PER SE VERSUS RULE OF REASON: ECONOMIC ANALYSIS OF US SUPREME COURT PREDATORY PRICING CASES

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Submitted to:
Central European University
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In partial fulfilment of the requirements for the degree of
Master of Arts in Legal and Economic Studies

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Budapest, Hungary

June 2012

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Abstract

Predatory pricing is a competition damaging act in which both the prey and customers directly suffer. This paper is looking at rules that are used to judge anticompetitive cases, per se and rule of reason, within the scope of predatory pricing. The main problems are whether the per se rule is better for predatory pricing cases and what the scope of predatory pricing in judicial processes should be, meaning the broadness of behaviors that are looked at as predatory pricing. The basic methods used are cases analysis of US Supreme Court predatory pricing cases and a detailed study of already existing literature, which proved to be more useful in finding answers in this case than the case analysis itself. The main assumptions were that predatory pricing should be per se illegal and that the scope of predatory pricing cases should be wider. Research showed that per se rule really is the better rule for predatory practices, but the scope of per se illegal cases should be kept narrow and have a clearly defined benchmark and exceptions. These implications should be used to form a new act that deals specifically with predation.

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Introduction

US antitrust law is based on two main acts, the Sherman Act (1890) and the Clayton Act (1914) (Rubin, 2001, p. 1), which are both created to protect competition. It is important to emphasize that they are aimed toward protecting competition, not individual competitors (Rubin, 2001, p. 1).

These two acts were the Congress response to anticompetitive practices between businesses in the late 1800s and early 1900s. The Sherman Act is very broad and US courts interpreted it differently throughout history[1]. The main point of the Clayton Act was to give more enforcement power to the Sherman Act. The Clayton Act also goes into more detail about which practices are anticompetitive and gives room for actively preventing anticompetitive actions from happening and it lists exceptions from certain rules (The Clayton Act, 1914). The power of enforcement is given to the Federal Trade Commission and Department of Justice (The Clayton Act, 1914). Even after the clarifications in the Clayton Act, there were still unanswered questions about the interpretation of the Sherman Act.

There are two basic ways in which antitrust cases can be interpreted, per se and rule of reason. The per se says that an agreement or conduct is illegal just because it is very obvious that it was made to distort competition and that the same goal could have been achieved by some other method in a less damaging way. The rule of reason looks at the economic realities of various conducts.

It is possible for a conduct to be illegal per se and justifiable under the rule of reason. Price fixing is an area of antitrust law that is supposed to fall under the per se rule, but, because of the heavy burden of proof, it frequently falls under the rule of reason. The topic of where predatory pricing cases fall, under the rule of reason or the per se rule needs to be dealt with. In

[1] Kimmel (2006) gives examples of *Appalacian Coals* (1933), *Socony-Vacuum*, (1940) *BMI* (1979) and *Maricopa* (1982) as cases where there were misrepresentations of previous cases and different interpretations of meanings of price fixing agreements under the Sherman Act (A/N Section 1 of the Sherman Act deals with agreements)

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order to analyze predatory pricing cases, there also needs to be an analysis of other price fixing practices, because they overlap in many cases.

It is still not clear what the exact benchmark in the US for determining predation is (Dechert LLP, 2009, p. 2). According to Black's law dictionary predatory pricing is:

> "Unlawful below-cost pricing intended to eliminate specific competitors and reduce overall competition; pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run." (Black's Law Dictionary, 2009, online edition)

Predatory pricing basically means that companies lower their prices to a point where they are not making profits, or even losing money per unit sold in an attempt to drive out competition or deter new entrants (Elhauge, 2003, p. 686). Predation can be justified as a strategic approach, but real dumping (lowering prices a lot below their cost of production so their damage cannot be made up for in the period after predation) means that the company will lose money in its attempts to drive out competitors.

Since the exact line between when to use the rule of reason or the per se rule is not clear, and it is also not clear how to determine predatory pricing, these issues combined make a very interesting research topic. There were decisions that the benchmark for determining predation is some sort of average cost (see *Brooke* case; Areeda, Turner, 1975; McGee 1958; McGee 1975). It is still not clear whether it is average variable cost, average total cost, average avoidable cost or some other means of determining where the line for predation is. It is difficult to clearly draw a line between per se and rule of reason because that would open up possibilities for circumvention and creating additional inefficiencies.

In response to the problem this paper will have two objectives. The first one is a question on whether the per se rule is better for determining predatory pricing, and the second is to define the actual scope of predatory pricing. Within the second question I will be looking at various price fixing arrangements that clearly distort competition and make suggestions on how to incorporate them into the per se rule on predatory pricing. Up until now only cases of pricing

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below a benchmark, which was defined as some sort of average cost, were punished. There is proof that even lesser decreases in price in some industries can create the same effect predatory pricing has, and should therefore be treated like predation (Elhauge, 2003). In a case when all predatory pricing cases would be illegal per se, there would be an even bigger issue on how to determine predation. These questions will be answered through case analysis of US Supreme Court cases.

The reason why only US Supreme Court cases will be analyzed is the fact that per se and rule of reason were invented by the US Supreme Court in an attempt to interpret the very broad spectrum of the Sherman Act. The US is still perceived to be the country where the notions of free market, fair competition and competitiveness are most developed and cases that appear there are bound to be most interesting. Cases from European Court of Justice will not be analyzed because their comparison to US cases would be beyond the scope of this paper

This paper consists of three main chapters. The first chapter will give a short introduction to the per se rule and the rule of reason in anticompetitive cases. The second chapter will provide a short theoretical introduction to predatory pricing. The purpose of the first two chapters is to introduce the terms necessary for understanding the case analysis. The third chapter will analyze the cases.

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1. The idea of rule of reason and per se rule

Rule of reason and per se rule are two rules under which anticompetitive cases can be judged. Since predatory pricing is a part of anticompetitive litigation, they need to be clear in order to be able to do a proper case analysis. This chapter will define the per se and rule of reason approach. It starts by saying why the rules developed, and continues with going into detail about the per se rule and the rule of reason. The rule of reason is explained through its creation and the procedures in lower courts. An important element of the rule of reason is the notion of reasonableness that will also be discussed separately. This chapter finishes with a brief discussion on how courts are really deciding between the rules.

Per se rule and rule of reason developed after the adoption of the Sherman Act in 1890, to be more exact in the 1897 *Trans Missouri* case, but rule of reason was not named till the 1911 *Standard Oil* case, and that is why literature still mistakenly says that it was developed in 1911. They have developed as an attempt of US courts in interpreting what the Congress meant by the Sherman Act (Loevinger, 1964, p. 25). For the purposes of this paper Section 1 and Section 2 of the Sherman Act are of most importance. An especially interesting part with regard to the actual use of per se and rule of reason is that even today there are different views on how, when, why and in what extent should each of the rules be used. Opinions vary from completely disregarding and stop using the rule of reason in certain cases (Stucke, 2009, p. 1) to making the use of rule of reason more structured in all levels of proceedings[2] (Stucke, 2009, p. 4-5). Some even argue that the rule of reason is the rule of law (Winrow and Johnson, 2008), because after there is a substantial amount of cases that are ruled the same way using the rule of reason approach, the issue at hand becomes illegal per se (Klitzke, 1980, p. 258).

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[2] Currently there are somewhat set rules that deal with the burden of proof in the rule of reason, but it is still not completely clear who should prove what and to what extent. Stucke (2009, p. 4-5) proposes that there should be set guidelines on how exactly rule of reason should be implemented. Now it mostly comes down to both sides hiring economic experts that give the jury their theory about the conduct in question

Since per se and rule of reason developed as an interpretation of the Sherman Act, primarily in connection to the Section 1 of the Sherman Act, the exact text of the Act that deals with trusts is provided and says that:

> "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..." (Sherman Act, Section 1, 1890)

Section 2 deals with monopolization and attempts of monopolization. This is especially important in connection to predatory pricing. The main purpose of predatory pricing is the expectations of monopoly profits in the long term, after the price war is over and the competition is very weak or non-existent. That is why predators lower their prices in the first place, because they reasonably expect that they will be able to make up for the lost profits by raising prices above the efficient level and by becoming a monopoly in the long term. This Section says that:

> "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, …" (Sherman Act, Section 2, 1980)

It is clear that the intention of the Congress was to reach as far as the Constitution would allow, but still there need to be some limits to the reach of the Sherman Act (Klitzke, 1980, p. 256). That is why the rule of reason and the per se rule were developed, to see where the limits of the Sherman Act scope are.

