the intent to destroy competitors.[66] This provides a basis for applying the Brooke Group requirements to Section 3. But the question is academic. Section 3 has not been enforced by the Department of Justice for years. The most recent case I can find resulting in a conviction was *National Dairy*, which was brought in 1959.[67] Another Section 3 case was brought in 1963, which the government lost.[68]

### Success in predatory pricing cases

*Brooke Group* recognized that the twin requirements of below-cost pricing and recoupment are demanding:

> These prerequisites to recovery are not easy to establish, but they are not artificial obstacles to recovery; rather, they are essential components of real market injury. As we have said in the Sherman Act context, "predatory pricing schemes are rarely tried, and even more rarely successful," and the costs of an erroneous finding of liability are high. "[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition; because 'cutting prices in order to increase business often is the very essence of competition . . . [;] mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect.'" It would be ironic indeed if the standards for predatory

64. *Id*. at 376-81; *accord* Safeway Stores v. Vance, 355 U.S. 389 (1958).

65. 372 U.S. 29 (1963).

66. *Id*. at 598.

67. *See* United States v. National Dairy Prods. Corp., Cr. 20542 (W.D. Mo. filed Sept. 16, 1959). After the Supreme Court reversed and remanded for trial, the jury found the company and its vice president guilty on some but not all of the Section 3 counts. *See* United States v. National Dairy Prods. Corp., 1964 Trade Cas. (CCH) ¶ 71,163 (W.D. Mo. 1964).

68. *See* United States v. H.P. Hood & Sons, Cr. 63-110-C (D. Mass. filed Mar. 15, 1963). On March 19, 1965, a jury found the defendants not guilty.

> pricing liability were so low that antitrust suits themselves became a tool for keeping prices high.[69]

Perhaps, then, it should not be surprising that since *Brooke Group* was decided in 1993 there has not been one predatory pricing case that has been successful on the merits.

Most of the cases have been dismissed on the pleadings for failure to plausibly allege either pricing below costs or a dangerous probability of recoupment. Consistent with the requirements of *Twombly* and *Iqbal*, a complaint must allege sufficient facts for the allegation of below-cost pricing to be plausible.[70] In some cases, the plaintiffs simply ignore pleading below-cost pricing.[71] Even when they do, courts frequently are very demanding on the specificity of the allegations. So, for example, courts have dismissed predation claims where the plaintiff's allegations assumed that the defendant's costs were similar to its own but failed to support the assumption even though the defendant's larger size implied that it realized efficiencies and hence had lower costs in developing, marketing, and delivering its services.[72] Likewise, courts have dismissed complaints where the plaintiff's allegations used "industry standard" cost as the cost measure but failed to support with additional factual allegations why the defendant—especially if it is of large size relative to the rest of the firms in the market and may enjoy significant economies of scale—should the same cost structure as the rest of the industry.[73] And courts will not assume simply because the defendant is charging a lower price for a bundle than it charges for a single component that the firm is engaged in below-cost pricing.[74] On the other hand, an admission by a knowledgeable defendant employee that the company is pricing "less than the cost of materials, assembly, and shipping" should

69. *Weyerhaeuser*, 549 U.S. at 320 (quoting *Brooke Group*, 509 U.S. at 226) (in turn quoting Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 122 n.17 (1986)).

70. Astra Media Group, LLC v. Clear Channel Taxi Media, LLC, 414 F. App'x 334, 335 (2d Cir. 2011) (unpublished).

71. *See, e.g.*, Johnny Prescott & Son Oil Co., Inc. v. Rymes Heating Oils, Inc., Civ. No. 13-cv-437–LM, 2014 WL 2557120, at *2 (D.N.H. June 6, 2014) (dismissing complaint for failure to allege that defendant priced below its costs).

72. *See, e.g.*, Affinity LLC v. GfK Mediamark Research & Intelligence, LLC, No. 12 Civ. 1728(RJS), 2013 WL 1189317, at *5 (S.D.N.Y. Mar. 25, 2013) (dismissing complaint), *aff'd*, 547 F. App'x 54, 56 (2d Cir. 2013) (unpublished).

73. Astra Media Group, LLC v. Clear Channel Taxi Media, LLC, 679 F. Supp. 2d 413 (S.D.N.Y. 2009) (dismissing predatory pricing claim), *aff'd*, 414 F. App'x 334 (2d Cir. 2011); *but see* Growers 1-7 v. Ocean Spray Cranberries, Inc., Civ. A. No. 12–12016–RWZ, 2014 WL 1764533, at *6 (D. Mass. May 2, 2014) (allowing complaint to proceed on allegations of pricing below average industry costs).

74. MiniFrame Ltd. v. Microsoft Corp., 551 F. App'x 1, 3 (2d Cir. 2013) (affirming dismissal of the complaint where the complaint failed to allege any measure of cost and rather relied on the allegation Microsoft charges less for a bundle that includes MultiPoint and Windows than it does for Windows alone).

be sufficient to withstand a motion to dismiss on the element of below-cost pricing.[75] At least one court—but almost surely an outlier—has held that a plaintiff can withstand a motion to dismiss the complaint on the pleadings on the below-cost element by alleging a sharp drop in price (about 50%), presumably on the idea that a reasonable inference could be drawn that the lower price was below cost even though the complaint did not so allege.[76]

The essential question on recoupment is whether the predator, having driven its competitors out of the market in the predation phase, can then raise prices high enough and long enough to recoup its losses without drawing new entrants to the market.[77] In assessing the likelihood of recoupment, courts have considered (1) the extent and duration of the alleged predatory pricing; (2) the relative financial strength of the predator and its intended victims; (3) an estimate of the cost of the alleged predation; (4) an analysis of likely or unlikely entry by new competitors; (5) the predator's capacity to absorb market demand as competitors exit the market; and (6) the structure of the market and whether any remaining competitors will be disciplined enough to raise prices to monopoly levels after the elimination of competition.[78] While a plaintiff need not plead and prove facts on each of these factors, an essential requirement to a plausible recoupment claim is the existence of high barriers to entry.[79] Courts have dismissed predatory pricing claims where the complaint fails to contain sufficient factual allegations to make out a plausible claim of high barriers to entry.[80] A fortiori, pleading or proof of significant entry into the market in at prepredation prices shows the absence of barriers sufficient to block entry at higher, postpredation prices.[81] In addition, courts have dismissed predatory pricing claims where the plaintiff only alleged that the defendant supported its predatory pricing through "cross subsidization" (that is, funding its below-cost losses

75 *See* Energy Conversion Devices Liquidation Trust *ex rel.* Madden v. Trina Solar Ltd., No. 13-14241, 2014 WL 5511517, at *4 (E.D. Mich. Oct. 31, 2014).

76 See Growers 1-7 v. Ocean Spray Cranberries, Inc., Civ. A. No. 12–12016–RWZ, 2014 WL 1764533, at *6 (D. Mass. May 2, 2014) ("

77. *See* Stearns Airport Equip. Co. v. FMC Corp., 170 F.3d 518, 528-29 (5th Cir. 1999).

78. *See, e.g.*, Felder's Collision Parts, Inc. v. General Motors Co., 960 F. Supp. 2d 617, 631-36 (M.D. La. 2013); GMA Cover Corp. v. Saab Barracuda LLC, No. 4:10-CV-12060, 2012 WL 642739, at *7-*10 (E.D. Mich. Feb. 8, 2012); Affinity LLC v. GfK Mediamark Research & Intelligence, LLC, No. 12 Civ. 1728(RJS), 2013 WL 1189317, at *5-7 (S.D.N.Y. Mar. 25, 2013); Mathias v. Daily News, L.P., 152 F. Supp. 2d 465, 474 (S.D.N.Y. 2001) (citing *Brooke Group*, 509 U.S. at 225-26).

79. *See* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 591 n.15 (1986).

80. *See, e.g.*, *Affinity*, 2013 WL 1189317, at *5 (dismissing complaint that contained allegations of low barriers to entry), *aff'd*, 547 F. App'x 54, 56 (2d Cir. 2013) (unpublished).

81 *See* Energy Conversion Devices Liquidation Trust *ex rel.* Madden v. Trina Solar Ltd., No. 13-14241, 2014 WL 5511517, at *6 (E.D. Mich. Oct. 31, 2014) (dismissing complaint that, among other things, alleged that "many solar companies, including Defendants, recently entered the solar panel industry in the past ten to fifteen years.").

in one product from earnings in another product), since this does not explain how the defendant intends to *recoup* the losses from below-cost pricing or, if one prefers, the forgone profit from the profitable second product that was used to subsidize the losses in the unprofitable product.[82] Courts have also dismissed predatory pricing claims where buyers have sufficient market power to prevent suppliers pricing below cost from recouping their losses in the predation period.[83]

In addition to proving that the defendant priced below cost and has a dangerous probability of recoupment, a private plaintiff must also show that it has antitrust standing to pursue a predatory pricing claim. Almost all predation cases are brought in the predation period by a competitor, since customers receiving the benefit of low prices will lack the incentive to sue. In the first instance, the plaintiff-competitor must show that it is threatened with exclusion from the market due to the defendant's below-cost pricing or, if it has already exited the market, that its withdrawal was the proximate result of the defendant's below-cost pricing. This is likely to be contested since there are many reasons why a firm may be struggling or have failed, including higher costs or management incompetence.[84]

82. *See* Rheumatology Diagnostics Lab., Inc. v. Aetna, Inc., No. 12–cv–05847–JST, 2013 WL 3242245, at *15 (N.D. Cal. June 25, 2013)

83. *See* GMA Cover Corp. v. Saab Barracuda LLC, No. 4:10–CV–12060, 2012 WL 642739, at *7 (E.D. Mich. Feb. 8, 2012).

84. *See* Big River Indus., Inc. v. Headwaters Resources, Inc., 971 F. Supp. 2d 609, 519-20 (M.D. La. 2013) (noting that the complaint was deficient in failing to allege that Headwaters' alleged predatory conduct drove BRI out of the market).

# THE ROBINSON-PATMAN ACT

**(CLAYTON ACT § 2, 15 U.S.C. § 13)**

**Section 2.**

(a) *Price; selection of customers.* It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: *Provided*, That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: Provided, however, That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or classes of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: And provided further, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: And provided further, That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned. [15 U.S.C. § 13(a)]

(b) *Burden of rebutting prima-facie case of discrimination.* Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: Provided, however, That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor. [15 U.S.C. § 13(b)]

(c) *Payment or acceptance of commission, brokerage, or other compensation.* It shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact for or in behalf, or is subject to the direct or indirect control, of any party to such transaction other than the person by whom such compensation is so granted or paid. [15 U.S.C. § 13(c)]

(d) *Payment for services or facilities for processing or sale.* It shall be unlawful for any person engaged in commerce to pay or contact for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities. [15 U.S.C. § 13(d)]

(e) *Furnishing services or facilities for processing, handling, etc.* It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms. [15 U.S.C. § 13(e)]

(f) *Knowingly inducing or receiving discriminatory price.* It shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section. [15 U.S.C. § 13(f)]

## NOTES

1. The Robinson-Patman Act[1] was enacted in 1936 to amend the existing price discrimination prohibition in Section 2 of the Clayton Act.

2. Section 2(a) is the main provision under the Robinson-Patman Act. Although there are other technical requirements, to prove a Section 2(a) violation the plaintiff must show that (a) sales of tangible commodities; (b) the sales were made in interstate commerce; (c) the commodities sold were of like grade and quality; (d) the defendant engaged in price discrimination (i.e., charged different prices to different

1. Pub. L. No. 74-692, 49 Stat. 1526 (codified at 15 U.S.C. § 13))

customers); and (e) this discrimination had the anticompetitive effect proscribed by the act.

2. The requisite anticompetitive effect proscribed by the RPA occurs "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them." The first effect is the same as for Section 7 (apart from Section 7's broader jurisdiction reach), but the second effect—"to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them"—is unique. Protection of competitors is not within the traditional ambit of the antitrust laws, since a competitor may be injured even if competition is not.[2]

2. *See* Brown Shoe Co. v. United States, 370 U.S., at 320 (holding that the antitrust were designed for "the protection of competition, not competitors"); *accord* Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 352 (1990); Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 115 (1986); Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977).

# Seminal Cases

## BROOKE GROUP LTD. v. BROWN & WILLIAMSON TOBACCO CORP.
## 509 U.S. 209 (1993)
### (EXCERPTS[1])

Cigarette manufacture in the United States long been dominated by six firms: Philip Morris (40%), R.J. Reynolds (28%), Brown & Williamson (12%), American Brands, Lorillard, and Liggett & Myers (now Brooke Group) (5%).[2] The industry is not only concentrated, but also historically has exhibited high profit margins and no significant price competition. By 1980, however, overall demand was declining and all manufacturers developed substantial excess capacity. Liggett was especially hard hit, with its market share tumbling from a high of 20% in the 1950s to 2.3% in 1980.

In an attempt to revive itself, Liggett in 1980 developed a new low-priced generic cigarette known as a "black and whites" because they were sold in plain white packages with black lettering and sold at retail at about 30% less than branded cigarettes. When Liggett introduced its black & white, generic cigarettes amounted to less than 1% of domestic cigarette sales. The black & white was very successful. By early 1984, the generic segment grew to 4% of the total cigarette sales, and Liggett's share of the generic segment was 97%.

In 1984, attached by the growth in the generic segment, Brown & Williamson began producing its generic cigarettes, including black and whites. Brown & Williamson lacked the brand loyalty of Philip Morris (Marlboro) and Reynolds (Camel, Kool, Winston) and its cigarettes were especially vulnerable to price competition from generic cigarettes. While other manufacturers also entered the generic segment, Liggett was most threatened by Brown & Williamson, since their black and whites were essentially fungible, B&W entered with volume rebates yielding net wholesale prices below those of Liggett, and B&W marketed its black and whites to Liggett's distributors—offerings its largest discounts to Liggett's 14 largest customers—as well as to B&W's own much larger list of distributors.

Liggett responded to Brown & Williamson introduction of black and whites by increasing its own volume rebates, which precipitated a price war that lasted from July 1984 to December 1985. While Liggett did not dispute that B&W's original wholesale price was above its costs, Liggett maintained that by the end of the price wage B&W was selling after rebates below its costs. Moreover, in planning to enter the generic segment, Brown & Williamson anticipated that it could generate $48.7 million in free cash flow between the beginning second half of 1984 and the

1. Most internal citations and footnotes omitted. For the opinions in the case, see Liggett Group, Inc. v. Brown & Williamson Tobacco Corp., 748 F. Supp. 344 (M.D.N.C. 1990), *aff'd*, 964 F.2d 335 (4th Cir. 1992), *aff'd*, 509 U.S. 209 (1993).

2. Shares are for sales of cigarettes of all types nationwide at the time of trial in 1984. *See Brooke Group*, 509 U.S. at 213.

end of 1985, but in light of likely "competitive counterattacks" it was "prepared to redistribute this entire amount in the form of additional trade allowances [whole discounts]."[3] The succeeding price war in fact did cause B&W to lose all of its projected free cash flow.[4]

Liggett also pursued a civil action against B&W, alleging among other things that B&W violated Section 2(a) of the Robinson-Patman Act by giving volume rebates to wholesalers that resulted in price discrimination that in turn had a reasonable probability of lessening competition. In particular, Liggett maintained that Brown & Williamson had reduced its net wholesale prices below its average variable costs with the intent of pressuring Liggett to raise its prices and so narrow the price difference between generic and branded cigarettes and preserve B&W supracompetitive profits on its branded cigarettes.[5] The evidence at trial showed that in late 1985, when the price war ended, the list price for black and whites and branded cigarettes were and $19.75 and $33.15 per carton, respectively, so that back and whites were selling at a little over 40% discount to branded cigarettes. Returning to industry norms, prices were increased twice a year, and by June 1989 the list price for black and whites and branded cigarettes had each been increased by about $14 to $33.75 and $46.15 per carton, respectively, or about a 27% price differential.[6]

After a 115-day trial, the jury returned a verdict in favor of Liggett. In its special verdict, the jury found that Brown & Williamson had engaged in price discrimination that had a reasonable possibility of injuring competition in the domestic cigarette market as a whole in violation of Section 2(a) of the Robinson-Patman Act. The jury awarded Liggett $49.6 million in actual damages, which the district court trebled to $148.8 million. After reviewing the record, however, the district court held that Brown & Williamson was entitled to judgment as a matter of law on three separate grounds: lack of injury to competition as required by Section 2(a), lack of antitrust injury to Liggett, and lack of a causal link between the discriminatory rebates and Liggett's alleged injury. The Fourth Circuit affirmed. The Supreme Court granted certiorari and affirmed on the grounds that the evidence could not support a jury finding of injury to competition.

Justice KENNEDY delivered the opinion of the Court.

This case stems from a market struggle that erupted in the domestic cigarette industry in the mid-1980's. Petitioner Brooke Group, Ltd., whom we, like the parties to the case, refer to as Liggett because of its former corporate name, charges that to

3. *Brooke Group*, 509 U.S. at 247 (Stevens, J., dissenting).

4. *Id*. at 248.

5. In his dissent, Justice Stevens reports that over the 18-month price war, Brown & Williamson's revenues ran consistently below its total variable costs, with an average deficiency of approximately $0.30 per carton and a total loss on B & W black and whites of almost $15 million. *Id*. at 249.

6. *Id*. at 250.

counter its innovative development of generic cigarettes, respondent Brown & Williamson Tobacco Corporation introduced its own line of generic cigarettes in an unlawful effort to stifle price competition in the economy segment of the national cigarette market. Liggett contends that Brown & Williamson cut prices on generic cigarettes below cost and offered discriminatory volume rebates to wholesalers to force Liggett to raise its own generic cigarette prices and introduce oligopoly pricing in the economy segment. We hold that Brown & Williamson is entitled to judgment as a matter of law.

I

[*Facts—omitted*]

II

A

Price discrimination is made unlawful by § 2(a) of the Clayton Act, 38 Stat. 730, as amended by the Robinson-Patman Act, which provides:

> "It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them." 15 U.S.C. § 13(a).

Although we have reiterated that "'a price discrimination within the meaning of [this] provision is merely a price difference,'" *Texaco Inc. v. Hasbrouck*, 496 U.S. 543, 558 (1990) (quoting *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 549 (1960)), the statute as a practical matter could not, and does not, ban all price differences charged to "different purchasers of commodities of like grade and quality." Instead, the statute contains a number of important limitations, one of which is central to evaluating Liggett's claim: By its terms, the Robinson-Patman Act condemns price discrimination only to the extent that it threatens to injure competition. The availability of statutory defenses permitting price discrimination when it is based on differences in costs, "changing conditions affecting the market for or the marketability of the goods concerned," or conduct undertaken "in good faith to meet an equally low price of a competitor," confirms that Congress did not intend to outlaw price differences that result from or further the forces of competition. Thus, "the Robinson-Patman Act should be construed consistently with broader policies of the antitrust laws."

Liggett contends that Brown & Williamson's discriminatory volume rebates to wholesalers threatened substantial competitive injury by furthering a predatory pricing scheme designed to purge competition from the economy segment of the cigarette market. This type of injury, which harms direct competitors of the discriminating seller, is known as primary-line injury. We last addressed primary-line injury over 25 years ago, in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). In *Utah Pie*, we reviewed the sufficiency of the evidence supporting jury verdicts against three national pie companies that had engaged in a variety of predatory practices in the market for frozen pies in Salt Lake City, with the intent to drive a local pie manufacturer out of business. We reversed the Court of Appeals and held that the evidence presented was adequate to permit a jury to find a likelihood of injury to competition.

*Utah Pie* has often been interpreted to permit liability for primary-line price discrimination on a mere showing that the defendant intended to harm competition or produced a declining price structure. The case has been criticized on the grounds that such low standards of competitive injury are at odds with the antitrust laws' traditional concern for consumer welfare and price competition. We do not regard the *Utah Pie* case itself as having the full significance attributed to it by its detractors. *Utah Pie* was an early judicial inquiry in this area and did not purport to set forth explicit, general standards for establishing a violation of the Robinson-Patman Act. As the law has been explored since *Utah Pie*, it has become evident that primary-line competitive injury under the Robinson-Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act. There are, to be sure, differences between the two statutes. For example, we interpret § 2 of the Sherman Act to condemn predatory pricing when it poses "a dangerous probability of actual monopolization," *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 455 (1993), whereas the Robinson-Patman Act requires only that there be "a reasonable possibility" of substantial injury to competition before its protections are triggered. But whatever additional flexibility the Robinson-Patman Act standard may imply, the essence of the claim under either statute is the same: A business rival has priced its products in an unfair manner with an object to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market.

Accordingly, whether the claim alleges predatory pricing under § 2 of the Sherman Act or primary-line price discrimination under the Robinson-Patman Act, two prerequisites to recovery remain the same. First, a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs.[1] Although *Cargill* and *Matsushita* reserved as a formal matter the question "'whether recovery should ever be available . . . when the pricing in question is above some measure of incremental cost,'" the reasoning in both opinions suggests that only below-cost prices should suffice, and we have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict

1. Because the parties in this case agree that the relevant measure of cost is average variable cost, however, we again decline to resolve the conflict among the lower courts over the appropriate measure of cost. See *Cargill, Inc. v. Montfort of Colorado, Inc.*, 479 U.S. 104, 117-118, n.12 (1986); *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 585, n.8 (1986).

injury to competition cognizable under the antitrust laws. "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. . . . We have adhered to this principle regardless of the type of antitrust claim involved." 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. "To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result."

Even in an oligopolistic market, when a firm drops its prices to a competitive level to demonstrate to a maverick the unprofitability of straying from the group, it would be illogical to condemn the price cut: The antitrust laws then would be an obstacle to the chain of events most conducive to a breakdown of oligopoly pricing and the onset of competition. Even if the ultimate effect of the cut is to induce or reestablish supracompetitive pricing, discouraging a price cut and forcing firms to maintain supracompetitive prices, thus depriving consumers of the benefits of lower prices in the interim, does not constitute sound antitrust policy.

The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices. "For the investment to be rational, the [predator] must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered." Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for "the protection of *competition*, not *competitors*." *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). Earlier this Term, we held in the Sherman Act § 2 context that it was not enough to inquire "whether the defendant has engaged in 'unfair' or 'predatory' tactics"; rather, we insisted that the plaintiff prove "a dangerous probability that [the defendant] would monopolize a particular market." *Spectrum Sports*, 506 U.S., at 459. Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or "purport to afford remedies for all torts committed by or against persons engaged in interstate commerce."

For recoupment to occur, below-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm's rivals, whether driving them from the market, or, as was alleged to be the goal here, causing them to raise their prices to supracompetitive levels within a disciplined oligopoly. This requires an understanding of the extent and duration of the alleged predation, the relative financial strength of the predator and its intended victim, and their respective incentives and will. The inquiry is whether, given the aggregate losses caused by the below-cost pricing, the intended target would likely succumb.

If circumstances indicate that below-cost pricing could likely produce its intended effect on the target, there is still the further question whether it would likely injure competition in the relevant market. The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it. As we have observed on a prior occasion, "[i]n order to recoup their losses, [predators] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices."

Evidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition. Determining whether recoupment of predatory losses is likely requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market. If market circumstances or deficiencies in proof would bar a reasonable jury from finding that the scheme alleged would likely result in sustained supracompetitive pricing, the plaintiff's case has failed. In certain situations--for example, where the market is highly diffuse and competitive, or where new entry is easy, or the defendant lacks adequate excess capacity to absorb the market shares of his rivals and cannot quickly create or purchase new capacity—summary disposition of the case is appropriate.

These prerequisites to recovery are not easy to establish, but they are not artificial obstacles to recovery; rather, they are essential components of real market injury. As we have said in the Sherman Act context, "predatory pricing schemes are rarely tried, and even more rarely successful," *Matsushita*, *supra*, 475 U.S., at 589 and the costs of an erroneous finding of liability are high. "[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition; because 'cutting prices in order to increase business often is the very essence of competition . . . [;] mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect.'" It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high.

B

Liggett does not allege that Brown & Williamson sought to drive it from the market but that Brown & Williamson sought to preserve supracompetitive profits on branded cigarettes by pressuring Liggett to raise its generic cigarette prices through a process of tacit collusion with the other cigarette companies. Tacit collusion, sometimes called oligopolistic price coordination or conscious parallelism, describes the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.

In *Matsushita*, we remarked upon the general implausibility of predatory pricing. *Matsushita* observed that such schemes are even more improbable when they require coordinated action among several firms. *Matsushita* involved an allegation of an express conspiracy to engage in predatory pricing. The Court noted that in addition to the usual difficulties that face a single firm attempting to recoup predatory losses, other problems render a conspiracy "incalculably more difficult to execute." In order to succeed, the conspirators must agree on how to allocate present losses and future gains among the firms involved, and each firm must resist powerful incentives to cheat on whatever agreement is reached.

However unlikely predatory pricing by multiple firms may be when they conspire, it is even less likely when, as here, there is no express coordination. Firms that seek to recoup predatory losses through the conscious parallelism of oligopoly must rely on uncertain and ambiguous signals to achieve concerted action. The signals are subject to misinterpretation and are a blunt and imprecise means of ensuring smooth cooperation, especially in the context of changing or unprecedented market circumstances. This anticompetitive minuet is most difficult to compose and to perform, even for a disciplined oligopoly.

From one standpoint, recoupment through oligopolistic price coordination could be thought more feasible than recoupment through monopoly: In the oligopoly setting, the victim itself has an economic incentive to acquiesce in the scheme. If forced to choose between cutting prices and sustaining losses, maintaining prices and losing market share, or raising prices and enjoying a share of supracompetitive profits, a firm may yield to the last alternative. Yet on the whole, tacit cooperation among oligopolists must be considered the least likely means of recouping predatory losses. In addition to the difficulty of achieving effective tacit coordination and the high likelihood that any attempt to discipline will produce an outbreak of competition, the predator's present losses in a case like this fall on it alone, while the later supracompetitive profits must be shared with every other oligopolist in proportion to its market share, including the intended victim. In this case, for example, Brown & Williamson, with its 11-12% share of the cigarette market, would have had to generate around $9 in supracompetitive profits for each $1 invested in predation; the remaining $8 would belong to its competitors, who had taken no risk.

Liggett suggests that these considerations led the Court of Appeals to rule out its theory of recovery as a matter of law. Although the proper interpretation of the Court of Appeals' opinion is not free from doubt, there is some indication that it held as a matter of law that the Robinson-Patman Act does not reach a primary-line injury claim in which tacit coordination among oligopolists provides the alleged basis for recoupment. The Court of Appeals' opinion does not contain the traditional apparatus of fact review; rather, it focuses on theoretical and legal arguments. The final paragraph appears to state the holding: Brown & Williamson may not be held liable because oligopoly pricing does not "'provide an economically rational basis'" for recouping predatory losses. 964 F.2d, at 342.

To the extent that the Court of Appeals may have held that the interdependent pricing of an oligopoly may never provide a means for achieving recoupment and so may not form the basis of a primary-line injury claim, we disagree. A predatory pricing scheme designed to preserve or create a stable oligopoly, if successful, can injure consumers in the same way, and to the same extent, as one designed to bring about a monopoly. However unlikely that possibility may be as a general matter, when the realities of the market and the record facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability

The Robinson-Patman Act, which amended § 2 of the original Clayton Act, suggests no exclusion from coverage when primary-line injury occurs in an oligopoly setting. Unlike the provisions of the Sherman Act, which speak only of various forms of express agreement and monopoly, the Robinson-Patman Act is phrased in broader, disjunctive terms, prohibiting price discrimination "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly." For all the words of the Act to carry adequate meaning, competitive injury under the Act must extend beyond the monopoly setting. The language referring to a substantial lessening of competition was part of the original Clayton Act § 2, and the same phrasing appears in § 7 of that Act. In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits. See, e.g., *United States v. Philadelphia Nat. Bank,* 374 U.S. 321 (1963). We adhere to "the normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning." We decline to create a per se rule of nonliability for predatory price discrimination when recoupment is alleged to take place through supracompetitive oligopoly pricing.

III

Although Liggett's theory of liability, as an abstract matter, is within the reach of the statute, we agree with the Court of Appeals and the District Court that Liggett was not entitled to submit its case to the jury. It is not customary for this Court to review the sufficiency of the evidence, but we will do so when the issue is properly before us and the benefits of providing guidance concerning the proper application of a legal standard and avoiding the systemic costs associated with further proceedings justify the required expenditure of judicial resources. The record in this case demonstrates that the anticompetitive scheme Liggett alleged, when judged against the realities of the market, does not provide an adequate basis for a finding of liability.

[*Review of evidence omitted*]

. . .

IV

We understand that the chain of reasoning by which we have concluded that Brown & Williamson is entitled to judgment as a matter of law is demanding. But a reasonable jury is presumed to know and understand the law, the facts of the case, and the realities of the market. We hold that the evidence cannot support a finding that Brown & Williamson's alleged scheme was likely to result in oligopolistic price coordination and sustained supracompetitive pricing in the generic segment of the national cigarette market. Without this, Brown & Williamson had no reasonable prospect of recouping its predatory losses and could not inflict the injury to competition the antitrust laws prohibit. The judgment of the Court of Appeals is

*Affirmed.*

Justice STEVENS, with whom Justice WHITE and Justice BLACKMUN join, dissenting. [Opinion omitted]

NOTES

1. The counsel before the Supreme Court were impressive. Phillip Areeda, joined on the brief by former solicitor general Charles Fried, argued the cause for Brooke Group, while Robert H. Bork, joined on the brief by former attorney general Griffen Bell, argued for Brown & Williamson. The oral argument may be heard on the Oyez web site.

## **WEYERHAEUSER COMPANY V. ROSS-SIMMONS HARDWOOD LUMBER CO. 549 U.S. 312 (2007[1])**

Justice THOMAS delivered the opinion for a unanimous Court.

Respondent Ross-Simmons, a sawmill, sued petitioner Weyerhaeuser, alleging that Weyerhaeuser drove it out of business by bidding up the price of sawlogs to a level that prevented Ross-Simmons from being profitable. A jury returned a verdict in favor of Ross-Simmons on its monopolization claim, and the Ninth Circuit affirmed. We granted certiorari to decide whether the test we applied to claims of predatory pricing in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), also applies to claims of predatory bidding. We hold that it does. Accordingly, we vacate the judgment of the Court of Appeals.

I

This antitrust case concerns the acquisition of red alder sawlogs by the mills that process those logs in the Pacific Northwest. These hardwood-lumber mills usually acquire logs in one of three ways. Some logs are purchased on the open bidding market. Some come to the mill through standing short- and long-term agreements with timberland owners. And others are harvested from timberland owned by the sawmills themselves. The allegations relevant to our decision in this case relate to the bidding market.

Ross-Simmons began operating a hardwood-lumber sawmill in Longview, Washington, in 1962. Weyerhaeuser entered the Northwestern hardwood-lumber market in 1980 by acquiring an existing lumber company. Weyerhaeuser gradually increased the scope of its hardwood-lumber operation, and it now owns six hardwood sawmills in the region. By 2001, Weyerhaeuser's mills were acquiring approximately 65 percent of the alder logs available for sale in the region.

From 1990 to 2000, Weyerhaeuser made more than $75 million in capital investments in its hardwood mills in the Pacific Northwest. During this period, production increased at every Northwestern hardwood mill that Weyerhaeuser owned. In addition to increasing production, Weyerhaeuser used "state-of-the-art technology," including sawing equipment, to increase the amount of lumber recovered from every log, By contrast, Ross-Simmons appears to have engaged in little efficiency-enhancing investment.

Logs represent up to 75 percent of a sawmill's total costs. And from 1998 to 2001, the price of alder sawlogs increased while prices for finished hardwood lumber fell. These divergent trends in input and output prices cut into the mills' profit

[1] Most internal citations and footnotes omitted. For the opinions in the case, see Confederated Tribes of Siletz Indians of Or. v. Weyerhaeuser Co., 411 F.3d 1030 (9th Cir. 2005), *aff'd sub nom.* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007).

margins, and Ross-Simmons suffered heavy losses during this time. Saddled with several million dollars in debt, Ross-Simmons shut down its mill completely in May 2001.

Ross-Simmons blamed Weyerhaeuser for driving it out of business by bidding up input costs, and it filed an antitrust suit against Weyerhaeuser for monopolization and attempted monopolization under § 2 of the Sherman Act. Ross-Simmons alleged that, among other anticompetitive acts, Weyerhaeuser had used "its dominant position in the alder sawlog market to drive up the prices for alder sawlogs to levels that severely reduced or eliminated the profit margins of Weyerhaeuser's alder sawmill competition." Proceeding in part on this "predatory-bidding" theory, Ross-Simmons argued that Weyerhaeuser had overpaid for alder sawlogs to cause sawlog prices to rise to artificially high levels as part of a plan to drive Ross-Simmons out of business. As proof that this practice had occurred, Ross-Simmons pointed to Weyerhaeuser's large share of the alder purchasing market, rising alder sawlog prices during the alleged predation period, and Weyerhaeuser's declining profits during that same period.

Prior to trial, Weyerhaeuser moved for summary judgment on Ross-Simmons' predatory-bidding theory. The District Court denied the motion. At the close of the 9-day trial, Weyerhaeuser moved for judgment as a matter of law, or alternatively, for a new trial. The motions were based in part on Weyerhaeuser's argument that Ross-Simmons had not satisfied the standard this Court set forth in *Brooke Group, supra*. The District Court denied Weyerhaeuser's motion. The District Court also rejected proposed predatory-bidding jury instructions that incorporated elements of the *Brooke Group* test. Ultimately, the District Court instructed the jury that Ross-Simmons could prove that Weyerhaeuser's bidding practices were anticompetitive acts if the jury concluded that Weyerhaeuser "purchased more logs than it needed, or paid a higher price for logs than necessary, in order to prevent [Ross-Simmons] from obtaining the logs they needed at a fair price." Finding that Ross-Simmons had proved its claim for monopolization, the jury returned a $26 million verdict against Weyerhaeuser. The verdict was trebled to approximately $79 million.

Weyerhaeuser appealed to the Court of Appeals for the Ninth Circuit. There, Weyerhaeuser argued that *Brooke Group's* standard for claims of predatory pricing should also apply to claims of predatory bidding. The Ninth Circuit disagreed and affirmed the verdict against Weyerhaeuser. *Confederated Tribes of Siletz Indians of Ore. v. Weyerhaeuser Co.*, 411 F.3d 1030, 1035-1036 (2005).

The Court of Appeals reasoned that "buy-side predatory bidding" and "sell-side predatory pricing," though similar, are materially different in that predatory bidding does not necessarily benefit consumers or stimulate competition in the way that predatory pricing does. Concluding that "the concerns that led the Brooke Group Court to establish a high standard of liability in the predatory pricing context do not carry over to this predatory bidding context with the same force," the Court of Appeals declined to apply *Brooke Group* to Ross-Simmons' claims of predatory bidding. 411 F.3d, at 1038. The Court of Appeals went on to conclude that substantial evidence supported a finding of liability on the predatory-bidding theory.

