Predatory Pricing: The Evolution of Judicial Standards in the United States and the European Economic Community

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I. INTRODUCTION

Predatory pricing is a technique used by a firm to drive competitors out of a market. Predatory pricing occurs when a predator firm with a monopoly in another market lowers its prices so that other firms lose business. Once the competition leaves the market, the firm can raise its prices, resulting in a monopolistic, rather than a competitive, market system. For example, a company with a monopoly in one regional market might seek to monopolize an adjacent market by raising prices in the monopolized market to support price cuts in the adjacent market. Any benefits to consumers from lower prices are only temporary. When competitors in the adjacent market are driven out, the price-cutting firm will absorb their business. The price-cutting firm eventually ends up with a monopoly, and thus can raise prices above the level of fair competition.

In the United States, predatory pricing is prohibited by section 2 of the Sherman Act and section 2 of the Clayton Act, as amended by the Robinson-Patman Act. The current standard for predatory pricing in the United States is based on an economic model which assumes that pricing is based solely on efficiency concerns. Under this model, pricing is predatory only when prices are below cost and when the firm can recoup the losses after driving competitors out of the market. This standard as interpreted by the courts in the United States has made pursuit of

predatory pricing cases very difficult.\(^5\)

The European Community (EC) is in the process of defining the standards it will use in predatory pricing cases under article 86 of the Treaty of Rome.\(^6\) In the *Akzo* decision,\(^7\) the European Economic Commission (Commission) explicitly ruled that article 86 does not require any cost-based legal rule to determine when price-cutting becomes abusive.

This Note describes how the standard for predatory pricing has evolved in the United States, focusing on the leading case in the Ninth Circuit\(^8\) and a recent decision from the U.S. Supreme Court.\(^9\) The Note also sets forth the standard for predatory pricing in the EC as articulated in *Akzo*. Treatment of predatory pricing in the United States and the EC is evaluated by a comparison of statutory language, underlying social values, and public policy concerns. Finally, the Note proposes that U.S. courts adopt the EC standard for reviewing predatory pricing claims.

II. JUDICIAL STANDARDS FOR PREDATORY PRICING IN THE UNITED STATES

A. Statutory Basis

Predatory pricing is an antitrust offense under section 2 of the Sherman Act, which forbids monopolization and attempts to create monopolies.\(^10\) A monopoly occurs when there is only one significant seller in a given market. The monopolist seller restricts output and raises prices, thereby promoting inefficient resource allocation. Allocative inefficiency harms society and prompts the creation of laws favoring competition. Economists argue that an economy based on competitive markets allows consumers to satisfy their preferences and thus promotes consumer welfare.\(^11\)

Price discrimination, another form of predatory pricing, is also for-

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\(^6\) TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY] art. 86.
\(^7\) Commission Decision 85/609, 1985 O.J. (L 374) 1.
\(^8\) William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981).
\(^10\) Section 2 of the Sherman Anti-Trust Act provides 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 . . . ." 15 U.S.C. § 2.
\(^11\) SCHWARTZ, *supra* note 1, at 42.
banned by the Clayton Act, as amended by the Robinson-Patman Act of 1936.12 Price discrimination occurs when a seller charges different rates to different buyers for similar goods in order to eliminate competition.13 The Robinson-Patman Act has been construed to prohibit both primary and secondary line discrimination.14 Primary line discrimination exists when the discriminating seller’s price cuts harm her competitors.15 When the discriminating seller’s price cuts harm competition on the buyer’s level, the discrimination affects secondary line competition.16

There are differences in predatory pricing theory under the Sherman Act and the Robinson-Patman Act. Under the Sherman Act, a court will determine whether the predator firm has monopolized or attempted to monopolize a defined market.17 This approach emphasizes structural competitiveness.18 Under the Robinson-Patman Act, by contrast, a court will focus on unfairness and determine whether the seller’s price discrimination has injured competition at the seller’s level.19 Despite these different emphases, both statutes prohibit predatory pricing and promote the establishment of competitive markets in the long-run by protecting new entrants and existing smaller firms.20

Both the Sherman Act and the Robinson-Patman Act require the plaintiff to establish the elements of predatory pricing.21 The plaintiff must prove the monopolistic power of the predator firm which serves several geographic or related product markets22 and show a pricing differential between the predator’s “monopoly” market and the competitive market.23 To be actionable, the differential must reveal that the predator’s sales are below average total cost in the competitive market and that these sales have resulted in injury to or exclusion of smaller competitors or new entrants.24 Some courts also look to the intent of the predator firm to exclude or discipline rivals.25

13. SCHWARTZ, supra note 1, at 871-72.
14. Id.
15. Id.
16. Id.
19. Id. at 766 n.82.
20. Id. at 766.
21. Id.
22. Id.
23. Id.
24. Id.
25. Id.
B. The Pre-1975 Standard

Case law has largely determined the interpretation of the elements of predatory pricing. Prior to 1975, the courts adopted a two factor analysis to decide predatory pricing cases: (1) the unfair use of pricing power against new entrants or smaller firms; and (2) the protection of long-run market competitiveness viewed primarily in terms of market structure. The courts did not articulate economic efficiency as a legal policy goal.