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1.1 Per se rule

The per se rule does not look at the circumstances, but it looks at the pure facts of a conduct and judges whether it is legal or illegal based purely on facts, with no regard to the economic reality or setting of the conduct in question (Loevinger, 1962, p. 32). There are six main groups of types of cases that are illegal per se. They are horizontal price fixing, vertical

price fixing ("resale price maintenance"), bid rigging, market division, boycotts and tying agreements. For the purposes of this paper they will not be defined, only if there is a need in analysis of cases. All of the above listed per se illegal conducts are in violation of the Section 1 on the Sherman Act (Rubin, 2001, p. 10).

The per se rule has many issues related to it in a majority of cases. The main three that are mentioned in the guidelines written by Areeda (1981, p.28-37) for the Federal Judicial Centre are varying intensity, express exceptions and defining the conduct. Varying intensity means that the per se rule excludes consideration, completely or to some degree (Areeda, 1981, p. 28). Some courts may require proof of actual harmful effects in a particular case, while others view an act as illegal with no regard to whether there is a reasonable justification; it may also conclude that something is illegal per se based solely on the name of the act (Areeda, 1981, p. 28). In each of these instances the interpretation of the wideness of the act and receptiveness toward the narrowness of this rule varies with the nature of the particular conduct (Areeda, 1981, p. 28).

Express exceptions deals with conducts that are unlawful per se, but are lawful under certain circumstances (Areeda, 1981, p. 28). In this case there needs to be clear wording about the specific situations in which the conduct is allowed. In this sense the per se rule resembles the notion of stare decisis, but should not be looked at purely from that standpoint because the per se rule is not so limited (Areeda, 1981, p. 30). The third problem of defining the conduct itself deals with the fact that not all conducts that fall within the scope of the per se rule are clearly defined, and cases can be judged using the rule of reason as soon as the conduct differs from what the conduct that generated the per se rule was (Areeda, 1981, p. 31).

There are two main reasons why using the per se rule is good for everyone involved, the first one is that it promotes judicial efficiency because it allows the courts to use a strict standard and avoids lengthy litigation on facts that have a high probability of violating the Sherman Act, and the second one is that it provides consistency within the law (Winrow and Johnson, 2008, p.

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64). The majority of cases are still judged according to the rule of reason; however that is not always the best approach, as will be discussed in the third part of this chapter.

1.2 Rule of reason approach

The main tradition of the rule of reason is that the law is concerned with the:

> "maximization of wealth or consumer want satisfaction… Acceptance of consumer want satisfaction as the law's ultimate value requires the courts to employ as their primary criterion the impact of any agreement upon output, and thus to determine whether the net effect of the agreement is to create efficiency, and thereby increase output or, alternatively, to restrict output." (Bork, 1966, p. 375)

This part of the text embodies the true nature of rule of reason. It is used to determine the efficiency of certain conducts with regard to the customer and maximization of wealth for the whole society. Even though in the beginning it was not recognized that customer want satisfaction should be one of the main pillars of making rule of reason based decisions, it came into practice very early. Only the first few cases that were used to establish the rule of reason did not take it into account, but it is a very important factor to take into consideration in all later cases.

The concept of customer want satisfaction in this sense means that it is seen as anticompetitive behavior if, for example, all providers of a certain product that has no close substitutes agree to limit the supply of the product in order to make the price higher. In this case it is not anticompetitive behavior if all manufacturers in the industry agree to produce and sell fewer products at a higher price, but it damages customers because they cannot purchase the amount of product they would like. This agreement is inefficient because there are deadweight losses for the society as a whole due to restricted supply. Customer want satisfaction basically means that rule of reason looks at the net effects on the society as a whole and looks for efficiency in markets.

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1.2.1 Making of the rule of reason approach

Essentially three judges thought of the rule of reason and introduced it through their judgments. They are Justice Peckham, who wrote the first US Supreme Court decision dealing with price fixing and market division, Judge Taft, who wrote one of the most suggestive judgments as a court of appeals judge and Chief Justice White who gave the name of "rule of reason" (Bork, 1965, p. 783).

Judge White's rule of reason was established in 1911 *Standard Oil* and *American Tobacco* cases (Bork, 1965, p. 801). These were merger and monopolization cases, but White took them as a chance to talk about law in general. He pointed out many important things, but the biggest contribution is the fact that he named the rule of reason and gave ideas and opinions on how it should be interpreted. He was misinterpreted by judges and academics, but the main findings he had are summarized in the following paragraph:

> "Chief Justice White's statement of the rule of reason, set forth in Standard Oil and American Tobacco, contains three tests which may be rendered as (1) the per se concept; (2) the intention of the parties; and (3) the effect of the agreement. These three tests are better viewed as guides for the litigation process than as logically separate criteria. In a larger sense, there is only one test-the effect of the agreement. The others are shortcuts to finding or inferring effect" (Bork, 1966, p. 387)

The real importance of Judge Whites reasoning in these cases can be seen when looking at later cases. Even to this day some details regarding burden of proof and the actual extent of proof that need to be provided are not clear. There are also important considerations with regard to circumvention in a case that everything was clearly defined.

Before Judge White made this decision, there were two judges that also need to be mentioned with regard to development and creation of the rule of reason. Justice Peckham is the father of the rule of reason (Bork, 1965, p. 785). There was a big debate between Peckham and White with regard to the *Trans Missouri* decision because they had different views on how flexible

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the interpretation of the Act should be (Bork, 1965, p. 785). This was the first case that required the US Supreme Court to apply the Sherman Act to a price fixing agreement (Bork, 1965, p. 785). Judge Peckham thought that every restraint on trade is illegal, but he gave a brief indication of his rule of reason:

> "A contract [by the vendor of business property not to enter into the same kind of business for a certain time or within a certain territory] which is the mere accompaniment of the sale of property, and thus entered into for the purpose of enhancing the price at which the vendor sells it, which in effect, is collateral to such sale, and where the main purpose of the whole contract is accomplished by such sale, might not be included within the letter or spirit of the statute in question."(US v. Trans-Missouri Freight, 1897)

Judge White pointed out that this paragraph has a downside, and that every contract can be seen as anticompetitive (Bork, 1965, p. 790). The biggest contribution of Justice Peckham was that he gave a basis for the interpretation of the Sherman Act that allows judgment of conducts based on their effects on efficiency and allowed the possibility of some price-fixing acts that promote industrial and commercial efficiency (Bork, 1965, p. 796).

After Justice Peckham gave the basis for the rule of reason, Judge Taft in his decision on *Addyson Pipe and Steel* made an attempt of making a workable formula for interpreting the Sherman Act. His idea was that common law held void agreements in restraint of trade whose only purpose was the restrain on trade, but allowed those that had another purpose apart from the restrain on trade (Bork, 1965, p. 787). He offered a concept of ancillary restrains which means that in order to be lawful the conduct needs to be subordinate and collateral to another legitimate transaction and necessary to make the transaction effective (Bork, 1965, p. 797-798).

Even though these decision by the US Supreme Court were made more than a hundred years ago, and the development of these rules began very rapidly (between 1897 and 1911 they went from a hint that there might be rule of reason to an actual statement of rule of reason and per se rule) the US Supreme Court still does not have a procedure on how to look at rule of reason cases. Lower courts have a procedure that is described in the next paragraph.