We granted certiorari to decide whether *Brooke Group* applies to claims of predatory bidding. 548 U.S. 903 (2006). We hold that it does, and we vacate the Court of Appeals' judgment.

II

In *Brooke Group*, we considered what a plaintiff must show in order to succeed on a claim of predatory pricing under § 2 of the Sherman Act.[1] In a typical predatory-pricing scheme, the predator reduces the sale price of its product (its output) to below cost, hoping to drive competitors out of business. Then, with competition vanquished, the predator raises output prices to a supracompetitive level. See *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 584-585, n. 8 (1986) (describing predatory pricing). For the scheme to make economic sense, the losses suffered from pricing goods below cost must be recouped (with interest) during the supracompetitive-pricing stage of the scheme. *Id*., at 588-589; *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 121-122, n.17 (1986); see also R. Bork, The Antitrust Paradox 145 (1978). Recognizing this economic reality, we established two prerequisites to recovery on claims of predatory pricing. "First, a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs." *Brooke Group*, 509 U.S., at 222. Second, a plaintiff must demonstrate that "the competitor had . . . a dangerous probabilit[y] of recouping its investment in below-cost prices." *Id*., at 224.

The first prong of the test—requiring that prices be below cost—is necessary because "[a]s 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." *Id*., at 223. We were particularly wary of allowing recovery for above-cost price cutting because allowing such claims could, perversely, "chil[l] legitimate price cutting," which directly benefits consumers. See *id*., at 223-224; *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990) ("Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition"). Thus, we specifically declined to allow plaintiffs to recover for above-cost price cutting, concluding that "discouraging a price cut and . . . depriving consumers of the benefits of lower prices . . . does not constitute sound antitrust policy." *Brooke Group*, *supra*, at 224.

The second prong of the *Brooke Group* test—requiring that there be a dangerous probability of recoupment of losses—is necessary because, without a dangerous probability of recoupment, it is highly unlikely that a firm would engage in predatory

1. *Brooke Group* dealt with a claim under the Robinson-Patman Act, but as we observed, "primary-line competitive injury under the Robinson-Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act." 509 U.S., at 221. Because of this similarity, the standard adopted in *Brooke Group* applies to predatory-pricing claims under § 2 of the Sherman Act. *Id*., at 222.

pricing. As the Court explained in *Matsushita*, a firm engaged in a predatory-pricing scheme makes an investment-the losses suffered plus the profits that would have been realized absent the scheme-at the initial, below-cost-selling phase. 475 U.S., at 588-589. For that investment to be rational, a firm must reasonably expect to recoup in the long run at least its original investment with supracompetitive profits. *Ibid*.; *Brooke Group*, 509 U.S., at 224. Without such a reasonable expectation, a rational firm would not willingly suffer definite, short-run losses. Recognizing the centrality of recoupment to a predatory-pricing scheme, we required predatory-pricing plaintiffs to "demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it." *Id*., at 225.

We described the two parts of the *Brooke Group* test as "essential components of real market injury" that were "not easy to establish." *Id*., at 226. We also reiterated that the costs of erroneous findings of predatory-pricing liability were quite high because "'[t]he mechanism by which a firm engages in predatory pricing-lowering prices-is the same mechanism by which a firm stimulates competition,' " and, therefore, mistaken findings of liability would " ' "chill the very conduct the antitrust laws are designed to protect."'" *Ibid*. (quoting *Cargill, supra*, at 122, n.17).

III

Predatory bidding, which Ross-Simmons alleges in this case, involves the exercise of market power on the buy side or input side of a market. In a predatory-bidding scheme, a purchaser of inputs "bids up the market price of a critical input to such high levels that rival buyers cannot survive (or compete as vigorously) and, as a result, the predating buyer acquires (or maintains or increases its) monopsony power." Monopsony power is market power on the buy side of the market. As such, a monopsony is to the buy side of the market what a monopoly is to the sell side and is sometimes colloquially called a "buyer's monopoly."

A predatory bidder ultimately aims to exercise the monopsony power gained from bidding up input prices. To that end, once the predatory bidder has caused competing buyers to exit the market for purchasing inputs, it will seek to "restrict its input purchases below the competitive level," thus "reduc[ing] the unit price for the remaining input[s] it purchases." The reduction in input prices will lead to "a significant cost saving that more than offsets the profit[s] that would have been earned on the output." If all goes as planned, the predatory bidder will reap monopsonistic profits that will offset any losses suffered in bidding up input prices.[2] (In this case, the plaintiff was the defendant's competitor in the input-purchasing market. Thus, this case does not present a situation of suppliers suing a

2. If the predatory firm's competitors in the input market and the output market are the same, then predatory bidding can also lead to the bidder's acquisition of monopoly power in the output market. In that case, which does not appear to be present here, the monopsonist could, under certain market conditions, also recoup its losses by raising output prices to monopolistic levels.

monopsonist buyer under § 2 of the Sherman Act, nor does it present a risk of significantly increased concentration in the market in which the monopsonist sells, i.e., the market for finished lumber.)

## IV

### A

Predatory-pricing and predatory-bidding claims are analytically similar. This similarity results from the close theoretical connection between monopoly and monopsony. The kinship between monopoly and monopsony suggests that similar legal standards should apply to claims of monopolization and to claims of monopsonization.

Tracking the economic similarity between monopoly and monopsony, predatory-pricing plaintiffs and predatory-bidding plaintiffs make strikingly similar allegations. A predatory-pricing plaintiff alleges that a predator cut prices to drive the plaintiff out of business and, thereby, to reap monopoly profits from the output market. In parallel fashion, a predatory-bidding plaintiff alleges that a predator raised prices for a key input to drive the plaintiff out of business and, thereby, to reap monopsony profits in the input market. Both claims involve the deliberate use of unilateral pricing measures for anticompetitive purposes.[3] And both claims logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future.

### B

More importantly, predatory bidding mirrors predatory pricing in respects that we deemed significant to our analysis in *Brooke Group*. In *Brooke Group*, we noted that "'predatory pricing schemes are rarely tried, and even more rarely successful.'" 509 U.S., at 226 (quoting *Matsushita*, 475 U.S., at 589). Predatory pricing requires a firm to suffer certain losses in the short term on the chance of reaping supracompetitive profits in the future. A rational business will rarely make this sacrifice. The same reasoning applies to predatory bidding. A predatory-bidding scheme requires a buyer of inputs to suffer losses today on the chance that it will reap supracompetitive profits in the future. For this reason, "[s]uccessful monopsony predation is probably as unlikely as successful monopoly predation."

And like the predatory conduct alleged in *Brooke Group*, actions taken in a predatory-bidding scheme are often "'"the very essence of competition."'" 509 U.S., at 226 (quoting *Cargill*, 479 U.S., at 122, n.17, in turn quoting *Matsushita*, *supra*, at

3. Predatory bidding on inputs is not analytically different from predatory overbuying of inputs. Both practices fall under the rubric of monopsony predation and involve an input purchaser's use of input prices in an attempt to exclude rival input purchasers. The economic effect of the practices is identical: Input prices rise. In a predatory-bidding scheme, the purchaser causes prices to rise by offering to pay more for inputs. In a predatory-overbuying scheme, the purchaser causes prices to rise by demanding more of the input. Either way, input prices increase. Our use of the term "predatory bidding" is not meant to suggest that different legal treatment is appropriate for the economically identical practice of "predatory overbuying."

594). Just as sellers use output prices to compete for purchasers, buyers use bid prices to compete for scarce inputs. There are myriad legitimate reasons-ranging from benign to affirmatively procompetitive-why a buyer might bid up input prices. A firm might bid up inputs as a result of miscalculation of its input needs or as a response to increased consumer demand for its outputs. A more efficient firm might bid up input prices to acquire more inputs as a part of a procompetitive strategy to gain market share in the output market. A firm that has adopted an input-intensive production process might bid up inputs to acquire the inputs necessary for its process. Or a firm might bid up input prices to acquire excess inputs as a hedge against the risk of future rises in input costs or future input shortages. There is nothing illicit about these bidding decisions. Indeed, this sort of high bidding is essential to competition and innovation on the buy side of the market.[4]

*Brooke Group* also noted that a failed predatory-pricing scheme may benefit consumers. The potential benefit results from the difficulty an aspiring predator faces in recouping losses suffered from below-cost pricing. Without successful recoupment, "predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced." Failed predatory-bidding schemes can also, but will not necessarily, benefit consumers. In the first stage of a predatory-bidding scheme, the predator's high bidding will likely lead to its acquisition of more inputs. Usually, the acquisition of more inputs leads to the manufacture of more outputs. And increases in output generally result in lower prices to consumers.[5] Thus, a failed predatory-bidding scheme can be a "boon to consumers" in the same way that we considered a predatory-pricing scheme to be.

In addition, predatory bidding presents less of a direct threat of consumer harm than predatory pricing. A predatory-pricing scheme ultimately achieves success by charging higher prices to consumers. By contrast, a predatory-bidding scheme could succeed with little or no effect on consumer prices because a predatory bidder does not necessarily rely on raising prices in the output market to recoup its losses. Even if output prices remain constant, a predatory bidder can use its power as the predominant buyer of inputs to force down input prices and capture monopsony profits.

C

The general theoretical similarities of monopoly and monopsony combined with the theoretical and practical similarities of predatory pricing and predatory bidding

4. Higher prices for inputs obviously benefit existing sellers of inputs and encourage new firms to enter the market for input sales as well.

5. Consumer benefit does not necessarily result at the first stage because the predator might not use its excess inputs to manufacture additional outputs. It might instead destroy the excess inputs. See Salop 677, n. 22. Also, if the same firms compete in the input and output markets, any increase in outputs by the predator could be offset by decreases in outputs from the predator's struggling competitors.

convince us that our two-pronged *Brooke Group* test should apply to predatory-bidding claims.

The first prong of *Brooke Group's* test requires little adaptation for the predatory-bidding context. A plaintiff must prove that the alleged predatory bidding led to below-cost pricing of the predator's outputs. That is, the predator's bidding on the buy side must have caused the cost of the relevant output to rise above the revenues generated in the sale of those outputs. As with predatory pricing, the exclusionary effect of higher bidding that does not result in below-cost output pricing "is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate" procompetitive conduct. Given the multitude of procompetitive ends served by higher bidding for inputs, the risk of chilling procompetitive behavior with too lax a liability standard is as serious here as it was in *Brooke Group*. Consequently, only higher bidding that leads to below-cost pricing in the relevant output market will suffice as a basis for liability for predatory bidding.

A predatory-bidding plaintiff also must prove that the defendant has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power. Absent proof of likely recoupment, a strategy of predatory bidding makes no economic sense because it would involve short-term losses with no likelihood of offsetting long-term gains. As with predatory pricing, making a showing on the recoupment prong will require "a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market."

Ross-Simmons has conceded that it has not satisfied the *Brooke Group* standard. Brief for Respondent 49; Tr. of Oral Arg. 49. Therefore, its predatory-bidding theory of liability cannot support the jury's verdict.

V

For these reasons, we vacate the judgment of the Court of Appeals and remand the case for further proceedings consistent with this opinion.

*It is so ordered.*

NOTES

1. Following the Supreme Court's decision, the Ninth Circuit remanded to the district court, where the parties filed a stipulation of dismissal. The district court entered a judgment of dismissal on September 4, 2007.

# DOJ Section 2 Report

U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act (issued by the Bush administration on Sept. 11, 2008) (withdrawn by the Obama administration on May 11, 2009).

# CHAPTER 4

# PRICE PREDATION

A firm with monopoly power can violate section 2 if it engages in classic price predation, namely, predatory pricing, or in its buy-side equivalent, predatory bidding.[1] Drawing on the testimony and submissions presented at the hearings, as well as cases and commentary, this chapter explores and provides the Department's views on some important issues surrounding these forms of exclusionary conduct.

## I. Predatory Pricing

### A. Introduction

There is broad consensus that, in certain circumstances, temporarily charging prices below a firm's costs can harm competition and consumers.[2] For example, harm could occur if a firm priced low to make it unprofitable for competitors to stay in the market and then, following their exits, increased price to supracompetitive levels for a significant period.[3] In such circumstances, although consumers may benefit in the short term from low prices, in the long term they may be worse off.[4] "There is, therefore, good reason for including a 'predatory pricing' antitrust offense within the proscription of monopolization or attempts to monopolize in section 2 of the Sherman Act."[5]

However, a firm accused of pursuing a predatory-pricing strategy is, in essence, accused of charging prices that are too low. Therein lies "a difficult conundrum in antitrust law."[6] Price cutting is a core competitive activity. Consumers prefer lower prices to higher prices, and they benefit when firms aggressively compete to price as low as possible. Price competition enables consumers to secure desired products and services for less.

Thus, alongside the broad consensus that predatory pricing can be anticompetitive, there is general recognition that, in the words of one treatise, "[a]ntitrust would be acting foolishly if it forbade price cuts any time a firm knew that its cuts would impose hardship on any competitor or even force its exit from the market."[7] In the absence of clear standards, distinguishing harmful predation from procompetitive discounting is often difficult and runs the risk of erroneous condemnation, which can discourage firms from engaging in beneficial price competition and thus "chill the very conduct the antitrust laws are designed to protect."[8] The key question, therefore, is how

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[1] *See generally* 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶ 722–49 (2d ed. 2002). This chapter deals solely with what one commentator characterizes as "conventional" predatory pricing and not with bundling, quantity discounts, market-share discounts, and other forms of what he terms "exclusionary pricing." Herbert Hovenkamp, *The Law of Exclusionary Pricing*, COMPETITION POL'Y INT'L, Spring 2006, at 21. These other types of conduct are addressed in other chapters.

[2] *See generally* AREEDA & HOVENKAMP, *supra* note 1, ¶ 723b, at 273–74; RICHARD A. POSNER, ANTITRUST LAW 214 (2d ed. 2001).

[3] *See* Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 117 (1986); AREEDA & HOVENKAMP, *supra* note 1, ¶ 723a, at 272.

[4] *See* Sherman Act Section 2 Joint Hearing: Predatory Pricing Hr'g Tr. 30, June 22, 2006 [hereinafter June 22 Hr'g Tr.] (Bolton).

[5] Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 697 (1975).

[6] Ari Lehman, Note, *Eliminating the Below-Cost Pricing Requirement from Predatory Pricing Claims*, 27 CARDOZO L. REV. 343, 385 (2005).

[7] AREEDA & HOVENKAMP, *supra* note 1, ¶ 722, at 271.

[8] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414 (2004) (quoting Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986)). *See generally* Phillip Areeda, *Monopolization, Mergers, and Markets: A Century Past and the Future*, 75 CAL. L. REV. 959, 965–70 (1987); Daniel A. Crane, *The Paradox of Predatory Pricing*, 91 CORNELL L.

to structure a rule under section 2 that effectively condemns only harmful predation while providing clear and sound guidance to firms, competition authorities, potential private plaintiffs, and courts.

**B. Background**

"The predatory price-cutter is one of the oldest and most familiar villains in our economic folklore."[9] For instance, the 1906 complaint in *Standard Oil Co. of New Jersey v. United States* alleged, among other things, "local price cutting at the points where necessary to suppress competition."[10] Similarly, in 1911, *United States v. American Tobacco Co.* involved allegations of "ruinous competition, by lowering the price of plug below its cost."[11]

"Historically, treatment of predatory pricing in the cases and the literature suffered from two interrelated defects: (1) failure to delineate clearly and correctly what practices should constitute the offense, and (2) exaggerated fears that large firms would be inclined to engage in predatory pricing."[12] The result was that in the decades before the Supreme Court decided *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,[13] "[p]laintiffs won most litigated cases, including those they probably should have lost."[14]

The Supreme Court's decision in *Utah Pie Co. v. Continental Baking Co.*,[15] although decided within the context of the Robinson-Patman Act[16] and not section 2 of the Sherman Act, nevertheless illustrates the courts' approach to predatory-pricing claims during that period. In *Utah Pie*, defendant Continental Baking Company sold apple pies for $2.85 a dozen, which "was less than its direct cost plus an allocation for overhead."[17] This caused plaintiff Utah Pie to reduce its price for frozen apple pies to $2.75 per dozen, a price Continental refused to match.[18] The Supreme Court found Continental had engaged in predatory pricing because a jury could have "reasonably concluded that a competitor who is forced to reduce his price to a new all-time low in a market of declining prices will in time feel the financial pinch and will be a less effective competitive force."[19]

*Utah Pie* received much scholarly criticism as an example of a case where "low prices seemed more likely to injure competitors than competition and consumers."[20] One commentator wrote that it "must rank as the most anticompetitive antitrust decision of the decade."[21] Judge Bork's view was that "[t]here is no economic theory worthy of the name that could find an injury to competition on the facts of the case."[22] As he saw it, "Defendants were convicted not of injuring competition but, quite

REV. 1, 55–56 (2005).

[9] Roland H. Koller II, *The Myth of Predatory Pricing: An Empirical Study*, ANTITRUST L. & ECON. REV., Summer 1971, at 105, 105.

[10] 221 U.S. 1, 43 (1911). *See generally* Elizabeth Granitz & Benjamin Klein, *Monopolization by "Raising Rivals' Costs": The* Standard Oil *Case*, 39 J.L. & ECON. 1 (1996); John S. McGee, *Predatory Price Cutting: The* Standard Oil *(N.J.) Case*, 1 J.L. & ECON. 137 (1958).

[11] 221 U.S. 106, 160 (1911).

[12] AREEDA & HOVENKAMP, *supra* note 1, ¶ 723a, at 272–73 (footnotes omitted).

[13] 509 U.S. 209 (1993).

[14] Patrick Bolton et al., *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239, 2250 (2000).

[15] 386 U.S. 685 (1967).

[16] 15 U.S.C. § 13(a) (2000); *see* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069, 1074 n.1 (2007) ("'[P]rimary-line competitive injury under the Robinson-Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act.'" (quoting *Brooke Group*, 509 U.S. at 221)).

[17] 386 U.S. at 698.

[18] *Id.* at 698–99.

[19] *Id.* at 699–700.

[20] Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 YALE L.J. 941, 953 (2002); *see also* Kenneth G. Elzinga & Thomas F. Hogarty, Utah Pie *and the Consequences of Robinson-Patman*, 21 J.L. & ECON. 427, 427 (1978) ("The *Utah Pie* opinion . . . has provoked much criticism on the grounds that it serves to protect localized firms from the competition of more distant sellers.").

[21] Ward S. Bowman, *Restraint of Trade by the Supreme Court*: *The* Utah Pie *Case*, 77 YALE L.J. 70, 84 (1967).

[22] ROBERT H. BORK, THE ANTITRUST PARADOX 387 (1978).

simply, of competing."[23]

*Utah Pie* was not an aberration. As one treatise points out, "Historically, courts approved formulations or jury instructions containing . . . useless formulae" that "provide[d] little or no basis for analyzing the predatory pricing offense."[24]

In 1975, after *Utah Pie* but before *Brooke Group*, Professors Areeda and Turner published a landmark article "attempt[ing] to formulate meaningful and workable tests for distinguishing between predatory and competitive pricing by examining the relationship between a firm's costs and its prices."[25] Their proposal was that, for a firm with monopoly power, "[a] price at or above reasonably anticipated average variable cost should be conclusively presumed lawful," and a price below that cost "should be conclusively presumed unlawful."[26] The rationale was that prices at or above average variable cost[27] exclude less efficient firms while minimizing the likelihood of excluding equally efficient firms.[28]

Notwithstanding the rapidity with which the appellate courts embraced the new Areeda-Turner test[29] and the increasing scholarly criticism of then-prevailing legal doctrine that predatory intent plus an unreasonably low price was sufficient to prove predatory pricing,[30] firms continued to face the risk of antitrust liability for price cutting that appeared to benefit consumers. For instance, in 1983, the Ninth Circuit rejected the notion, espoused by Areeda and Turner, that "prices above average total cost 'should be conclusively presumed legal.'"[31] The court reasoned that "we should hesitate to create a 'free zone' in which monopolists can exploit their power without fear of scrutiny by the law" and that a "rule based exclusively on cost forecloses consideration of other important factors, such as intent, market power, market structure, and long-run behavior in evaluating the predatory impact of a pricing decision."[32] The court accordingly held that "if the challenged prices exceed average total cost, the plaintiff must prove by clear and convincing evidence—i.e., that it is highly probably true—that the defendant's pricing policy was predatory."[33]

But in 1986, the Supreme Court handed down two significant decisions—*Matsushita Electric Industrial Co. v. Zenith Radio Corp.*[34] and *Cargill*[35]—that focused on the relationship between price and cost and the central role that recoupment plays in a successful predation strategy, and thus anticipated by seven years its opinion in *Brooke Group*.[36] In *Matsushita*, the

[23] *Id.*; *see also* Edlin, *supra* note 20, at 953 (the "facts [of *Utah Pie*] suggest vigorous price competition that benefited consumers").

[24] AREEDA & HOVENKAMP, *supra* note 1, ¶ 723d, at 276–77.

[25] Areeda & Turner, *supra* note 5, at 699–700, *see also* June 22 Hr'g Tr., *supra* note 4, at 8 (Elzinga) (stating that Areeda and Turner's 1975 article on predatory pricing is "the most often cited article in antitrust scholarship").

[26] Areeda & Turner, *supra* note 5, at 733.

[27] DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 29 (4th ed. 2005) (Average variable costs are the "costs that change with the level of output.").

[28] Areeda & Turner, *supra* note 5, at 711, 716–18.

[29] *See, e.g.*, Bolton et al., *supra* note 14, at 225 ("The Areeda-Turner rule had an immediate impact on the courts."); William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1, 46 ("In 1975, Areeda and Turner published a proposal that courts use the relationship of the dominant firm's prices to its variable costs to determine the legality of a challenged pricing strategy. Within months of the article's publication, two courts of appeals relied heavily on the paper to dismiss predatory pricing allegations.").

[30] *See generally* Richard O. Zerbe, Jr. & Michael T. Mumford, *Does Predatory Pricing Exist? Economic Theory and the Courts After* Brooke Group, 41 ANTITRUST BULL. 949, 949–50 (1996) (summarizing the pre-*Brooke Group* criticism).

[31] Transamerica Computer Co. v. IBM, 698 F.2d 1377, 1386 (9th Cir. 1983). Average total cost is total fixed and total variable costs, divided by quantity of output. *Id.* at 1384.

[32] *Id.* at 1387.

[33] *Id.* at 1388.

[34] 475 U.S. 574 (1986).

[35] 479 U.S. 104 (1986).

[36] *See* June 22 Hr'g Tr., *supra* note 4, at 8 (Elzinga) (describing *Matsushita* and the Areeda and Turner

Court affirmed the grant of summary judgment in favor of defendants on a claim that a group of twenty-one Japanese television manufacturers and U.S. subsidiaries had engaged in a twenty-year predatory-pricing conspiracy,[37] noting in the process that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."[38] Similarly, *Cargill* contains an extensive discussion of why predatory pricing rarely succeeds.[39] In particular, the Court highlighted two significant obstacles to a successful predation strategy that are not often overcome. First, "[T]o succeed in a sustained campaign of predatory pricing, a predator must be able to absorb the market shares of its rivals once prices have been cut."[40] Second, "It is also important to examine the barriers to entry into the market, because 'without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time.'"[41]

Three years after *Matsushita* and *Cargill*, Professors Elzinga and Mills proposed that the feasibility of recoupment be used as a complement to the Areeda-Turner below-average-variable-cost requirement.[42] Under their recoupment-feasibility test, "if a given predatory strategy is an economically implausible investment, as judged by the parameters of the recoupment plan it implies, then the alleged predator is exonerated."[43] Elzinga and Mills viewed this "investment test" as "a check on the internal consistency of a plaintiff's allegations."[44] They pointed out that in predatory pricing, "[t]he predator's short-run loss is an investment in prospective monopoly profits." Consequently, "predatory pricing is attractive to a profit-seeking firm only where it expects enough monopoly profit to earn a return on its investment in predation that equals or exceeds the interest rate that could be earned on alternative investments."[45] In particular, "If it can be shown that a firm has no reasonable prospect for recouping its losses and profiting from its investment, then predatory claims would be discredited."[46]

In 1993, *Brooke Group* presented the Supreme Court with a direct opportunity to consider the then-contemporary legal and economic scholarship on predatory pricing, including the already extant game theoretic literature.[47] The plaintiff in *Brooke Group*, Liggett, contended that a rival cigarette manufacturer had "cut prices on generic cigarettes below cost . . . to force Liggett to raise its own generic cigarette prices and introduce oligopoly pricing in the economy segment."[48] Viewing the evidence in the light most favorable to Liggett, the Court held that the rival cigarette manufacturer was entitled to judgment as a matter of law since "the evidence cannot support a finding that [the rival cigarette manufacturer]'s alleged scheme was likely to result in oligopolistic price coordination and sustained supracompetitive

article as the two events that most changed the thinking regarding predatory pricing).

[37] 475 U.S. at 590–92 ("In order to recoup their losses, petitioners must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices. Two decades after their conspiracy is alleged to have commenced, petitioners appear to be far from achieving this goal: the two largest shares of the retail market in television sets are held by RCA and respondent Zenith. . . . The alleged conspiracy's failure to achieve its ends in the two decades of its asserted operation is strong evidence that the conspiracy does not in fact exist." (citations omitted) (footnote omitted)).

[38] *Id.* at 589. *But see Cargill*, 479 U.S. at 121 ("While firms may engage in [predatory pricing] only infrequently, there is ample evidence suggesting that the practice does occur.").

[39] *See* 479 U.S. at 119–21 n.15; *id.* at 121–22 n.17.

[40] *Id.* at 119 n.15.

[41] *Id.* at 120 n.15 (quoting *Matsushita*, 475 U.S. at 591).

[42] Kenneth G. Elzinga & David E. Mills, *Testing for Predation: Is Recoupment Feasible?*, 34 ANTITRUST BULL. 869 (1989).

[43] *Id.* at 871.

[44] *Id.*

[45] *Id.* at 870.

[46] *Id.* at 872.

[47] *See infra* Part C(1).

[48] 509 U.S. 209, 212 (1993).

pricing in the generic segment of the national cigarette market."[49]

Relying on the principles set forth in both the Areeda and Turner and Elzinga and Mills articles, the Court in *Brooke Group* held that there are "two prerequisites to recovery" where the claim alleges predatory pricing under section 2.[50] Plaintiff must prove that (1) the prices were "below an appropriate measure"[51] of defendant's costs in the short term, and (2) defendant had "a dangerous probability of recouping its investment in below-cost prices."[52] The Court elaborated on the recoupment prerequisite, concluding that "plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it."[53]

**To prevail on a predatory-pricing claim, plaintiff must prove that (1) the prices were below an appropriate measure of defendant's costs in the short term, and (2) defendant had a dangerous probability of recouping its investment in below-cost prices.**

By establishing these basic prerequisites, *Brooke Group* brought needed rigor and order to predatory-pricing law. Importantly, while the Court in *Brooke Group* recognized that there can be occasions when above-cost pricing theoretically could hurt consumers, it also concluded that there is no reliable way to distinguish between above-cost predatory pricing and legitimate price discounting.[54] Thus, any rule permitting findings of above-cost predation, the Court reasoned, could discourage desirable price competition. The Court concluded that above-cost predatory-pricing schemes may be "beyond the practical ability of a judicial tribunal to control"[55] and created a safe harbor for pricing above cost.

Also importantly, by limiting liability to prices below a short-run measure of incremental cost, the Court implicitly rejected the idea that liability in this context could be based on a failure to maximize profits.[56] Evidence that defendant would have been better off at least in the short run by shutting down production provides a reasonable indication that there might be harmful exclusion. It is a far different step—and one the Court rejected—to base liability on an ex post evaluation of the relative profitability of another potential course of action that defendant might not have even considered at the time.[57]

Some have suggested that since *Brooke Group* it has become unnecessarily difficult for plaintiffs to prove predatory pricing.[58] Another commentator, however, suggests that this view is unsupported, arguing that, even under *Brooke Group*, plaintiffs still "can strategically misuse predatory pricing law to coerce more efficient rivals to forgo . . . price cuts."[59]

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[49] *Id.* at 243.

[50] *Id.* at 222–27.

[51] *Id.* at 222.

[52] *Id.* at 224.

[53] *Id.* at 225.

[54] *See id.* 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 . . . or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting.").

[55] *Id.* The Court strongly reiterated this conclusion in *Weyerhaeuser*, 127 S. Ct. 1069, 1074 (2007), and *Trinko*, 540 U.S. 398, 414 (2004).

[56] *Brooke Group*, 509 U.S. at 223.

[57] *See* June 22 Hr. Tr., *supra* note 4, at 52 (Melamed).

[58] Bolton et al., *supra* note 14, at 2241–49; Edlin, *supra* note 20, at 941–942.

[59] Crane, *supra* note 8, at 1; *see also id.* at 4–5 (noting that "although it is accepted wisdom that no predatory pricing plaintiff has won a verdict since Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., plaintiffs have recently won some predatory pricing cases and procured substantial settlements in others. Additionally, regardless of their low probability of success, plaintiffs continue to file a significant number of federal predatory pricing cases, suggesting that predatory pricing complaints may afford plaintiffs strategic advantages whether or not they ultimately prevail.") (footnote omitted).

Since *Brooke Group*, a significant issue in the lower courts has been defining the "appropriate measure" of cost, an issue the Court expressly did not resolve in *Brooke Group*. In 2003, the Tenth Circuit noted in *United States v. AMR Corp.*, "Despite a great deal of debate on the subject, no consensus has emerged."[60]

In *AMR*, the Tenth Circuit affirmed a grant of summary judgment in favor of an established airline that allegedly engaged in a scheme of price cutting and predatory-capacity additions designed to drive out a start-up airline. The Tenth Circuit held that the government had not established "pricing below an appropriate measure of cost."[61]

The Court "decline[d] to dictate a definitive cost measure for all cases."[62] It observed that average variable cost is a "commonly accepted proxy for marginal cost in predatory pricing cases,"[63] citing Areeda and Turner's 1975 article. But it also cautioned that "[w]hatever the proxy used to measure marginal cost, it must be accurate and reliable in the specific circumstances of the case at bar."[64]

In particular, the court emphasized that "[s]ole reliance on AVC [average variable cost] as the appropriate measure of cost may obscure the nature of a particular predatory scheme and, thus . . . we do not favor AVC to the exclusion of other proxies for marginal cost."[65] The court rejected several proposed measures of incremental costs and revenues attributable to allegedly predatory capacity additions in part because they would be equivalent to applying an average total cost test "implicitly ruled out by *Brooke Group*'s mention of incremental costs only."[66]

In another recent case in which an established air carrier allegedly engaged in predation against a new competitor, the Sixth Circuit took a different approach. Applying a "modified version of the Areeda-Turner test," the court seemed open to the possibility of a price being illegal under section 2 even if it is above average variable cost, so long as it is below average total cost:

> If the defendant's prices were below average total cost but above average variable cost, the plaintiff bears the burden of showing defendant's pricing was predatory. If, however, the plaintiff proves that the defendant's prices were below average variable cost, the plaintiff has established a prima facie case of predatory pricing and the burden shifts to the defendant to prove that the prices were justified without regard to any anticipated destructive effect they might have on competitors.[67]

### C. Analysis

Six key issues animate the structuring of a rule under section 2 that provides clear and sound guidance regarding predatory pricing: (1) the frequency of predatory pricing, (2) treatment of above-cost pricing, (3) cost measures, (4) recoupment, (5) potential defenses, and (6) equitable remedies. This part of the chapter describes the legal and economic analysis pertinent to each of these issues.

#### 1. Frequency of Predatory Pricing

As one commentator notes, "A key premise in developing an enforcement policy for predatory pricing is the expected frequency and severity of its occurrence."[68] Some commentators maintain that the Court's statement in *Matsushita* that "predatory pricing schemes are rarely tried, and even more rarely successful"[69] is "not justified by the available data"[70] and that there is "little reason to accept the comforting view that predation very rarely

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[60] 335 F.3d 1109, 1115 (10th Cir. 2003).

[61] *Id.* at 1120.

[62] *Id.* at 1116.

[63] *Id.* at 1116 & n.7.

[64] *Id.* at 1116.

[65] *Id.*

[66] *Id.* at 1119.

[67] Spirit Airlines, Inc. v. Nw. Airlines, Inc., 431 F.3d 917, 938 (6th Cir. 2005).

[68] Bolton et al., *supra* note 14, at 2243.

[69] 475 U.S. 574, 589 (1986).

[70] Richard O. Zerbe, Jr., *Monopsony and the* Ross-Simmons *Case: A Comment on Salop and Kirkwood*, 72 ANTITRUST L.J. 717, 717 (2005); *see also* Zerbe & Mumford, *supra* note 30, at 955–64, 982–85 (noting that "there is theoretical and empirical evidence to refute" the Court's statement).

or never occurs in reality."[71] However, others argue that regardless of how often predatory-pricing schemes are attempted, successful predation—predation that causes consumer harm—is indeed rare.[72]

This controversy over the frequency and severity of predatory pricing has existed since at least 1958.[73] That year, economist John McGee published a seminal article arguing that predatory pricing is not a rational business strategy, and hence is rare or nonexistent,[74] because the monopolist, by cutting prices, loses more than its prey: "To lure customers away from somebody, [the monopolizing firm] must be prepared to serve them himself. The monopolizer thus finds himself in the position of selling more—and therefore losing more—than his competitors."[75] Thus, in the words of Judge Bork, "predatory price cutting is most unlikely to exist," and we should instead "look for methods of predation which do not require the predator to expand output and incur disproportionately large costs."[76]

Modern economic game theory models, developed in the 1980s, counter the view that predatory pricing cannot be a rational business strategy.[77] These models provide theoretical support for the proposition that a monopolist may be willing to trade off current and future profits under certain circumstances. When it induces the exit of a recent entrant or deters future entrants, according to these models, predatory pricing can be a successful and rational strategy that maximizes long-run profits. As one commentator explains:

> Thus, for example, a firm in an industry with rapid product change might cut prices sharply in answer to new entry in order to discourage the new entrant from continuing an active product development programme. Whether the entrant attributes its lack of profitability to its high costs, to weak market demand, to overcapacity in the industry, or to aggressive behaviour by its competitor, it will properly reduce its estimate of its future profits. If its capital has other good uses, this might lead it to withdraw from the industry. If not, it may nevertheless be dissuaded from making new investments in and developing [n]ew products for the industry. At the same time, other firms may be deterred from entering the industry. If *any* of these things happen, the predator benefits.[78]

Other economists, however, are less sanguine about the ability of modern game

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[71] William J. Baumol, *Principles Relevant to Predatory Pricing*, *in* SWEDISH COMPETITION AUTHORITY, THE PROS AND CONS OF LOW PRICES 15, 35 (2003); *see also* June 22 Hr'g Tr., *supra* note 4, at 58 (Bolton) ("[T]here has been new scholarship started in the 1980s, rigorous economic scholarship based on rigorous game theory analysis showing exactly how predatory pricing strategy could be rational, and . . . slowly, this literature is being brought in, is being acknowledged, and is being recognized, and so . . . today, we should be less skeptical about the rationale for predatory pricing than we have been and that the Supreme Court has been in its *Brooke* decision and its *Matsushita* decision, which was based on older writing which couldn't be articulated using the tools of modern game theory."); Thomas B. Leary, *The Dialogue Between Students of Business and Students of Antitrust: A Keynote Address*, 47 N.Y.L. SCH. L. REV. 1, 13 (2003).