C. Post-1975 Standard: The Areeda-Turner Model

In 1975 Professors Phillip Areeda and Donald F. Turner of Harvard University published a very influential article describing their economic model for determining predatory pricing. By late April 1986, the Areeda and Turner article had been cited in fifty-nine decisions of the federal courts and a number of important Federal Trade Commission decisions. Moreover, many courts initially adopted Areeda and Turner's marginal cost pricing theory.

Areeda and Turner departed from then-prevailing approaches to predatory pricing by relying on a non-linear, rather than linear, cost model. The linear model is based upon constant marginal costs and no fixed costs. It thereby assumes that marginal costs equal average costs and allows a court to determine whether a price is above or below cost. Because it is simpler than a non-linear model, the linear model is thought by some commentators to be "the preferable model for the analysis of cost-based legal rules." Areeda and Turner believe that more complex cost functions are necessary to understand predatory pricing and that the non-linear model is more appropriate.

The Areeda-Turner model is based upon short-run production costs

26. Id. at 765.
27. Liebeler, supra note 5, at 1055.
29. Liebeler, supra note 5, at 1053 n.12.
30. Brodley & Hay, supra note 18, at 767-68.
31. Id. at 748.
32. Id. at 743. Marginal cost is defined as the increase in price per unit increase in output.
33. Id.
34. Id.
35. Id. at 746. In contrast to the linear model, the non-linear model assumes fixed costs and non-constant marginal costs.
of the firm viewed at a single moment in time. 36 Under this approach, the marginal cost 37 is the correct standard for efficient pricing. 38 If the predator firm's price equals or falls below marginal cost, it will exclude new entrants 39 who cannot produce at an output level that yields average costs as low as the dominant firm. Although this price will eliminate an inefficient rival, 40 it will not eliminate an equally efficient competitor. Since marginal cost is very difficult to calculate, Areeda and Turner substitute average variable cost. 41

The courts rely on two premises which are derived from the Areeda-Turner model. First, pricing above marginal cost is lawful. Second, pricing below marginal cost is presumed conclusively to be unlawful, except under conditions of strong demand, when the price may fall moderately below marginal cost as long as it remains above average total cost. 42

The permissive pricing rule of the Areeda-Turner model reflects Areeda and Turner's belief that predatory pricing is a rare phenomenon. The rule is designed to discourage frequent predatory pricing litigation, and thereby encourage socially desirable pricing conduct. 43 Without the Areeda-Turner model to define predation, risk-averse firms might avoid lawful price reductions. 44

Contrary to what Areeda and Turner intended, there have been numerous cases alleging predatory pricing since the introduction of the Areeda-Turner model. 45 In deciding these cases, federal courts have adopted three variations of the Areeda-Turner approach. 46 First, some courts directly adopted the marginal cost standard advocated by Areeda and Turner. 47 Second, courts have used an augmented marginal cost standard, which dictates that pricing below marginal cost is unlawful. 48 Under this standard, pricing above marginal cost is also unlawful when

36. Id. at 751.
37. Id. at 743.
38. Id. at 751.
39. Id.
40. Id. at 749.
41. Id. at 752.
43. Brodley & Hay, supra note 18, at 753.
44. Id. at 753-54.
45. Liebeler, supra note 5, at 1052.
46. Brodley & Hay, supra note 18, at 767-768.
high barriers to entry exist or when other elements demonstrate predatory pricing. Such elements include intent, limit pricing, non-price predation, and entry barriers. Third, courts have looked to average total cost to decide predation. Under this standard, courts find that pricing below average total cost is unlawful when, in light of all facts, the price is unreasonable or predatory.

D. Analysis of the Areeda-Turner Model

In recent years, economists have criticized the Areeda-Turner model and courts have begun to recognize the difficulties of employing it in complex litigation. This section discusses the principal criticisms of the model and offers a possible alternative.

1. Criticisms of the Areeda-Turner Model

The Areeda-Turner model has been criticized for its use of average variable cost (AVC) as a substitute for marginal cost (MC). Areeda and Turner use AVC as a substitute for marginal cost because it makes establishment of the elements of a predatory pricing claim easier. The substitution of AVC for MC is problematic because no constant relationship exists between them. In fact, MC can be greater than, equal to, or less than AVC depending on the level of output. MC is high when production begins, decreases as the plant nears capacity, and then rises as the plant begins to strain past its capacity. The strain created at higher output levels forces MC to rise significantly above AVC.