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1.2.2 The procedure for rule of reason in lower courts

There is a set of rules for using the rule of reason in lower courts. The Supreme Court does not use this exact procedure, but in the lower courts the rule of reason works. Plaintiffs must prove that there is an agreement[3], they must prove direct or indirect effect on competitiveness in a sense of an impact on prices or the output, the defendants need to show their pro-competitive justification, and plaintiffs have the right to react to their pro-competitive arguments, or show that the anti-competitive arguments outweigh the pro-competitive arguments (Stucke, 2009, p. 4). Both sides usually hire economic experts that try to convince the court that their explanation of the act in question prevails, and their explanations and reasoning takes the judicial procedures further and further from the per se rule (Stucke, 2009, p. 9).

That is one of the most important arguments to take into account while looking at predatory pricing cases and the way they should be looked at. If a case falls under the per se approach it falls under very strict proof requirements and could allow predators to get away without being punished. On the other hand, the rule of reason approach could allow predators to get away with predation because of better arguments and more "developed" economic approach in which they could convince non experts that a conduct is non predatory when it actually is.

The notion of reasonableness in rule of reason is very important because it is very hard to circumvent. Even a non-expert in economics or law can see whether a particular conduct seems like it is reasonable. It is especially important in the US and the jury system. Jurors are regular people, and most cases do not get to the Supreme Court and are decided at lower instances. The notion of reasonableness gives the jury an advantage of being able to solve complex economic and legal issues by looking at them only to say whether the conduct seems reasonable or not. Even under the notion of reasonableness there still exists the problem of manipulating information and presenting it as suitable.

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[3] Unilateral agreements are also considered agreements under rule of reason

1.2.3 The notion of reasonableness

One of the most important notions with regard to rule of reason is the notion of "reasonableness". The notion of reasonableness has a few basic features that will be listed here, but I will not go into them in too much detail. They are basic inquiries, competitive harm, redeeming virtues, less restrictive alternatives, intention, administrative convenience, horizontal-vertical classification and common purpose or coerced agreement (Areeda, 1981, p. 2-18).

Basic inquiries deal with harms to competition that come as a result of the collaborators activities, the nature and magnitude of the redeeming virtues (the objects they are trying to achieve and its legitimateness and significance), and the alternatives that could have been used to achieve legitimate goals that harm competition less (Areeda, 1981, p. 2). Competitive harms are important to courts because only after judging the possible competitive harms can they go into a deeper analysis of the probability of occurrence, the likely magnitude of the anticompetitive consequences, the evidence that needs to be presented and formulate the presumptions that guide the case further (Areeda, 1981, p. 3).

Redeeming virtues are a part that deals with the fact that the only excuse for anti-competitive acts is that they have a legitimate objection that cannot be reached in any other less damaging way and that the harm to society is less than the benefits that the agreement produces (Areeda, 1981, p. 5). Less restrictive alternatives means that even in cases that there is a legitimate goal that will be achieved by a certain conduct they still need to prove that there are no alternatives to that act that are less restrictive and that could be used to achieve the same goal (Areeda, 1981, p. 8). Intention is a very confusing idea in antitrust law. There are two main reasons why intention is important, one is that the actors' state of mind is key in determining whether a conduct is illegal, and second is that intention sometimes replaces the analysis of the conduct itself (Areeda, 1981, p. 11). Administrative convenience is a question about

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> "the relative wisdom of alternative approaches or rules, the relative administrability of each such rule, the consequences of uncertainty or erroneous application on the parties' market behavior, … the relative gravity of the antisocial consequences that might flow from uncontrolled behavior adjusted for its frequency, and the relative gravity and frequency of the antisocial consequences of excessive or erroneous control of such behavior" (Areeda, 1981, p. 15)

Horizontal-vertical classification places the agreements according to whether they are agreements between competitors (horizontal agreements) or agreements between manufacturers and customers (vertical agreements). This division is not as important because the thing that is looked at in cases is competitive effects and redeeming virtues, and not whether they are horizontal or vertical agreements (Areeda, 1981, p. 17). The last feature deals with the fact that, even thought the wording of the agreement might be ambiguous, what matters is the goal that they have together, which is to distort competitiveness, and the reach of the act is very broad, so all acts that distort competitiveness can be viewed under it, even those that seem highly unilateral (Areeda, 1981, p. 17).

After having explained the rule of reason and per se rule, it becomes clearer what the issues with deciding which cases to judge using which rule are. Certainty that the per se rule offers can be substituted with the freedom that the rule of reason allows. That is why it is important to see how courts make decisions n which rule to use.

1.3 Deciding between the per se and rule of reason approach

After defining what the rules of reason and per se are, it is important to see how courts actually decide between them. All acts fall under the intrinsically or extrinsically unreasonable scope. Intrinsically unreasonable means that the act is so unreasonable and so obviously distorts competition that the courts will not even go into the detailed economic analysis of the case, but will rather just conclude that it is illegal based on the initial facts presented (Loevinger, 1964, p. 27). The easier way of determining which acts fall under per se or rule of reason scope is the

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intrinsically and extrinsically unreasonable act test. If agreements are intrinsically unreasonable, they fall under the per se category, and all other fall under the rule of reason category.

The most important thing is to look into the nature of the case and make a decision on whether to go into the detailed economic analysis based on how obviously it distorts competition. If the case distorts competition, regardless of the rule under which it is governed, redeeming virtues of the observed agreement become very important (Areeda, 1981, p. 21). Redeeming virtues are ways to compensate for the damage done by the anticompetitive conduct. Redeeming virtues are in most cases ban on the conduct and/or big fines. Bork (1966, p. 384) claims that agreements eliminating competition which have no efficiency-creating potential are the proper scope of the per se rule. There is no clear division as to which cases fall under the rule of law or the per se rule scope. The main deciding point is the nature of the case before the court.

Currently, the main problem is the fact that too many cases fall under the rule of reason and therefore produce judicial inefficiencies. Courts see the predictability of the per se rule as a negative thing, and therefore decide the majority of cases can using the rule of reason (Kayne, p. 3). The 2007 *Leegin Leather Products* case presents a precedent that is expected to shape the way rule of reason and per se rule will be looked at in the future. The things to keep in mind are the positive and negative sides of both approaches which are listed in the following table

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	Per se rule	Rule of reason
Positive	- Law enforcement efficiency, cheaper to administer (Bork, 1966, p. 386) -provides predictability (Winrow and Johnson, 2008, p. 64)	- Allows competitors to act more freely on the market (A/N)
Negative	- varying intensity, express exceptions and defining the conduct, (Areeda, 1981, p. 27-37) -unfairness to parties whose actual capability of injuring consumers, regardless of the parties' intent, is very slight and probably nonexistent (Bork, 1966, p. 387)	-Limiting factual inquiries and jury role (Areeda, 1981, p. 37) - lasts long and expensive to administer (Bork, 1966, p. 386)

Table1. Positive and negative sides of the rule of reason

There are examples of cases that are very clearly better judged by one or the other approach, but most cases fall under the uncertain category. That is why courts need to always keep in mind the positives and the negatives in the context of a certain case.

Deciding between per se and rule of reason is not easy. Even in defining the rules, it is clear that there are many traps related to making a clear line on which rule is to be used when. In this chapter both rules and their implications on the judicial process were explained. The main reason for having a set procedure for deciding between the two rules would be to prevent lengthy litigation over issues that are not as important as to not be decided in the first instance.

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2. Predatory Pricing

Predatory pricing is the act in which the predator lowers their prices below a certain benchmark in order to drive competition out of the market or to prevent new competitors from entering the market. This chapter will explain the idea of predatory pricing. It begins with a definition of predatory pricing and the types of predatory pricing. It continues with the strategic theory of predatory pricing which is followed by assessment of predatory pricing and the notion of recoupment. It then moves on to predatory pricing strategies and counterstrategies, history of predatory pricing in the US and the differences between the EU and the U.S approach to predatory pricing.