[72] *See* Kenneth G. Elzinga, Remarks 3 (June 23, 2006) (hearing submission) ("In my experience, if one plays with the math behind most alleged episodes of predatory pricing, it is difficult to come up with examples where recoupment is mathematically possible."). *See generally* JOHN R. LOTT, JR., ARE PREDATORY COMMITMENTS CREDIBLE? 4–10 (1999).

[73] *See* AREEDA & HOVENKAMP, *supra* note 1, ¶ 723b, at 273 & nn.7–9.

[74] McGee, *supra* note 10.

[75] *Id*. at 140.

[76] BORK, *supra* note 22, at 155; *see also* Frank H. Easterbrook, *When Is It Worthwhile to Use Courts to Search for Exclusionary Conduct?*, 2003 COLUM. BUS. L. REV. 345, 346–47 ("Claims that the long run will depart from the short run are easy to make but hard to prove. . . . If monopolistic prices happen later, prosecute then."); Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 263–64 (1981) [hereinafter *Predatory Strategies*] ("[T]here is no sufficient reason for antitrust law or courts to take predation seriously.").

[77] *See, e.g.*, Paul Milgrom & John Roberts, *Predation, Reputation, and Entry Deterrence*, 27 J. ECON. THEORY 280, 303 (1982); David M. Kreps & Robert Wilson, *Reputation and Imperfect Information*, 27 J. ECON. THEORY 253 (1982).

[78] Paul Milgrom, *Predatory Pricing*, *in* 3 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 937, 938 (John Eatwell et al. eds., 1987) (emphasis in original).

theoretic models to distinguish between predatory pricing and benign price discounting. Thus, one commentary argues, "Although strategic theories of predatory pricing are exemplary in their coherence and rigor, their potential to add value to antitrust policy is much more modest than the authors admit."[79] This is because the strategic theories of predatory pricing that underlie these game theoretic models "are so fragile," relying on strict assumptions that may not be met in the real world.[80]

One panelist suggested that these economic models could help identify predatory pricing,[81] while acknowledging that the "formal economic proof of the theories is complex."[82] Most panelists, however, expressed concern regarding the practical utility of many of these models. As one panelist put it, "[W]e should take the learning of these models and figure out what they mean in terms of implementable rules."[83] He also noted,

> [W]e come back to the question . . . [of] how to translate it into something that a businessperson, who has to be counseled, will be able to understand in day-to-day operations, and how [a] Court [will] be able to take these principles of game theory, subgame perfect[] Nash equilibria and all these things, and translate it into some simple rules that . . . thou shall not do what?[84]

As Judge Posner notes, "[R]ecent scholarship has brought to light a nontrivial number of cases of predatory pricing."[85] As another commentary puts it, "Even were empirical evidence lacking, one should be cautious in saying that predation does not exist today since theory suggests that it can occur."[86] Indeed, the

[79] Kenneth G. Elzinga & David E. Mills, *Predatory Pricing and Strategic Theory*, 89 GEO. L.J. 2475, 2475 (2001).

[80] *Id.* at 2494; *see also id.* at 2493–94 (noting that they are "pristine theoretical existence proofs" and "require[] more factual support than the authors admit" and require compliance with strict assumptions that may not be likely to be met in the real world); *id.* at 2478 ("These theories typically assume an extremely simple market structure. . . . While this stylized market structure yields sufficient conditions to sustain the plausibility of predatory pricing, the plausibility does not transfer automatically to other generally more complex market structures."); *id.* at 2477–78 ("The foundational assumption upon which most strategic theories of predation rest is either asymmetric information or asymmetric access to financial resources. . . . Before the authority of a strategic theory can be invoked in a particular dispute, it must be established that the information or financial resource condition in the market square[s] with the theory." (internal quotation marks omitted)).

[81] *See* June 22 Hr'g Tr., *supra* note 4, at 58 (Bolton).

[82] Bolton et al., *supra* note 14, at 2248.

[83] June 22 Hr'g Tr., *supra* note 4, at 67–68 (Ordover).

[84] *Id.* at 67 (Ordover); *see also id.* at 74 (Melamed) (noting the difficulty of implementing a game theory model); Sherman Act Section 2 Joint Hearing: Business Testimony Hr'g Tr. 187, Feb. 13, 2007 [hereinafter Feb. 13 Hr'g Tr.] (Sewell) ("The laws [to which] we're seeking to conform need to be understandable by the people who are asked to adhere to them.").

[85] POSNER, *supra* note 2, at 214; *see also* Malcolm R. Burns, *New Evidence of Price-Cutting*, 10 MANAGERIAL & DECISION ECON. 327, 327 (1989) (letters between officers of the tobacco trust show predatory intent); Malcolm R. Burns, *Predatory Pricing and the Acquisition Cost of Competitors*, 94 J. POL. ECON. 266, 268–69 (1986) (the tobacco trust between 1891 and 1901 engaged in profitable predation); Kenneth G. Elzinga & David E. Mills, *Predatory Pricing in the Airlines Industry:* Spirit Airlines v. Northwest Airlines, *in* THE ANTITRUST REVOLUTION 219, 244 (John E. Kwoka & Lawrence J. White eds., 5th ed. 2008) ("[T]he facts in *Spirit v. Northwest* feature the exit of a viable competitor and a subsequent increase in prices."); David Genesove & Wallace P. Mullin, *Predation and Its Rate of Return: The Sugar Industry, 1887–1914*, 37 RAND J. ECON. 47, 67 (2006) (the American Sugar Refining Company engaged in predatory pricing); Fiona Scott Morton, *Entry and Predation: British Shipping Cartels 1879–1929*, 6 J. ECON. & MGMT. STRATEGY 679, 714 (1997) ("The evidence on price wars in the early liner shipping industry suggests they were predatory in nature."); Balder Von Hohenbalken & Douglas S. West, *Empirical Tests for Predatory Reputation*, 19 CAN. J. ECON. 160, 176 (1986) (describing empirical evidence that "having a reputation for aggressiveness created by earlier spatial predation" discourages "new entry by other firms"); David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894–1912*, 102 J. POL. ECON. 103, 103 (1994) ("Southern Bell effectively eliminated competition through a strategy of pricing below cost in response to entry. . . ."); B. S. Yamey, *Predatory Price Cutting: Notes and Comments*, 15 J.L. & ECON. 129, 137–42 (1972) (a conference of shipowners in the China-England trade in the 1880s engaged in predatory pricing).

[86] Zerbe & Mumford, *supra* note 30, at 956.

consensus at the hearings, and the predominant (but by no means unanimous) view among commentators, is that, in certain circumstances, predatory pricing can be a rational strategy for a firm with monopoly power facing a smaller competitor.[87]

**In certain circumstances, predatory pricing can be a rational strategy for a firm with monopoly power facing a smaller competitor.**

Although theoretically a rational strategy, actual evidence on the frequency of predatory pricing, nonetheless, is limited. "Since *Brooke Group* was decided in 1993, at least fifty-seven federal antitrust lawsuits alleging predatory pricing have been filed."[88] Because publicly available data about all predatory-pricing claims or allegations are limited, it is impossible to determine whether this number either supports or refutes the conclusion that "evidence regarding predation does not suggest it is either rare or unsuccessful."[89] In addition, as one antitrust scholar notes, "[I]t is impossible to be certain how pervasive predation would be or how long its effects would endure" because "[a]ny studies of business behavior today are affected by the fact that predatory pricing is illegal."[90]

However, certain market characteristics may contribute to potentially successful predatory pricing.[91] For example, in markets where information is imperfect, a predator can mislead potential entrants into thinking that market conditions are unfavorable when they are not or that the predator's costs are lower than they actually are.[92] Also, the predator can engage in "reputation-effect" predation by building a reputation that discourages future entrants from entering the market because they fear that they will suffer the same fate as earlier victims.[93] This may occur when "the entrants [are] less than certain that they are correct in modeling the established firm as rationally choosing between predation and peaceful coexistence."[94] Where potential rivals refrain from entering simply because they fear the "retribution" of the dominant firm,[95] the dominant firm's reputation as a predator itself operates as an entry barrier.[96]

[T]hink of it this way. You are walking

[87] *See, e.g.*, June 22 Hr'g Tr., *supra* note 4, at 31 (Bolton) ("I would argue that over time, things have moved in the direction of thinking of predatory pricing as being more prevalent than we thought and also more likely to succeed than we thought before . . . ."); *id.* at 55–56 (Elzinga); *see also, e.g.*, CARLTON & PERLOFF, *supra* note 27, at 360 ("[I]t is a mistake to think of price predation as inconceivable.").

[88] Crane, *supra* note 8, at 6.

[89] Zerbe & Mumford, *supra* note 30, at 957; *see also* Bolton et al., *supra* note 14, at 2258–59 (noting that in the six years following the 1993 *Brooke Group* decision, defendants won thirty-six of thirty-nine reported decisions; two cases settled after plaintiffs' claims survived motions for summary judgment; and the disposition of the remaining case was uncertain).

[90] Crane, *supra* note 8, at 39; *see also id.* at 38–39 ("The incidence of costs of predatory pricing in a regime without any predatory pricing prohibition . . . remains highly speculative" and "is unlikely to be ascertained empirically except by reference to historical case studies of particular firms from the time period before the adoption of the Sherman Act, since predatory pricing has long been illegal . . . ." (footnote omitted)). *Accord* POSNER, *supra* note 2, at 214; Bolton et al., *supra* note 14, at 2247.

[91] *See generally* AREEDA & HOVENKAMP, *supra* note 1, ¶ 723c.

[92] *See* Bolton et al., *supra* note 14, at 2248–49.

[93] *The Current State of Economics Underlying Section 2: Comments of Michael Katz and Michael Salinger*, ANTITRUST SOURCE, Dec. 2006, at 1, 5, http://www.abanet.org/antitrust/at-source/06/12/Dec06-BrownBag.pdf [hereinafter *Katz & Salinger Comments*]; Bolton et al., *supra* note 14, at 2248 ("In reputation effect predation . . . a predator reduces price in one market to induce the prey to believe that the predator will cut price in its other markets or in the predatory market itself at a later time, thereby enabling multimarket recoupment of predatory losses.").

[94] Milgrom & Roberts, *supra* note 77, at 302; *see also* Bolton et al., *supra* note 14, at 2301 n.271.

[95] *See Katz & Salinger Comments*, *supra* note 93, at 5.

[96] *See* Sherman Act Section 2 Joint Hearing: Academic Testimony Hr'g Tr. 12, Jan. 31, 2007 [hereinafter Jan. 31 Hr'g Tr.] (Farrell) ("[E]verybody recognizes that if [Spirit] enters and offers the three hundred dollar deal, Northwest will cut its price to two hundred dollars. . . . So, [Spirit] anticipates that, doesn't enter, and consumers continue to pay five hundred dollars.").

> along and you want to have a picnic, and there's a sign that says, "No trespassing." . . . You throw down your blanket, you have a nice picnic, and you leave, right?
>
> Now you are walking along and there's another field where you want to have a picnic and there's a no trespassing sign, and there are about four or five corpses lying around. Are you going to have a picnic there? I don't think so.[97]

As a result, by predating in one or more markets, the monopolist potentially can defend many of its other markets from entry, making predation more profitable.[98] And in any market where entry barriers are high, there will be greater opportunity for the monopolist to recoup whatever investment it makes in below-cost pricing.[99]

The Department concurs with the panelists and the vast majority of commentators that, absent legal proscription, predatory pricing can occur in certain circumstances. Accordingly, it is necessary to develop rules for distinguishing between legitimate discounting and unlawful predation.

#### 2. Above-Cost Pricing

While acknowledging the theoretical possibility that above-cost pricing may sometimes reduce welfare, the Court in *Brooke Group* held that above-cost pricing does not violate section 2 because condemning it would chill desirable discounting: "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 . . . or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting."[100] Over a decade later, in *Weyerhaeuser*, the Court pointed out that in *Brooke Group*, "[w]e were particularly wary of allowing recovery for above-cost price cutting because such claims could, perversely, 'chil[l] legitimate price cutting,' which directly benefits consumers."[101]

Thus, *Brooke Group* created a safe harbor for above-cost pricing, concluding that reliably distinguishing between welfare-enhancing and welfare-decreasing above-cost pricing was impractical and counterproductive. As one commentator notes, "Even though one can easily construct theoretical models of above-cost predatory pricing, antitrust authorities treat above-cost pricing decisions as a safe harbor, not to be challenged."[102]

Some commentators advocate revisiting *Brooke Group*'s safe harbor for above-cost pricing. They contend that economic theory now can reliably be used to identify and efficiently prosecute anticompetitive above-cost pricing.[103] One economist, for example, asserts that above-cost predation is possible "where rivals have higher costs than an incumbent monopoly."[104] He proposes preventing an incumbent monopolist from charging prices above its costs if preventing it from doing so would facilitate entry by new competitors.

> In markets where an incumbent monopoly enjoys significant advantages over potential entrants, but another firm enters and provides buyers with a substantial discount, the monopoly should be prevented from responding with substantial price cuts or significant product enhancements until the entrant has had a reasonable time to recover its entry costs and become viable, or until the entrant's share grows enough so that the monopoly loses its dominance.[105]

However, others strongly disagree. One

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[97] Sherman Act Section 2 Joint Hearing: Monopoly Power Session Hr'g Tr. 191, Mar. 7, 2007 (Stelzer).

[98] *See* Jonathan B. Baker, *Predatory Pricing After* Brooke Group*: An Economic Perspective*, 62 ANTITRUST L.J. 585, 590 (1994).

[99] AREEDA & HOVENKAMP, *supra* note 1, ¶ 723c.

[100] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

[101] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069, 1074 (2007) (alteration in original) (citing *Brooke Group*, 509 U.S. at 222–23).

[102] Dennis W. Carlton, *Does Antitrust Need to Be Modernized?*, J. ECON. PERSP., Summer 2007, at 155, 160.

[103] Some commentators are particularly concerned about possible above-cost predation with products such as software or pharmaceuticals that have large fixed costs but very low marginal costs. This is discussed further below at part C(3)(c) in connection with long-run average incremental cost.

[104] Edlin, *supra* note 20, at 963.

[105] *Id.* at 945.

commentator concludes:

> Even when incumbents do have market power, restrictions on their ability to adopt reactive above-cost price cuts are unlikely to achieve the objective of encouraging and protecting entry because less efficient entrants cannot survive in the long run, and entrants who are (or will predictably become) more efficient need no encouragement or protection.[106]

As then-Judge Breyer once explained:

> In sum, we believe that such above-cost price cuts are typically sustainable; that they are normally desirable (particularly in concentrated industries); that the "disciplinary cut" is difficult to distinguish in practice; that it, in any event, primarily injures only higher cost competitors; that its presence may well be "wrongly" asserted in a host of cases involving legitimate competition; and that to allow its assertion threatens to "chill" highly desirable procompetitive price cutting.[107]

Most panelists concluded that "[p]rices above some measure of cost . . . should not be considered predatory."[108] They largely agreed that "[administrability] is a serious concern,"[109] that current game theory models "do not give a clear reading on cost benchmarks,"[110] and that it is still not within "the practical ability of a judicial tribunal to control" above-cost predatory pricing "without courting intolerable risks of chilling legitimate price cutting."[111] The Department sees no reason to revisit *Brooke Group* under these circumstances.

**Most panelists concluded that prices above some measure of cost should not be considered predatory.**

Moreover, even if beneficial above-cost price cutting and deleterious predatory pricing could be distinguished after the fact, the Department does not believe that there is a practical, readily applicable test businesses can use to determine whether their above-cost prices are legal at the time they are making pricing decisions.[112] For example, under the approach one commentator describes, the legality of above-cost price cuts could depend, in part, on whether the price cut permits an entrant "reasonable time" to recover its "entry costs" or "become viable," or capture sufficient market share so that the price-cutting firm "loses its dominance."[113] However, an incumbent firm is unlikely to be able to make this determination with any confidence, even assuming it has all relevant data about its rivals, which it usually will not.

If firms can violate section 2 by pricing above cost, this likely will discourage

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[106] Einer Elhauge, *Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory—and the Implications for Defining Costs and Market Power*, 112 YALE L.J. 681, 826 (2003).

[107] Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 235–36 (1st Cir. 1983) (Breyer, J.).

[108] June 22 Hr'g Tr., *supra* note 4, at 72. Although one panelist disagreed that "prices above average variable cost should not be considered as predatory," *id.* at 72 (Bolton), he "would not object to a rule that says price above average total cost is per se legal as a way of implementing an easily administrable rule," *id.* at 75.

[109] *Id.* at 75 (Bolton); *see also id.* at 99 (Ordover) ("I think at this point we have enough learning to try to go back to first principles and try to understand what it is that we are trying to accomplish, taking full account of the [administrability] of whatever provisions are going to ultimately be developed . . . .").

[110] *Id.* at 73 (Bolton); *see id.* (Ordover); *see also id.* (Bolton) (adding, however, that focusing on cost may not be an effective way of distinguishing between procompetitive and anticompetitive effects).

[111] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993); *see also* June 22 Hr'g Tr., *supra* note 4, at 74 (Melamed) ("I understand the theory, even if I cannot understand the game theory, of why an above cost . . . test could be predatory. . . . What I don't understand . . . is how one turns that into a legal rule that companies can comply with."); *id.* at 75 (Bolton).

[112] *See* June 22 Hr'g Tr., *supra* note 4, at 67–68, 74 (Ordover); *id.* at 74 (Melamed).

[113] *See, e.g.*, Edlin, *supra* note 20, at 945. This commentator notes, however, that "for the sake of correctness in application, this Essay usually assumes that if an entrant prices twenty percent below an incumbent monopoly, the incumbent's prices will be frozen for twelve to eighteen months." *Id.* at 945–46. "The exact operationalization of the rule," however, "could vary by industry or be decided on a case-by-case basis. The price freeze might also be adjusted for inflation in periods of high inflation or for substantial industry-specific price trends." *Id.* at 946 n.19.

aggressive price discounting that benefits consumers. As was noted at the hearings, sometimes firms with monopoly power will not lower their prices to consumers because they are worried about false condemnations.[114] Such a result harms consumer welfare and justifies a safe harbor for above-cost pricing.[115]

The Department believes that above-cost pricing should remain per se legal. Aggressive price cutting is central to a properly functioning market.[116] Consequently, it is critical that enforcement against predatory pricing avoids chilling procompetitive price discounting to the extent reasonably possible. The Department, therefore, will intervene only in those instances where prices are below an appropriate measure of cost, in addition to meeting the other elements of a price-predation claim.

**The Department believes that above-cost pricing should remain per se legal.**

### 3. Appropriate Measure of Cost

#### a. Analytical Considerations

The Department believes three factors bear on the appropriate measure of cost to use in the price-cost test for predatory pricing. First, the cost measure should help reveal whether the firm made unprofitable sales—or, to be more precise, whether the firm's sales were economically irrational but for their apparent exclusionary effect.

Second, the cost measure should help identify situations in which the firm's pricing would force the exit of a rival that could produce the additional output resulting from the pricing strategy (i.e., the predatory increment) as efficiently as the monopolist. An efficient firm should not be prohibited from reducing its prices based on claims that a rival could become equally efficient in the future, as such claims are too speculative to support a finding of section 2 liability and would sacrifice current consumer benefits for uncertain future gains.[117]

Both of these factors point to a focus on some form of incremental cost. *Brooke Group*[118] and its precursors,[119] while not prescribing any particular cost measure, nonetheless are predicated upon the notion, perhaps best expressed by then-Judge Breyer in *Barry Wright*, that "modern antitrust courts look to the relation of price to 'avoidable' or 'incremental' costs as a way of segregating price cuts that are 'suspect' from those that are not."[120] This is because, in general, if

> a firm charges prices that fail to cover these "avoidable" or "incremental" costs—the costs that the firm would save by not producing the additional product it can sell

[114] *See* June 22 Hr'g Tr., *supra* note 4, at 68–69 (Melamed) (acknowledging some chilling of procompetitive discounting but refraining from comparing the magnitude of harm from false positives and false negatives); *see also* Crane, *supra* note 8, at 10.

[115] *Cf.* Crane, *supra* note 8, at 32 ("In sum, the available information on lawyer fee structures in post-*Brooke Group* predatory pricing cases supports two hypotheses regarding the Chicago School predatory pricing precedents: First, that the potential for substantial plaintiff's verdicts in predatory pricing cases remains, and second, that some firms use predatory pricing complaints strategically to diminish price competition by competitors."). Available evidence, however, suggests that in recent years liability findings on claims involving predatory pricing have been rare. *See supra* Part I(C)(1).

[116] *Cf.* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986) (noting that "cutting prices in order to increase business often is the very essence of competition").

[117] *Cf.* Elhauge, *supra* note 106, at 784 (suggesting no need to protect from incumbent's above-cost price cuts an entrant who will eventually become more, or as, efficient as the incumbent since capital markets already successfully take that into account); *id.* at 782–92.

[118] 509 U.S. 209, 223 (1993) ("Although *Cargill* and *Matsushita* reserved as a formal matter the question whether recovery should *ever* be available . . . when the pricing in question is above some measure of incremental cost, the reasoning in both opinions suggests that only below-cost prices should suffice . . . ." (citations omitted) (internal quotation omitted) (emphasis in original)).

[119] *Matsushita*, 475 U.S. at 585 n.9 ("We do not consider whether recovery should *ever* be available on a theory such as respondents' when the pricing in question is above some measure of incremental cost." (emphasis in original)); Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 117 n.12 (1986) (same).

[120] Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 232 (1st Cir. 1983) (Breyer, J.).

> at that price . . . . [t]hen one would know that the firm cannot rationally plan to maintain this low price; if it does not expect to raise its price, it would do better to discontinue production.[121]

As a consequence, there is general agreement that the appropriate measure of cost in any price-cost test for predatory pricing is "some kind of incremental cost."[122]

The third factor is administrability. Businesses must have rules that they can readily apply at the time of their conduct to know with a reasonable degree of confidence whether their pricing will be deemed predatory. As one panelist stressed, it is valuable in "saying to the client, when I'm talking about costs, 'What are the costs you are incurring to engage in the strategy at issue *that you wouldn't otherwise have incurred*?' Clients understand that question, and it's not always a trivial question, but I think it's one they can answer."[123] In addition, courts and enforcers must be able to assess whether the rules were applied properly. "A rule that cannot be intelligibly applied invites confusion and quixotic results . . . ."[124]

Panelists emphasized that this third consideration is as important as the first two.[125] One panelist noted:

> [I]t is absolutely essential that we take these models and we translate them into principles that are implementable by the business people, by the lawyers and by the courts. Otherwise, we are nowhere, and . . . what we have been struggling with is trying to come to articulation of some principles that are actually understandable . . . .[126]

The issue, then, is what kind of incremental cost best serves the above three goals.

#### b. Average Total Cost

Given the above factors, the Department agrees with the many courts and commentators concluding that pricing above average total cost—total cost divided by total output—should be per se legal.[127] Moreover, even pricing below average total cost frequently may be economically rational.[128] A price below average total cost would often be cash-flow positive for an equally efficient competitor. Such a rival would find it more advantageous in the short run to continue producing than to exit. Accordingly, since lower prices will always provide short-term benefits to consumers, the Department believes that merely showing that prices are below average total cost should not be sufficient to support a finding of liability.

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[121] *Id.*

[122] June 22 Hr'g Tr., *supra* note 4, at 44–45 (Melamed).

[123] *Id.* at 46 (emphasis added).

[124] AREEDA & HOVENKAMP, *supra* note 1, ¶ 736d, at 392.

[125] June 22 Hr'g Tr., *supra* note 4, at 74 (Melamed); *see also id.* at 75 (Bolton); Sherman Act Section 2 Joint Hearing: Section 2 Policy Issues Hr'g Tr. 77–79, May 1, 2007 [hereinafter May 1 Hr'g Tr.] (Baker) (discussing difficulties in administering price-cost test in predatory-pricing cases); Feb. 13 Hr'g Tr., *supra* note 84, at 187 (Sewell).

[126] June 22 Hr'g Tr., *supra* note 4, at 67 (Ordover).

[127] *See, e.g.*, United States v. AMR Corp., 335 F.3d 1109, 1117 (10th Cir. 2003) (asserting that *Brooke Group*'s focus on incremental costs "implicitly ruled out" above-total-cost pricing as a basis for antitrust liability); AREEDA & HOVENKAMP, *supra* note 1, ¶ 723d2, at 280 ("Dicta in the Supreme Court's *Brooke* decision appears to have settled this matter for all prices higher than average total cost."); *id.* ¶ 739c3, at 420 ("But numerous lower courts have concluded that condemning prices greater than average total cost—that is, fully profitable prices—unwisely invites plaintiffs into protracted litigation and close questions about the precise location of marginal cost and the reasons for such prices. The prospect of such litigation serves to deter legitimate, pro-competitive price cutting." (footnote omitted)); *see also* June 22 Hr'g Tr., *supra* note 4, at 75 (Bolton) ("I would not object to a rule that says price above average total cost is per se legal as a way of implementing an easily administrable rule.").

[128] June 22 Hr'g Tr., *supra* at note 4, at 8–9 (Elzinga) ("Let's say . . . that this [television] set was sold by Toshiba . . . to Sears for $95, and the average total cost was $100, but the average variable cost was $90 . . . . Almost everyone at the time believed Toshiba was selling below cost. . . . And it took an instinct for economic reasoning or a recollection of a price theory course to realize that such a price was above the shut-down point, it was cash flow positive, and that Toshiba was better off making the sale to Sears than not making that sale . . . .").

#### c. Measures of Incremental Cost

The four most frequently suggested incremental-cost measures are: (1) marginal cost, (2) average variable cost, (3) long-run average incremental cost, and (4) average avoidable cost. Each seeks to ascertain what it would cost a firm to make additional units of output.

***Marginal Cost.*** For each unit sold, marginal cost is the additional cost of producing that unit.[129] It refers to short-run marginal cost—the change in cost that results from producing a unit of output during a period in which "a firm does not change its fixed cost-productive assets, such as its plant."[130] In other words, fixed costs are not included in determining marginal costs.

Many courts have suggested that marginal cost is the theoretically appropriate measure of cost for evaluating predatory pricing. For example, in *AMR* the Tenth Circuit observed, with qualifications,[131] that marginal cost is "the ideal measure of cost . . . because '[a]s long as a firm's prices exceed its marginal cost, each additional sale decreases losses or increases profits.'"[132] Likewise, a treatise notes that "[m]arginal-cost pricing generally maximizes market efficiency."[133] Hence, "no price equal to or exceeding properly defined and reasonably anticipated marginal cost should be deemed unlawful under the antitrust laws."[134] One panelist also said that marginal cost "really i[s] the right test."[135]

However, as Areeda and Turner pointed out as early as 1975, marginal cost is difficult to determine in most instances.[136] In addition, because marginal cost indicates only the cost of a single unit, comparing price with marginal cost does not indicate whether the alleged predation is causing the firm to lose money on anything but that single unit—normally the last unit produced.

***Average Variable Cost.*** Average variable cost is the total of all the costs that vary when there is a change in the quantity of a particular good produced, divided by the quantity of the goods produced.[137] Average variable cost excludes all fixed costs.[138] Typical costs that vary with changes in output are materials, fuel, labor, repair and maintenance, use depreciation, and per-unit royalties and license fees.[139]

A treatise notes that "[n]umerous decisions have concluded that [average variable cost] is at least the presumptive baseline for determining predation."[140] Average variable cost is favored both as a more workable proxy for marginal cost[141] and because it is instructive in and of

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[129] *E.g.*, Pac. Eng'g & Prod. Co. of Nev. v. Kerr-McGee Corp., 551 F.2d 790, 796 n.7 (10th Cir. 1977) (citing Areeda & Turner, *supra* note 5, at 700); AREEDA & HOVENKAMP, *supra* note 1, ¶ 753b3, at 367; CARLTON & PERLOFF, *supra* note 27, at 783 (defining marginal cost as "the increment, or addition, to cost that results from producing one more unit of output").

[130] AREEDA & HOVENKAMP, *supra* note 1, ¶ 735b1, at 365; *see id.* ¶ 735b3, at 367.

[131] *See infra* note 136.

[132] *AMR*, 335 F.3d at 1116 (alteration in original) (quoting Advo, Inc. v. Phila. Newspapers, Inc., 51 F.3d 1191, 1198 (3d Cir. 1995)); *see also* Spirit Airlines, Inc. v. Nw. Airlines, Inc., 431 F.3d 917, 937–38 (6th Cir. 2005); Stearns Airport Equip. Co. v. FMC Corp., 170 F.3d 518, 532 (5th Cir. 1999); Kelco Disposal, Inc. v. Browning-Ferris Indus. of Vt. Inc., 845 F.2d 404, 407 (2d Cir. 1988), *aff'd on other grounds*, 492 U.S. 257 (1989); McGahee v. N. Propane Gas Co., 858 F.2d 1487, 1504 (11th Cir. 1988); Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050, 1056 (6th Cir. 1984); MCI Commc'ns Corp. v. AT&T, 708 F.2d 1081, 1119–23 (7th Cir. 1983).

[133] AREEDA & HOVENKAMP, *supra* note 1, ¶ 739a, at 412–13.

[134] *Id.*

[135] Feb. 13 Hr'g Tr., *supra* note 84, at 185 (Wark).

[136] *See* Areeda & Turner, *supra* note 5, at 716 (noting that "[t]he incremental cost of making and selling the last unit cannot readily be inferred from conventional business accounts"); *see also AMR*, 335 F.3d at 1116 (acknowledging that "marginal cost, an economic abstraction, is notoriously difficult to measure and 'cannot be determined from conventional accounting methods'" (quoting Ne. Tel. Co. v. AT&T, 651 F.2d 76, 88 (2d Cir. 1981))).

[137] AREEDA & HOVENKAMP, *supra* note 1, ¶ 735b3 ("Variable costs, as the name implies, are costs that vary with changes in output," and "[t]he average variable cost is the sum of all variable costs divided by output." (internal quotation marks omitted)).

[138] *See* Bolton et al., *supra* note 14, at 2271–72.

[139] AREEDA & HOVENKAMP, *supra* note 1, ¶ 735b3, at 366.

[140] *Id.* ¶ 740a, at 425.

[141] *See AMR*, 335 F.3d at 1116; Stearns Airport Equip.

itself in evaluating allegedly predatory pricing.[142]

However, a major shortcoming of average variable cost is that it measures the average cost of the entire output, not just of the incremental output that is the focus of the predation claim.[143] Moreover, using average variable cost frequently requires difficult determinations of whether a particular cost is, in the circumstances involved, fixed or variable. Only the latter is included in calculating the average variable cost. But ascertaining whether a particular expenditure should be classified as fixed or variable is often difficult or at least seemingly somewhat arbitrary.[144] For example, the Second Circuit has held that "the general legal rule is that depreciation caused by use is a variable cost, while the depreciation through obsolescence is a fixed cost," and "the characterization of legitimately disputed costs is a question of fact for the jury."[145]

***Long-run Average Incremental Cost.*** Long-run average incremental cost is the average "cost of producing the predatory increment of output whenever such costs [are] incurred."[146] Unlike average variable cost, it includes all product-specific fixed costs, "even if those costs were sunk before the period of predatory pricing."[147] That is, long-run average incremental cost by definition includes both recoverable and sunk fixed costs.

Long-run average incremental cost has been suggested as the appropriate cost measure when predatory conduct involves intellectual property. The contention is that "the only tenable cost standard" for predatory pricing with regard to intellectual property "must be a long-run cost measure,"[148] because "after the product is developed and launched, [average avoidable cost] or [average variable cost] may approach or equal zero."[149] In computer software, for example, once the software product has been developed "the short-run incremental cost of a program downloaded from the Internet is nil."[150]

In many instances, however, long-run average incremental cost may identify as "predatory" pricing that is actually economically rational apart from any exclusionary effect. Because long-run average incremental cost includes all product-specific sunk fixed costs, a firm pricing below that cost could generate a positive cash flow (i.e., cover its variable costs and make a contribution to its already-sunk fixed costs) and thus would not necessarily be better off by discontinuing or reducing production. Such sales, which a long-run average incremental cost standard might condemn as predatory, would therefore be potentially profitable, and hence reflect no

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Co. v. FMC Corp., 170 F.3d 518, 532 (5th Cir. 1999); *see also* Areeda & Turner, *supra* note 5, at 718 ("[D]espite the possibility that average variable cost will differ from marginal cost, it is a useful surrogate for predatory pricing analysis"); Feb. 13 Hr'g Tr., *supra* note 84, at 185 (Wark) ("I think it's important to recognize that average variable cost is really a proxy for marginal cost because that really i[s] the right test.").

[142] *See* William J. Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 J.L. & ECON. 49, 55–57 (1996); *cf.* Cascade Health Solutions v. PeaceHealth, 515 F.3d 883, 910 (9th Cir. 2008) (holding that the appropriate measure of costs in a "bundled discounting context" is average variable cost).

[143] *See* Baumol, *supra* note 142, at 57–59; *see also* June 22 Hr'g Tr., *supra* note 4, at 32 (Bolton) ("price being below average variable cost[] is a very poor proxy for measuring profit sacrifice, which is what we are trying to go after").

[144] *See* June 22 Hr'g Tr., *supra* note 4, at 82–83 (Elzinga); *id.* at 83 (Ordover).

[145] Kelco Disposal, Inc. v. Browning-Ferris Indus. of Vt., Inc., 845 F.2d 404, 408 (2d Cir. 1988), *aff'd on other grounds*, 492 U.S. 257 (1989); *see also* U.S. Philips Corp. v. Windmere Corp., 861 F.2d 695, 704 (Fed. Cir. 1988) (whether advertising expenses were variable or fixed costs was a question of fact); Sunshine Books, Ltd. v. Temple Univ., 697 F.2d 90, 94–97 (3d Cir. 1982) (whether inventory shrinkage and payroll expenses are variable or fixed costs are questions of fact); Ne. Tel. Co. v. AT&T, 651 F.2d 76, 86 n.12 (2d Cir. 1981) ("Whether a particular expense, e.g., the cost of a new factory, should be classified as variable or fixed depends in part on the time under consideration.").

[146] Bolton et al., *supra* note 14, at 2272.

[147] *Id.* at 2272. "Sunk cost" is "the portion of fixed costs that is not recoverable." CARLTON & PERLOFF, *supra* note 27, at 785.