There has been talk about non-pricing predation that basically means that companies use all available administrative and judicial resources to drive the costs of their competitors up and that way make their prices relatively lower (OECD, 1989, p. 5). Non-pricing predation is one of the reasons why the scope of predatory pricing needs to be kept narrow, so that competitors do not abuse their rights of legal action against alleged predators. Other reasons why it needs to be kept at an optimal level are positive[4] and negative falses[5] (OECD, 1989, p. 6).

Predatory pricing is a price reduction that is profitable only because of the additional market power that the predator reaches by it and the increase in prices that will be possible because of the monopoly position that the predator is trying to get (Bolton, Broadley and Riordan, 1999, p. 3). There are three types of behavior that fall under predatory pricing. They are below-cost pricing, price discrimination and price warring (Gundlach, 1990, p. 132). Below cost pricing is the lowering of price to an unreasonably low (below some measure of cost) or unprofitable level in a market in an effort to weaken, eliminate or block the entry of competition

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[4] The false positive paradox (can also be called positive false) is a statistical result where the false true result is more likely than the actual true result. In the case of predatory pricing it means that when the overall predatory pricing enforcement is high, even conducts that are not predatory pricing will be punished and competition will be damaged that way.

[5] The false negative is a statistical result where results seem negative even when they are not. In the case of predatory pricing this means that when the overall predatory pricing enforcement is low, conducts that are predatory pricing will not be punished and competition will be damaged.

(Gundlach, 1990, p. 132). Price discrimination is the selling or purchasing of units of the same commodity at price differentials not directly related to differences in the cost of supply in an attempt to injure competitors (Gundlach, 1990, p. 132). Price warring is a drastic temporary lowering in price of a product below immediate or variable costs in an effort to injure competitors who have less financial resources (Gundlach, 1990, p. 132).

The main act that deals with predation in the US is the Sherman Act, especially Section 2 that deals with attempts of monopolization (Guandlach, 1990, P. 137). This is interesting because there was never a proved example of a company that became a monopoly using predatory tactics (DiLorenzo, 1992, p. 1). All predatory practices must have a strategic goal; otherwise they make no economic sense.

2.1 Strategic theory of predatory pricing

Strategic theory of predatory pricing is a way of approaching predatory pricing that tries to find justifications that prove its credibility (Elzinga and Mills, 2001, p. 4-5). Strategic theory is trying to find explanations that allow companies that already have some monopoly power to gain more power and exclude rivals (Elzinga and Mills, 2001, p. 4-5). The two main assumptions that strategic predatory pricing theories rely on are asymmetric information or asymmetric access to financial resources (Elzinga and Mills, 2001, p. 4-5). Informational asymmetries in this case mean that the predator has all the information the prey has plus additional information (Elzinga and Mills, 2001, p. 4-5). The basic of strategic theories of predatory pricing is to mislead other players on the market as to what the future holds for the prey (Elzinga and Mills, 2001, p. 4-5). Before introducing the strategic theory to a judicial process there needs to be strong proof of an underlying strategic theory that underlies the low-price period, and an unobvious proof of a monopoly power of financial power (Elzinga and Mills, 2001, p. 4-5).

Bolton, Broadley and Riordan (1999, p. 30-45) have identified five elements necessary for proving a predatory pricing case, and they are: a facilitating market structure, a scheme of

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predation and supporting evidence, probable recoupment, price below cost and absence of a business justification of efficiencies defense. A facilitating market structure contains three essential parts: the predator must have a significant market share, barriers to entry must be high, and supply elasticities of existing competitors must be high (Elzinga and Mills, 2001, p. 7). The second element looks into whether the alleged predatory scheme is plausible (Elzinga and Mills, 2001, p. 9). Probable recoupment is the proof that the loss during the period of predation is less than the profits after the period of predation (Elzinga and Mills, 2001, p. 11). Price below cost means that there must be a certain benchmark and prices must be below that benchmark (Elzinga and Mills, 2001, p. 13). The last element means that there must also be a discussion about the pro competitive effects (Elzinga and Mills, 2001, p. 14). Firms' low prices are defensive if they come as a response to a rival's low prices (Elzinga and Mills, 2001, p. 14). There has been much discussion about how to assess predatory pricing. The next subchapter presents suggestions on how to assess predatory pricing.

2.2 Assessing predatory pricing

There are various ways of determining and proving predatory pricing. The most often used by the US courts are determining predation by comparing it to some sort of cost and determining predation in cases when price is below the chosen level of cost (Areeda and Turner, 1975, p. 699). Table 2 lists and explains the academic proposals of approaches that could be used in assessing predatory pricing in judicial procedures, and lists their advantages and disadvantages.

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Academic Proposals for Assessing the Anticompetitive Nature of Predatory Strategies			
Rule	Description	Strengths	Weaknesses
Cost-based rules	Price set below some measure of cost (e.g. Short-run average variable cost, long-run marginal cost or cost-output) is considered anticompetitive (Areeda and Turner, 1975)	Conceptually appealing Easy to apply Judicially endorsed	Appropriate measure of "below cost" not agreed upon May not be appropriate for evaluating some forms of predatory pricing conduct (e.g. reputation or signaling strategies) Overlooks the strategic nature of some forms of predatory pricing conduct
Price-based rule	Increasing a price in a market after successfully deterring the entry of a competitor through lowering of price is considered anticompetitive	Forecloses monopoly profits to predator after predatory interaction Deterrent effect	Monitoring period difficult to administer Changed circumstances (e.g. product line changes) within monitoring period not accounted for in standard May reduce occurrence of procompetitive price cuts due to the restrictive nature of the rule
Rule-of-reason rules	Anticompetitive nature of predatory price conduct assessed through inquiry into a variety of factors (Scherer 1976; Joskow and Klevorick 1979)	Inclusive nature of inquiry "Two-tier" approach provides screening mechanism "Industry specific" rules allow more focused inquiry	Choice of which factors to evaluate Administrative difficulties stemming from wide ranging inquiry Potential inequities across "industry specific" rules
No rule	No standard or rule against predatory pricing (Bork 1978; McGee 1980; Easterbrook 1981)	Reduces the risk of falsely identifying a procompetitive strategy as predatory Reduces the risk that a rule could be employed by a predator against a competitor	Predatory conduct which is anticompetitive may injure consumers and competitors alike

Table 2. Academic Proposals for Assessing the Anticompetitive Nature of Predatory Strategies (Gundalch, 1990, p. 142)

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In all methods of assessment one of the most important presumptions to keep in mind is that the point of predatory pricing is to make monopoly profits in the long term. That is why recoupment is an essential part of any predatory scheme.

2.3 Recoupment

Recoupment is an especially interesting concept since it caused "false negatives"[6] in the US (Hemphill, 2001, p. 1586). A structural approach to recoupment deals with identifiable elements of the economic environment of the alleged predation (Hemphill, 2001, p. 1587). It does not look at the actual price cuts, but rather the surrounding elements. There are three elements that are especially helpful in determining likelihood of recoupment, and they are market share (and present concentration), capacity constrains and barriers to entry (Hemphill, 2001, p. 1587). Market share shows the benefits the alleged predator might have had in power. Capacity constraints are a limiting factor in predation because, if they exist, they prevent the predator from driving the price too low because he will not be able to supply as much as he would need to in case of a predatory price. Barriers to entry prevent other entrepreneurs from entering as a result of a price cut and they also prevent the predator from increasing the price in the anticipation of their likely reaction (Hemphill, 2001, p. 1587). A nice example of this is the *A.A. Poultry Farms v. Rode Acre Farms* case.

The *Brooke* case suggests a simpler way of approaching the matter. Their idea of calculating recoupment is to sum up the losses from predation and compare them to the profits obtained after predation period was perceived to end (Hemphill, 2001, p. 1590). This way of calculating recoupment is conduct based recoupment. If gains are higher than losses, there is recoupment, and if they are not there is no recoupment (Hemphill, 2001, p. 1591). The main problem related to this approach is that it happens that obvious cases of predation are unidentified by the courts because the gains after predation do not offset the losses from

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[6] When the overall enforcement is low, the real predators will escape without attracting judicial notice

predation (Hemphill, 2001, p. 1953), this is the paradox of deep price cuts. There are also problems related to conduct-based assessment of predation and they are measurement problems and insensitivity to high social costs of predation (Hemphill, 2001, p. 1596).