[148] Bolton et al., *supra* note 14, at 2273.

[149] *Id.* at 2272.

[150] *Id.*

more than economically rational competition, not predation.[151]

***Average Avoidable Cost.*** Average avoidable cost consists of all costs, including both variable costs and product-specific fixed costs, that could have been avoided by not engaging in the predatory strategy. Unlike long-run average incremental cost, average avoidable cost omits all fixed costs that were already sunk before the time of the predation; consequently, average avoidable cost will generally be lower than long-run average incremental cost.

Many have observed that by omitting fixed costs that were sunk before the predatory sales, average avoidable cost appropriately answers the question about avoidable losses.[152] The absence or presence of avoidable losses is the best indicator of whether the firm made or lost money on the additional increment of product, which *Brooke Group* and *Weyerhaeuser* made clear is the critical question in predatory-pricing cases. Moreover, by including all costs that the firm could have avoided by not producing the additional units, average avoidable cost circumvents the difficult issue of whether a particular cost is fixed or variable. This obviates the frequently thorny expense classification that the use of average variable cost often entails. These considerations are no doubt factors in the recent decision of several foreign competition authorities to use average avoidable cost as their preferred measure in predatory-pricing cases.[153]

***Illustrative Application of Different Cost Measures***

The following example illustrates some of these different cost measures. Suppose a dominant firm produces 1,500 units at a variable cost of $8 per unit with no fixed costs. A new firm enters the market. The dominant firm produces an additional 500 units at a variable cost of $10 per unit and sells 2,000 units at a price of $9.50 per unit. Since the dominant firm would have sold 1,500 units absent entry, the potentially predatory increment is 500 units. The dominant firm's marginal cost (the cost of producing the last good) is $10, its average variable cost is $8.50 per unit,[154] and its average avoidable cost is $10 per unit.[155] The firm's $9.50 per unit price is thus greater than its average variable cost, but less than its marginal cost and its average avoidable cost and is potentially predatory.

In this example, all the costs included in average avoidable cost are variable. There can be instances where some fixed costs would be included in average avoidable cost, such as if some fixed costs were incurred to produce the predatory increment, but would have been avoided if that increment had not been produced. For example, suppose that the dominant firm had a factory capable of producing 1,500 units and that to produce the additional 500 units it had to expand the

[151] *See generally* Elzinga & Mills, *supra* note 79, at 2484 ("Adopting . . . [the long-run average incremental cost standard] would be inconsistent with the generally accepted view that predatory pricing means pricing that would not be remunerative except for its exclusionary effect."); AREEDA & HOVENKAMP, *supra* note 1, ¶ 741e, at 449–55 (noting that preexisting capital costs "are not part of the cost of predation, because those costs remain the same").

[152] *See* CARLTON & PERLOFF, *supra* note 27, at 29 ("A sunk cost is like spilled milk. Once it is sunk, there is no use worrying about it, and it should not affect any subsequent decisions. . . . Costs, including fixed costs, that are not incurred if operations cease are called avoidable costs.").

[153] *See* COMPETITION BUREAU, CAN., ENFORCEMENT GUIDELINES: PREDATORY PRICING 14–15 (2008), *available at* http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/vwapj/Predatory_Pricing_Guidelines-e.pdf/$file/Predatory_Pricing_Guidelines-e.pdf; DIRECTORATE-GEN. FOR COMPETITION, EUROPEAN COMM'N, DISCUSSION PAPER ON THE APPLICATION OF ARTICLE 82 OF THE TREATY TO EXCLUSIONARY ABUSES 31 (2005), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf.

[154] (1,500 units at $8 per unit + 500 units at $10 per unit) divided by 2,000 units.

[155] (500 units at $10 per unit) divided by 500 units.

factory. The cost of expansion would be included in average avoidable cost. In contrast, long-run average incremental cost would include the cost of both the initial factory and the expansion.

#### d. Emerging Consensus Support for Average Avoidable Cost

The emerging consensus is that average avoidable cost typically is the best cost measure to evaluate predation claims.[156] However, there is not complete unanimity on this issue.

One panelist, although willing to use average avoidable cost to define a level below which price should be presumptively unlawful,[157] urged that prices above average avoidable cost but below long-run average incremental cost be treated as predatory in the absence of a plausible efficiency defense.[158] He argued that a long-run standard is necessary to provide meaningful protection against predatory pricing in contexts like computer software, where costs are minimal after the product has been developed and launched.[159] Another commentator, however, maintains that, although long-run average incremental cost would be relevant for testing whether a defendant's price is compensatory in the long run, that is not the appropriate question regarding predatory pricing. Rather, he concludes that defendant's average avoidable cost is the appropriate cost measure because it focuses on the threat to an efficient rival in the short run.[160]

The Department agrees that average avoidable cost is the most appropriate cost measure to use when evaluating an alleged predatory-pricing scheme because it focuses on the costs that were incurred when the predatory pricing was pursued. Predatory pricing, if it is to have an exclusionary effect, must result in additional sales for the predator that were taken away from its prey. When price is set below average avoidable cost, the firm is experiencing a negative cash flow on its incremental sales at that price. Prices below average avoidable cost should trigger antitrust inquiry because they suggest that the firm is making sales that are unprofitable and may reflect an effort to exclude. Prices that are set above average avoidable cost, however, may enhance the firm's profits irrespective of any exclusionary effects.

The illustration demonstrates the superiority of average avoidable cost over both marginal cost and average variable cost as the appropriate measure for predatory pricing. The dominant firm made 500 additional units when the new firm entered. It was not the 500th unit that caused the new firm's demise. Rather, it was all 500 new units—the whole additional incremental lot. Average avoidable cost measures what it cost to make those additional units. That is a better measure of what it cost the firm to make the alleged predatory incremental sales than the cost of the last unit of that increment.

Likewise, it was not the original production quantity of the dominant firm that caused the entrant's demise. It was the 500 additional units the dominant firm produced after the new firm arrived on the scene. Yet, average variable

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156 *See* June 22 Hr'g Tr., *supra* note 4, at 36 (Bolton), 46 (Melamed); *id.* at 53–54 (Melamed); *id.* at 77–80 (panelists voiced no disagreement that average avoidable cost was the "best cost measure," although one panelist questioned this proposition's phrasing and another panelist noted definitional ambiguities in the cost measure); Baumol, *supra* note 142, at 49, 57–59; Bolton et al., *supra* note 14, at 2271–72; *see also* Gregory J. Werden, *The* American Airlines *Decision: Not with a Bang but a Whimper*, ANTITRUST, Fall 2003, at 32, 34–35; UNILATERAL CONDUCT WORKING GROUP, INT'L COMPETITION NETWORK, REPORT ON PREDATORY PRICING 3, 10–11 (2008), *available at* http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/FINALPredatoryPricingPDF.pdf ("The most commonly cited measure is average variable cost, although there appears to be a growing trend toward the use of average avoidable cost."); *see supra* note 153.

157 *See* Bolton et al., *supra* note 14, at 2271; June 22 Hr'g Tr., *supra* note 4, at 36–37 (Bolton).

158 *See* June 22 Hr'g Tr., *supra* note 4, at 37 (Bolton); Bolton et al., *supra* note 14, at 2271–74.

159 *See* Bolton et al., *supra* note 14, at 2272–73; *cf.* Feb. 13 Hr'g Tr., *supra* note 84, at 93 (Balto) (arguing that average variable cost is a poor test for predatory pricing in the context of pharmaceuticals where "all the costs are up front").

160 *See* Baumol, *supra* note 142, at 58–59.

cost reflects what it cost the dominant firm to make each unit of the combined original and incremental production. Average avoidable cost, in contrast, focuses on what it cost the dominant firm to make just the incremental amount.

Moreover, as long as the rival firm can cover its average avoidable cost, selling its goods will be more profitable than exiting the market or not entering.[161] The consequence is that an equally efficient rival pricing below long-run average incremental cost, but above average avoidable cost, will remain in the market and compete against the alleged predator. Only when price falls below average avoidable cost will the equally efficient rival exit the market.

Panelists cautioned it may be difficult to implement an average avoidable cost standard.[162] But the Department believes that average avoidable cost is easier to calculate and theoretically more appropriate than either marginal cost—with its abstract "single, last unit"—or average variable cost—with its difficult separation of variable from fixed costs.[163] Although the difficulties presented by the use of an average avoidable cost standard should not be understated, panelists suggested that the basic concept of identifying those costs that would be avoided in the absence of an alleged predatory strategy was something that businesses understand and can analyze.[164]

The hearings focused particular attention on one implementation issue—whether avoidable costs should include any revenues forgone by reducing price on sales that the firm would have made without the predatory scheme. Although panelists generally agreed that opportunity costs should be included in the calculation of avoidable costs, they disagreed on whether these lost "inframarginal revenues" should be considered. One panelist contended that, theoretically, lost inframarginal revenues should be taken into account,[165] although he expressly recognized a "real question" as to whether this would be administrable.[166] Another panelist argued that "inframarginal revenues . . . shouldn't be treated as an opportunity cost, at least not for this purpose, because they are not a cost. . . . They are simply a transfer payment actually from producer to consumer . . . ."[167] Taking into account inframarginal revenues, he continued, requires "a profit maximization test . . . and that is in most cases going to be virtually impossible . . . for the Court to figure out and surely impossible for the firm to figure out in real time when it's trying to comply with the law."[168] Moreover, a commentator has argued that the loss of inframarginal revenues should be ignored because "it is irrelevant to whether the lower price, in itself, is or is not a threat to an efficient rival."[169]

Furthermore, there is no support in the case law for including lost inframarginal revenues as a cost.[170] *AMR*, for example, notes that the

[161] *See id.* at 58.

[162] *See* June 22 Hr'g Tr., *supra* note 4, at 83 (Ordover).

[163] *Cf. id.* at 82 (Elzinga) (noting the potential sensitivity of average variable cost to choice of accounting convention). *But see* Feb. 13 Hr'g Tr., *supra* note 84, at 187 (Sewell) (stating that "average variable cost is a measure which is widely understood by business people . . . it's a metric that exists for other than just antitrust enforcement purposes . . . and therefore has some additional validity").

[164] *See* June 22 Hr'g Tr., *supra* note 4, at 46 (Melamed); *id.* at 79 (Ordover) (noting that "these avoidable costs which we looked at at the route level are typically the kind of costs business people look at when they make business decisions in the airline business").

[165] *Id.* at 84–85 (Bolton); *see also* Jan. 31 Hr'g Tr., *supra* note 96, at 33 (Edlin) ("The [*AMR* trial] Judge thought there that the extra plane was profitable if you ignore effects on other planes. I suggest that everyone reread footnote 13 of that case over and over and over again if you think that the extreme sacrifice test might make sense, as the Judge did.").

[166] June 22 Hr'g Tr., *supra* note 4, at 84 (Bolton).

[167] *Id.* at 53 (Melamed).

[168] *Id.* at 52.

[169] Baumol, *supra* note 142, at 70–71.

[170] *See* United States v. AMR Corp., 335 F.3d 1109, 1118–19 (10th Cir. 2003) (treating as "invalid as a matter of law" a cost test that "simply performs a 'before-and-after' comparison of the route as a whole, looking to whether profits on the route as a whole decline after capacity was added, not to whether the challenged capacity additions were done below cost" because such a test treats foregone profits as costs (citation omitted)).

Supreme Court's predatory-pricing jurisprudence rejects requiring a firm to maximize profits.[171] A firm failing to maximize profits could nevertheless still be attaining a positive cash-flow, and hence acting rationally irrespective of the impact of the firm's conduct on rivals.[172]

The Department concludes that consideration of foregone revenues is neither appropriate nor likely to be administrable. The Department consequently will not consider the lost revenues on inframarginal sales as a cost when evaluating predatory-pricing claims.[173]

Given the above, when the Department can determine the predatory increment, it generally will rely on average avoidable cost as the appropriate measure of incremental cost under the *Brooke Group* test. The Department believes average avoidable cost typically will most accurately reflect the incremental cost of the alleged predatory output increase, and therefore will most accurately depict whether sales are beneficial to the firm, apart from any exclusionary effect, and whether the pricing strategy could cause the exit in the short run of an equally efficient competitor. Furthermore, average avoidable cost tends to be a more administrable standard than the other available cost measures and business-decision makers readily understand the concept. However, if the predatory increment is indeterminate and average avoidable cost is difficult to assess, the Department will consider other measures of cost, with average variable cost as typically the next best alternative.[174]

**When the Department can determine the predatory increment, it generally will rely on average avoidable cost in determining whether prices are predatory.**

#### 4. Recoupment

"Predatory pricing is a three-stage process: Low prices, followed by the exit of producers who can no longer make a profit, followed by monopoly prices."[175] The Supreme Court observed in *Brooke Group* that, unless recoupment is feasible, "predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced."[176] Thus, the Court held that a plaintiff in a section 2 predatory-pricing case must demonstrate that the dominant firm had "a dangerous probability[] of recouping its investment in below-cost prices."[177]

One panelist at the hearings was "very skeptical" about retaining the recoupment requirement as an element of the offense.[178] He argued that this requirement "clearly complicates the proceedings,"[179] explaining that "[i]t's not necessary in order to identify anticompetitive conduct, because if we think we got the price-cost test right and the guy is selling below cost, you can . . . infer that he

[171] *Id.* at 1118–19. *See also* Stearns Airport Equip. Co., Inc. v. FMC Corp., 170 F.3d 518, 533 n.14 (5th Cir. 1999); MCI Comm'ns Corp. v. AT&T, 708 F.2d 1081, 1114 (7th Cir. 1983).

[172] *Cf.* June 22 Hr'g, *supra* note 4, at 9 (Elzinga).

[173] The Department will, however, consider the foregone value of the possibility of renting or leasing an owned fixed asset in determining the cost the firm incurred in producing the putatively predatory increment. *See generally* Baumol, *supra* note 142, at 70–71 (noting that "a price of firm F that does not cover the opportunity cost of that firm's avoidable investment can constitute a threat to a more efficient rival and should be considered to fail the generalized Areeda-Turner Test"). In that situation, there is a readily available means to ascertain the firm's cost of the asset used to produce the purportedly predatory increment. This does not involve constructing hypothetical costs for the firm or imputing lost profits to it.

[174] *See generally id.* at 55–58 ("I will argue now that the Areeda-Turner test is entirely defensible as a criterion to determine whether the price at issue constitutes a threat to efficient rivals of firm F. But I will show that for this purpose it is average variable cost or a near relative of [average variable cost], rather than marginal cost, that provides the requisite information."); Hovenkamp, *supra* note 1, at 23–24.

[175] Wallace v. IBM, 467 F.3d 1104, 1106 (7th Cir. 2006) (Easterbrook, J.).

[176] 509 U.S. 209, 224 (1993). *But see Katz & Salinger Comments*, *supra* note 93, at 6 (noting that, as a logical matter, even without successful recoupment, predatory pricing could, under certain circumstances, harm consumers).

[177] 509 U.S. at 224.

[178] June 22 Hr'g Tr., *supra* note 4, at 49–50 (Melamed).

[179] *Id.* at 49.

expects to recoup."[180]

However, as Professors Elzinga and Mills have pointed out, the recoupment requirement serves as a valuable reality check—if a firm is unlikely to be able to recoup, then it raises the question of why the firm would have tried to engage in predatory pricing.[181] It appropriately leads courts to inquire into alternative explanations for the lower prices. For example, lower prices may simply be some type of procompetitive discounting.[182] As one panelist noted, failing the recoupment test "can dispose of a large fraction of predatory pricing cases . . . [because] at the end of the day, [that] indicates that there is really not harm to consumer welfare; there is not exclusion that you need to be concerned about."[183]

This reality check is particularly important because predatory pricing contains a key temporal element: a monopolist incurs short-term losses in the expectation of recouping those losses in the future by raising prices.[184] Thus, the *Brooke Group* Court went to some length to set out the analytic framework for deciding whether a firm could recoup short-term losses.[185] The Court held that assessment of recoupment "requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market."[186]

A panelist indicated that recoupment is most likely when there is asymmetry between conditions of exit from, and entry into, a particular market—in other words, when exit from the market is easy, but entry is difficult.[187] In that situation, a predator is more likely to recoup its investment in below-cost pricing. Once its prey exits quickly, the predator may enjoy the payoff of its relatively low-cost investment without fear of subsequent entry rapidly eroding its monopoly profits.

In assessing whether recoupment is likely, courts since *Brooke Group* have also considered reputation effects. For example, the Tenth Circuit recognized that a firm might engage in predation in one market to prevent the target of the predation from expanding to compete in a separate market.[188] Similarly, the Third Circuit explained that predation makes sense when a monopolist operates in several related markets because "the predator needs to make a relatively small investment (below-cost prices in only a few markets) in order to reap a large reward (supra-competitive prices in many markets)."[189] As these cases suggest, consideration of out-of-market effects can be significant because the predator's low prices in only one market may induce the prey or other competitors to believe that the predator will reduce prices in other monopolized markets in the future, discouraging entry there as well.[190]

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[180] *Id.* at 50.

[181] Elzinga & Mills, *supra* note 42, at 870–72, 893; *see also* Bolton et al., *supra* note 14, at 2263; *Katz & Salinger Comments*, *supra* note 93, at 6.

[182] *Cf.* June 22 Hr'g Tr., *supra* note 4, at 71–72 (Bolton) (stating that recoupment is "the right question to ask").

[183] Sherman Act Section 2 Joint Hearing: Conduct as Related to Competition Hr'g Tr. 70, May 8, 2007 [hereinafter May 8 Hr'g Tr.] (Rule).

[184] *See* June 22 Hr'g Tr., *supra* note 4, at 10 (Elzinga) ("[T]he recoupment returns for the aspiring monopolist must be enjoyed for a longer time period than the time frame in which the aspiring monopolist shouldered the cost of the predation strategy . . . ."); *Predatory Strategies*, *supra* note 76, at 266–69.

[185] *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 225–26 (1993).

[186] *Id.* at 226.

[187] *See* June 22 Hr'g Tr., *supra* note 4, at 13 (Elzinga); *see also* Kenneth G. Elzinga, *When Does Predatory Pricing Work?* 1 (n.d.) (hearing submission).

[188] *See* Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal and Prof'l Publ'ns, Inc., 63 F.3d 1540, 1549 n.6 (10th Cir. 1995).

[189] Advo, Inc. v. Phila. Newspapers, Inc., 51 F.3d 1191, 1196 n.4 (3d Cir. 1995); *accord* AREEDA & HOVENKAMP, *supra* note 1, ¶ 727g, at 337 (stating that a firm that operates in numerous markets may predate in only one to acquire or maintain "higher prices in all the others as well"); *see also* Bolton et al., *supra* note 14, at 2267–68 (recoupment "may occur in either the predatory market or in a strategically related market where the effects of the predation are felt"); *id.* at 2300 ("Reputation effects may be present when the predator sells in two or more markets or in successive time periods within the same market.").

[190] *See* Baker, *supra* note 98, at 590–91; Bolton et al., *supra* note 14, at 2248–49, 2267–68; *see also* June 22 Hr'g

Panelists generally agreed that, in principle, reputation effects should be taken into account when considering predatory-pricing claims.[191] At the same time, however, panelists voiced substantial concern about the administrability of considering reputation effects. While one panelist asserted that reputation effects could conceivably be assessed by analyzing "[c]ircumstantial evidence,"[192] other panelists cautioned that such effects may depend on factors that are difficult, if not impossible, to measure. "What we don't know in real life is how many of these new entrants do you have to kill . . . before somebody finally realizes, hey, I'm not coming in . . . ."[193] Thus, while courts may be able to evaluate reputation effects in assessing the probability of recoupment, they must exercise great care when doing so, or otherwise risk exceeding their "practical ability . . . to control [predatory pricing] without courting [the] intolerable risks of chilling legitimate price cutting."[194]

The Department believes that the recoupment requirement, when properly applied, serves as a valuable screening device to identify implausible predatory-pricing claims. In many instances, the obvious inability of a firm to recoup any losses may obviate the more difficult task of determining whether prices were below cost.[195] Further, the recoupment requirement may help ensure that procompetitive price discounting is not unduly chilled. Although acknowledging the difficulties inherent in doing so, the Department may, in appropriate circumstances, consider both in-market and out-of-market effects when assessing recoupment.[196]

**The recoupment requirement serves as a valuable screening device to identify implausible predatory-pricing claims.**

#### 5. Potential Defenses

Even when recoupment appears plausible, below-cost pricing is not necessarily proof of

Tr., *supra* note 4, at 22 (Ordover); *id.* at 36 (Bolton).

[191] *See, e.g.*, June 22 Hr'g Tr., *supra* note 4, at 63 (Bolton) ("We have to look at the deterrent effect of episodic, very rare predatory pricing."); *id.* at 86–92 (multiple panelists).

[192] *Id.* at 87 (Bolton); *see also* Aaron S. Edlin & Joseph Farrell, *The* American Airlines *Case: A Chance to Clarify Predation Policy (2001)*, *in* THE ANTITRUST REVOLUTION 502, 518–19 (John E. Kwoka & Lawrence J. White eds., 2004) (observing that "there is apt to be a reason why a firm is in multiple markets, so there will usually be some link").

[193] June 22 Hr'g Tr., *supra* note 4, at 89–90 (Ordover) (adding, "I just don't see how I can translate that into an administrable test for the courts and for counsel . . . ."); *see also id.* at 48–49 (Melamed) (noting that while "the recoupment requirement is central to and a great contribution to predatory pricing law," demanding stringent quantification as some have suggested "clearly complicates the proceedings, increases costs" and "may be an impossible burden for the plaintiff in a multi-market reputation effect recoupment story"); *cf. id.* at 88 (Elzinga) ("[O]nce you start bringing in reputation effects as a potential hammer for antitrust plaintiffs, what is the consequence of that for all the good things that reputations do . . . to keep people, even for their own good, out of markets in which they have no business competing because they will not be efficient utilizers of society's scarce resources in those settings?").

[194] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

[195] *See* A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1401 (7th Cir. 1989) (Easterbrook, J.) ("Only if market structure makes recoupment feasible need a court inquire into the relation between price and cost."); *see also* June 22 Hr'g Tr., *supra* note 4, at 70 (Ordover) (stating sometimes "there is no need to somehow construct this potentially complicated analytics" because industry structure is such that "you know, quick as a bunny, somebody else is going to show up who may be even [a] more competitively advantaged rival"); *id.* at 71 (Elzinga) ("I do not think you need to do a recoupment analysis for many predation allegations, because entry conditions or prices and costs will tell you you needn't take that extra step.").

[196] For an example of an approach to considering out-of-market effects in assessing the likelihood of recoupment, see Bolton et al., *supra* note 14, at 2302–04 (articulating a four-part test: (1) a dominant multi-market firm or a predator that "faces localized or product-limited competition or potential competition, or alternatively operating within a single market . . . and faces probable successive entry over time," (2) the reputation effect either reinforces another predatory strategy or is based on the perceived probability that the predator will repeat its conduct in the future, (3) the "predator deliberately pursues a reputation effects strategy," and (4) potential entrants observe the exit or other adverse effect).

anticompetitive predation. Certain defenses may justify below-cost pricing. Although the Department will not accept a meeting-competition defense, as discussed below, the Department will consider efficiency defenses in appropriate circumstances.

**a. Meeting Competition**

There is a substantial question regarding whether the antitrust laws should ever prohibit a firm from matching a rival's prices. In *United States v. AMR Corp.*, the trial court held in the alternative that defendant was entitled to summary judgment because "it is uncontroverted that American's prices only matched, and never undercut, the fares of the new entrant."[197] The court reasoned that "[t]he meeting competition defense to Section 2 liability is predicated on a similar statutory defense to price discrimination claims under the Robinson-Patman Act."[198] In contrast, the United States on appeal argued that "[t]here is nothing in [the] text of the Sherman Act that speaks of such a defense" and that "such a defense would make *Brooke Group*'s below-cost pricing prerequisite superfluous when it is most important: when an entrenched, high-cost monopolist faces new, more efficient competition."[199]

The Tenth Circuit "decline[d] to rule that the 'meeting competition' defense applies in the § 2 context" but did note that "[t]here may be strong arguments for application of the meeting competition defense in the Sherman Act context by analogy to the Robinson-Patman context."[200] On the other hand, the trial court in *Spirit Airlines* ruled there was no such defense, "respectfully declin[ing] to follow *AMR Corp.* on this point," because "[a]lthough *Brooke Group* does not formally and expressly reject the possibility of a 'matching competition' defense, it does adopt an economic model which is at odds with the assumptions underlying such a defense."[201]

Panelists did not agree on whether there should be a meeting-competition defense to predatory-pricing claims. One panelist asserted there should be no safe harbor for pricing below cost to meet competition.[202] Another panelist had previously written that "[a] monopoly or dominant firm should not be permitted to sell below its short-run costs to meet the price of a new entrant or smaller rival."[203] "To allow a predator to price below its short-run cost frustrates a market test based on . . . relative efficiency," he explained, because "[i]f the rival's price is sustainable, it will almost surely be above short-run cost."[204] On the other hand, one panelist asserted there should be a general meeting-competition defense under section 2 since "[s]uch a rule would provide a clear line, and matching a competitor's price in hopes of competing for every last customer is exactly what competitors are supposed to do."[205] He added that a "competitor that cannot survive at the price point it has chosen is not the type of efficient competitor the antitrust laws should be protecting."[206]

Panelists also expressed concern regarding the administrability of a meeting-competition defense:

> [W]hat do we mean by meeting the competition? Is matching the price of the entrant meeting the competition? Is that

[197] 140 F. Supp. 2d 1141, 1204 (D. Kan. 2001).

[198] *Id.*

[199] Brief for Appellant United States of America at 67, United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003) (No. 01-3202), *available at* http://www.usdoj.gov/atr/cases/f9800/9814.pdf.

[200] *AMR*, 335 F.3d at 1120 n.15.

[201] Spirit Airlines, Inc. v. Nw. Airlines, Inc., No. 00-71535, 2003 WL 24197742, at 12 & n.15 (E.D. Mich. Mar. 31, 2003), *rev'd on other grounds*, 431 F.3d 917 (6th Cir. 2005).

[202] June 22 Hr'g Tr., *supra* note 4, at 93 (Melamed).

[203] Bolton et al., *supra* note 14, at 2276 n.198.

[204] *Id.* At the hearings, however, this panelist stated, "If meeting the competition is a best response, then this should be a defense." June 22 Hr'g Tr., *supra* note 4, at 92 (Bolton). Another panelist responded, "If it's the best response, then it would seem . . . that the revenues generated by the response are in excess of the avoidable costs, in which case it passes the price-cost test, but if that's not the case, if it fails that test, it's an inefficient response." *Id.* at 93 (Melamed).

[205] Feb. 13 Hr'g Tr., *supra* note 84, at 180 (Wark).

[206] *Id.*

> how we define it? I would argue that's dangerous, because the products may not be the same. If the incumbent's product is higher quality than the entrant's, then matching the price of the entrant is not meeting competition.[207]

A meeting-competition defense would be difficult to administer and could protect below-cost pricing that harms competition and consumers. The Department believes that a meeting-competition defense should not apply in section 2 predatory-pricing cases.

**The Department believes that a meeting-competition defense should not apply in section 2 predatory-pricing cases.**

#### b. Efficiency Defenses

The Department will consider as possible defenses to below-cost pricing a persuasive showing that the conduct is part of a firm's procompetitive efforts to promote or improve its product or reduce its costs and may, in the long term, reduce the price consumers pay for its goods and services or increase the value of those goods or services.[208] One panelist suggested,

> There are all sorts of reasons that [pricing below costs] could be okay . . . I mean, it could be that . . . the price is low relative to whatever the measure is because the firms are making all sorts of investments in market share . . . to induce people to try the product . . . or . . . create scale economies or learning.[209]

These efficiency defenses received little attention at the hearings, and the Department will not attempt in this report to depict all the circumstances in which their recognition would or would not be appropriate. However, some general points can be made here.

Certain types of efficient conduct, such as promotional pricing,[210] may not be plausible when the firm already has monopoly power or a dangerous probability of acquiring monopoly power.[211] Network externalities, which occur "when a consumer's valuation of a product increases with the number of other consumers using the product,"[212] raise somewhat similar issues. When a firm is trying to build an installed base and win a standards competition, initially pricing below cost may enhance the value of and demand for its product.[213] When a monopolist has already built a large installed-base network, that rationale may not hold.[214] Other efficiencies, such as "learning-by-doing," which occurs when a firm's cost of production "decreases as it produces more because it learns how to produce the product more efficiently,"[215] may be plausible for a new product even when a firm has achieved monopoly power as to different products; the below-cost price of today may become an above-cost price in the future, and "the prospect of reducing costs in the future"

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[207] June 22 Hr'g Tr., *supra* note 4, at 92–93 (Bolton).

[208] *See, e.g.*, AREEDA & HOVENKAMP, *supra* note 1, ¶ 742f, at 470–71, *id.* ¶ 746a, at 491–95. *See generally* Bolton et al., *supra* note 14, at 2276–82.

[209] May 1 Hr'g Tr., *supra* note 125, at 78–79 (Baker).

[210] *See* Bolton et al., *supra* note 14, at 2278–79 (noting that promotional pricing involves "temporarily pric[ing] below . . . cost in order to induce consumers to try a new product"). The firm's expectation in engaging in promotional pricing is that "a favorable consumption experience induced by prices below cost will increase future consumer demand at prices above cost." *Id.* at 2279. Efficiency is enhanced if this occurs, since the firm's profits stem from customers' future willingness to purchase its product and not the elimination of rivals. This "reflects rational, profit-maximizing behavior," not predation. CARLTON & PERLOFF, *supra* note 27, at 357.

[211] *See* AREEDA & HOVENKAMP, *supra* note 1, ¶ 746a, at 494 ("When a firm has considerable market power in the very product or service being promoted, the promotional pricing defense disappears. . . . In contrast to new entrants or small rivals, the monopolist has little need to resort to extreme price reductions to acquaint existing consumers with the merits of its brand."); *cf. id.* at 492 ("Unless continued over a long period of time, in which case it is no longer promotional, promotional pricing by new entrants or established firms who lack power in the promoted product or service are no threat to competition.").

[212] Bolton et al., *supra* note 14, at 2281.

[213] *See* Sherman Act Section 2 Joint Hearing: Remedies Hr'g Tr. 95–97, Mar. 29, 2007 (Page).

[214] *See* Bolton, *supra* note 14, at 2281–82.

[215] CARLTON & PERLOFF, *supra* note 27, at 359.

may "justif[y] the lower price as an important investment for the firm."[216] Accordingly, the Department will consider efficiency claims supported by evidence even in settings where there is existing monopoly power.

#### 6. Equitable Remedies

In cases where predatory pricing is established, the next question for an enforcer or a court is what to do about it. Chapter 9 of this report discusses the topic of section 2 remedies in greater detail, but there are aspects of equitable remedies in the context of predatory-pricing cases that should be noted here.

Injunctive remedies can pose particularly severe difficulties in predatory-pricing cases. For instance, an injunction setting a defendant's prices would substitute a court's or agency's judgment for the workings of the market. Summarizing concerns with this approach, one panelist observed that he "probably like everybody" is "suspicious of having antitrust become a price regulatory regime."[217] The pricing issues often will be both complex and constantly shifting and call to mind the Supreme Court's warning against remedies that require a court "to assume the day-to-day controls characteristic of a regulatory agency."[218] And, of course, in predatory-pricing contexts, any errors on the side of stringency will suppress legitimate price competition.

The Department believes courts should exercise particular care when crafting behavioral injunctive relief in privately litigated predatory-pricing cases.[219] The plaintiff in a private predatory-pricing injunctive action is typically a rival whose interests may conflict with those of consumers or the general public. Indeed, it may be in the interest of both plaintiff and defendant to have the court preclude defendant from discounting even if consumers would be better off with the lower prices.

Other approaches sometimes may be possible. One panelist suggested crafting injunctive remedies that do not involve price-regulation regimes: "I don't think we would want to have a remedy that said, defendant, don't sell your widgets for less than $4. But we might say don't sell it for less than whatever we think the appropriate cost measure is and in effect incorporate into an injunction the substantive standard."[220] Compliance issues, however, could become complex; the court or agency might be called upon over time, for example, repeatedly to assess a multitude of changing prices against the cost standard.[221]

Another suggestion was that courts, where possible, consider ways of altering market structure to eliminate opportunities for continued predatory pricing.[222] A drawback to this approach, however, is that structural remedies may impose large costs of their own; a divestiture may harm a firm's own efficiency and not necessarily create an efficient rival.[223] A divestiture also may raise regulatory issues. For example, one panelist suggested that predatory pricing by an airline might be remedied by requiring the airline to divest airport-gate leases or landing or take-off rights that prevent entry and enable predation to

[216] *Id.*

[217] June 22 Hr'g Tr., *supra* note 4, at 95 (Elzinga).

[218] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 415 (2004) (discussing access remedies for refusals to deal).

[219] *See* May 8 Hr'g Tr., *supra* note 183, at 159–60 (Rule) (suggesting that injunctive remedies be available only in section 2 cases brought by the federal government).

[220] *Id.* at 158 (Melamed); *see also* Gregory J. Werden, *Remedies for Exclusionary Conduct Should Protect and Preserve the Competitive Process*, 76 ANTITRUST L.J. (forthcoming 2009) ("[A] predatory pricing decree should prescribe a particular price-cost comparison. Thus, the decree should specify a particular measure of the defendant's cost and indicate how the defendant's accounts are to be employed in constructing that cost measure. The decree also should specify how the defendant's price data are to be used in the comparison.").

[221] *Cf. Trinko*, 540 U.S. at 414–15.

[222] *See, e.g.*, June 22 Hr'g Tr., *supra* note 4, at 95–96 (Elzinga) ("It may be that in a genuine predatory pricing case . . . you could get at some other part of the structure of the market that allows the predatory pricing to be a viable marketing strategy.").

[223] *See infra* Chapter 9, Part IV(B).

succeed.[224] However, another panelist responded that this remedy raised issues of access pricing for those gates. According to this panelist, the structural remedy might merely replace a difficult price-regulation issue with an even more difficult access-regulation issue.[225] Thus, the Department believes that courts should be very cautious in imposing structural remedies in predatory-pricing cases.

### D. Conclusion

The Department believes that predatory pricing can harm competition and should be condemned in appropriate circumstances. It is nonetheless important to develop sound, clear, objective, effective, and administrable predatory-pricing rules that enable firms to know in advance whether their price cutting will result in antitrust liability. The development of such rules is necessary, feasible, and already far along. Such rules must enable enforcers, courts, and businesses to determine whether the incremental revenue from the pricing claimed to be predatory is greater than the incremental cost of the additional output. Only claims involving prices below average avoidable cost, or below a similarly appropriate cost measure, combined with a dangerous probability of recoupment, should be subject to potential liability. Efficiency defenses, when supported by evidence, should be considered, and, in instances where injunctive relief is appropriate, care should be taken to ensure that the remedy imposed ultimately benefits consumers.

## II. Predatory Bidding

Predatory bidding involves a buyer of a critical input bidding up the price of that input and thereby foreclosing rival buyers from competing. In certain circumstances, a buyer might be able to drive rival purchasers from the market. By obtaining monopsony power and thereby the ability to purchase its inputs at prices below competitive levels, the predatory buyer would recoup any losses it might incur from "paying too much" in the short run.[226]

In effect, predatory bidding is the mirror image of predatory pricing.[227] When a firm engages in predatory pricing, it lowers its price to consumers, to the detriment of competing sellers. When a firm engages in predatory bidding, it raises its price to input suppliers, to the detriment of competing input buyers. Just as consumers benefit in the short run from lower prices charged by a firm that pursues a predatory-pricing strategy, input suppliers benefit in the short run from higher prices paid for inputs by a firm that pursues a predatory-bidding strategy.

Historically, predatory bidding had been a minor antitrust issue.[228] However, in 2005, the Ninth Circuit issued an opinion finding Weyerhaeuser liable for timber-buying practices that the court deemed predatory.[229] This decision generated substantial interest concerning the proper legal standards for predatory bidding, which were addressed at the hearings.[230] The consensus at the hearings was that successful predatory bidding is relatively rare and should be penalized only when bidding up input prices will clearly lead to long-run competitive harm. The Supreme Court granted certiorari in *Weyerhaeuser* during the course of the hearings.[231]

In *Weyerhaeuser*, a sawmill operator claimed that Weyerhaeuser, a rival sawmill operator, violated section 2 by predatorily bidding up the price for alder sawlogs in the Pacific Northwest. The trial court instructed jurors that they could find that Weyerhaeuser, which had a sixty-five

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[224] *See* June 22 H'rg Tr., *supra* note 4, at 96 (Elzinga).

[225] *See id.* at 97 (Ordover).

[226] *See generally* John B. Kirkwood, *Buyer Power and Exclusionary Conduct: Should* Brooke Group *Set the Standards for Buyer-Induced Price Discrimination and Predatory Pricing?*, 72 ANTITRUST L.J. 625, 652 (2005).

[227] June 22 Hr'g Tr., *supra* note 4, at 104 (Kirkwood).

[228] *See* Scott C. Hall, Ross-Simmons v. Weyerhaeuser: *Antitrust Liability in Predatory Bidding Cases*, ANTITRUST, Spring 2006, at 55.

[229] Confederated Tribes of Siletz Indians v. Weyerhaeuser Co., 411 F.3d 1030 (9th Cir. 2005), *vacated and remanded sub nom.* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007).

[230] June 22 Hr'g Tr., *supra* note 4.

[231] 127 S. Ct. 1069.

percent share of the alder sawlog market, had acted anticompetitively if they found that Weyerhaeuser had "purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent the Plaintiffs from obtaining the logs they needed at a fair price."[232] The jury found for plaintiff, and the Ninth Circuit affirmed, concluding that the prerequisites for establishing liability for predatory pricing set forth in *Brooke Group*[233] did not control predatory bidding.[234]

The Supreme Court unanimously overruled the Ninth Circuit, holding that the *Brooke Group* test for predatory pricing—below-cost pricing and likelihood of recoupment—also applies to predatory bidding. The Court noted that "predatory bidding mirrors predatory pricing" in respects most significant to its analysis in *Brooke Group*.[235] Just as with predatory pricing, the Court found, predatory bidding involves a firm suffering short-term losses on the chance of recouping those losses through supracompetitive profits in the future. The Court reasoned that no rational business will incur such losses unless recoupment is feasible,[236] and recognized that recoupment could occur through lower input or higher output prices.[237] It noted that there are many benign or even procompetitive reasons why a buyer might bid up the price of inputs, ranging from merely miscalculating its input needs to attempting to increase its market share in the output or downstream market. The Court stressed that there is "nothing illicit about these bidding decisions;" indeed, they are "the very essence of competition."[238] Thus: "Given the multitude of procompetitive ends served by higher bidding for inputs, the risk of chilling procompetitive behavior with too lax a liability standard is as serious here as it was in *Brooke Group*."[239] Accordingly, to prevail on a predatory-bidding claim, plaintiff must show that defendant (1) suffered (or expected to suffer) a short-term loss as a result of its higher bidding and (2) had a dangerous probability of recouping its loss.[240]

**To prevail on a predatory-bidding claim, plaintiff must show that defendant (1) suffered (or expected to suffer) a short-term loss as a result of its higher bidding and (2) had a dangerous probability of recouping its loss.**

The Department believes that, as with predatory pricing,[241] the focus of the price-cost analysis should be on the additional output generated by the incremental input purchases. The Department also believes that, in most cases, average avoidable cost is likely to be the best measure of the incremental changes in cost associated with the increased purchase of inputs resulting from the allegedly predatory act.[242]

Although the exercise of monopsony power against input suppliers can be associated with the exercise of monopoly power in the output market, that does not have to be the case, and *Weyerhaeuser* was a case in which the potential anticompetitive effects were confined to the input market.[243] The Department believes that the Sherman Act "does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers."[244] "The Act is comprehensive in its terms and coverage, protecting all who are made victims of . . . forbidden practices[,] by whomever they may be perpetrated."[245] As the Court observed in

[232] 411 F.3d at 1036 n.8.

[233] 509 U.S. 209 (1993).

[234] 411 F.3d at 1037 (concluding that "benefit to consumers and stimulation of competition do not necessarily result from predatory bidding the way they do from predatory pricing").

[235] 127 S. Ct. at 1077.

[236] *Id.*

[237] *Id.* at 1076–77 & n.2.

[238] *Id.* at 1077 (internal quotation marks omitted).

[239] *Id.* at 1078.

[240] *Id.*

[241] *See supra* Part I.

[242] *Id.*

[243] *See* 127 S. Ct. at 1076 ("[T]his case does not present . . . a risk of significantly increased concentration in . . . the market for finished lumber.").

[244] Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co., 334 U.S. 219, 236 (1948).

[245] *Id.*

*Weyerhaeuser*, "The kinship between monopoly and monopsony suggests that similar legal standards should apply to claims of monopolization and to claims of monopsonization."[246] Thus, the Department will challenge under section 2 conduct that threatens harm to the competitive process, whether that harm occurs upstream or downstream.

In this regard, as the Supreme Court recognized in *Weyerhaeuser*, higher input prices alone do not indicate harm to the competitive process.[247] To the contrary, they are often indicative of vigorous competition, raising the danger that faulty assessments could chill procompetitive activity.[248] For example, a firm might "acquire excess inputs as a hedge against the risk of future rises in input costs or future input shortages"[249] or to "ensure that it obtains the input from a particularly reliable or high-quality supplier."[250] In those situations, the competitive process has not been harmed, and antitrust enforcement should not discourage the conduct.[251] Moreover, even where potential harm to competition can be demonstrated, appropriate efficiency defenses also need to be considered.

The Supreme Court's *Weyerhaeuser* decision was a significant step towards the development of clear, administrable rules for predatory bidding. The Department believes that the decision strikes the right balance in ensuring that only bidding that harms the competitive process will be found to violate section 2.

[246] 127 S. Ct. at 1076.

[247] *Id.* at 1077.

[248] *See* June 22 Hr'g Tr., *supra* note 4, at 135 (Salop) (stating that he was "very worried that there could be false positives"). *But cf. id.* at 106 (Kirkwood) ("[A]rguably, there have been no false positives, no liability findings [in predatory bidding cases] where it appeared that the defendant had not, indeed, harmed welfare.").

[249] *Weyerhaeuser*, 127 S. Ct. at 1077; *see also* June 22 Hr'g Tr., *supra* note 4, at 158 (McDavid) (stating that a firm might decide to "stockpile inventory to preclude future shortages or to hedge against a future price increase").

[250] Brief for the United States as Amicus Curiae Supporting Petitioner at 16, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (No. 05-381), *available at* http://www.usdoj.gov/atr/cases/f217900/217988.pdf.

[251] *Cf.* June 22 Hr'g Tr., *supra* note 4, at 113 (Kirkwood) ("[I]f the defendant can show that bidding up input prices was profitable, without regard to any increase in monopsony power, [then] it should have a complete defense.").

# Some Recent Decisions

**UNITED STATES DISTRICT COURT**
**MIDDLE DISTRICT OF LOUISIANA**

**FELDER'S COLLISION PARTS, INC.**

**CIVIL ACTION**

**VERSUS**

**NO. 12-646-JJB**

**GENERAL MOTORS COMPANY ET AL.**

**RULING ON DEFENDANTS' MOTION TO DISMISS**

This matter is before the Court on a Motion to Dismiss (Doc. 22) pursuant to Federal Rule of Civil Procedure 12(b)(6), filed by Defendants General Motors LLC[1] ("GM"), All Star Advertising Agency, Inc., All Star Chevrolet North, L.L.C., and All Star Chevrolet, Inc. (the All Star Defendants are referred to as "All Star"). Plaintiff, Felder's Collision Parts, Inc. ("Felder's"), has filed an opposition (Doc. 25), to which Defendants have filed a reply (Doc. 28). In opposition, Felder's has requested leave to amend any allegations that this Court deems insufficient. Oral argument is not necessary. The Court's jurisdiction exists pursuant to 28 U.S.C. § 1331. For the reasons herein, the Defendants' Motion to Dismiss (Doc. 22) is DENIED, and Plaintiff's request for leave to amend (Doc. 25 at 22-23) is GRANTED.

I.

Felder's brought this action pursuant to the Robinson-Patman Act ("RPA"), 15 U.S.C. § 13, the Sherman Act, 15 U.S.C. § 2, the Louisiana Unfair Trade Practices and Consumer Protection Act ("LUTPA"), La. Rev. Stat. § 51;1401, *et seq.*, and several other Louisiana revised statutes, La. R.S. §§ 51:122, 123, 124, 137, and 422 (Doc. 1). Additionally, Felder's contends that GM, All Star, and John Doe Defendants 1-25 ("Doe Defendants") should be held jointly and severally liable for conspiring to aforementioned violations under La. Civ. Code art. 2324.

[1] Defendants assert that the Complaint incorrectly identifies General Motors LLC as General Motors Company.

Defendants' Motion to Dismiss is brought on the following grounds: (1) the claims are insufficiently pled, (2) the RPA claim must fail because Felder's does not allege price discrimination, (3) Felder's fails to state a predatory pricing claim because the allegations inadequately address relevant market(s), market power, and barriers to entry, (4) dismissal is appropriate because Felder's cannot establish below-cost pricing, (5) Felder's lacks antitrust standing, (6) the Louisiana antitrust claims must fall because the federal claims are deficient, (7) Felder's' other state law claims fail as a matter of law, and (8) Felder's impermissibly refers to the three All Star entities as "All Star."

The following facts are from the Complaint (Doc. 1) and are accepted as true for the purposes of this motion. *See Bass v. Stryker Corp.*, 669 F.3d 501, 507 (5th Cir. 2012). There are two types of automobile parts: original equipment manufacturer parts ("OEM parts"), which are produced by the manufacturer, and aftermarket parts, which are produced by other entities. All Star and the Doe Defendants sell OEM parts, specifically GM-compatible parts, to collision centers and body shops throughout southern Louisiana and southern Mississippi. Felder's operates in the same geographic area and at the same level of the distribution chain as All Star and Doe Defendants, but Felder's sells aftermarket parts. Aftermarket collision parts consist of approximately 20% of the automobile replacement party market and historically, have been sold for lower prices than their OEM counterparts.

In 2009, GM established a price incentive program called the "Bump the Competition" program, which offers "highly competitive pricing" on GM parts (Doc. 1, Ex. 1). As part of the program, GM created a "GM Collision Conquest Calculator," which Felder's alleges is a facilitating device for Defendants' conspiracy to resell OEM parts for a price below the average variable cost ("AVC")[2] paid by dealers to GM for the parts. According to Felder's, Defendants' intention is to undercut aftermarket dealer prices in order to drive the aftermarket competition out of business.

Under the program, distributors, like All Star, may sell OEM parts at a "bottom line price," which is 33% lower than the price for the aftermarket equivalent, and then apply to GM for a rebate. The rebate enables dealers to collect the difference between the sale price and the cost paid to GM, plus an additional profit. Additionally, GM allegedly offers cash rebate cards to sales representatives to induce sales under the program's terms. The pricing program is available for 4,400 parts. According to Felder's, the pricing program has only been instituted with respect to OEM parts with a comparable aftermarket alternative. GM does not incentivize OEM dealers to sell parts without an aftermarket alternative at prices below cost. Ultimately, Felder's alleges that Defendants conduct is an unlawful attempt to obtain monopoly power.

Felder's provides several examples[3] to illustrate its assertion that Defendants are conspiring to obtain a monopoly by engaging in predatory pricing. For instance, GM offers to sell one particular OEM part for $135.01, which is normally listed by the dealer for $228.83. The comparable aftermarket part is listed for $179.00. Under the pricing program, an OEM dealer can sell the part for a "bottom line price," which is the aftermarket price less 33%. Here, the bottom line price is $119.93. After selling the part for $119.93, the dealer is entitled to a rebate from GM for the difference between the price paid for the part, $135.01, and the price for which the dealer sold the part, $119.93, plus an additional 14% profit, which is $18.90.

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[2] As will be addressed, *infra*, AVC is the "appropriate measure of cost" for a predatory pricing claim under the prevailing Fifth Circuit standards. Since Felder's' Complaint incorrectly defines AVC, the formula offered in the Complaint is not included in the statement of facts in an attempt to minimize confusion.

[3] Although Felder's provides three examples of this pricing program, only one will be repeated here.

Felder's alleges that, in recent years, the pricing program has significantly impacted the sale of aftermarket parts throughout southern Louisiana and southern Mississippi. Felder's asserts that four of its competitors have already gone bankrupt due to the Defendants' conduct. Felder's also alleges that it has suffered a steady profit decline during the program's existence. In 2008, the last year before this program was implemented, Felder's had a total income in excess of $3 million. By 2011, Felder's' income had decreased by more than $1 million.

Felder's contends that All Star and Doe Defendants have a "reasonable prospect and/or dangerous probability of recouping any losses resulting from the sale of collision parts below AVC." (Doc. 1 at 9). Felder's contends that once the competition has been "bumped," Defendants will reap monopoly profits by ceasing to offer reduced prices on parts that currently have aftermarket alternatives. Defendants will be able to maintain these supracompetitive prices, according to Felder's, because "high and difficult" barriers to entry in the automobile parts industry will prevent new entrants from effectively competing with Defendants (Doc. 1 at 10).

II.

Federal Rule of Civil Procedure 12(b)(6) provides for dismissal of a complaint for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). When reviewing the complaint, the court must accept all well-pleaded facts in the complaint as true. *C.C. Port, Ltd. v. Davis-Penn Mortg. Co.*, 61 F.3d 288, 289 (5th Cir. 1995). In order to survive a motion to dismiss, the complaint must plead "enough facts to state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

III.

**FEDERAL ANTITRUST CLAIMS**

Felder's has alleged that Defendants engaged in predatory pricing, thereby violating both the RPA and § 2 of the Sherman Act. Since the standards applicable under these acts are distinct, these claims will be addressed in turn.

To establish a claim under the RPA, a plaintiff must show: (1) sales made in interstate commerce; (2) the commodities sold were of like grade and quality; (3) the defendant-seller discriminated in price between buyers; and (4) that the price discrimination had a prohibited effect on competition. *Infusion Res., Inc. v. Minimed, Inc.*, 351 F.3d 688, 692 (5th Cir. 2003). The complained-of injury[4] must flow from a defendant's acts of price discrimination, which is "merely a price difference." *Water Craft Management, L.L.C. v. Mercury Marine*, 361 F. Supp. 2d 518, 526 (M.D. La. 2004) (citing *Texaco Inc. v. Hasbrouck*, 496 U.S. 543, 559 (1990)). Price discrimination is "defined as charging different buyers different prices for the same items." *Id*.

Under § 2 of the Sherman Act, three broad categories of conduct are actionable: monopolization, attempted monopolization, and conspiracy to monopolize. The measure of proof for each is distinct. *See generally Vaughn Medical Equipment Repair Services, L.L.C., v. Jordan Reeses Supply Co.*, 2010 WL 3488244, at *9-10 (E.D. La. Aug. 26, 2010). To state a claim for *monopolization*, the plaintiff must allege that the defendant: (1) possesses monopoly power in the relevant market, and (2) willfully acquired or maintained that power. *Eastman Kodak Co. v. Image Tech Servs., Inc.*, 504 U.S. 451, 481 (1992). To state a claim for *attempted monopolization*, the plaintiff must allege that "(1) the defendant has engaged in predatory or

[4] Two basic types of injury are recognized under RPA: primary-line injury and secondary-line injury. *Infusion*, 351 F.3d at 692. A primary-line injury results when one seller's acts of price discrimination between favored and disfavored buyers results in an injury to a market player competing at the same level of direct competition. *Water Craft*, 361 F. Supp. 2d at 565. A secondary-line injury results from a seller's price discrimination between favored and disfavored buyers. *Infusion*, 351 F.3d at 692.

anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power" in the relevant market. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993). Finally, to state a claim for *conspiracy to monopolize*, the plaintiff must allege: (1) specific intent to monopolize, (2) the existence of a combination or conspiracy to monopolize, (3) an overt act in furtherance of the combination or conspiracy, and (4) an effect upon a substantial portion of interstate commerce. *Stewart Glass & Mirror, Inc. v. U.S. Auto Glass Disc. Centers, Inc.*, 200 F.3d 307, 316 (5th Cir. 2000).

At the outset, the Court addresses two areas of ambiguity in the pleadings. First, the Complaint is unclear about whether Defendants have engaged in actual monopolization, an attempt to monopolize, or a conspiracy to monopolize.[5] Predatory pricing can serve as a basis for either actual monopolization or an attempt to monopolize. *See, e.g.*, *Stearns Airport Equipment Co., Inc. v. FMC Corp.*, 170 F.3d 518, 528 (5th Cir. 1999) (discussing plaintiff's actual monopolization claim based on predatory pricing); *Taylor Pub. Co. v. Jostens, Inc.*, 216 F.3d 465, 477-79 (5th Cir. 2000) (analyzing predatory pricing under first of three elements relative to plaintiffs claim for attempted monopolization). Notably, Defendants cite the elements for *attempted* monopolization, tailoring the analysis therein accordingly.[6] Confusing matters, Felder's' opposition cites to the same elements, but indicates that the elements relate to actual monopolization.[7] Despite the fact that Felder's' opposition refers to the attempted

[5] According to the Complaint, Defendants "have *colluded and conspired* to *and have engaged* in the below cost predatory pricing described herein *in an attempt* to monopolize the sale of collision repair parts in southern Louisiana and Mississippi." (Doc. 1 at 13).
[6] As Defendants state in their Motion to Dismiss, "To state an *attempt to monopolize* claim: a plaintiff must prove (1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." (Doc. 22-1 at 11).
[7] According to Felder's' opposition, "A claim for *monopolization* under the Sherman Act requires proof of (1) predatory or anti-competitive conduction; (2) specific intent to monopolize; and (3) dangerous probability of achieving monopoly power." (Doc. 25 at 10).

monopolization elements as the elements for actual monopolization, the analysis below treats Felder's' Sherman Act § 2 claim as an attempted monopolization claim.

Second, Felder's' arguments regarding the federal antitrust claims ignore key distinctions between the predatory pricing claims cognizable under the RPA and § 2 of the Sherman Act. It is true that predatory pricing is actionable under either statute. Indeed, "primary-line *injury* under the [RPA] is of the same general character as the *injury* inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 221 (1993) (emphasis added). Nevertheless, there are fundamental distinctions between the *claims* that are cognizable under either statute,[8] which are outlined below.[9]

**A. <u>Robinson-Patman Act</u>**

Under the RPA, a plaintiff must show that (1) sales were made in interstate commerce; (2) the commodities sold were of like grade and quality; (3) the defendant(s) engaged in price discrimination; and (4) this discrimination had an anticompetitive effect. *Infusion*, 351 F.3d at 692. Defendants argue that the Complaint fails to address the first three elements. However, the Complaint does support an inference that sales were made in interstate commerce. All Star is located in Louisiana and the Complaints refers to sales in both Louisiana and Mississippi. Any sale by All Star to a buyer in Mississippi involves interstate commerce.

As for the second element—commodities of like grade and quality—Felder's argues that the direct competition between aftermarket and OEM parts suggests that the goods are

[8] According to the Supreme Court, in *Brooke Group*:

> There are, to be sure, differences between the two statutes. For example, we interpret § 2 of the Sherman Act to condemn predatory pricing when it poses 'a dangerous probability of actual monopolization,' whereas the Robinson–Patman Act requires only that there be 'a reasonable possibility' of substantial injury to competition before its protections are triggered….

*Brooke Group*, 509 U.S. at 222 (citation omitted).

[9] For example, hiring away a competitor's employees may be unlawful under § 2 of the Sherman Act, *Taylor Pub.*, 216 F.3d at 480 n.11; but the lack of price discrimination renders the same not violative of the RPA.

reasonably interchangeable and, thus, of like grade and quality. Defendants counter that Felder's' argument is irrelevant to the second element. The Court agrees. The issue is not whether aftermarket parts are comparable to OEM parts. Rather, the question is whether Felder's alleged that Defendants sold goods of like quality to different buyers for different prices. *Supra* note 4; *see also Infusion*, 351 F.3d at 692 (asking whether goods sold to disfavored purchaser were comparable to goods sold to others). Since Felder's' allegations do not address this issue, the second element of the RPA claim is insufficiently pled.

As for the third element, price discrimination, Felder's argues that this is shown by establishing (1) below-cost pricing and (2) a reasonable prospect of recoupment (Doc. 25 at 10 (citing *Brooke Group*)). However, this is legally incorrect. Below-cost pricing and recoupment are prerequisites to recovery for *predatory pricing*. *Brooke Group*, 509 U.S. at 223. Price discrimination requires a showing that the defendant charged different buyers different prices for the same item(s). *Water Craft*, 361 F. Supp. 2d at 526. The Complaint does not allege that GM discriminated in price as between All Star and Felder's (or, for that matter, between any two distributors), nor does it allege that that any of the Defendant-dealers charged different buyers different prices for the same item. Thus, Felder's does not allege facts from which a fact finder could plausibly find Defendants engaged in price discrimination.[10] Nevertheless, the Court grants Felder's' request to amend its complaint.

**B. <u>Sherman Act</u>**

Turning to the attempted monopolization claim under § 2 of the Sherman Act,[11] in order to withstand a motion to dismiss, the Complaint must sufficiently allege (1) that Defendants have

[10] Where price discrimination is not alleged, as required by the third element, the Court must also conclude that fourth element is deficiently pled because, by its terms, the RPA "condemns price discrimination only to the extent that it threatens to injure competition." *Brooke Group*, 509 U.S. at 220.

[11] The Court reiterates that the elements for attempted monopolization will be applied to the § 2 claim. *Supra*, p. 6.

engaged in in exclusionary conduct; (2) that Defendants engaged in such conduct with a specific intent to monopolize; and (3) that there is a dangerous probability that Defendants will obtain monopoly power in the relevant market. *Spectrum Sports*, 506 U.S. at 456. Exclusionary conduct is defined as conduct "other than competition on the merits…that reasonably appear[s] capable of making a significant contribution to creating or maintaining monopoly power." *Taylor Pub.*, 216 F.3d at 475 (citing 3 Phillip E. Areeda & Herbert Hovenkamp, ANTITRUST LAW ¶ 651, at 82 (1996)) (internal quotation omitted).

**1. Market Structure and Market Power**

As a predicate to an attempted monopolization claim, a plaintiff must show that the defendant has significant market power. Market power is a measure of a firm's "ability to control prices or exclude competition." *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F.3d 1379, 1386 (5th Cir. 1994). Where a defendant's market power is insignificant, it is unlikely that a plaintiff will be able to "show a dangerous probability that [the defendant will] gain monopoly power in" the relevant market, as required for an attempted monopolization claim. *Surgical Care Ctr. of Hammond, L.C. v. Hosp. Serv. Dist. No. 1 of Tangipahoa Parish*, 309 F.3d 836, 840 (5th Cir. 2002). However, before market power can be assessed, a definition of the relevant market is required. *Jayco Sys., Inc. v. Savin Bus. Machines Corp.*, 777 F.2d 306, 319 (5th Cir. 1985).

**a. <u>Market Definition</u>**

An adequate definition of the relevant market is critical because it "provides the framework against which economic power can be measured."[12] *Id*. The Fifth Circuit has recognized that a trial court may dismiss a § 2 claim for a plaintiff's failure to define the relevant market. *Id.*; *see also Apani Sw., Inc. v. Coca-Cola Enterprises, Inc.*, 300 F.3d 620, 628 (5th Cir.

[12] Here, for example, an analysis of market power would vary depending upon whether the product market is defined as a market for "auto parts" or, alternatively, a market for "collision parts compatible with GM automobiles for which there is an aftermarket alternative."

2002) (explaining that deficient market definition may be grounds to grant a motion to dismiss a § 1 claim).[13] A plaintiff's complaint must "plausibly define the relevant product and geographic markets." *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 615 F.3d 412, 417 (5th Cir. 2010) (internal citation omitted). The proposed product market must account for cross-elasticity of demand, i.e., whether a product is "reasonably interchangeable by consumers for the same purposes." *Id.* The plaintiff must offer evidence "demonstrating not just where consumers currently purchase the product, but where consumers could turn for alternative products or sources of the product if a competitor raises prices." *Doctor's Hosp. of Jefferson*, 123 F.3d at 311. The proposed geographic market "must correspond to the commercial realities of the industry and be economically significant." *Apani*, 300 F.3d at 628, and it must account for "the area of effective competition...in which the seller operates, and to which the purchaser can practicably turn for supplies." *Id.* (citation omitted).

The Complaint vaguely and inconsistently refers to numerous markets without stating which is relevant. The various product markets referred to by Felder's include markets for: (1) car collision parts compatible with GM vehicles and for which there is no aftermarket equivalent; (2) replacement parts compatible with GM vehicles for which there is no aftermarket alternative; and (3) collision parts compatible with GM vehicles and for which there is an aftermarket alternative. Defendants note that the first two markets are not the same because "collision" parts and "replacement" parts are different, and the third market is completely different from the first two markets. This inconsistency without specifically identifying relevant product market(s),

[13] According to the Fifth Circuit,

> Whether a relevant market has been identified is usually a question of fact; however, in some circumstances, the issue may be determined as a matter of law. Where the plaintiff fails to define its proposed relevant market with reference to the rule of reasonable interchangeability and cross-elasticity of demand, or alleges a proposed relevant market that clearly does not encompass all interchangeable substitute products even when all factual inferences are granted in plaintiff's favor, the relevant market is legally insufficient, and a motion to dismiss may be granted.

*Apani*, 300 F.3d at 628 (internal quotations and citations omitted).

according to Defendants, is grounds for dismissal. Additionally, Defendants argue that the proposed geographic market is legally insufficient because the Complaint does not allege the number of competitors in the market, where market competitors operate or where they may reasonably turn for supplies, and does not state that Felder's is the only aftermarket dealer in the relevant market. Further, notwithstanding Felder's' allegation that four of its competitors were driven into bankruptcy by the pricing program, Defendants argue that the market definition is inadequate because Felder's fails to state whether the bankrupted entities competed with All Star, sold only GM-compatible parts, or operated in the relevant geographic area.

The Court recognizes the potential for confusion regarding the multiple product markets mentioned in the Complaint. However, the Fifth Circuit has recognized that multiple markets may be relevant. "[E]conomically significant submarkets may exist which themselves constitute relevant product markets." *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480, 487 (5th Cir. 1984). Thus, the Court finds that the allegations are sufficient to withstand the motion to dismiss. It is at least plausible that there are at least two product markets working in tandem. The first market is the market for OEM automobile parts, which GM sells to All Star, where there is an aftermarket equivalent. The second market is the market for OEM automobile parts compatible with GM vehicles for which there is no aftermarket equivalent. However, Felder's' failure to specify the relevant market(s) in the Complaint is a deficiency which must be cured.

Turning to the proposed geographic market, southern Louisiana and southern Mississippi, Felder's does not address whether consumers could practicably turn to other geographic areas for parts, nor does Felder's specify whether competing dealers from outside areas could come into the market. Thus, Felder's has failed to allege specific facts regarding the "area of effective competition." *Apani*, 300 F.3d at 628, which must be cured. To establish a relevant geographic market, Felder's must allege further detail regarding the number of competitors in the geographic area, the area of effective competition, whether buyers can practicably turn to other sellers for supplies, and whether other dealers can reasonably move into the market to compete.

In sum, the definition of the relevant market is critical because it is the leg upon which much of the attempted monopolization analysis stands. Felder's cannot vaguely propose a series of markets without identifying which are relevant in the Complaint and expect that this Court will analyze, for example: (1) whether Defendants have market power in each market, (2) whether barriers to entry exist in each market, and (3) whether there is a dangerous probability that Defendants will achieve monopoly power in each market. Accordingly, more specificity will be required in the amended complaint.

**b. <u>Defendants' Market Power</u>**

Defendants argue that Felder's' Complaint should be dismissed for failure to allege sufficient facts regarding Defendants' market power. The Court agrees, as this conclusion must be reached since the Court has found that the Complaint insufficiently defines the relevant market(s). Quite simply, "[a]n assessment of market power requires a definition of the relevant market." *Roy B. Taylor*, 28 F.3d at 1386.

Substantial market power "may result solely from control of a large share of the market, or from control of some significant part of a market containing characteristics that allow it to be controlled by a participant not having a grossly disproportionate share of it." *Domed Stadium*, 732 F.2d at 489. But a firm's market share is only one measure of the firm's market power, *id.*, as measurement of market power also requires consideration of other factors including: "the strength of the competition, probable development of the industry, the barriers to entry, the nature of the anti-competitive conduct, and the elasticity of consumer demand." *Pastore v. Bell*

*Tel. Co. of Pennsylvania*, 24 F.3d 508, 513 (3d Cir. 1994). Even when a firm has a statistically high market share, these additional factors may undercut the firm's true market power. For instance, absent barriers to entry, "a competitor waiting on the sidelines can deny those in the market the power to control prices-because current players cannot exclude competition." *Roy B. Taylor*, 28 F.3d at 1388. Still, in order to establish attempted monopolization under § 2 of the Sherman Act, a plaintiff must show that "a defendant must have [a] legally significant share of the market." *Pastore*, 24 F.3d at 490.

Felder's asserts that GM must necessarily dominate the market because "the relevant product market in this case is for collision replacement parts compatible with GM automobiles." (Doc. 25 at 21). Such a naked assertion of market domination is not legally sufficient under the Fifth Circuit's standards to establish market power.[14] Rather, Felder's' statement regarding GM's dominant position only speaks to the firm's market share. Additionally, Felder's' assertion about GM's market share does not directly address whether the Defendant-dealers—All Star and Doe Defendants—dominate the market to the potential exclusion of Felder's and other aftermarket parts distributors. Felder's argues that, since four of its competitors have closed since the pricing program commenced, it could plausibly be inferred that Defendants have some degree of market power. The Court recognizes Felder's' position, and this inference could be drawn if it is also assumed that the bankrupted competitors operated in the relevant market. However, as previously stated, Felder's must amend to provide further factual support as to whether the bankrupted competitors operated in the relevant market.

[14] As the Fifth Circuit has explained:

> We do not suggest here a market share percentage that of itself rises to the level of legal significance, but note that a share of less than the fifty percent generally required for actual monopolization may support a claim for attempted monopolization if other factors such as concentration of market, high barriers to entry, consumer demand, strength of the competition, or consolidation trend in the market are present.

*Domed Stadium*, 732 F.2d at 490.

Regarding one of the other factors for market power, barriers to entry,[15] the Complaint states that "barriers to entry into the automotive parts industry are high and difficult…." (Doc. 1 at 10). Defendants retort that this is a legally insufficient conclusory statement. Felder's counters that the Complaint establishes the overall scheme in which All Star can undersell Felder's and then collect a rebate for lost profits. Felder's argues that, at this stage of litigation, it is sufficient to allege an "anticompetitive scheme that itself creates the barriers to entry." (Doc. 20 at 20). *See Nat'l Athletic Trainers' Ass'n, Inc. v. American Physical Therapy Ass'n*, 2008 WL 4146022, at *14 (N.D. Tex. 2008). Defendants reply that "it is impossible to tell whether any barriers exist with respect to parts manufacturing or parts distribution, or both." (Doc. 22-1 at 14). The Court is inclined to agree with Defendants, but the underlying flaw in Felder's' position is a failure to identify exactly which market(s) it references when it says barriers to entry exist in "the market."[16] Thus, the Court reiterates that Felder's must clarify which markets are relevant in an amended complaint. However, the Court agrees with Felder's that it is plausible that new market entrants dealing aftermarket parts would find it difficult to compete with OEM dealers, like All Star, while the challenged pricing program exists. Furthermore, "[t]he question is not whether there are barriers to entry, but rather whether the barriers in a particular industry are large enough to trigger judicial concern." *FMC Corp.*, 170 F.3d at 531. Thus, although Felder's' allegations are thin, the Court finds that Defendants' sudden and drastic reduction in prices warrants judicial concern and that Felder's' allegations are sufficient to withstand a motion to dismiss.

[15] The market power analysis, here, assesses market power in light of *existing* barriers to entry. Notably, barriers to entry are also discussed, *infra*, but the inquiry below assesses the potential existence of *future* barriers to entry which might contribute to a dangerous probability that Defendants will recoup.

[16] If "the market" is the "automotive parts industry," then Defendants' market share is statistically different than it would be if the relevant market were defined as "collision parts compatible with GM vehicles." This is an illustration of why the Fifth Circuit requires definition market of relevant market(s). *See supra* note 13.

Felder's must amend its Complaint to include more specific allegations regarding the definition of the relevant market(s), the number of competitors in the market, and the current state of competition. Additionally, even though courts do not require a specific market share percentage to warrant recovery for a § 2 claim, Felder's must provide specific allegations supporting that Defendants' market share is significant. Finally, Felder's must provide further specifics as to why Defendants have legally significant market power given (1) the nature of the relevant market(s) and (2) Defendants' market share therein.