The notion of per se legality of predatory pricing cases would create substantial inefficiencies, deepen the false negativities and the issue of asymmetric information and market linkages, if not implemented in the analysis, will likely become even higher (Hemphill, 2001, p. 1606). Another important issue that is currently being avoided is the reputation of companies and effects of predation on their reputation (Hemphill, 2001, p. 1607). Elhauge (2003) develops an interesting idea on how even attempts that are not below the benchmark set by certain courts but are, for example a 20% cut in price, still distort competition and have deterrent effects for any entrants that might want to join the market in the future. He also emphasizes the fact that those attempts are not treated as predatory, but they distort competition in the same way as predatory pricing does.

Crane (2003, p. 27) suggests that the effects of predatory pricing litigation are not merely the who won or lost the judicial procedure, but that there are far less visible indirect consequences that we do not see immediately when looking into the procedure. First of all, the defendants need to provide many documents about their costs and pricing that cost a lot to produce and they need to hire good lawyers to defend them. The costs of litigation to defendants in cases of predatory pricing are much higher than the costs to plaintiffs. Apart from that, their reputation is damaged and their pricing policies go under the spotlight. After spending the amount of money they need to spend in order to defend themselves from the allegations, their costs will probably drive them to raise prices. If they are found guilty, the damages are usually so high that the predation will not have made sense in the first place. That is partially the reason why so many predatory pricing cases end up with a settlement.

When the burden of proof is high, and the costs for defendants are high, there is more incentive for non-pricing predation. Apart from non-pricing predation, there are many other

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strategies that companies use. The real trick is to be able to prove predation. That is why strategies were divided into six groups according to the underlying behavior and the burden of proof for particular group of strategies.

2.4 Predatory pricing strategies

There are various strategies that make predatory pricing work. In order to prove each of these strategies markets must have preconditions for predation and all five proofs that are going to be named strategic theory of predatory pricing need to be satisfied. The first group is financial predation (Bolton, Broadley and Riordan, 1999, p. 56-64). It is basically about the fact that most companies have a running line of credit or variable interest rate loans and those are renegotiated when there is a change in the value of assets, volume of sales or some other factor that could endanger the repayment plan. There are ways in which the creditor determines when and how to change the conditions of these agreements and in a case of a price war, the preys revenues go down, the value of their assets also goes down due to their lower liquidity in case of default and there is a possibility that the creditor will break the line of credit completely, or make the interest higher. In this case the proof requires five conditions, namely that:

> "the prey depends on external financing, the financing depends on its initial performance, predation reduces the initial performance enough to endanger its further financing, the predator understands the prey's reliance on external financing, and the predator can finance predation internally" (Bolton, Broadley and Riordan, 1999, p. 56-64).

The second group is reputation effect and signaling strategies, which work in a way that the predator lowers their price to signal the others that market conditions are unfavorable (Bolton, Broadley and Riordan, 1999, p. 77). This is a good strategy because most companies make their decisions on whether to enter an industry based on projected revenues (Bolton, Broadley and Riordan, 1999, p. 77). Apart from that, the entrants usually do not have all the information that predators have about the industry (Bolton, Broadley and Riordan, 1999, p. 77).

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Signaling theories involve reputation effect, cost signaling, test market and signal jamming (Bolton, Broadley and Riordan, 1999, p. 77). In reputation effects the predator basically cuts prices in one market to make the entrants believe that he is willing to do the same in other markets as well (Bolton, Brodaley and Riordan, 1999, p. 78).

Reputation effects usually happen when the predator is in more markets at the same time or in more markets at different times (Bolton, Broadley and Riordan, 1999, p. 77). Reputation effects are not a good strategy to prove on its own, but if it is combined with a clearer proof of predation, it emphasizes it (Bolton, Broadley and Riordan, 1999, p. 78). By lowering prices, the predator also signals that he might have a cost advantage due to informational asymmetries (Bolton, Broadley and Riordan, 1999, p. 79). This policy also affects the already existing competitors because lack of new entrants makes the liquidation value of assets lower, and that influences their repayment plans and approach to financing (Bolton, Broadley and Riordan, 1999, p. 81). In order to prove a signaling predation, the plaintiffs need to prove that:

> "(1). The predator, a dominant multi-market firm, faces localized or product-limited competition or potential competition; or alternatively, operating within a single market, the predator faces successive entry over time… (2). The alleged reputation effect reinforces an identified predatory strategy pursued by the predator, such as financial market predation, cost signaling, or test market predation... (3). The predator deliberately pursues a reputation effect strategy ... (4). The potential entrant victim observes the exit or other adverse effect experienced by the predator's existing rival in the demonstration market; and such knowledge is to be presumedif it is commonly known in the industry" (Bolton, Brodley and Riordan, 1999, p. 83-84)

The third predation strategy is demand signaling (Bolton, Brodley and Riordan, 1999, p. 94). In demand signaling the predator reduces prices to convince the competition that the demand is too low to justify both companies being in the market (Bolton, Brodley and Riordan, 1999, p. 94). It is very unlikely that one company will have more information about aggregate demand than the other. Two types of demand signaling are test market predation and signal jamming predation (Bolton, Brodley and Riordan, 1999, p. 94). Both of them rely on informational asymmetries as the main feature of predation (Bolton, Brodley and Riordan, 1999,

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p. 94). In test market predation the predator secretly cuts prices in order to reduce the entrants' sales in the test market and that way makes them believe that the demand is too low for them to enter the market (Bolton, Brodley and Riordan, 1999, p. 94). In signal jamming the predator openly cuts prices in order to distort test results (Bolton, Brodley and Riordan, 1999, p. 94). In these circumstances the entrant cannot see what the demand would be in normal conditions. (Bolton, Brodley and Riordan, 1999, p. 95) The proof of test market strategies requires:

> "(1). The predator observes that the victim is attempting to enter a limited product or geographic market with a new product or brand. (2). The predator secretly offers below cost prices on its own competing product or brand, either following or in anticipation of the victim's entry. (3). The predator's secret price cutting in the test market differs from its pricing conduct in other markets where it faces competition on a sustained basis. (4). The victim could rationally believe that the price cutting prevents it from effectively ascertaining demand for its product in the test market." (Bolton, Brodley and Riordan, 1999, p. 97-99)

The fourth predation strategy if cost signaling which makes the prey believes that the predator has a cost advantage by cutting prices drastically and that way make them leave the market (Bolton, Brodley and Riordan, 1999, p. 105). This can be done in cases when one company is close to a breakthrough that will allow them to have a real price advantage, and they cut prices before the breakthrough happens to drive the competitor out (Bolton, Brodley and Riordan, 1999, p. 105). Proof of a cost signaling strategy would not in itself form an antitrust violation. The required proof is:

> "(1). Some event has occurred, known by the victim, that could have enabled the predator to significantly reduce its variable costs. ...(2) At or about the same time the predator significantly reduces its price. ...(3). As a result of such price reduction the victim could rationally believe that the predator may have lowered its costs, e.g. in the past the predator has reduced price when costs fell significantly. … (4) The possible cost reduction is of sufficient magnitude to require the victim to exit or to limit its expansion into other markets." (Bolton, Brodley and Riordan, 1999, p. 109-110)

The prey also has room to defend using various counterstrategies. The problem with price wars is that both strategies and counterstrategies are illegal in most cases.