**2. Attempted Monopolization Elements**

As referenced above, the first element of an attempted monopolization claim is exclusionary conduct. Here, the alleged exclusionary conduct is predatory pricing. The essence of a predatory pricing claim is as follows: "A business rival has priced its products in an unfair manner with an object to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market." *Brooke Group,* 509 U.S. at 221. A predatory pricing claim under § 2 of the Sherman Act must sufficiently allege facts supporting the two prerequisites to recovery—namely, that (1) the defendant's pricing is below an appropriate measure of its costs, and (2) there is a dangerous probability that the defendant will recoup any losses sustained during the below-cost pricing period. *Brooke Group,* 509 U.S. at 222-24.[17]

Although *Brooke Group*'s predatory pricing prerequisites strike at the first and third elements of an attempted monopolization claim, the prerequisites do not directly relate to the second element of attempted monopolization—namely, the issue of specific intent. Regarding the first element (sometimes, the "conduct element") of attempted monopolization, predatory pricing is generally one form of exclusionary behavior. Furthermore, since "[t]he success of any

[17] While § 2 of the Sherman Act condemns "predatory pricing when it poses a dangerous probability of actual monopolization," the RPA "requires only that there be a reasonable possibility of substantial injury to competition before its protections are triggered." *Brooke Group,* 509 U.S. at 222 (internal quotations and citations omitted).

predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain," *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) (emphasis in original), the recoupment prong of a predatory pricing claim overlaps with the third element of attempted monopolization. Put differently, in order to establish that a defendant has a dangerous probability of recoupment, the plaintiff must also offer proof that the defendant has a dangerous probability of acquiring monopoly power or already possesses such power.

Therefore, Felder's must provide facts sufficient to support inferences that: (1) Defendants' prices are below an appropriate measure of their costs, (2) there is a dangerous probability that Defendants' will recoup profits lost due to below-cost sales, and (3) Defendants' engaged in the alleged predatory practice with the specific intent to gain monopoly power.

**a. <u>Predatory Pricing</u>**

When analyzing a claim of predatory pricing, courts routinely address the recoupment element first, because "[i]f there is no likelihood of recoupment, it would seem improbable that a scheme would be launched." *FMC Corp.*, 170 F.3d at 528.[18] "Only if market structure makes recoupment feasible need a court inquire into the relation between price and cost." *A.A. Poultry Farms*, 881 F.2d at 1401. Recoupment has two prongs. First, a plaintiff must show that the predatory scheme "could actually drive the competitor out of the market." *FMC Corp.*, 170 F.3d at 528. Second, "there must be evidence that the surviving monopolist could then raise prices to consumers long enough to recoup his costs without drawing new entrants to the market." *Id.* at 528-29 (citing *Brooke Group*). The question is whether a defendant will be able to offset losses by recovering "in the form of later monopoly profits." *Brooke Group*, 509 U.S. at 224.

[18] Accordingly, the recoupment analysis assumes *arguendo* that below-cost pricing can be established. *See FMC Corp.*, 170 F.3d at 532 (explaining this procedure for analysis of predatory pricing).

Defendants contend that Felder's has failed to plead sufficient facts to permit such an inference because: (1) Felder's has failed to sufficiently allege facts regarding the relevant market and the state of competition therein; (2) in several places, Felder's merely recites the legal element for recoupment; (3) Felder's has failed to specifically allege barriers to entry exist that make recoupment feasible; and (4) Felder's admits that the program has existed for years, yet pricing remains competitive. In opposition, Felder's argues that it has pled facts sufficient to meet the first prong of recoupment because Felder's has suffered a steady decline in profitability and market share since Defendants implemented the pricing program.

**i. <u>First Prong of Recoupment – Possibility of eliminating Felder's</u>**

Under the first prong, Felder's must adequately support the proposition that Defendants' alleged predatory conduct could drive Felder's out of the market. The Court recognizes Defendants' position—namely, that market power and market definition are essential to the analysis of whether Felder's could be (or is being) driven out of the market due to Defendants' conduct. However, having addressed these issues above, the Court's analysis must proceed under the assumption that a relevant market exists and that Defendants have sufficient market power to warrant antitrust concern under § 2 of the Sherman Act.

Before delving into the issue of whether Felder's could be driven out of business by the alleged predatory scheme, the Court first rejects the implication that the name of the program evidences such a likelihood. Felder's asserts that the title of the program, "Bump the Competition," is "very telling nomenclature." (Doc. 25 at 11). However, the name of the program has no bearing on whether predatory pricing exists.[19] The Court will not entertain arguments about the title of GM's program. Furthermore, "[i]t is axiomatic that the antitrust laws

[19] *See R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!*, 462 F.3d 690, 696 (7th Cir. 2006) (observing that phrases like "kill the competition" do not support inference of predatory pricing).

were passed for the protection of *competition*, not *competitors*." *Brooke Group*, 509 U.S. at 224 (emphasis in original) (internal quotation and citation omitted). Since competition is the "conduct the antitrust laws are designed to protect." *Matsushita*, 475 U.S. at 594, Felder's is simply incorrect to imply that "competition" is a dirty word.

When determining whether an alleged predatory scheme could eliminate a competitor, relevant considerations include "the extent and duration of the alleged predation, the relative strength of the predator and its intended victim, and their respective incentives and will." *Brooke Group*, 509 U.S. at 225 (internal quotation and citation omitted). Pushing aside the issue of the parties' relative strength, the Court addresses the extent and duration of alleged predation.

Defendants reference the duration of the pricing program in the course of arguing that All Star is unlikely to ever recover profits.[20] Defendants do not, however, argue that the duration of the program evidences that Felder's will continue to coexist while the program continues. In opposition, Felder's further explains its theory of why it could be driven out of the market if the pricing program is not condemned, relating its theory to the extent and duration of the program in the course of the argument (Doc. 25 at 14-16). Felder's argues there are two ways in which All Star profits[21] from sales of OEM parts. First, when All Star sells OEM parts that have an aftermarket equivalent, GM's program provides All Star with the option to sell at a price below dealer cost and collect a rebate. Second, even though the program does not apply to OEM parts without an aftermarket equivalent, All Star nevertheless profits on the sale of these OEM parts

[20] All Star's ability to recover profits does not have to do with whether Felder's will be driven out of business, but rather has to do with the second prong of the recoupment analysis.

[21] Felder's actually uses the word "recoup." As Defendants correctly point out, this is technically inaccurate, since recoupment has to do with recovering lost profits after an alleged predator has driven its competition out of business. The term "recoup," therefore, properly refers to the ability to recover profits lost as a result of below-cost pricing by charging supracompetitive prices after other firms have been driven out of business by a predator. Notwithstanding Felder's' technical misuse of the term recoup, its point is well taken—that Defendants make money (1) by selling OEM parts that have no aftermarket equivalent at high prices, and (2) by selling OEM parts with aftermarket equivalents at prices that undercut competition.

by keeping prices high since GM already has a monopoly on these parts. Felder's asserts that Defendants will be able to eliminate Felder's and other similarly situated aftermarket dealers, at which point the OEM dealers will be able to increase the price on parts for which there were once aftermarket parts. Furthermore, Felder's alleges that, since the implementation of the program, its revenues have significantly decreased and four other distributors have been driven to bankruptcy. At this stage of the litigation, although Felder's has not adequately addressed market power and definition, the Court finds that the allegations regarding extent and nature of the program support a plausible inference that Felder's could be driven out of business by the program's continued existence.[22] Therefore, Felder's' allegations regarding the first prong of recoupment are sufficient to withstand a motion to dismiss.

**ii. <u>Second Prong of Recoupment – Plausibility of Recoupment</u>**

The second prong assesses the probability of whether Defendants could charge supracompetitive prices for a period of time long enough to recoup profit lost as a result of the challenged program. The object of this inquiry is to determine the likelihood of a predator's success in achieving the end goal of any predatory plan—net profit. Courts will not condemn behavior where it appears likely that a predator's plan will fail to be profitable, because such behavior "produces lower aggregate prices in the market, and consumer welfare is enhanced." *Brooke Group*, 509 U.S. at 224.

Defendants question Felder's' allegation that All Star will be able to set supracompetitive prices to recoup the losses associated with the pricing program once aftermarket competitors have been driven out of business. Defendants contend that All Star has nothing to recoup because

[22] Since the Court has already stated that Felder's must amend to clarify whether the bankrupted entities competed in the relevant market, *supra* at p. 12-13, the conclusion reached here assumes that the bankrupted entities did in fact compete in the relevant market.

prices are not below cost, as required to establish liability for a predatory pricing scheme.[23] Alternatively, Defendants assert that Felder's allegations are not sufficient to show that recoupment is plausible, because Felder's has provided insufficient factual support regarding market definition and the potential for future barriers to entry. Finally, Defendants contend that because All Star has not raised prices in the last four years, this undercuts the notion that the firm has the ability to recover profits in the future.

The Court first addresses Defendants' argument regarding market definition. Critically, Felder's' allegations regarding how All Star profits on OEM parts *today* has little to do with the relevant inquiry under the second prong of recoupment, which is whether All Star will be able to recover profits lost as a result of the "Bump the Competition" sales by charging supracompetitive pricing if Felder's goes out of business *in the future*. Since such a prediction certainly relates back to the issue of market definition, Felder's must allege additional facts to show how this particular market structure is susceptible to a monopoly takeover by All Star for a long enough period so that All Star would be able to net a profit in the future by charging supracompetitive prices to offset losses sustained by the current pricing structure.

Related to the issue of market definition is the issue of whether future barriers to entry would enable recoupment. One key market factor to consider whether the alleged predator will be able to "raise prices to consumers long enough to recoup his costs without drawing new entrants to the market." *FMC Corp.*, 170 F.3d at 528-29 (citing *Brooke Group*). "If barriers to entry in an industry are low, new entrants into the industry will appear when the monopolist raises its prices, and the net effect of the campaign will be a loss to the predator. . . ." *Id.* at 530.

For a predatory pricing claim, a court "should focus on whether significant entry barriers would exist *after* the [defendant] had eliminated some of its rivals." *Cargill, Inc. v. Monfort of*

[23] Below cost pricing is addressed *infra*.

*Colorado, Inc*., 479 U.S. 104, 119 n.15 (1986). It is only "at that point the remaining firms would begin to charge supracompetitive prices, and the barriers that existed during competitive conditions might well prove insignificant." *Id*.

As referenced above, the Complaint states "barriers to entry into the automotive parts industry are high and difficult…." (Doc. 1 at 10). Defendants argue that this is a "naked assertion" that is insufficient to withstand a motion to dismiss. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). Further, Defendants argue that existing barriers to entry are not the question. In this regard, the Court agrees that, in the context of recoupment, the question is "whether significant entry barriers would exist *after* the [defendant] had eliminated some of its rivals." *Cargill*, 479 U.S. at 119 n.15. It is only "at that point the remaining firms would begin to charge supracompetitive prices, and the barriers that existed during competitive conditions might well prove insignificant." *Id*.

Defendants additionally rely on *FMC Corp.* for the point that Felder's' allegations regarding barriers to entry are insufficient. In *FMC Corp.*, the plaintiff argued that the defendant would be able to raise prices after driving the plaintiff out of business, because of alleged barriers to entry in the marketplace including "transportation costs, manufacturing costs, and the demonstrated ability of the dominant firm to charge supracompetitive prices." *FMC Corp.*, 170 F.3d at 530 (internal quotations omitted). The Fifth Circuit rejected the plaintiff's argument, noting that "[t]he question is what will stop foreign firms from appearing on the scene, pointing out to municipalities the supracompetitive prices, and providing an alternative." *Id.* While the Court recognizes Defendants' position, the Fifth Circuit was reviewing a motion for summary judgment, not a motion to dismiss. Although Felder's' allegations are thin, at this point in the litigation, they are sufficient to withstand the motion to dismiss. However, Felder's will have to adduce evidence that future entry into the market is difficult beyond Defendants' ability to charge supracompetitive prices. Felder's will have to show that the future barriers to entry in the relevant market(s) are significant enough to trigger the Court's concern.[24]

Turning back to the extent and nature of the pricing program, Defendants contend that while the program has existed for several years, pricing is still competitive, and therefore, it is unlikely that All Star could ever recoup its investment. Defendants point out that one of the reasons that courts are skeptical of predatory schemes because it is nearly impossible to successfully achieve the end goal of recouping lost profits. *FMC Corp.*, 170 F.3d at 527-28 ("[T]he consensus among economists [is] that such schemes are difficult if not impossible to successfully complete and thus unlikely to be attempted by rational businessmen."). In response, Felder's argues that this is a factual issue inappropriate for consideration at this stage. Significantly, neither party cites any authority that imposes a time period for how long a program must exist to support plausibility of recoupment. The Supreme Court has noted the extended length of a program may undercut the plausibility of recoupment. *Matsushita*, 475 U.S. at 591 ("Two decades after their conspiracy is alleged to have commenced, petitioners appear to be far from achieving this goal: the two largest shares of the retail market in television sets are held by RCA and respondent Zenith, not by any of petitioners."). Although the alleged pricing scheme here has not been in existence for nearly as long as the program in *Matsushita*, the Court finds that this fact is not dispositive of whether there is a dangerous probability of recoupment in the future.

In sum, the central flaw with respect to the entire recoupment analysis relates back to Felder's' need to amend the Complaint with respect to market definition and market power. The

[24] To reiterate, here the analysis is unlike the analysis of barriers to entry above, which asks about existing barriers to entry. *See supra* note 15 and accompanying text. The inquiry with respect to recoupment is whether future barriers to entry will exist that could influence a defendant's ability to charge supracompetitive prices.

Court agrees with Defendants to this extent. *Cf. Brooke Group*, 509 U.S. at 226 ("In certain situations—for example, where the market is highly diffuse and competitive, or where new entry is easy, or the defendant lacks adequate excess capacity to absorb the market shares of his rivals and cannot quickly create or purchase new capacity—summary disposition of the case is appropriate."). Nevertheless, the Court also recognizes that, due to the nature of predatory pricing claims, the "prerequisites to recovery are not easy to establish." *Id*. For that reason and those stated above, the Court concludes that Felder's' allegations with regard to recoupment are sufficient to trigger antitrust concern at this stage of the litigation.

**iii. <u>Below Cost Pricing</u>**

The Court now addresses the issue of below-cost pricing. Felder's' Complaint states that All Star and Doe Defendants sold OEM parts below cost.[25] The parties dispute the appropriate measure of cost for the purposes of this analysis. The fundamental disagreement between the parties is temporal in nature and, as such, the question before the Court is whether below-cost pricing should be adjudged at the time of sale, as Felder's contends, or after the dealers are reimbursed by GM, as Defendants assert.

Felder's alleges that—at the time of the sale—the Defendant-dealers sell the OEM parts at a price below the dealers' cost. Felder's argues that this allegation is sufficient to establish below-cost pricing under the Fifth Circuit's standards. Defendants recognize that the point-of-sale price is below dealer cost. However, Defendants contend that the sales were not below-cost because dealers are made whole under the pricing program and, in fact, make a profit. As the exhibits illustrate, GM compensates participating dealers who sell at the bottom line price by refunding claims for the difference between the sale price and the dealer's cost, plus a 14%

[25] Felder's does not allege that GM sold parts below cost in the course of transacting with the Defendant-dealers.

profit. Thus, Defendants contend that it is appropriate to view the entire transaction when determining whether the sales are below-cost.

Defendants further contend that Felder's' arguments fail to account for how the parts are sold to collision centers and body shops. Defendants point to a footnote in *FMC Corp.*, which provides that the entire transaction, rather than its individual components, must be below cost for a predatory pricing claim. *See FMC Corp.*, 170 F.3d at 533 n.15. Felder's, however, argues that Defendants' focus *FMC Corp.* is inapposite. After reviewing *FMC Corp.*, the Court agrees with Defendants' interpretation of the case.

In *FMC Corp.*, the plaintiff argued that a part of the defendant's project would "run at a negative operating margin." *Id*. at 533. This, according to the plaintiff, was evidence of a below cost price. However, as the Fifth Circuit noted, the plaintiff's allegation was flawed because even if a particular part of the project were below cost, the plaintiff failed to allege that the "project *as a whole* was unprofitable." *Id.* at 533 n.15 (emphasis added). Having previously confronted a similar argument, the court further explained that it has rejected a plaintiff's contention that price cuts should be examined in isolation. *Id.* The Fifth Circuit concluded that this would be akin to looking at a "buy one get one free" deal and only looking at the price of the free product to conclude that there was predation. *Id.*

Based on *FMC Corp.*, this Court concludes that considering the transaction 'as a whole' is appropriate. Felder's' contention that the analytical focus of below-cost pricing should be limited to the time of sale is difficult to square with the logic espoused in *FMC Corp*. The more reasonable inference drawn from *FMC. Corp.* is that the cost and revenue associated with a particular sale should not be dissected into pieces, but rather treated as a whole, regardless of the time associated with any discount or rebate programs. Additionally, the Court is persuaded by the authority cited by Defendants, suggesting that, in the context of an RPA claim, price is measured after considering any discounts or rebates. *See A.A. Poultry Farms*, 881 F.2d at 1407 ("Selling a chain 100% of its requirements at 80¢/dozen is the same as furnishing 80% of the requirements at $1.00/dozen and giving it the other 20% for 'free.' Whether price discrimination has occurred depends, therefore, on the price *after* all discounts, specials, and so on."). To find that the relevant sales by All Star are below-cost ignores the commercial realities of the transaction – specifically the fact that All Star probably would not sell at the suggested "bottom-line" price absent GM's claim system, which allows for collection of the difference between the sales price and dealer cost, plus a 14 percent profit.

Having disposed of the parties' temporal debate, the question remains whether the sales are below-cost under the Fifth Circuit's standards. Predatory pricing claims require a showing that pricing is below some "appropriate measure" of cost. *Brooke Group*, 509 U.S. at 223.[26] Although circuits are split on what constitutes the appropriate measure of cost, *see id*. at n.1 (explaining this split), the Fifth Circuit has "long embraced" the standard that average variable cost ("AVC") is an appropriate measure of cost. *FMC Corp.*, 170 F.3d at 528 (5th Cir. 1999) (reaffirming this standard after *Brooke Group*). Accordingly, this Court must consider prices below AVC as "below-cost" for the purposes of a predatory pricing claim. *Id*.

All costs can be lumped into one of two categories—fixed or variable. *FMC Corp.*, 170 F.3d at 532. Fixed costs are those that remain substantially unaffected due to changes in short-term output—for example, the costs associated with acquiring land. *Id*. Variable costs are those which are affected by changes in output – for example, hourly wages, cost of materials, or other costs associated with production. *Id*. AVC is measured by dividing variable costs by output.

[26] Where the challenged prices are above cost, recovery is rare because such claims could set a precedent that may have a chilling affect on the type of legitimate price cuts that directly benefit consumers. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 549 U.S. 312, 319 (2007).

*Taylor Pub.*, 216 F.3d at 478 n.6.[27] AVC is not, as Felder's suggests, "cost of the part plus the variable costs of selling the part." (Doc. 1 at 5). Notably, the Fifth Circuit "has found that judgment as a matter of law is appropriate when a plaintiff fails to adequately specify how the challenged pricing undercuts the defendant's variable costs." *Id*.

Felder's' Complaint focuses on (1) the cost that the Defendant-dealers paid to GM and (2) the Defendant-dealers' sale price. More is required under the Fifth Circuit's standard. *See FMC Corp.*, 170 F.3d at 532 (observing that failure to "explor[e] the relationship between variable costs, fixed costs, and profits" is legal error). Perhaps the lack of exploration is due, in whole or in part, to the circumstances—namely, that Felder's may not have access to certain information about Defendants' costs and profits. Alternatively, the failure could be attributable to the fact that Felder's used the incorrect formula to calculate AVC. Regardless, Felder's must address these deficiencies by amendment.

**b. <u>Specific Intent to Achieve Monopoly Power</u>**

Specific intent to monopolize is an essential element of an attempted monopolization claim. *Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc.*, 735 F.2d 884, 887 (5th Cir. 1984). "The intent must be to do more than compete vigorously; vigorous competition is precisely what the antitrust laws are designed to foster." *Id*. Rather, the plaintiff asserting attempted monopolization must show a defendant's specific intent to acquire and exercise the power to fix price or exclude competition. *Id*. (citations omitted). Felder's alleges that Defendants entered into the pricing program with GM for the "specific purpose of eliminating competition and making GM the only seller of collision parts for repairs of GM vehicles in southern Louisiana and Southern Mississippi." (Doc. 1 at 5). Defendants' Motion to Dismiss

[27] For further explanation of costs, *see FMC Corp.*, 170 F.3d at 532.

does not directly argue this issue. Thus, the Court declines to delve into whether Felder's' allegations provide sufficient factual support regarding the specific intent element.

**c. <u>Dangerous Probability of Obtaining Monopoly Power</u>**

Under the third element for an attempted monopolization claim, Felder's must show that Defendants have a dangerous probability of obtaining monopoly power due to the program. As previously stated, the recoupment analysis for predatory pricing directly relates to this final element for attempted monopolization. Thus, the Court finds that the analysis of the former, *supra*, applies equally here. Accordingly, in an amended complaint permitted, Felder's must provide further factual support regarding the issues discussed in the recoupment analysis, including Defendants' market power and Defendants' potential ability to dominate the market to the exclusion of others for a time period long enough to recover money lost as due to the alleged predatory program.

**C. <u>Standing under Federal Antitrust Law</u>**

In Defendants' Motion to Dismiss, the issue of antitrust standing is raised in a footnote (Doc. 16 at n.12). Private party standing in antitrust litigation is governed under the Clayton Act.[28] Antitrust standing only exists where "a plaintiff shows: 1) injury-in-fact, an injury to the plaintiff proximately caused by the defendants' conduct; 2) antitrust injury; and 3) proper plaintiff status, which assures that other parties are not better situated to bring suit." *Doctor's Hosp.*, 123 F.3d at 305. The third prong is not argued by Defendants. The core contention of Defendants' argument is that the Complaint does not support an inference that the complained-of injury flows from the alleged predatory conduct. Felder's does not counter this argument in opposition. The Complaint simply asserts that the alleged violations of federal antitrust law give

[28] 15 U.S.C. § 15(a) ("[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor"); 15 U.S.C. § 26 (providing that private parties "threatened [with] loss or damage by a violation of the antitrust laws" may seek injunctive relief).

rise to a private right of action for damages under §4 of the Clayton Act, 15 U.S.C. § 15(a), and for injunctive relief under § 16 of the Clayton Act. 15 U.S.C. § 26. Nevertheless, because neither party has sufficiently briefed the law with respect to the issue of antitrust standing, the Court declines to resolve the issue at this time.

**LOUISIANA'S ANTITRUST LAWS**

The Court next addresses the state law claims, starting with the claimed violations of Louisiana's antitrust statutes. Felder's alleges that Defendants have violated La. R.S. 51:122 and La. R.S. 51:123, which are the functional equivalents to § 1 and § 2 of the Sherman Act, respectively. Because the state statutes track the Sherman Act almost verbatim, "Louisiana courts have turned to the federal jurisprudence analyzing those parallel federal provisions for guidance." *Southern Tool & Supply, Inc. v. Beerman Precision, Inc.*, 03-0960, p. 7 (La. App. 4 Cir. 11/26/03); 862 So.2d 271, 278. Thus, the analysis of the alleged § 2 violation, *supra*, is relevant, and Felder's must amend with respect to La. R.S. 51:123 for the same reasons articulated in the foregoing discussion of § 2.

As for La. R.S. 51:122, the Complaint is also deficient because it states that Defendants are liable for "conspiracy in restraint of trade," which is simply a recitation of La. R.S. 51:122 and its federal counterpart, § 1. (Doc. 1 at 16). Both require proof of an agreement that unreasonably restrains trade. *Southern Tool*, 862 So.2d at 278. However, Felder's never alleged a § 1 violation. As such, Felder's' naked assertion that Defendants violated the equivalent state statute is insufficient as stated.

As for the other revised statutes cited to in Count Four of the Complaint, §§ 51:124(A), 51:137, and 51:422, the Court reaches a similar conclusion. Felder's' position is that the federal antitrust allegations are sufficient support these claims. However, having found that the federal antitrust allegations are insufficient as pled, the Court must also find that the alleged violations of state law are insufficient.

In sum, it is true that violations of federal antitrust law can support a claim that Louisiana's antitrust law has been violated, *provided that the federal antitrust violations are sufficiently pled*. Because Felder's' allegations are currently insufficient to support the federal antitrust claims, it follows that the state law claims are deficient, as Felder's merely restates each revised statute in its Complaint. Felder's may amend to cure such deficiency. Regarding La. R.S. 51:123, the Court will hold Felder's to standards similar to those stated in the § 2 analysis. However, since neither parties has sufficiently briefed the issues presented under § 1 and La. R.S. 51:122, the Court declines delve into further detail regarding what will be required in the amendment. The Court reaches the same conclusion with respect to §§ 51:124(A), 51:137, and 51:422. Felder's may attempt to cure these deficiencies in an amended complaint.

**LUTPA**

Defendants contend that Felder's fails to allege facts sufficient to establish a violation of the Louisiana Unfair Trade Practices Act ("LUTPA"). Defendants argue the LUTPA claim fails because Felder's fails to allege conduct that falls within the range of fraudulent or deceptive practices prohibited by LUTPA, and also because Felder's has not, in Defendants' view, sufficiently alleged the antitrust violation upon which the LUTPA claim is premised.

Private parties have a right of action under LUTPA. *Cheramie Services, Inc. v. Shell Deepwater Production, Inc.* 2009-1633 (La. 4/23/10); 35 So.3d 1053, 1060, *construing* La. R.S. 51:1409(A). The Supreme Court of Louisiana recently held that this right of action extends to all persons, including business competitors, who assert loss of money or property as a result of another's unfair or deceptive trade practices. *Id*. LUTPA prohibits "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." La. R.S. 51:1405(A). Businesses are prohibited from engaging in "fraud, misrepresentation, deception, and other oppressive and unscrupulous conduct." *Tubos de Acero de Mexico, S.A. v. Am. Intern. Invest. Corp.*, 292 F.3d 471, 480 (5th Cir. 2002). "[O]nly egregious actions involving elements of fraud, misrepresentation, deception, or other unethical conduct will be sanctioned based on LUTPA." *Cheramie*, 35 So.3d at 1060. The "range of prohibited practices under LUTPA is extremely narrow," *id*., and "sound business practice or the exercise of permissible business judgment" are not prohibited. *High Tech Communications v. Panasonic Co.*, 1995 WL 65133, at *3 (E.D. La. 1995).

A party "alleging fraud or mistake…must state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). Rule 9(b) further requires a plaintiff complaining of fraud to allege "the particulars of time, place, and contents of the false representations, as well as the identity of the person making the misrepresentation and what he obtained thereby." *Tel-Phonic Services, Inc. v. TBS Int'l, Inc.*, 975 F.2d 1134, 1139 (5th Cir. 1992) (internal quotations and citations omitted). In Louisiana, fraud requires a showing of "(1) a misrepresentation of a material fact, (2) made with the intent to deceive, and (3) causing justifiable reliance with resultant injury." *Newport Ltd. v. Sears, Roebuck & Co.*, 6 F.3d 1058, 1068 (5th Cir. 1993).

The parties dispute the issue of whether a LUTPA claim may be based solely upon a violation of federal antitrust laws. The parties' dispute boils down to differing interpretations of a recent decision by the Louisiana Court of Appeal for the First Circuit, *Van Hoose v. Gravois*, 2011-0976 (La. App. 1 Cir. 7/7/11); 70 So.3d 1017, 1024. In *Van Hoose*, the court concluded that the allegations were insufficient to establish "injury to competition," and that the plaintiff therefore failed to "state a claim for unfair trade practices under the LUTPA." *Id*. at 1024. Felder's maintains that, under *Van Hoose*, a sufficiently pled a federal antitrust violation also suffices to state a cause of action under LUTPA. In reply, Defendants contend that Felder's has misread *Van Hoose* and, according to Defendants, the case is properly understood as standing for the proposition that a plaintiff's failure to sufficiently allege an antitrust violation supports a finding that the plaintiff has also failed to state a claim under LUTPA. The converse of this proposition, Defendants argue, is not necessarily true. The Court agrees. For this reason, as well as those in the paragraph that follows, Felder's has failed to specifically allege sufficient facts to support a claim under LUTPA.

Here, as a business competitor of All Star, Felder's would fit within the class of plaintiffs who have standing to bring a claim under LUTPA. However, a claim based on Felder's' lost profits is only actionable if the lost profits were a result of "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." *Cheramie,* 35 So.3d at 1057. Felder's does not specifically allege that Defendants committed fraud, misrepresentation, deception, or unethical conduct. Instead, the Complaint asserts that Defendants engaged in an effort to sell repair parts below cost, thereby committing an unfair or deceptive practice as contemplated by LUTPA. (Doc. 1 at 15, ¶ 51). This allegation is nothing more than a naked assertion followed by a recitation of the applicable law. Thus, the Court finds that the Complaint is insufficient to state a claim under LUTPA, but will grant Felder's' request for leave to amend to cure the deficiency.

**SOLIDARY LIABILITY UNDER La. Civ. Code art. 2324**

La. Civ. Code art. 2324 provides the basis for solidary liability under Louisiana law. The article provides in pertinent part: "He who conspires with another person to commit an intentional and willful act is answerable, in solido, with that person for the damage caused by that act." *Id*. Courts have clarified that Art. 2324 "does not recognize an independent cause of action for civil conspiracy." *Rhyce v. Martin*, 173 F. Supp. 2d 521, 535 (E.D. La. 2001). Rather, the actionable element is the wrong perpetrated by the actors involved in the conspiracy. *Id*. Stated differently, the conspiracy is the mechanism that must exist for a plaintiff to recover under Art. 2324. The mere existence of a conspiracy, however, is not a basis for liability.

Here, Felder's repeatedly asserts that Defendants engaged in a conspiracy throughout the Complaint. Yet, as Defendants correctly point out, nowhere in the Complaint does Felder's specifically allege an antitrust conspiracy claim. (Doc. 22-1 at 18). Defendants further argue that because the antitrust and other state law claims should be dismissed, the dismissal of those claims mandates dismissal of Felder's' claim for solidary liability.

As it stands, Felder's merely alleges that Defendants have conspired to commit violations of the law. (Doc. 1 at 17). Significantly, the Complaint (1) never mentions § 1 of the Sherman Act, which condemns unlawful conspiracies in restraint of trade, is never mentioned in the Complaint; (2) fails to specifically allege facts in support of the elements for a conspiracy to monopolize claim under § 2; and (3) fails to specifically plead a cognizable conspiracy claim under Louisiana antitrust law. Therefore, Felder's' argument skips the critical step of specifically pleading the existence of a conspiracy. In the absence of specific allegations supporting the existence of a conspiracy, Count 5 is deficient as pled.

**<u>ALL STAR AS SINGLE DEFENDANT</u>**

Defendants assert that Felder's' reference to the three All Star entities as the "All Star Defendants" is impermissible. According to Defendants, Felder's has failed to allege specific facts related to each individual entity for its claims against the All Star entities to be actionable, and such failure mandates dismissal. Felder's argues that the issue of whether the parent company should be dismissed is a matter for further discovery.

Defendants cite to two district court cases in support of their proposition. *In re California Title Ins. Antitrust Litig.*, C 08-01341 JSW, 2009 WL 1458025, at *7 (N.D. Cal. May 21, 2009); *McCray v. Fid. Nat. Title Ins. Co.*, 636 F. Supp. 2d 322, 335 (D. Del. 2009). In *McCray* and *California Title*, the issue was whether a plaintiff could recover from a parent company based on an agency or alter ego theory when the parent's subsidiary engaged in a "conspiracy" under § 1 of the Sherman Act. In both cases, the courts held that the plaintiffs' complaints insufficiently pled that the parent was involved in the conspiracy. *McCray*, 636 F. Supp. 2d at 335 ("Without some averment that the corporate parent defendants directly entered into agreements, or the [subsidiary defendants] are the corporate parent defendants' alter egos, the plaintiffs have not alleged enough to establish that the corporate parent defendants entered into a conspiracy"); *California Title*, 2009 WL 1458025, at *8 (rejecting argument based on agency theory since plaintiffs did "not attempt to allege any facts to show that the parent corporations knew what their subsidiaries were doing").

Here, Felder's has affirmatively alleged that the multiple All Star entities do business under a single trade name—All Star Automotive Group—and that the name is owned by All Star Advertising Agency, Inc. ("All Star Advertising"). Although the Complaint asserts that "All Star Defendants" engaged in a conspiracy with GM, Felder's does not specifically state the degree to which All Star Advertising was involved with or had knowledge of the alleged conspiracy. In this regard, the instant case runs parallel with *McCray* and *California Title*. However, it is also true that *McCray* and *California Title* are immediately distinguishable from the instant case, since Felder's has not alleged a violation of § 1 of the Sherman Act. Thus, while the facts alleged would not warrant § 1 liability for All Star Advertising, the Court rejects Defendants' proposition that the tactic of using a single name in reference to a group of entities is impermissible (Doc. 22-1 at 21). Nevertheless, the Court finds that the amended complaint must provide more specific factual support with regard to All Star Advertising's involvement (or lack thereof) with GM, particularly if Felder's wishes to pursue the Louisiana antitrust law claim under La. R.S. 51:122.

**FELDER'S' REQUEST FOR LEAVE TO AMEND**

Felder's HAS requested leave to file an amended complaint to cure any deficiencies that the Court may find. Defendants, in reply, argue that Felder's' request should be denied because it offers no insight on the grounds on which amendment is sought or how an amendment would cure any deficiencies. According to Defendants, Felder's' request for leave is a "bare request" and, therefore, it should be denied.

According to the Fifth Circuit, "a bare request in an opposition to a motion to dismiss—without any indication of the particular grounds on which the amendment is sought- does not constitute a motion [for leave to amend]." *Pension Fund v. Integrated Electrical Services, Inc.*, 497 F.3d 546, 555-56 (5th Cir. 2007) (quotation and citation omitted). However, it is also true that "district courts often afford plaintiffs at least one opportunity to cure pleading deficiencies before dismissing a case, unless it is clear that the defects are incurable or the plaintiffs advise the court that they are unwilling or unable to amend in a manner that will avoid dismissal." *Great Plains Trust Co. v. Morgan Stanley Dean Witter & Co.*, 313 F.3d 305, 329 (5th Cir. 2002). The permissible reasons for denying a request to amend include "undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc." *Pension Fund*, 497 F.3d at 556.

Here, Felder's is willing to amend and it does not appear that such a request would be futile. Given the sudden and drastic difference between standard OEM prices and the prices offered under the challenged pricing program, there is reason for suspicion. For instance, one particular auto part mentioned in the Complaint is normally sold by an OEM dealer, like All Star, for $228.83, but under the pricing program, dealers may offer the same part for a "bottom line price" of $119.93. This demonstrates that the program allows OEM dealers to cut pricing by nearly half for an OEM part with an aftermarket counterpart. Given the nature of antitrust suits, in which the plaintiff's access to information is often limited, the Court is inclined to grant Felder's' request for leave to amend. Cf. *Poller v. Columbia Broad. Sys., Inc.*, 368 U.S. 464, 473 (1962) ("We believe that summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot.").

IV.

Accordingly, Defendants' Motion to Dismiss (Doc. 22) is DENIED, and Plaintiff's request for leave to amend (Doc. 25 at 22-23) is GRANTED.

Signed in Baton Rouge, Louisiana, on April 16th, 2013.

**JAMES J. BRADY, DISTRICT JUDGE**
**MIDDLE DISTRICT OF LOUISIANA**

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF LOUISIANA

FELDER'S COLLISION PARTS, INC.

CIVIL ACTION

VERSUS

NO. 12-646-JJB-SCR

GENERAL MOTORS COMPANY ET AL

**RULING ON DEFENDANT'S MOTION TO DISMISS FIRST AMENDED AND SUPPLEMENTAL COMPLAINT**

This matter is before the Court on a Motion (doc. 54) to Dismiss First Amended and Supplemental Complaint brought by Defendants, General Motors LLC ("GM"), and All Star Advertising Agency, Inc., All Star Chevrolet North, L.L.C., and All Star Chevrolet, Inc. (collectively referred to herein as "All Star"). Plaintiff, Felder's Collision Parts, Inc. ("Felder's"), has filed an opposition (doc. 56), to which the Defendants have filed a reply (doc. 59). Oral argument is unnecessary. The Court's jurisdiction exists pursuant to 28 U.S.C. § 1331. For the reasons stated herein, the Defendants' Motion (doc. 54) is GRANTED.

## I. Background

Felder's has brought this action pursuant to several federal and state antitrust statutes as well as other Louisiana state laws. Specifically, Felder's has brought claims pursuant to Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1,2, the Louisiana Unfair Trade Practices and Consumer Protection Act ("LUTPA"), La. Rev. Stat. § 51:1401, *et seq.*, and several other Louisiana revised statutes, La. R.S. §§ 51:122, 123, 124, 137, and 422. Additionally, Felder's contends that GM, All Star, and John Doe Defendants 1-25 ("Doe Defendants") should be held jointly and severally liable for conspiring to aforementioned violations under La. Civ. Code art. 2324.

The facts of this case have been detailed in a previous ruling and therefore will be summarily addressed herein. The suit arises out of a price incentive program called "Bump the Competition" in which distributors like All Star can sell GM's original equipment manufacturer parts ("OEM parts") at a deep discount below its costs to consumers and then apply to GM for a rebate to account for the lost cost. The distributors are also entitled to receive a lost profit. Felder's alleges that this program is only available for OEM parts that have an aftermarket equivalent. Felder's further alleges that the program is nothing more than a predatory pricing scheme intended to drive aftermarket part dealers out of the market in an effort to obtain monopoly power.

Defendants filed a Motion (doc. 22) to Dismiss Felder's complaint arguing that the claims were insufficiently pled. Upon reviewing the complaint and the memorandum filed in both support and opposition to the motion to dismiss, the Court agreed with the Defendants but granted Felder's leave to cure the complaint's insufficiently pled claims (doc. 32). Though there were many deficiencies in Felder's complaint, the Court found that the most glaring were that the complaint failed to allege facts to adequately define the proper geographic market, demonstrate All Star's market power in the relevant market, and demonstrate that All Star participated in predatory below-cost pricing. The Court set forth a detailed roadmap, firmly rooted in federal antitrust jurisprudence, to guide Felder's as it cured its insufficiently pled claims. Further, Felder's was allowed to conduct discovery to unearth facts to support its claims before it was required to file its Amended and Supplemental Complaint ("Amended Complaint") (doc. 47).

All Star now argues by way of the motion to dismiss presently before the Court, that Felder's has failed to heed the Court's instruction and therefore failed to sufficiently plead its claims. In response, Felder's argues that it has provided the required factual matter to support each and every one of its claims. Thus, its Amended Complaint is sufficient to withstand Felder's motion to dismiss. After considering the parties' arguments and reviewing the Amended Complaint, the Court is ready to rule.

## II. Discussion

### A. Rule 12(b)(6) Standard

Federal Rule of Civil Procedure 12(b)(6) provides for dismissal of a complaint for "failure to state a claim upon which relief can be granted." FED. R. CIV. P. 12(b)(6). When reviewing the complaint, a court must accept all well-pleaded factual allegations as true. *C.C. Port. Ltd. v. Davis-Penn Mortg. Co.*, 61 F.3d 288, 289 (5th Cir. 1995). In order to survive a motion to dismiss, the complaint must plead "enough facts to state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A court need not determine at this preliminary stage whether the plaintiff's claims will ultimately succeed on the merits. *Id*. at 556. Instead, a court must identify the factual allegations entitled to the presumption of truth and determine whether they state a plausible claim for relief. *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009).

### B. Federal Antitrust Claims

Felder's would like this Court to believe that at the heart of this case "is a fundamental legal question—whether the All Star Defendants' practice of selling parts to collision centers and body shops at a price below the cost paid to GM for a particular part constitutes predatory pricing." *Opposition*, Doc. 56, at 13. However, what is fundamental to any antitrust analysis is a proper definition of the relevant market and a defendant's power to detrimentally effect competition therein. Indeed, this inquiry into both market definition and market power is fundamental to properly evaluating the plausibility of a predatory pricing scheme. *See Ruling*, Doc. 32, at 17 (recognizing that "market power and market definition are essential to the analysis of whether Felder's could be (or is being) driven out of the market due to Defendants' conduct."); *see also A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1369 (7th Cir. 1989) ("Only if market structure makes recoupment feasible need a court inquire into the relation between price and cost."). For this reason, the Court will first determine whether Felder's has properly pled the relevant market definition before delving into Felder's substantive antitrust claims.

**i. Market Definition**

An adequate definition of the relevant market is critical because it "provides the framework against which economic power can be measured." *Jayco Sys., Inc. v. Savin Bus. Machines Corp.*, 777 F.2d 306, 319 (5th Cir. 1985). The relevant market is determined by analyzing the relevant geographic and product markets. *Apani Sw., Inc. v. Coca-Cola Enterprises, Inc.*, 300 F.3d 620, 626-28 (5th Cir. 2002). The Fifth Circuit has recognized that a trial court may dismiss a § 2 claim for a plaintiff's failure to define the relevant market. *Jayco Sys.*, 777 F.2d at 319; *see also Apani Sw.*, 300 F.3d at 628 (explaining that deficient market definition may be grounds to grant a motion to dismiss a § 1 claim).[1] The complaint must account for cross-elasticity of demand, i.e., whether a product is "reasonably interchangeable by consumers for the same purposes." *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 615 F.3d 412, 417 (5th Cir. 2010). A plaintiff must offer evidence demonstrating where consumers currently purchase the product and where alternative products or alternative sources of the

[1] According to the Fifth Circuit,

> Whether a relevant market has been identified is usually a question of fact; however, in some circumstances, the issue may be determined as a matter of law. Where the plaintiff fails to define its proposed relevant market with reference to the rule of reasonable interchangeability and cross-elasticity of demand, or alleges a proposed relevant market that clearly does not encompass all interchangeable substitute products even when all factual inferences are granted in plaintiff's favor, the relevant market is legally insufficient, and a motion to dismiss may be granted.

*Apani*, 300 F.3d at 628 (internal quotations and citations omitted).

product could be found if a competitor raises prices. *Doctor's Hosp. v. Southeast Med. Alliance*, 123 F.3d 301, 311 (5th Cir. 1997); *see also Apani*, 300 F.3d at 628 (explaining that geographic market "must correspond to the commercial realities of the industry and be economically significant.").

As it pertains to the relevant product market, the Court previously found that the allegations found in the complaint were sufficient to withstand a motion to dismiss but cautioned that Felder's failure to specify the relevant market(s) was something that needed to be corrected in the Amended Complaint. *Ruling*, Doc. 32, at 11. Felder's has done this by defining the market as one for "automobile collision parts for which there is an aftermarket alternative and that are compatible with GM vehicles." Doc. 50, at ¶ 10. The issue is whether Felder's has alleged enough facts to sufficiently define the relevant geographic market.

The Court found Felder's definition of the relevant geographic market to be insufficiently pled. Specifically, the Court found that "Felder's does not address whether consumers could practicably turn to other geographic areas for parts, nor does Felder's specify whether competing dealers from outside areas could come into the market." *Ruling*, Doc. 32, at 11. To cure this deficiency, the Court instructed Felder's to "allege further detail regarding the number of competitors in the geographic area, the area of effective competition, whether buyers can practicably turn to other sellers for supplies, and whether other dealers can reasonably move into the market to compete." *Id.* at 12.

In its motion to dismiss, All Star argues that Felder's has failed to follow the Court's instructions. All Star acknowledges that Felder's has included information listing the counties in Louisiana and Mississippi in which both it and All Star compete. Nevertheless, All Star avers that Felder's Amended Complaint remains deficient because Felder's neither mentions whether body shops in these counties obtain collision parts from dealers outside of the geographic area, nor whether outside dealers in other parts of the country could move into the market to compete. Furthermore, Felder's fails to mention whether it operates in areas outside of the proposed geographic market. Felder's responds by arguing that it has pled a sufficient geographic market. In addition to highlighting the counties listed in which both it and All Star compete, Felder's points to the facts it added concerning competitors who have been driven out of the market, competitors who have not entered into the market to compete, and discussed how difficult it is to enter into the proposed market. All Star replies by arguing that Felder's is merely attempting to persuade the Court to make impermissible inferences about the definition of the geographic market without alleging the requisite facts. Additionally, All Star argues that Felder's proposed geographic market is implausible as a matter of law because the Amended Complaint establishes, by including a national dealer of after-market parts, that the geographic market is larger than that demonstrated by the listed counties.

After reviewing the Amended Complaint, the Court disagrees with All Star's contention that Felder's has completely failed to follow the Court's instructions. Indeed, Felder's has included information about a competitor in the proposed market in its discussion of Keystone Automotive Industries, Inc. ("Keystone"), the country's largest after-market parts distributor. Doc. 50, at ¶ 54. This new allegation also demonstrates whether and where buyers can turn to other sellers for supplies. Finally, Felder's included allegations to support an inference that it is difficult for other dealers to reasonably move into the proposed market to compete. *Id.* at ¶ 48-50. Nevertheless, the Court agrees with the Defendant's ultimate contention that Felder's has failed to adequately define the geographic market. Critically, Felder's own allegations contradict its proposed geographic market.

First, Felder's amendment includes a national seller of after-market parts as a competitor in the proposed geographic market. While it does not naturally follow that the inclusion of a national seller leads to the conclusion that the geographic market should be national in scope, it does lead to the plausible inference that the actual geographic scope of competition is larger than that which is proposed in the Amended Complaint. It further leads to more questions as to the existence of other national or regional sellers, which may not be "the country's largest aftermarket parts distributor," but nonetheless are sellers to which buyers in the proposed market could reasonably turn. Second, Felder's alleges that a direct competitor operating in the proposed geographic market was forced out of the market by the alleged predatory pricing scheme. Doc. 50, at ¶ 53. The fact that this direct competitor is located over 100 miles away from any of the counties also included in the proposed geographic market also leads to the plausible inference that the geographic market is larger than presently defined in the Amended Complaint. Therefore, the Court must conclude that the proposed geographic market is too narrowly drawn and thus insufficiently pled. *Wampler v. Southwestern Bell Telephone Co.*, 597 F.3d 741 (5th Cir. 2010) (affirming the dismissal of a plaintiff's claim when the proposed geographic market was too narrowly defined to represent a plausible geographic market).

In sum, the Court finds that Felder's has failed to sufficiently define the effective area of competition because the Amended Complaint's allegations belie its own alleged proposed geographic market. For this reason, Felder's has failed to adequately plead its antitrust claims because they are all dependent upon a sufficient definition of the relevant market. *See Apani*, 300 F.3d at 632-33 (affirming the district court's dismissal of all of the plaintiff's antitrust claims for failure to adequately define the geographic market). Accordingly, Felder's federal antitrust claims are dismissed.[2]

**i. Predatory Pricing**

Though it has found that the predatory pricing claim has been insufficiently pled due to Felder's failure to properly allege the geographic market, the Court will nevertheless briefly address this claim. This is due primarily in part to Felder's request for reconsideration of the Court's previous ruling in which the Court held that whether the dealers engaged in below-cost pricing should be determined at the time that the dealers were reimbursed.

Rule 54(b) of the Federal Rules of Civil Procedure provides that:

> [A]ny order or other decision, however designated, that adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties does not end the action as to any of the claims or parties and may be revised at any time before the entry of a judgment adjudicating all the claims and all the parties' rights and liabilities.

FED. R. CIV. P. 54(b). A Court retains jurisdiction over all claims in a suit and may alter its earlier decisions until a final judgment has been issued. *Livingston Downs Racing Ass'n v. Jefferson Downs Corp.*, 259 F. Supp. 2d 471, 475 (M.D. La. 2002). "District courts have considerable discretion in deciding whether to reconsider an interlocutory order." *Keys v. Dean Morris, LLP*, 2013 WL 2387768, at *1 (M.D. La. May 30, 2013). "Although courts are concerned with principles of finality and judicial economy, 'the ultimate responsibility of the federal courts, at all levels, is to reach the correct judgment under law.'" *Id.* (quoting *Georgia Pacific, LLC v. Heavy Machines, Inc.*, 2010 WL 2026670, at *2 (M.D. La. May 20, 2010)).

[2] The Court's findings as to the sufficiency of the federal antitrust claims apply with equal force to Felder's claims brought pursuant to state law antitrust statutes. Because the state statutes track the Sherman Act almost verbatim, "Louisiana courts have turned to the federal jurisprudence analyzing those parallel federal provisions for guidance." *Southern Tool & Supply, Inc. v. Beerman Precision, Inc.*, 862 So.2d 271, 278 (La. App. 4 Cir. 11/26/03). Having found that the federal antitrust allegations are insufficient as pled, the Court must also find that the alleged violations of state law are likewise insufficiently pled.

Nevertheless, "rulings should only be reconsidered where the moving party has presented substantial reasons for reconsideration." *Louisiana v. Sprint Communications Co.*, 899 F. Supp. 282, 284 (M.D. La. 1995).

After review, the Court does not find substantial grounds for reconsideration pursuant to Rule 54(b) of the Federal Rules of Civil Procedure. Felder's has not presented "substantial reasons for reconsideration." Instead, Felder's attempts to persuade this Court that the case law that it has already thoroughly evaluated and found to apply to the facts of this case is unavailing. Critically, Felder's attempts to do so without citing a single case, law review article, advisory opinion, or any administrative guidance to support its position.[3] Accordingly, Felder's request for reconsideration is denied.

With its holding in place, the Court turns to whether Felder's has amended its complaint to allege below-cost pricing in line with Fifth Circuit precedent. The Court previously surmised that Felder's had failed to originally do so as a result of a lack of information related to the Defendants' costs and profits, or alternatively, the use of an incorrect formula to calculate average variable costs. The imbalance of information was cured when the Defendants were compelled by this Court to turn over relevant documents. After reviewing the Amended Complaint, the Court finds that Felder's has failed to amend to allege below-cost pricing pursuant to the Fifth Circuit standard as instructed by the Court in its previous ruling. Therefore, even if Felder's had sufficiently pled the relevant geographic market, it would still have failed to properly plead a predatory pricing scheme.

**C. LUTPA**

[3] The Automotive Body Parts Association has filed a Motion for Leave to File an Amicus Brief in Support of Plaintiffs (doc. 57). The Court has in its broad discretion elected not to grant leave. The amicus brief deals primarily with the issue of monopoly leveraging which is not an issue that is before the Court. Accordingly, the Motion (doc. 57) is denied.

The Court previously found that Felder's had failed to sufficiently plead a claim under LUTPA but granted Felder's leave to amend its claim. *Ruling*, Doc. 32, at 31. The Court agreed with the Defendants' reading of *Van Hoose v. Gravois*, 70 So.3d 1017, 1024 (La. App. 1 Cir. 7/7/11) and found that Felder's failure to sufficiently allege an antitrust violation prevented it from being able to sufficiently plead a violation of LUTPA. *Id.* The Court also found that Felder's failed to specifically allege that the Defendants committed fraud, misrepresentation, deception, or unethical conduct. *Id.* Instead, Felder's asserted that the Defendants engaged in an effort to sell repair parts below cost, thereby committing an unfair or deceptive practice as contemplated by LUTPA. *Id.* This the Court found to be "nothing more than a naked assertion followed by a recitation of the applicable law." Neither a naked assertion nor a mere recitation is entitled to the presumption of truth. *Ashcroft*, 556 U.S. at 678. Given that Felder's has again failed to sufficiently plead an antitrust violation and failed to amend its LUTPA claim to specifically allege that the Defendants committed fraud, misrepresentation, deception, or unethical conduct, the Court has no choice but to find that Felder's LUTPA claim must be dismissed.

**D. Solidary Liability Under La. Civ. Code art. 2324**

La. Civ. Code art. 2324 provides the basis for solidary liability under Louisiana law. The article provides in pertinent part: "He who conspires with another person to commit an intentional and willful act is answerable, in solido, with that person for the damage caused by that act." *Id*. Courts have clarified that Art. 2324 "does not recognize an independent cause of action for civil conspiracy." *Rhyce v. Martin*, 173 F. Supp. 2d 521, 535 (E.D. La. 2001). Rather, the actionable element is the wrong perpetrated by the actors involved in the conspiracy. *Id*.

Stated differently, the conspiracy is the mechanism that must exist for a plaintiff to recover under Art. 2324. The mere existence of a conspiracy, however, is not a basis for liability.

The Court previously found that Felder's failure to plead the existence of a conspiracy made its claim for solidary liability deficient. *Ruling*, Doc. 32, at 32. Though Felder's has amended its complaint to include allegations concerning the existence of a conspiracy, the Court has found that these allegations are insufficiently pled and therefore dismissed. Accordingly, Felder's claim for solidary liability is dismissed.

## III. Conclusion

For the reasons stated herein, the Defendants' Motion (doc. 54) to Dismiss is GRANTED. Accordingly, all of the claims contained in the Amended Complaint (doc. 50) are DISMISSED.

The Motions (docs. 57 & 60) filed by the Automotive Body Parts Association as amicus curiae are DISMISSED AS MOOT.

Signed in Baton Rouge, Louisiana, on April 23, 2014.

**JUDGE JAMES J. BRADY**
**UNITED STATES DISTRICT COURT**
**MIDDLE DISTRICT OF LOUISIANA**

## FELDER'S APPEAL

The dismissal of Felder's complaint is currently on appeal to the Fifth Circuit. The case is scheduled for oral argument on December 3, 2014, in New Orleans.

**UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF MICHIGAN**
**SOUTHERN DIVISION**

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ENERGY CONVERSION DEVICES
LIQUIDATION TRUST, BY AND THROUGH
ITS LIQUIDATING TRUSTEE, JOHN MADDEN,

Plaintiff,

v.

Case No. 13-14241

TRINA SOLAR LIMITED, et al.,

Defendants.
_______________________________________/

**OPINION AND ORDER GRANTING DEFENDANTS' JOINT MOTION TO DISMISS PLAINTIFF'S COMPLAINT**

On October 4, 2013, Plaintiff Energy Conversion Devices Liquidation Trust filed a complaint against Defendants Trina Solar Limited and its wholly-owned American subsidiary Trina Solar (U.S.), Inc. (collectively, "Trina"), Yingli Green Energy Holding Company Limited and its wholly-owned American subsidiary Yingli Green Energy America, Inc. (collectively "Yingli"), and Suntech Power Holdings Company, Ltd. and its wholly-owned American subsidiary Suntech America, Inc. (collectively "Suntech"). Plaintiff alleges that Defendants violated the Sherman Act, 15 U.S.C. § 1, and the Michigan Antitrust Reform Act (the "MARA"), Mich. Comp. Laws § 445.772, by engaging in "an unlawful conspiracy and combination to fix prices at unreasonably low and/or predatory levels and to dump product" in restraint of trade. (Dkt. # 1, Pg. ID 30-31.) Now before the court is Defendants' Rule 12(b)(6) motion to dismiss for failure to state a claim, filed on April 18, 2014. The matter is fully briefed, and no hearing is needed.

*See* E.D. Mich. LR 7.1(f)(2). For the following reasons, Defendants' motion to dismiss will be granted.

## I. BACKGROUND

From 2003 until 2012, Plaintiff produced flexible, thin-film photovoltaic solar panels. (Dkt. # 1, Pg. ID 7.) Plaintiff earned $239.4 million in revenue from solar panel sales in 2009 and $302 million in 2009. (*Id.* at 16.) Plaintiff's solar panel revenues dropped to $211 million in 2010 and $193 million in 2011, leading Plaintiff to file for bankruptcy in 2011. (*Id.* at 2, 17.) According to Plaintiff's complaint, Trina Solar Limited, Yingli Green Energy Holding Company Limited, and Suntech Power Holdings Company, Ltd. are leading manufacturers of solar panels, each incorporated in the Cayman Islands and headquartered in China, with billions in assets and annual revenue. (*Id.* at 7-11.)

Plaintiff alleges that, through the China New Energy Chamber of Commerce ("China New Energy")—a leading trade association in China for alternative energy—Defendants would, *inter alia*, "share market and industry information, 'collaborate', [and] coordinate efforts with the government." (*Id.* at 11.) Plaintiff further alleges that, starting in 2008, Defendants agreed to sell solar panels at artificially low and/or below-cost prices and "simultaneously reduced prices at rates in tandem by approximately 75%" (*id.* at 17), which forced approximately twenty American companies out of the solar panel market and resulted in Defendants' collective market share exceeding 80%. (*Id.* at 17-18.) According to Plaintiff, following the annual China New Energy International Forum in 2007, 2008, and 2010, Defendants "uniformly" reduced the price of imported solar panels by 40%, 18%, and then 20%. (*Id.* at 23-24.)

## II. STANDARD

Federal Rule of Civil Procedure 8(a)(2), requires that a complaint contain "a short and plain statement of the claim showing that the pleader is entitled to relief." In order to survive Defendants' motion to dismiss, the complaint must allege "[f]actual allegations . . . enough to raise a right to relief above the speculative level . . . on the assumption that all the allegations in the complaint are true." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). Accordingly, the court views the complaint in the light most favorable to the plaintiff and takes all well-pleaded factual allegations as true. *Tackett v. M&G Polymers, USA, LLC*, 561 F.3d 478, 488 (6th Cir. 2009). However, the court "need not accept as true legal conclusions or unwarranted factual inferences." *Directv, Inc. v. Treesh*, 487 F.3d 471, 476 (6th Cir. 2007). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim for relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged—but it has not shown—that the pleader is entitled to relief." *Id.* at 679.

"In determining whether to grant a Rule 12(b)(6) motion, the court primarily considers the allegations in the complaint, although matters of public record, orders, items appearing in the record of the case, and exhibits attached to the complaint, also may be taken into account." *Amini v. Oberlin College*, 259 F.3d 493, 502 (6th Cir. 2001) (emphasis omitted). The court may also consider documents introduced by defendants in their motion to dismiss if the documents "are referred to in the plaintiff's complaint and are central to her claim." *Weiner v. Klais & Co.*, 108 F.3d 86, 89 (6th Cir. 1997).

## III. DISCUSSION

### A. The Sherman Act

Plaintiff alleges that Defendants violated § 1 of the Sherman Act by engaging in a conspiracy "to fix prices at unreasonably low and/or predatory levels and to dump product." (Dkt. # 1, Pg. ID 30.) Section 1 of the Sherman Act provides, in relevant part, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1. In general, "[t]o establish an antitrust violation, a plaintiff must show a contract, combination, or conspiracy that affects interstate commerce and unreasonably restrains trade. To show unreasonable restraint of trade, the plaintiff must show that the conspiracy has the potential to produce adverse, anti-competitive effects within relevant product and geographic markets." *Lie v. St. Joseph Hosp. of Mount Clemens, Mich.*, 964 F.2d 567, 568 (6th Cir. 1992) (internal quotation marks and citations omitted).

The Supreme Court has set forth "two complementary categories of antitrust analysis." *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 692 (1978). Courts typically analyze the alleged conduct under the "rule of reason" which "requires the factfinder to decide whether under all the circumstance of the case the restrictive practice imposes an unreasonable restraint on competition." *Arizona v. Maricopa Cnty. Med. Soc.*, 457 U.S. 332, 344 (1982). The rule of reason analysis requires courts "to 'evaluate[ ] [the agreement] by analyzing the facts peculiar to the business, the history of the restraint, and the reasons it was imposed . . . to form a judgment about the competitive significance of the restraint.'" *Lie*, 964 F.2d at 569 (quoting *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 692). However, "agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality . . . are 'illegal per se.'" *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 692. "Per se illegal restraints on trade . . . do not require proof of market power." *Lie*, 964 F.2d at 569. Plaintiff alleges both that Defendants' price-fixing and dumping conspiracy is a *per se* restraint of trade and that, in the alternative, it is an unreasonable restraint of trade.

**B. Antitrust Standing**

In addition to establishing Article III standing, when bringing an action under the Sherman Act, the plaintiff must establish antitrust standing in order to survive a Rule 12(b)(6) motion to dismiss. *NicSand, Inc. v. 3M Co.*, 507 F.3d 442, 449 (6th Cir. 2007) (en banc). To establish antitrust standing, "an antitrust claimant must do more than make 'allegations of consequential harm resulting from a violation of the antitrust laws,' and that is true even when the complaint is 'buttressed by an allegation of intent to harm the [plaintiff].'" *Id.* (quoting *Ass'n Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519, 545 (1983)). Likewise, a plaintiff does not have antitrust standing when certain "relevant factors—the nature of the [claimant's] injury, the tenuous and speculative character of the relationship between the alleged antitrust violation and the [claimant's] alleged injury, the potential for duplicative recovery or complex apportionment of damages, and the existence of more direct victims of the alleged conspiracy—weigh heavily against judicial enforcement." *Id.* (citing *Ass'n Gen. Contractors of Cal., Inc.*, 459 U.S. at 545.).

"[A]ntitrust standing 'ensures that a plaintiff can recover only if the loss stems from a competition-*reducing* aspect or effect of the defendant's behavior.'" *Id.* (quoting *Atl. Richfield Co. V. USA Petroleum Co.*, 495 U.S. 328, 344 (1990)). As such, a "necessary, but not always sufficient," requirement for antitrust standing is an antitrust injury. *Id.* at 450 (citing *Cargill, Inc. v. Monfort of Colo.*, *Inc.*, 479 U.S. 104, 110 n.5 (1986)).[1] An antitrust injury is an "injury of the type the antitrust laws were intended to prevent and that flows from that which makes the defendants' acts unlawful." *Id.* (citing *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977)). "Far from being 'a mere technicality,' antitrust standing 'is the glue that cements each suit with the purposes of the antitrust laws, and prevents abuses of those laws' by claimants seeking to halt the strategic behavior of rivals that increases, rather than reduces, competition." *Id.* at 449-50 (quoting *HyPoint Tech., Inc. v. Hewlett-Packard Co.*, 949 F.2d 874, 877 (6th Cir. 1991).

Defendants argue that Plaintiff has not suffered antitrust injury and therefore lacks antitrust standing. (Dkt. # 17, Pg. ID 121.) The complaint alleges that Defendants sold solar panels at "unreasonably low and/or [at] predatory levels." (Dkt. # 1, Pg. ID 30.) It asserts that "Defendants directly harmed competition in the United States for commercial and industrial rooftop solar panels by reducing consumer choice, stifling

[1]The fact that Plaintiff alleged "a *per se* illegal restraint of trade does not obviate the need to . . . adequately allege[] antitrust injury." *In re Cardizem CD Antitrust Litig.*, 332 F.3d 896, 909 n.15 (6th Cir. 2003); *see Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 341-42 (1990) ("We . . . reject respondent's suggestion that no antitrust injury need be shown where a *per se* violation is involved. The *per se* rule is a method of determining whether § 1 of the Sherman Act has been violated, but it does not indicate whether a private plaintiff has suffered antitrust injury . . . .").

innovation, drastically undercutting solar panel prices, and forcing a substantial part of American production into bankruptcy." (*Id.* at 26.) However, unreasonably low and/or below-cost pricing does not harm competition and, thereby, confer antitrust standing by itself. Such "[p]ricing is predatory when a company foregoes short-term profits in order to develop a market position such that the company can later raise prices and recoup profits. Predatory pricing differs from healthy competitive pricing in its motive: a predator by his pricing practices seeks to impose losses on other firms, not garner gains for itself." *Richter Concrete Corp. v. Hilltop Concrete Corp.*, 691 F.2d 818, 823 (6th Cir. 1982). In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222-24 (1993), the Supreme Court set forth two prerequisites for a plaintiff to recover on a claim for predatory pricing under § 2 of the Sherman Act: a plaintiff must show that (1) "the prices complained of are below an appropriate measure of its rival's costs" and (2) "the competitor had . . . a dangerous probability[] of recouping its investment in below-cost prices." *Id.* at 222-24.

**i. The Complaint Alleges Below-Cost Pricing**

Regarding the first prerequisite, the complaint adequately alleges that Defendants engaged in below-cost pricing. Plaintiff claims that Suntech's former CEO admitted that "Suntech, to build market share, is selling solar panels on the American market for less than the cost of materials, assembly, and shipping." (Dkt. # 1, Pg. ID 4.) Additionally, Plaintiff reported that, on October 10, 2012, the United States Department of Commerce "found that Defendants and other Chinese manufacturers of solar panels dumped product in the United States market at less than fair value.[[2]] Commerce assigned to each of Suntech, Trina, and Yingli a weighted average dumping margin[[3]] of up to 31%." (Dkt. # 1-1, Pg. ID 33.) Plaintiff also states that the International Trade Commission conducted hearings on Defendants' pricing scheme and concluded "that the solar manufacturing industry in the United States has been materially injured by reason of the subsidized Chinese [s]olar panels that are sold at less than fair value in the United States."[4] (Dkt. # 1, Pg. ID 19.)

**ii. Plaintiff Is Required to Allege Recoupment**

Regarding the second prerequisite, Plaintiff first contends that it was not required to allege recoupment to survive a motion to dismiss because the recoupment requirement only applies to claims of monopolization asserted under § 2 of the Sherman Act and not to claims asserted under § 1 of the Sherman Act. (Dkt. # 38, Pg. ID 373.)

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[2] For the purposes of the United States's antidumping statutes, the determination as to whether goods are being sold "at less than fair value" is based upon a comparison of the export price for the goods and the "normal value" of the goods. 19 U.S.C. § 1677b(a). The "normal value" of goods is, generally, the price at which "like product" is first sold in the exporting country (or the price at which like product is sold in a different country when certain requirements are met). 19 U.S.C. § 1677b(a)(1)(B)-(C); *see generally* 19 C.F.R. § 351.401–351.415 (regulating the calculation of export price, constructed export price, fair value, and normal value). Thus, the Department of Commerce's finding that Defendants' dumped product at less than fair value is not equivalent to a finding of below-cost pricing.

[3]A "dumping margin . . . is the amount by which the normal value exceeds the export price or constructed export price of the subject merchandise." (Dkt. # 1-1, Pg. ID 34.)

[4] According to Plaintiff, the United States Department of Commence "determined that illegal subsidies accounted for 14.78%, 15.97%, and 15.24% of Suntech, Trina, and Yingli's respective prices." (Dkt. # 1-1. Pg. ID 35.)

Section 2 of the Sherman Act provides, in relevant part, "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ." 15 U.S.C. § 2. Plaintiff relies on *American Needle, Inc. v. National Football League*, 560 U.S. 183 (2010), in which the Supreme Court discussed the differences between § 1 and § 2 of the Sherman Act, to argue that case law involving § 2 of the Sherman Act has limited precedential value when evaluating a claim brought under § 1. However, Plaintiff's reliance on *American Needle* is misplaced. In *American Needle*, the Supreme Court noted that "Section 1 applies only to concerted action that restrains trade," whereas "Section 2, by contrast, covers both concerted and independent action, but only if that action 'monopolize[s]' or 'threatens actual monopolization,' a category that is narrower than restraint of trade." *Id.* at 190 (internal quotation marks and citations omitted). The Court then expounded on the logic behind these two provisions:

> [I]n § 1 Congress treated concerted behavior more strictly than unilateral behavior. This is so because unlike independent action, [c]oncerted activity inherently is fraught with anticompetitive risk insofar as it deprives the marketplace of independent centers of decisionmaking that competition assumes and demands. And because concerted action is discrete and distinct, a limit on such activity leaves untouched a vast amount of business conduct. As a result, there is less risk of deterring a firm's necessary conduct; courts need only examine discrete agreements; and such conduct may be remedied simply through prohibition. Concerted activity is thus judged more sternly than unilateral activity under § 2. For these reasons, § 1 prohibits any concerted action in restraint of trade or commerce, even if the action does not threate[n] monopolization. And therefore, an arrangement must embody concerted action in order to be a contract, combination . . . or conspiracy under § 1.

*Id.* (internal quotation marks and citations omitted).

*American Needle* does not support Plaintiff's contention that case law discussing § 2 of the Sherman Act has little value when considering a claim brought under § 1. In *American Needle*, the Court merely recognized that a § 1 violation requires concerted action whereas a § 2 violation requires monopolization or a threat of actual monopolization. This distinction does not impact the purpose behind requiring a plaintiff to allege recoupment in order to state a claim of predatory pricing. The logic for such a requirement applies with equal force to claims brought under § 1 or § 2. In *Brooke Group*, the Supreme Court explained that below-cost pricing without recoupment—"unsuccessful predation"—would generally be a boon to consumers:

> Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

*Brooke Group*, 509 U.S. at 224.

"That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured." *Id.* In order for a complaint to allege that below-cost pricing injures competition, it must allege that "there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it." *Id.* at 225.

Furthermore, by requiring plaintiffs to allege recoupment, courts reduce the risk of litigants using the Sherman Act to harm, rather than protect competition. *Brooke Group*, 509 U.S. at 226-27 ("It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high."). As the Court explained in *Brooke Group*, below-cost pricing and recoupment "are not artificial obstacles to recovery; rather, they are essential components of real market injury." 509 U.S. at 226. "[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition; because 'cutting prices in order to increase business often is the very essence of competition . . . [;] mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect.'" *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 122 n.17 (quoting *Matsushita v. Elec. Indus. Co., Ltd.*, 475 U.S. 574, 594 (1986)).

Conversely, there is little fear that dismissing a predatory pricing conspiracy for failure to allege recoupment would encourage such conspiracies because "*successful* predatory pricing conspiracies involving a large number of firms can be identified and punished once they succeed, since some form of minimum price-fixing agreement would be necessary in order to reap the benefits of predation." *Matsushita*, 475 U.S. at 595 (emphasis in original) (reviewing claims that defendants violated §§ 1 and 2 of the Sherman Act by engaging in a scheme that involved maintaining low prices for television receivers sold in the United States).