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2.5 Predatory pricing counterstrategies

There are many counterstrategies available to fight predatory pricing. The effects of their use depend on the market power and size of the prey. Most counterstrategies are not productive and they damage the prey, especially if they have sufficient market power to defend themselves in the price war (Easterbrook, 1981, p. 297). Seven counterstrategies are:

> "(1) coalitions between the predatory victim and its customers bypassing the predator, (2) coalitions among victims coordinating a defensive strategy, (3) counter-threats by the victim to enter the predator's other markets, (4) the classic "chain store paradox" that assertedly makes predatory strategies non-credible, (5) customer stockpiling, (6) mutual ignorance of the predator and the prey about market conditions, and (7) sale of the victim's assets to a successor firm if the victim fails." (Bolton, Brodley and Riordan, 1999, p. 110-111)

The problems with counterstrategies are that they assume informational symmetries (at least in Easterbrook's interpretation) and most modern theories say that strategic predation comes from information asymmetries. Other issues involve the fact that the predator probably made sure that his customers cannot start using competitors' products by contracts that have costly fines for ending it and the deals between victims have anticompetitive features and might be unenforceable (Bolton, Brodley and Riordan, 1999, p. 111-112). There are also many other issues related to other counterstrategies, but for the scope of this paper the above named ones are sufficient.

Now that all the relevant theoretical, procedural and proof requirements have been explained, it is time to look at actual judicial developments in predatory practices litigation throughout its history. There were three basic eras that developed from a very loose period, when in most allegations the defendant was proven guilty, to contemporary approach where predation can hardly be proven. It is interesting to note here that they went from a period of excessive small competitor protection to the current free competition if recoupment cannot be proven approach.

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2.6 History of predatory pricing judicial cases in the US

According to Bolton, Broadley and Riordan (1999, p. 14-29) there were basically three eras in the judicial history of predatory pricing in the US: the pre-Brooke decision era with the Areeda-Turner rule, the Brooke decision and post Brooke era. Before the Brooke decision, and before the Areeda-Turner rule, the law protected small companies and plaintiffs won cases that they were supposed to lose, there was no consideration of consumer welfare and the emphasis was on protection of small companies.

The Areeda-Turner rule changed this in 1975. Areeda and Turner published an article in which they introduced the idea of a single per se standard: the price needs to be higher that the variable cost of producing each unit (average variable cost). Even though there was strong opposition to this rule, because it lacks the essential element of strategic behavior of predatory pricing, it almost immediately changed the number of court cases that were won by the plaintiff (Bolton, Brodley and Riordan, 1999, p. 14-20).

Reasoning of the 1993 *Brooke* case completely changed the way predatory pricing is looked at by courts. Under the Brooke rule, the average variable cost could not be used as a universal benchmark to determine predation, but there needs to be some line below which it is predation, and it introduced the need for proof of recoupment.

After the Brooke decision the great majority of cases were won by the defendants. The main reasons for this are the exact proofs and pleading requirements, skepticism that predation could never be a plausible business strategy and judicial neglect of modern economic theories. After the Brooke decision there have been some attempts of creating a new outlook on predatory pricing. Maybe the best example is the Department of Transportation proposed predatory pricing guidelines that say that the strategic dimension of predatory pricing should be taken into account (Bolton, Brodley and Riordan, 1999, p. 2).

European courts also meet predatory pricing cases, and it is very interesting to see how these two completely different systems have only slight differences in this perspective. Through

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the view of the first research goal, it is very interesting to see how the European approach, which seems to be more effective, has the main features that the US system had from 1975 to 1993.

2.7 Differences between US and EU approach

US and EU use differing tests on predation. The most important difference is that according to the ECJ in Europe prices must be above average total cost to avoid claims for predation, while in the US there is no consensus, but the US Department of Justice says that companies are safe from predation allegations if their prices are set above average avoidable costs[7] (Dechert LLP, 2009, p. 2).

Another important difference has to do with recoupment. In the US, according to the US Supreme Court *Brooke* decision, there needs to be proof of higher prices after the predatory price cut in order to establish predatory pricing. This part is not necessary, but is highly useful in predatory pricing cases. No such proof is needed in Europe, although it is considered useful if proven (Dechert LLP, 2009, p.2). It is interesting to notice that there have been no proven cases of predatory pricing in the US after the *Brooke* decision introduced the burden of proving recoupment (Dechert LLP, 2009, p.3).

Various conducts that constitute predation can be interpreted in different ways. From this chapter it is obvious that predatory pricing cases are not easily visible or easily enforceable. The main thing that needs to be kept in mind is the end goal of the conduct. If it is to grab a monopolistic share of the market and charge monopolistic prices, then there should be a high probability of finding and proving predation in the conduct. As the next chapter will show, the outcome of litigation is not always that unanimous or clear and it also depends on which ground the suit is brought.

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[7] Avoidable cost are cost that can be avoided by not producing a particular good. For example in car manufacturing the avoidable cost is the aluminium and the plastcs used in production

3. Case analysis

Case analysis will be done case by case and the focus will be in answering the two posed questions within the facts of each case. My basic presumption is that the per se approach is better for predatory pricing cases and that the scope of predatory pricing cases should be wider.

The main reasons why predatory pricing should be looked at using the per se approach is that predatory pricing clearly disrupts competition. It is used by monopolists, or companies with a high market share that want to become monopolists, it damages them in most cases, and disrupts competition. In a case of making it per se illegal, the burden of proof on defendants should be lower and plaintiffs should pay for all costs of litigation in case they clearly made the allegations only to use it as a means of increasing defendants cost.

The scope of predatory pricing should be wider because cases that clearly disrupt competition cannot be litigated properly under the current system. Some of the reasons for that are that prices used by the same company are not looked at as a single unit if they are in different industries, or the price is not low enough to be provable as predation, but it is low enough to drive out or deter competition, different geographical markets under the same company are looked at individually etc.

Cases used for this analysis are US Supreme Court cases on predatory pricing that happened after 1967. Only those with somewhat clear predatory practices will be looked at in more detail, but some of them will be used to demonstrate how predation that has most features of predatory pricing escapes the judicial system using loopholes. They will be presented from the most recent to the eldest case because newer cases serve as better indicators of what I am trying to prove.

Cases presented are cases that happened after 1963 because that way there is example of cases from all the three eras of predatory pricing litigation. That is important because of the conclusions to be made in the end. The most important thing in this analysis is the point of view

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of courts on facts of the case and the schemes used, not the decisions of the court themselves. They are used to prove a point about the system itself, not the individual case.

3.1 Pacific Bell Telephone Company v. Linkline Communications (2009)

The first case is economically a very clear case of anticompetitive behavior. It is about a monopolist that raised prices to small companies that were depending on the monopolist to rent them a part of essential equipment they needed in order to to provide their services to end customers. The main problem is that the monopolist raised wholesale prices and lowered retail prices, so smaller competitors that depended on them to provide them with an input had much lower profit margins and less chance of staying on the market. This suit was brought under Section 2 of the Sherman Act.

According to the US Supreme Court this conduct is legal because prices are looked at separately. If either wholesale or retail prices were predatory, the smaller companies that were the prey in this case would have room for action, but since the monopolist did not make any of the prices predatory, this conduct is completely legal. Even though economically it is obvious that it is an act that this company made in order to disrupt competition and make its products relatively cheaper.

Looking at this case using the per se approach would mean that it is legal per se. The Sherman Act was primarily made to protect competition. In this case the monopolist is free to charge monopolistic prices and there is no proof of predatory pricing under the Brooke rule (Justice Roberts, 2009). Justice Breyer (2009) says this case can be looked at as a "price squeeze" under Section 2 of the Sherman Act, but not as predatory pricing. In this case it is impossible to prove predatory pricing because none of the prices are below a benchmark that could be used to prove that this is a case of predatory pricing. Using the rule of reason approach this case is fairly simple. It can be proven that this is anticompetitive behavior and should be punished. If a single company has the power to make prices of an input it provides to other companies higher and, at

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the same time, lower prices of the a final product that uses identical inputs it is obvious that it is a case of predatory behavior.

As far as the scope of predatory pricing is concerned, this is one of the situations in which there should be an exception and price squeeze claims should be looked at using the rule of reason approach. Price squeezes can be done in many ways, so it is important to leave room for interpretation of economic impacts of certain conducts.