**iii. The Complaint Does Not Allege a Dangerous Probability of Recoupment**

Plaintiff has failed to adequately allege antitrust injury caused by predatory pricing because the complaint does not allege that "the competitor had . . . a dangerous probability[] of recouping its investment in below-cost prices." *Brooke Grp.*, 509 U.S. at

222-24. Although the complaint alleges that Defendants have sold solar panels at below-cost prices in order "to build market share" (Dkt. # 17, Pg. ID 34), "[e]vidence of below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition." *Brooke Grp.*, 509 U.S. at 226. The complaint does not allege that Defendants intend to raise prices to, and sustain prices at, supracompetitive levels sufficient to recoup the losses (with interest) that were allegedly sustained as a result of below-cost pricing. The complaint merely states that, in light of Defendants' 80% market share, Defendants have the *ability* to raise prices to such a level. (*See* Dkt. 1, Pg. ID 18 ("Defendants can freely raise prices"); *id.* at 26-27 ("[T]he steady and sustained low and/or predatory pricing and the resulting destruction of American commerce resulted in Defendants having power and control over entry and price so that Defendants are able to raise prices and thus injure consumers.").)

Furthermore, accepting the factual allegations contained in the complaint as true, not only has Plaintiff failed to allege a dangerous probability of recoupment, it is questionable whether Plaintiff has alleged any probability of recoupment. "[W]ithout barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time" in order for conspirators to recoup their losses (including interest) from their below-cost prices. *Matsushita*, 475 U.S. at 591 n.15. In the absence of barriers to entry, "[i]f the defendants should try to raise prices [to high enough prices to recoup losses from below-cost pricing], they would attract new competition." *Id.* (quoting Frank H. Easterbrook, *The Limits of Antitrust*, 63 Texas L. Rev. 1, 26 (1984)).

Plaintiff alleges that "[t]here are substantial barriers to entry into the production of commercial and industrial rooftop solar systems," namely (1) "[Plaintiff's] intellectual property and successful history of producing industry-progressing technologies," (2) "[t]he cost for acquiring the necessary land and commodities, and constructing the required plant facility," and (3) the need to "hire hundreds of highly educated employees . . . and invest tens of millions of dollars in research and development." (Dkt. # 1, Pg. ID 14-15.) However, the complaint also states that "many solar companies, including Defendants, recently entered the solar panel industry in the past ten to fifteen years." (*Id.* at 16.) Accepting as true Plaintiff's allegations of barriers to entry into the solar panel market, the ability of "many" companies to enter the market in recent years makes it implausible that Defendants would be able to recoup their alleged losses. Even if recoupment were economically feasible, the complaint does not plausibly allege that there is "a dangerous probability[] of recoup[ment]." *Brooke Grp.*, 509 U.S. at 224.

Because the court finds that Plaintiff has failed to allege a dangerous probability of recoupment and, therefore, has failed allege antitrust standing, the court does not consider Defendants' additional arguments for dismissing Defendant's Sherman Act claim.

**B. The MARA Claim**

Section 445.772 of MARA provides, "A contract, combination, or conspiracy between 2 or more persons in restraint of, or to monopolize, trade or commerce in relevant market is unlawful." That section "adopted language from and is interpreted consistent with the Sherman Act, 15 U.S.C. § 1." *Perceptron, Inc. v. Sensor Adaptive Machines, Inc.*, 221 F.3d 913, 919 n.6 (citing *Compton v. Joseph Lepak, D.D.S., P.C.*, 397 N.W.2dd 311 (Mich. 1986)); *see* Mich. Comp. Laws Ann. § 445.784(2) (1985) ("It is the intent of the legislature that in construing all sections of [MARA], the courts shall give due deference to interpretations given by the federal courts to comparable antitrust statutes . . . ."). "Because [MARA] and the Sherman Anti-Trust Act mirror each other, [the court] appl[ies] the same analysis to both the federal and state anti-trust claims." *Am. Council of Certified Podiatric Physicians & Surgeons v. Am. Bd. of Podiatric Surgery, Inc.*, 323 F.3d 366, 368 n.1 (6th Cir. 2003); *First Med. Representatives, LLC v. Futura Med. Corp.*, 195 F. Supp. 2d 917, 922 (E.D. Mich. 2002) ("Michigan courts apply Sherman Act analysis to the MARA . . . ."). Accordingly, Plaintiff's MARA claim will be dismissed as well.

## IV. CONCLUSION

For the reasons stated above, IT IS ORDERED that Defendants' Joint Motion to Dismiss Plaintiff's Complaint (Dkt. # 17) is GRANTED.

s/Robert H. Cleland
ROBERT H. CLELAND
UNITED STATES DISTRICT JUDGE

Dated: October 31, 2014

I hereby certify that a copy of the foregoing document was mailed to counsel of record on this date, October 31, 2014, by electronic and/or ordinary mail.

s/Lisa Wagner
Case Manager and Deputy Clerk
(313) 234-5522

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# For Discussion

# IN THE UNITED STATES DISTRICT COURT
# FOR THE DISTRICT OF KANSAS

| | | |
|---|---|---|
| UNITED STATES OF AMERICA,<br><br>*Plaintiff,*<br><br>v.<br><br>AMR CORPORATION,<br>AMERICAN AIRLINES, INC., and<br>AMR EAGLE HOLDING<br>CORPORATION,<br><br>*Defendants.* | ) | Civil Action No.:<br><br>Filed: |

## COMPLAINT

The United States of America, plaintiff, by its attorneys, acting under the direction of the Attorney General of the United States, brings this antitrust action to enjoin AMR Corporation and its two airline subsidiaries, American Airlines, Inc. and AMR Eagle Holding Corporation (together, "American"), from monopolizing and attempting to monopolize airline passenger service to and from Dallas/Ft. Worth International Airport ("DFW") in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

American dominates DFW and charges monopoly fares on many DFW routes. When small airlines try to compete against American on these routes, American typically responds by increasing its capacity and reducing its fares well beyond what makes business sense, except as a means of driving the new entrant out of the market. Once the new entrant is forced out, American promptly raises its fares and usually reduces its service. Through its predatory and monopolistic conduct, American deprives consumers of the benefits of competition in violation of the antitrust laws.

## INTRODUCTION

1. American is the second largest airline in the United States, offering service throughout the country. In 1998, American operated over 850 aircraft, earning more than $1.7 billion in operating profit on passenger ticket sales exceeding $15 billion. American concentrates its operations at "hub" airports at which it offers multiple daily flights to and from dozens of other cities.

2. American operates its largest and most profitable hub at DFW, which is the third largest airport in the United States serving over 55 million passengers annually. American is by far the dominant carrier at DFW, offering over 700 flights daily to more than 100 destinations. In 1998, American's service to and from DFW accounted for nearly $2 billion in annual revenues.

3. American has monopoly power in many of its routes from DFW. For many of the destinations it serves from DFW, American is the only nonstop carrier; it seldom competes with more than one other nonstop carrier on any route. Because it faces so little competition, American can and does charge fares on DFW routes that are significantly higher than the fares it charges on other routes where its faces more competition.

4. These high fares make entry into DFW routes attractive to start-up airlines with relatively low costs (known in the industry as "low cost carriers" or "LCCs"). When an LCC enters a route, it offers fares that are substantially lower than the fares the incumbent hub carrier

has been charging, attracting not only consumers who have been paying the higher fares, but also consumers who previously could not afford to fly.

5. Beginning in 1993, American became concerned that LCCs would begin to offer service on DFW routes at fares lower than it had been charging and, once established, would expand low-fare competition to more DFW routes. American adopted a strategy to prevent LCCs from developing a toehold at DFW: if an LCC began to offer service on a DFW route, American would add capacity and lower fares on the route until the LCC was driven out of the market.

6. American realized its strategy would be costly in the short run but concluded that short-term losses were good "investments" if they forced an LCC out of the DFW markets it was serving, thwarted future expansion by the LCC into additional DFW routes, or deterred entry into DFW routes by other LCCs. As the chairman and CEO of American put it in 1996, "[i]f you are not going to get them [LCCs] out then no point to diminish profit." American pursued its strategy, however, because it knew that once LCCs were driven out of DFW routes, it could reduce its service and raise its fares, thereby recouping its short-term losses through future supracompetitive fares.

7. American successfully used its strategy against Vanguard Airlines, Sun Jet International, and Western Pacific, each of which attempted to challenge American on certain DFW routes. In each instance, American added flights and reduced fares, losing money as a result. While consumers benefited temporarily from the capacity increases and fare decreases, in each instance, the LCC was driven out of some or all of the DFW routes it was serving; in each instance, American substantially raised fares after the LCC exited; in most instances, American

reduced its service after the LCC exited; and in every instance, American solidified its power to charge high fares on DFW routes well into the future.

**PARTIES AND JURISDICTION**

8. The United States files this complaint and institutes this proceeding under Section 4 of the Sherman Act, 15 U.S.C. § 4, to prevent and restrain American from continuing to violate Section 2 of the Sherman Act, 15 U.S.C. § 2.

9. AMR Corporation is a Delaware corporation with its principal offices at DFW. AMR Corporation owns 100 percent of the common stock of American Airlines, Inc. and AMR Eagle Holding Corporation ("American Eagle"), and those two companies are wholly owned and controlled subsidiaries of AMR Corporation.

10. American Airlines, Inc. is a Delaware corporation that has its principal place of business at DFW. American Airlines, Inc. operates large passenger turbojet aircraft in airline passenger air service throughout the United States and between cities in the United States and numerous international destinations.

11. American Eagle is a Delaware corporation that has its principal place of business at DFW. American Eagle operates turboprop and small jet aircraft in airline passenger air service in numerous U.S. cities.

12. American is engaged in interstate commerce and in activities that substantially affect interstate commerce. The Court has jurisdiction over this action and over the defendants pursuant to 28 U.S.C. §§ 1331 and 1337. Venue is proper in this district under 15 U.S.C. § 22 and 28 U.S.C. § 1391(b).

## RELEVANT MARKETS, ENTRY BARRIERS, AND MONOPOLY POWER

13. Airlines provide regularly scheduled service between a city of origin and a city of destination. Such origin-destination combinations are known in the industry as "city pairs." Airlines may offer city-pair service on a "nonstop" basis or on a "connecting" or "one-stop" basis that requires a passenger to make one or more stops en route and perhaps change planes on the way. Passengers traveling on a particular city-pair route do not view service in alternative city pairs as a reasonable substitute: they are unlikely to substitute travel to a different destination in response to a fare increase for the city-pair service they desire. Unless travelers' destination cities are located close to their origin cities, few will regard other modes of transportation (*e.g.*, automobile, bus, or train) as reasonable substitutes. Airline passenger service in a city pair constitutes a relevant market for antitrust purposes.

14. Many passengers do not regard connecting or one-stop service as a reasonable alternative to nonstop service. Connecting or one-stop service typically takes significantly longer than nonstop service. Time-sensitive passengers, such as persons traveling on business, are unlikely to substitute connecting or one-stop service for nonstop service in response to a fare increase for nonstop service. Airlines can and do charge higher fares for nonstop service. Thus, for a substantial number of passengers, nonstop airline passenger service in a city pair constitutes a relevant market for antitrust purposes.

15. Airlines use restrictions on fares, such as advance purchase and Saturday-night stayover requirements, to distinguish between business passengers -- who often cannot make travel plans in advance, must be able to change travel plans on short notice, and have little choice but to pay the high fares for unrestricted tickets -- and leisure passengers -- who

ordinarily can make reservations well in advance and tend to be more price conscious. Using sophisticated computer software, known in the industry as “yield management” programs, carriers determine for each flight how many seats to hold back for high-fare passengers making reservations on short notice, and ration seats for low-fare leisure passengers who are less profitable for the airlines.

16. Since deregulation of the airline industry in 1978, the major airlines, including American, have tended to concentrate a large portion of their respective operations at certain airports, known as “hub” airports. Carriers operate “spoke” routes that emanate from these “hubs” to numerous other endpoints. On spoke routes, hub carriers carry both “local” traffic (passengers traveling between the hub and the spoke city) and “connecting” traffic (passengers traveling between two spoke cities and transferring at the hub). Such hub-and-spoke systems allow an airline to consolidate connecting passengers traveling from numerous points of origin via the hub to any other endpoint in the system.

17. Once an airline has established a hub at an airport, several structural and strategic factors combine to present high entry barriers to any other airline that might try to enter spoke routes emanating from that hub:

a. Operation of a hub provides significant economies of scale and scope for the airline that operates it. A hub-spoke configuration allows an airline to serve more city pairs with any given number of airplanes than simple point-to-point service would allow because passengers can connect at the hub to virtually any other route served from the hub. In addition, because the hub airline can combine local and connecting traffic in each hub-spoke city pair, it can operate more flights than if it carried only local passengers.

b. By providing more departures to more destinations, the hub carrier attracts a disproportionate share of the hub airport's passengers. This happens for several reasons, including the preference of many travelers to use the carrier with the most flights in a city pair (so that the passenger can change departure times if travel plans change), marketing programs (such as frequent flyer programs) that create loyalty incentives for consumers to concentrate their travel on the dominant airline in their home city, and graduated sales commission practices that create incentives for travel agents to encourage passengers to use the locally dominant airline.

c. A hub carrier enters into contracts with local businesses that commit them to use the hub carrier for all or substantially all of their air travel in exchange for modest discounts, thus making it more difficult for smaller airlines that serve fewer destinations to attract business customers.

d. An airline seeking to enter another carrier's hub must be prepared to make substantial non-recoverable financial investments, including commitments for ticket counters, gates, luggage handling, aircraft servicing, advertising, and other promotions.

The effect of these entry barriers is exacerbated by the ability of a hub carrier to reduce its fares or increase its seating capacity and frequency of service virtually overnight, responding to expected entry before such entry can be successfully implemented.

18. As a result, hub carriers often have substantial market power in city pairs served from their hubs. With respect to many spokes, a hub carrier will have no competition. With respect to a spoke running to another carrier's hub, both hub carriers are likely to provide nonstop service, but no other carrier is likely to do so. Because of this market power, a hub carrier is often able to charge higher fares on its hub routes than it could charge on routes where it faces meaningful competition. These higher fares are commonly referred to as a "hub premium."

**American's DFW Hub**

19. For most airline passenger service to or from the Dallas/Ft. Worth area, DFW is the only available airport. The only other airport in the area used for commercial interstate airline service is Dallas Love Field, but the geographic scope and nature of service at that airport are restricted by federal statute. Under the Wright Amendment, Pub. L. No. 96-192, 24 Stat. 35, 48-49, as in effect during the period relevant to this Complaint, no ticket on an aircraft with more than 55 seats could be sold for flights to or from Love Field unless the other endpoint of the ticketed travel was within Texas or a contiguous state. City pairs that could have been served by large jet aircraft from Love Field will be referred to in this Complaint as "Wright Amendment city pairs," while other city pairs for which Dallas/Ft. Worth is an endpoint, including DFW-Wichita, are referred to as "DFW city pairs."

20. American earns a substantial hub premium in DFW city pairs. American's dominance of DFW is demonstrated by the following:

a. American carries 70% of all passengers who travel nonstop in DFW city pairs;

b. American carries 58% of all passengers who travel in DFW city pairs;

c. American carries 77% of all passengers originating in DFW who travel nonstop in DFW city pairs; and

d. American carries 65% of all passengers originating in DFW who travel in DFW city pairs.

The next largest carrier serving DFW is Delta Air Lines, Inc. (“Delta”), which carries 16% of all passengers who travel nonstop in DFW city pairs. No other carrier accounts for more than 4% of such passengers.

21. American’s operations at DFW present substantial barriers to entry to any other airline that might try to enter or expand operations there. American operates many more flights at DFW than all other carriers combined, attracts a disproportionate share of DFW originating passengers, offers a frequent flyer program to passengers and commission incentives to local travel agents, and has entered into numerous contracts with local businesses.

22. No major airlines are positioned to challenge American’s dominant market position in DFW city pairs. Delta operates a small hub at DFW but does not prevent American from exercising market power on DFW city pairs. Moreover, Delta has gradually decreased the size and scope of its DFW operations over time and is unlikely to expand them. Southwest Airlines, Inc. (“Southwest”) offers service from Dallas Love Field in some Wright Amendment city pairs, but is not likely to provide service in DFW city pairs.

23. American has monopoly power in most of its DFW city pairs and faces little current competition and little prospect of entry on those routes. Its monopoly power allows it to charge supracompetitive fares. American’s fares on DFW city pairs are substantially higher than its fares on otherwise comparable routes where it faces competition. American also can restrict

output in DFW city pairs: it can limit the number of seats it makes available at low fares, making far fewer available than consumers would be willing to purchase.

**AMERICAN'S RESPONSE TO LCCs**

24. The only airlines that might be in a position to undercut American's monopoly power in DFW city pairs are LCCs. These small, start-up airlines have much lower operating costs than major hub carriers, such as American. American recognized the threat posed by LCCs and adopted a predatory strategy designed to preserve its monopoly in DFW city pairs.

25. American identified the LCC threat to its monopoly power in 1993. At that time, several LCCs were entering the airline industry, using their relatively low operating costs to charge substantially lower fares than the hub carrier on some routes. Although LCCs typically sought to carry a large number of low-fare passengers -- the kind of passengers often turned away by American -- American recognized that LCCs had the potential to expand their operations, become even more efficient, and set up a competing "mini hub." This could endanger American's market power and hub premium in DFW city pairs. Indeed, in 1993, American determined that $3.6 billion in "AA revenue was . . . at risk" annually because of LCCs, and it estimated potential annual systemwide revenue losses due to LCCs in the range of $586 million to $1.47 billion.

26. The growth during 1994 and 1995 of ValuJet, an LCC based at the Atlanta airport, Delta's largest hub, confirmed American's worst fears about LCCs. In response to ValuJet's entry, Delta initially sought to retain higher fare local and connecting passengers. ValuJet successfully attracted enough traffic with its low fares to operate at profitable "load factors" (*i.e.*, the number of passengers carried on a flight, expressed as a percentage of the total

available seats). Over time, ValuJet expanded, gradually eroding Delta's ability to charge high fares in many Atlanta spoke markets. However, the 1996 crash of a ValuJet plane in the Everglades and the subsequent grounding of all ValuJet aircraft halted ValuJet's expansion.

27. Estimating the impact of ValuJet's growth on Delta to be $232 million in lost annual revenue, American concluded that "clearly we don't want that to happen to [American] at DFW." To that end, American employees devoted substantial effort to studying the LCC threat to American's DFW profits, culminating in a presentation of a "DFW LCC Strategy" in February 1996.

28. At that meeting, American's senior management reviewed, revised, and approved the strategy that the company had gradually developed over the preceding several years: when an LCC entered a DFW route and it appeared that the LCC would be economically viable if American simply followed a profit-maximizing business strategy, American would instead saturate the route with enough additional capacity at low fares to keep the entrant from operating profitably. American also would take further steps, such as matching the LCC's connecting fares with its own nonstop fares, to keep traffic away from the LCC. To evaluate the success of its strategy and determine whether to intensify its response, American would investigate the financial resources of LCCs, determine their break-even load factors, and conduct head counts at the departure gate to monitor their passenger loads.

29. This DFW LCC Strategy differed markedly from American's strategy in city pairs where it competes with Southwest, which has the low costs of an LCC but is large, financially secure, and has a substantial scale of operations at its Dallas Love Field base. Knowing that Southwest was too well-established to be driven out of those city pairs, American did not

saturate the routes with capacity or match the lowest Southwest fares for all of its available seats. Instead, American set fares and capacity so as to maximize its profits on the assumption that it would have to compete with Southwest over the long term.

30. In applying its DFW LCC Strategy, American deliberately disregarded its usual standard for evaluating route performance -- a profitability measure it calls "FAUDNC" -- as well as its usual practice of seldom tolerating FAUDNC losses on DFW routes for extended periods of time. The vast majority of American's DFW routes are FAUDNC "positive," that is, profitable, on an annual basis. Each month, American's senior management reviews the small number of its routes that are FAUDNC "negative" for the prior twelve-month period and typically prescribes operational, pricing, or marketing changes, which may include reducing service or exiting the route altogether, in order to improve performance. With respect to routes served by LCCs, however, American was willing to add flights and/or reduce fares even though the effect would be to reduce FAUDNC profitability substantially or even to turn a FAUDNC positive route into a FAUDNC negative route.

31. American recognized that its DFW LCC Strategy could prove unprofitable in the short run. It concluded, however, that "[t]he short term cost, or impact on revenue [of the LCC strategy] can be viewed as the investment necessary to achieve the desired effect on market share." Both the purpose and the effect of American's DFW LCC strategy were to drive LCCs out of DFW markets so that American could subsequently recoup its "investment" and preserve its monopoly fares. This recoupment strategy was at the heart of American's response to LCCs. As its then chairman and CEO stated, "[i]f you are not going to get them [LCCs] out then no point to diminish profit."

## APPLICATION OF AMERICAN'S EXCLUSIONARY STRATEGY

### Vanguard Airlines

32. Vanguard Airlines ("Vanguard"), which began operations in late 1994, commenced nonstop service from DFW to Kansas City with three daily round trips in January 1995. At the time, American operated eight round trips, carrying 65% of the passengers in the market at an average one-way fare of $108. Delta offered six round trips. In response to Vanguard's entry, American matched Vanguard's fares on all of its DFW-Kansas City flights, reducing its average one-way fare to $80 by April 1995, at which time Vanguard cut back its service to one round trip. Delta withdrew all of its service in May 1995. From May to July 1995, American added six more round trips. American's documents indicate that it intended its additional flights "to drive [Vanguard] from the market."

33. In December 1995, Vanguard withdrew its remaining nonstop DFW-Kansas City service. American immediately began reducing its service, going from 14 to 11 daily round trips in February and to 10 by July, and increasing its fares. During the ensuing six months, American's average one-way fare ranged from $112 to $147, as much as 80% higher than in the prior year when Vanguard was providing nonstop service.

34. After Vanguard's ceased its nonstop service, American made substantial profits on the DFW-Kansas City route. Indeed, according to American's documents the route went from being one of American's "worst performer[s]" when American added flights in response to Vanguard to being the "best in the west" after Vanguard withdrew its nonstop service.

35. In September 1996, Vanguard announced that it would expand its DFW operations on October 1 by introducing nonstop service between DFW and Kansas City,

Cincinnati, and Phoenix. Vanguard's announced service represented a significant expansion of its DFW operations, with new nonstop service to three cities (Kansas City, Phoenix, and Cincinnati), continued nonstop service to Wichita (which Vanguard had inaugurated in 1995), and potential connecting service via Kansas City to eight cities (Chicago, Minneapolis, Des Moines, Denver, Salt Lake City, San Francisco, Seattle, and Los Angeles).

36. Within days of Vanguard's announcements, American planned the following schedule changes and service additions:

a. In DFW-Kansas City, American would add two new round trips as of October 1 (advancing the commencement date of two round trips that had already been scheduled for November in order to undercut the viability of Vanguard's one-stop DFW-Kansas City service via Wichita) and a third as of November 1, for a total of 13 round trips in the market.

b. In DFW-Wichita, where American had operated nine round trips with small commuter aircraft, American would substitute five new jet round trips for four of its commuter flights -- the largest introduction of jet service by American in any market since at least 1994, increasing its seating capacity on the route by 35%.

c. In DFW-Cincinnati, a route American had abandoned as unprofitable in 1994, American would begin nonstop service on December 1, with three round trips.

d. In DFW-Phoenix, American would accelerate the addition of two planned seasonal frequency increases, from November 1 and November 27 to October 1.

37. In addition to carrying out this plan, American also matched Vanguard's fares on selected flights in DFW markets (DFW-Chicago and DFW-Des Moines) that Vanguard served

only on a connecting basis, even though American's service was nonstop. The flights on which American offered the matching fares operated at times that "bracketed" the flight times of the Vanguard connecting flights.

38. Vanguard quickly abandoned its plans, pulling out of DFW-Cincinnati and DFW-Phoenix in November 1996. In DFW-Kansas City, Vanguard reduced its service to a single daily nonstop flight in one direction, with a single daily one-stop flight in the opposite direction. Vanguard exited DFW-Wichita in December 1996.

39. After Vanguard announced that it would be exiting the three DFW spoke routes, American promptly increased its fares on those routes. By June 1997, American's seating capacity in DFW-Wichita had decreased by 30%, returning to the level American had maintained before it learned of Vanguard's planned DFW expansion, and its average local one-way fare had increased by more than 50 percent, to over $90 from approximately $60. In DFW-Phoenix, American's average fares, which had fallen by roughly 30% during Vanguard's brief appearance in the market, increased quickly to pre-existing levels after Vanguard exited. American's fares in Cincinnati rose by 60%-80% after its first month of operation.

40. Unable to sustain its proposed DFW operations, Vanguard subsequently pulled back to Kansas City, where it began to establish a mini-hub. Today, Vanguard serves DFW only from its Kansas City hub; it no longer provides nonstop service on any other DFW city pair.

**Sun Jet**

41. Sun Jet began operations in the fall of 1993 with flights between Newark and selected Florida markets. In 1994, Sun Jet entered DFW with limited scheduled airline passenger service to Newark, Long Beach, and Tampa/St. Petersburg. During 1994 and 1995,

American paid little attention to Sun Jet, but as American developed its DFW LCC Strategy, it began to see that Sun Jet was a "major" threat to American because Sun Jet's DFW route structure "presents hubbing opportunities at DFW." While American's Strategy indicated it should not adopt an aggressive response at that time, American decided it would reconsider if Sun Jet "increases frequency or adds spokes from DFW." An internal American follow-up analysis also recommended reconsidering American's "moderate" approach "in the event [Sun Jet] adds frequencies on existing routes or adds new DFW spokes."

42. In October 1996, Sun Jet began to offer a third scheduled round trip in DFW-Long Beach. In November 1996, Sun Jet announced that it would begin DFW-Oakland service. In mid-November 1996, American revised its previously "moderate" response to Sun Jet by removing restrictions from its DFW-Newark and DFW-Tampa/St. Petersburg fares (*i.e.*, making more seats available at its lower fares) and by substantially matching Sun Jet's DFW-Oakland fares. At the same time, American began to consider re-entering the DFW-Long Beach route -- which it had abandoned as unprofitable in l994.

43. American finalized its decision to re-enter Long Beach in December and commenced service with three round trips on Janaury 31, 1997, substantially matching Sun Jet's fares, and added a fourth round trip in August 1997. American entered Long Beach even though its entry was likely to reduce its profits by diverting passengers from American's flights between DFW and other airports in the Los Angeles area. In fact, American's profitability on flights to other Los Angeles airports declined as a result of its entering into Long Beach.

44. Sun Jet did not commence service in DFW-Oakland, and soon began reducing its other DFW operations, exiting DFW-Tampa/St. Petersburg in March 1997, DFW-Newark in

December 1997, and DFW-Long Beach in January 1998. Sun Jet does not currently serve any DFW city pairs. American maintained its four DFW-Long Beach flights but raised fares by over 30% within two months of Sun Jet's exit.

**Western Pacific**

45. Western Pacific entered DFW-Colorado Springs in April 1995 with two round trips. At that point, American operated five frequencies with 100-seat jet aircraft and Delta operated three frequencies. Prior to Western Pacific's entry, American's average one-way fare on the route was more than $150.

46. American added two more round trips in July 1995, for a total of seven, and matched Western Pacific's fares on the American flights leaving at the same time of day. By the end of 1995, American concluded that it had Western Pacific "pretty much in check with enplaned load factors of 30.1%" and, indeed, Western Pacific dropped down to one frequency in January 1996 as a result of extremely low load factors. American's senior management nonetheless decided at its February 1996 DFW LCC Strategy meeting to step up the pressure. American concluded that it should "get [Western Pacific] out before they are encouraged to put [the second] frequency back in COS-DFW." In April 1996, American implemented this strategy by making more seats available at lower fares on American flights departing near Western Pacific's flight times. In June 1996, American added one frequency (to reach eight) and further increased its capacity by operating larger aircraft on the route. In September 1996, American expanded its fare match to all of its flights and intervened in its yield management system to ensure that lower fares were always available. American also maintained its summer high-season frequency level through the fall and winter. In March 1997, Western Pacific tried

increasing its frequency to three daily round trips, but American further increased its frequency to nine round trips and substituted planes with greater capacity.

47. Thereafter, during the summer and fall of 1997, Western Pacific significantly reduced its DFW-Colorado Springs service and, on October 15, 1997, exited DFW-Colorado Springs altogether. Western Pacific later collapsed into bankruptcy. For the period of September 1996 through June 1997, when Western Pacific was competing on the route, American's average one-way local fares ranged from $81 to $105. By February 1998, American had reduced its service on the DFW-Colorado Springs route to six round trips and increased its average fare to $137.

**PREDATORY NATURE OF AMERICAN'S STRATEGY**

48. American undertook its exclusionary conduct with the intent of driving Vanguard, Sun Jet, and Western Pacific out of the DFW city pairs that they served, preventing them from entering other DFW city pairs in competition with American, and discouraging other LCCs from commencing service in DFW city pairs. American's LCC strategy was successful in excluding or stifling competition in numerous DFW spoke routes. American implemented its strategy in spite of the fact that it was not profitable except as a means of excluding or stifling competition.

49. In order to increase capacity in response to LCCs, American had to allocate additional resources to the LCC routes, thereby increasing its cost of serving the routes. The cost of those resources includes operating and ownership costs of the additional aircraft allocated to the LCC route, and labor, fuel, food, sales, and other costs that would not have been incurred on the route absent the capacity increases. The cost to American of its capacity increases in LCC markets includes all such costs.

50. The additional revenues American obtained as a result of adding capacity on its Kansas City, Wichita, Long Beach, and Colorado Springs routes pursuant to its LCC strategy were less than American's costs of adding the flights, as demonstrated in various ways, including the following:

a. On each route, American’s revenues on one or more of its added flights were below that flight’s variable costs;

b. On each route, as a result of adding capacity, American’s total revenues on the route fell below American’s total cost of serving the route, and the capacity additions worsened American’s profit performance; and

c. On each route, American’s operations were unprofitable under its own measure of route profitability after it added capacity, and the capacity additions made American’s operations more unprofitable.

51. American has been able to obtain and preserve a monopoly in numerous DFW city pairs, and there is a dangerous probability that American will succeed in obtaining and maintaining a monopoly in other DFW city pairs, by driving LCCs out and deterring LCCs from entering those markets.

52. American has been or will be able to recoup the costs of its predatory strategy by, among other things:

a. reducing its capacity and increasing its fares to monopoly levels following the exit of an LCC from a DFW city pair;

b. preventing expansion by LCCs into other DFW markets in which American has monopoly power; and

c. establishing a reputation as a carrier that will employ predatory strategies to drive an LCC out of DFW city pairs, thereby deterring future entry by other LCCs into DFW markets.

53. As a result of American's predatory conduct, consumers have been and will be denied the benefits of competitive service and lower fares in numerous DFW city pair markets.

## CLAIMS FOR RELIEF

### First Claim for Relief: Monopolization

54. Plaintiff incorporates the allegations in paragraphs 1 through 53 above.

55. American possesses monopoly power in the provision of airline passenger service in various DFW city pairs and nonstop service in such DFW city pairs. Through the conduct described herein, American has willfully maintained that monopoly power by anticompetitive and exclusionary predatory conduct. American has acted with the intent to maintain its monopoly power, and its illegal conduct has enabled it to do so, in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

### Second Claim for Relief: Attempted Monopolization

56. Plaintiff incorporates the allegations of paragraphs 1 through 53 above.

57. American has willfully engaged in a course of conduct, including anticompetitive and exclusionary predatory actions, with the specific intent of monopolizing airline passenger service in various DFW city pairs and nonstop service in such DFW city pairs, and there is a dangerous probability that, unless restrained, it will succeed in obtaining monopolies in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

## PRAYER FOR RELIEF

WHEREFORE, plaintiff prays:

1. That the practices described above be adjudged in violation of Section 2 of the Sherman Act.

2. That a permanent injunction be issued preventing and restraining the defendants and all persons acting on their behalf from engaging in the predatory acts described and imposing restraints on American to remedy the effects of its past predation.

3. That plaintiff have such other and further relief as the nature of this case may require and as this Court may deem just and proper.

4. That plaintiff recover the costs of this action.

Dated: May 13, 1999

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## UNITED STATES V. AMR CORP.[1]

The government's complaint, filed on May 13, 1999, alleged that American's response to the entry of low-cost carriers (LCCs) in four city-pairs involving the Dallas-Fort Worth airport of lowering prices and increasing route capacity and convenience by adding additional planes constituted predation in violation of Section 2 of the Sherman Act. The case was remarkable because the DOJ did not allege that American had priced below its marginal or variable cost as traditionally measured. The difficulty, of course, was that the traditional measure of marginal cost—the cost of transporting an additional passenger on a place serving the city-pair—was essentially zero in the usual case (then, unlike now) when airlines flew their at much less than full capacity. To overcome this difficulty, the DOJ argued that the opportunity cost of adding an airplane to the route—that is, the maximum profits that could be earned by flying the aircraft on an alternative route—should be included in measuring incremental cost. This was a novel approach, and the courts rejected it. On April 27, 2001, the district court granted American's motion for summary judgment, finding that the government failed to present evidence raising a genuine issue of material fact on both below-cost pricing and recoupment. On appeal, the Tenth Circuit affirmed. The court of appeals found that the tests employed by the DOJ for detecting below-incremental cost pricing were invalid as a matter of law, fatally flawed in their application, and fundamentally unreliable. Since it was uncontested that American did not price below its average variable costs for any route as a whole, summary judgment was appropriate.

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*American Airlines* was one of two cases brought in the Clinton Administration in an effort to revive classic foreclosure monopolization cases. Overall, the effort was not very successful. The first of these cases was *United States v. Microsoft*,[2] which was filed in 1998 and which we examined in Unit 16. Perhaps if pressed, the *Microsoft* case may have resulted in meaningful relief. In late 1981, however, with a change to the

1. United States v. AMR Corp., 140 F.Supp.2d 1141 (D. Kan. 2001), *aff'd*, 335 F.3d 1109 (10th Cir. 2003). For more on *American Airlines*, see, for example, Aaron Edlin & Joseph Farrell, *The American Airlines Case: A Chance to Clarify Predation Policy*, *in* THE ANTITRUST REVOLUTION (4th ed. J. Kwoka & Lawrence J. White eds. 2004); Gregory J. Werden, *The American Airlines Decision: Not with a Bang but a Whimper* (U.S. Dep't of Justice Antitrust Div. Working Paper No. EAG 03-8. Sept. 2003); Leah Platt, *Predatory Pricing: How the Airlines Kill Their Competitors, Screw Their Customers, and Get Away With It,* The American Prospect (Apr. 10, 2001). Both opinions, the appellate briefs, and the commentary is available on the Unit 17 web page.

2. United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001), *aff'g in part, rev'g in part, and remanding in part*, 87 F. Supp. 2d 30 (D.D.C. 2000).

Bush (43) administration, the DOJ settled the *Microsoft* case with a consent order that is generally regarded as having little if any effect on Microsoft's operations.[3]

3. *See* Final Judgment, United States v. Microsoft Corp., No. Civ. A. No. 98-1232 (D.D.C. Nov. 12, 2002) (for settling plaintiffs United States, Illinois, Kentucky, Louisiana, Maryland, Michigan, New York, North Carolina, Ohio, and Wisconsin).