3.2 Weyerhaeuser Company v. Ross-Simmons Hardwood Lumber Company, Inc (2007)

This is a case of predatory bidding, but its connection to predatory pricing is in the fact that the test applicable for predatory bidding is the same test as the one applicable for predatory pricing. Predatory bidding involves use of market power on the input side of the market. It means that a large competitor on the market will drive input prices up, so that the profit margins of other competitors at the market, given that they want to stay competitive, are lowered to an unsustainable level in order to drive them out of the market. Another peculiarity of this case is the fact that lower courts recognized that it is a predatory practice and awarded damages of $79 million to Ross-Simons. The Supreme Court held that this case should use the Brooke test for predatory pricing and that it is not a predatory scheme.

In this case the large mill, that was at the time acquiring approximately 65% of the alder logs available in the region, increased the price of saw logs to other competitors that used it as an input, while at the same time the prices of final products to the mutual customer pool were lowered. In this case it is especially interesting because the alleged predator had a large share of the market which made them less vulnerable to predatory counterstrategies. The basic claim of Ross-Simons was that, due to its market power, Weyerhaeuser had the power to increase the cost of inputs for them, and they did this by overpaying for the lumber, while prices of finished hardwood lumber fell. This suit was brought under Section 2 of the Sherman Act. The main

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reason why the US Supreme Court found that Weyerhaeuser is not liable due to the fact that this action makes no economic sense and recoupment (an essential part of the Brooke test, see 2.3) in this case is unlikely.

Per se rule in this case would allow the lower instances court to make the decision that it is illegal, and this actually happened using the Brooke test. The appeal caused judicial processes that in the end led to Weyerhaeuser being freed from liability due to inability to satisfy the Brooke test. In making the per se rule for predatory pricing there should be a solution that would prevent defendants in cases that clearly involve anticompetitive behavior from appealing.

The other issue being addressed is the scope of predatory pricing. This case is a clear example of what should be a per se illegal predatory pricing case. I am not even going to address the issue of one company having 65% of the market. What is important here is that the conduct in this case clearly had the goal of the predator becoming the only buyer, and in doing that, they clearly damaged themselves (it was discussed that they had lower profit margins as well at the time of the price war) and drove competitors out of business. A comparison between the new avoidable costs of competitors compared to predators avoidable costs would probably serve as a clear proof of predation.

3.3 Brooke Group Ltd. v. Brown and Williamson Tobacco Corporation (1993)

Brooke is the most important precedent for predatory pricing in recent history. Even though it is highly unusual, the US Supreme Court looked into evidence to come to a verdict on this case. Even the case itself is very peculiar. It is about the tobacco industry, which was ruled by an oligopoly of six companies that eventually got into a price war. This case represents a historical point after which the predatory pricing litigation at higher instances became unlikely because in most cases predatory pricing is disregarded and perceived not to exist by the courts due to lack of provable recoupment.

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The main features that make this case different from any other similar case are the fact that the tobacco industry was ruled by an oligopoly and that the price war began as a result of an oligopoly gone wrong, meaning that one of the six big companies that was in the industry wanted to take a bigger share of the generics tobacco market. In this case the predatory pricing could have been proven using tests previously used by the courts (Areeda-Turner rule) because there was a sale of cigarettes below their average variable production cost for a period of 18 months, but the specifics of the industry made, in my opinion, the court develop a test that will not allow one company to be punished within the industry that worked as an oligopoly before this price war started. This suit claimed that the new pricing schemes were in violation of the Robinson-Patman Act.

The US Supreme Court in this case developed a test that basically looks at whether prices are set below a certain measure of costs and whether recoupment after the predation period is possible. In my opinion, the recoupment test was put in as an essential part of the test exactly because companies that previously engaged in oligopolistic agreements are unlikely to increase their prices back to their previous level after the price war is over, and the chances of recoupment are therefore very low. If they enjoyed very high profits before, it would be unjust to punish one of them for turning to anticompetitive practices in a later period.

As a per se rule, predatory pricing would have been determined in this case, however, due to the specifics of the industry it would be unfair to competition in general to start enforcing competition through judicial procedures at this point. That should have been done in a time when all six companies were making high profits and prevented entrants with their oligopoly. Even if the per se rule for predatory pricing were accepted, this type of cases should be an exception. If an industry is built on anticompetitive practices, it should not be unlawful for one company to take the anticompetitive behavior a step further.

As far as the issue with the scope of predatory pricing is concerned, it is clear in this case that the conduct in question was predatory pricing, but the main reason why it is not recognized

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as such is the high unlikely of recoupment. This case serves as a good example on how predatory pricing that is clearly predatory pricing should not be punished because it is a result of a long tradition of anticompetitive practices within an industry.

As far as the Brooke test is concerned, after getting familiar with the facts of the case, it becomes perfectly clear why the Supreme Court made it so strict. Later interpretations of the Brooke test are not necessarily correctly implemented. In this case, the Brooke test looked at recoupment because of the high level of anticompetitive practices in this particular industry. It is not suitable for other industries where competition is clearly disrupted by only one of more competitors that are in an otherwise fair and competitive market.

3.4 Atlantic Richfield Co. v. USA Petroleum Co. (1990)

In this case there is a claim that a vertical, non predatory price-fixing agreement in the gasoline industry constitutes an antitrust injury for the purposes of a private suit under Section 4 of the Clayton Act. There is no antitrust injury in this case, and therefore there is no cause for this suit. Also, the oil company did not have enough market power to actually damage competition even if it did limit the prices at a very low level. But in this case even the level of prices that the retailers were allowed to charge was not unreasonably low or predatory; it was matched to the prices of independents, such as USA Petroleum. The claim needs to be made on the basis that vertical price-fixing agreements are unlawful per se. That way it might have a standing under the Sherman Act, but there still needs to be proof of competitive injury.

This case seems to be a case of very successful non-pricing predation. The cost of this litigation to Atlantic Richfield was probably very high, but there is no ground for the suit. If the case were judged only based on the illegality of the vertical price-fixing agreement the suit would have lasted much shorter, the expenses for the defendant would be lower and the reputation effects would not be as high as they probably were for this suit. From the fact that the suit was brought under the Clayton Act, and from the fact that it went to such a high instance it can be

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concluded that the only goal the plaintiff had was to increase cost for Atlantic Richfield, especially after taking into account the fact that no antitrust injury can be proven and there was no predatory pricing.

This case would benefit from the per se approach because per se rule would conclude at the lowest instances that this is not a case of predatory pricing, and the plaintiff would have no room for appeals. He would have been directed to the per se rule on vertical price-fixing agreements immediately.

As far as the scope of predatory pricing is concerned, this case does not benefit the analysis much because it is clearly not a case of predatory pricing. It is a clear example of how antitrust allegations with no ground can burden the judicial system and cost the defendant a lot of money because the burden of proof in predatory pricing cases is mostly on the defendant. In this case the plaintiff did lose some of its market share but it was not due to the decrease in price, but to other factors.

3.5 Matsushita Electrical Industrial Co., Ltd. et al. v. Zenith Radio Corp., et al. (1986)

This is a suit brought by American electronic companies, mainly television producers, claiming that there is a conspiracy between Japanese electronics manufacturers. The claim was that they sell their products for a higher price in Japan so that they can sell their products at a loss in America and that way ruin existing US electronics manufacturers and deter new entrants. In this case there was a claim for a summary judgment under Section 1 of the Sherman Act, and the Supreme Court held the evidence insufficient for a summary judgment.

In this case predatory pricing appeared in a strange way. If it were a claim against one manufacturer with one product there could have been a comparison that would show whether the product is being sold below the average variable unit cost of production (that was the test applied at the time, the Areeda Turner rule) and case would have been solved. In a case of

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summary judgments the benchmark for determining predation is the party most favorable to the party opposing the notion. Winning a claim against all Japanese electronics manufacturers as a summary judgment was very unlikely from the beginning.

As far as the per se rule for predation goes, it would have been better in this case, but only if there were separate claims against specific electronic manufacturers for specific products. As far as the scope of predatory pricing is concerned this case is interesting because it raises the question of comparison of prices of the same company across geographical markets to determine predation. I think it is a thing that needs to be taken into account because there are companies that price their products differently across geographical markets, even after taking into account the difference in price levels in general.

3.6 California Retail Liquor Dealers Assn. v. Midcal Aluminum Inc., et al. (1980)

In this case the state itself is disrupting competition. It arose after the California Department of Alcoholic Beverage Control charged a wholesale distributor of wine in California for having charged a price less than the original price that was stated in the producers' price list and for having sold wines for which no fair trade contract or schedule has been filed. The alleged violations were that there was a breach of California's statutory plan for wine pricing requiring a filing of fair trade contracts or the price schedule with the state and prohibiting the sale of wine by state licensed producers for the prices other than those stated in the price lists. The dealers responded by filing a writ of mandate saying that the California Department of Alcoholic Beverages was in breach of Section 1 of the Sherman Act because it prohibited competition by this law and asked for an injunction against the state wine pricing plan.

There is a test that requires two conditions; and if a state satisfies those conditions ("state action" exemptions) it is allowed to pass laws that prohibit or limit competition. Conditions are that the challenged restraint must be one clearly articulated and affirmatively expressed as state

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policy and that the policy must be actively supervised by the state itself. In this case the Supreme Court held that California's wine pricing system is in violation of the Sherman Act and that it constitutes resale price maintenance.

There was a similar case in 1987, *324 Liquor Corp., DBA Yorkshire Wine and Spirits v. Duffy,* where New York had a law that said that the resale prices of liquor must be a minimum of 112% of wholesale prices of liquor. In this later case the Supreme Court also decided that the 112% price rule is not an exception of antitrust law and that it disrupts competition. It is interesting to see how these cases arise in the beverage industry, where the retail network is highly diversified and cases of predatory pricing for some products are likely to happen because of many retailers who are all trying to get a part of the industry. Predatory pricing in this case is not to gain monopolistic power, but to be able to stay on the market and recoupment is achieved by selling more complementary products.

In this case there is a clearly defined price below which cases are treated as predatory pricing and below which the state takes the liquor license away and charges fines. I think that this way of controlling this particular market is good. There should be a federal statute allowing states to set minimum or maximum percentage increase in price from the wholesale to retail level, or to require a list of products and their prices. Especially big problems arise in industries where there are many retailers because incentives for predation are higher, and the chances of being tried for predatory pricing as a single retailer with a small market share are very low.

3.7 Federal Trade Commission v. Procter and Gamble Co. (1967.)

In this case a merger was prevented because of a high possibility of predation in the future. Procter and Gamble wanted to acquire a large bleach producer and they were not allowed to merge because of high possibility of predatory behavior and disruption of competition on the future. The bleach manufacturer that was supposed to be acquired had a market share of over 45%, and the whole industry was highly oligopolistic, so an appearance of a big producer with

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significant market power in this and other related industries would be a big threat for competition. In this case the prevention part of the Clayton Act is showing its power because the suit was brought under Section 7 of the Clayton Act. The acquisition was prohibited.

Another case appeared later, in 1986 *Cargill v. Monfort of Colorado* when the fifth largest beef packer sued the second largest beef packer that was planning to merge with the third largest beef packer saying that their merger would cause severe competition damage and a price squeeze. The Supreme Court found that it is not a violation of the Clayton Act. In this case the Supreme Court also showed its hostility toward private claims with regard to competitive claims, especially when brought on by competitors of companies that are merging. All mergers are reported to the Federal Trade Commission and in cases of a threat to competition the Commission files a suit.

With regard to per se rule or rule of reason being better for this type of cases, it is useful to have a benchmark set in terms of market power for how much market power is one company allowed to have within an industry. This is a nice example of prevention of predatory behavior. Nothing happened yet, but in expectation of a company being able to lower their costs and prices below the level that the competition is reasonably expected to have costs the Federal Trade Commission prevented the merger in the first place. But this case touches the issue of lowering costs and lowering prices as a result of lowering costs of production in a particular industry. Even though the lowering of costs can be due to technical improvements or superiority in processes it should still be prohibited that one company reaches a monopoly position due to a breakthrough. Some states have legislation on maximum market shares allowed.

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3.8 Lessons from Cases Analyzed

All of the above mentioned cases involve predatory pricing in some way. There are rarely any real predatory pricing cases that involve clear predatory practices because companies manage to circumvent current judicial practices without being punished, or they settle out of court if they

are guilty and think they could be found guilty in court. The above mentioned cases go from latest cases on predatory pricing to a time when predatory pricing was banned on lower instances.

The most important conclusions that can be taken from these cases are that predatory pricing was prevented much more effectively when there was a clear benchmark on how to determine predatory pricing and that, taking into account the current system, it would be beneficial to determine a benchmark for predation. In the current system there are cases that make it to the highest instance in the US, which the Brooke test, which was suitable for that particular case because of the oligopoly that was in that particular industry before the price war started, is now being used in all other cases that could involve predatory pricing.

At the same time it is visible that before the Brooke case obvious cases of predation did not get to the Supreme Court. At that time there was a benchmark that courts used in determining predation and companies knew that, if they price the product below that level, they will be fined and suffers consequences.

The notion of recoupment is not easily provable and therefore should not be the most important thing to look at while looking at predatory cases. A great solution for the US would be to gather all precedents and their decisions and define which ones can be used in which cases to avoid the confusion that is currently present. The current system is not suitable for predations that happen in the market, and there needs to be a change in order to preserve competition.

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Conclusion

Predatory pricing is a major problem in terms of competitive practices, especially in industries that have a few large competitors and in industries that have one leader with a high market share and many smaller competitors. The aims of this paper were to place predatory pricing within the scope of the two rules that can be used in the US to judge competition cases, per se and rule of reason, and to tackle the real scope of predatory pricing.

The initial assumptions were that a well worded per se rule with a set benchmark and exceptions would be a better rule for predatory pricing than the Brooke test that is currently used, and that the scope of the predatory pricing cases should be wider. The research included only US Supreme Court decisions, and did not tackle decisions of lower courts or practices in other jurisdictions.

Research showed that the initial assumptions were partially correct. Per se seems to be the better rule for predatory pricing, even though it is difficult to find case examples of it because many cases get settled out of court. The other assumption was not satisfied. If the scope of predatory pricing were wider, and there was a strict per se rule dealing with it, many competitive practices would be considered illegal, and that would severely damage competition because it would prevent conducts that drive innovation and development.

On the other hand, some might claim that predatory pricing already is illegal per se, or that the scope of predatory pricing is too wide as it is. My interpretation asks for a set of clear rules on how to judge cases that would also list exemptions. It would benefit competition if everybody were aware of the consequences their actions will have, and this way cases of clear dumping would be avoided.

Discussion on predatory pricing in the US revealed serious shortcomings. The biggest problem is that many obvious cases of predation stay unpunished due to a high burden of proof and uncertain procedures at the Supreme Court. Another issue is the interpretation of the

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currently existing acts that can be avoided by summarizing already existing precedents into one act.

As a note for future research it would be beneficial to research out of court settlements and all cases of predatory pricing that were finished in lower instances. Also, ways of determining cross market predation in a geographical sense and making a way of dealing with it. Ways that precedents can most efficiently be compiled into an act and what its implications on overall efficiency will be should also be researched. This is probably the biggest lesson that comes out of this research. There are rules that already exist in various papers and precedents, they just need to be compiled and there need to be clear guidelines on when to use them.

Anticompetitive practices litigation is important to businesses within the industry, all their employees, suppliers, distributors, other business partners and end consumers. All levels suffer from anticompetitive practices, even if it is not directly. The biggest impact is on other competitors in the industry and competition itself. The industry is losing variety and competitiveness that drives efficiency, and the long term consequences of that far outweigh any short term benefits that might be achieved.

The main conclusion of this thesis is that a clearly defined per se rule on predatory pricing is essential, and that there needs to be a defined benchmark below which prices will be considered predatory.

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