Critics believe that since AVC is not an accurate substitute for MC and does not reveal the correct pricing floor, AVC alone should not be used to determine legitimate pricing practices. Instead, the relationships between price and cost at any current level of output should be examined in order to determine the appropriate pricing floor. At low levels of output, AVC is the lowest cost below which the price cannot drop and is

49. See Chillicothe Sand & Gravel Co. v. Martin Marietta Corp., 615 F.2d 427 (7th Cir. 1980); California Computer Prods., Inc. v. IBM Corp., 613 F.2d 727 (9th Cir. 1979).
50. Brodley & Hay, supra note 18, at 769.
51. Brodley & Hay, supra note 18, at 769-70.
52. Id. at 768.
53. Id. at 751.
54. Id. at 752.
55. Id.
56. Id.
57. Id. at 753.
58. Id.
used as the judicial standard because it is acceptably close to MC. At moderate levels, MC rises significantly above AVC, and thus MC should be used as the pricing floor. As output increases over the moderate range, AVC should be the pricing floor because it approximates MC. Finally, as output continues to increase, MC again must serve as the pricing floor.

The calculation of AVC gives rise to several problems. The Areeda-Turner model does not reflect the differences between AVC and MC. AVC does not include long-term costs and thus is underinclusive. Areeda and Turner attempt to compensate by including in their definition of average variable cost components not normally defined as variable costs. For example, the Areeda-Turner model includes all advertising and promotional expenses as short-run costs, even though these expenses are long-run in nature.

Another problem with the use of AVC is that it can easily be distorted. AVC is subject to distortion because the marginal cost/average variable cost test is affected by variances in the ratio of fixed to variable cost. Firms can influence the marginal cost figure by manipulating the classification of costs as either fixed or variable and thereby calculating average variable cost in different ways. Thus, firms with identical costs could have different AVCs and thereby distort the model.

2. Predatory Pricing Which Does Not Violate the Areeda-Turner Model

Professor Oliver E. Williamson of the University of Pennsylvania points out that the Areeda-Turner model gives a dominant firm with excess capacity flexibility to achieve predatory purposes without violating the dictates of the Areeda-Turner model. Williamson argues that the rule encourages a firm to deliberately choose a plant size that is larger than would be optimal to produce the short-run profit-maximizing out-

59. Id.
60. Id.
61. Id.
62. Id.
63. Id. at 754.
64. Id.
65. Id. at 754 n.41.
66. Id. at 754.
67. Id.
68. Id. at 754-55.
69. Id. at 762-63.
put and then to operate that plant at less than full capacity. To the extent this occurs, the dominant firm's present output is less than its most efficient level. At this relatively low output level, the dominant firm's marginal cost is far below its average total cost.

Under these conditions, a marginal cost pricing rule provides the dominant firm with a substantial range over which it may expand output and reduce price below average cost. Thus, its permissible price is below the costs of an equally efficient entrant. A potential entrant, recognizing the dominant firm's position, is deterred from entering the market.

Professor F.M. Scherer of Northwestern University views limit pricing as another way in which a dominant firm can deter entrants without violating the Areeda-Turner model. A dominant firm using this strategy will, before the new entrant enters the market, set its output at a level so high that the market can accommodate the entrant's additional output only at a price below the entrant's average cost. The potential entrant, foreseeing these repercussions, is deterred from entering the market even though the pre-entry price is always above the dominant firm's costs.

3. Predatory Behavior Not Detected by the Areeda-Turner Model

The critics of the Areeda-Turner model contend that a short-run marginal cost pricing rule disregards strategic behavior over time. These critics favor enlarging the legal definition of predatory pricing to include predatory behavior.

They argue that predation is essentially a form of communication aimed at convincing prospective entrants that they will not recoup their costs and earn a positive return. Predation is economically undesirable when it excludes from the market any firm that would make a positive contribution to allocative efficiency, measured over the long-run. Thus,
a short-run marginal cost pricing rule may not effectively bar predatory behavior that reduces long-term economic efficiency. Critics of the Areeda-Turner model conclude that an effective predatory pricing policy must include strategic factors and assess legal rules in terms of long-run effects.

At least two types of predatory behavior which are not accounted for by the Areeda-Turner model have been identified. First, economists have found a predatory effect from strategic behavior based on reputation. They argue that costly investment in reputation-building proves profitable in the long-run if it eliminates or disciplines an existing rival and deters, scares, or disciplines potential entrants. Perceiving the tough tactics of the existing firm, a potential entrant is likely to choose to avoid a fight over market share and, therefore, not enter the market.

Second, signaling has been defined as predatory behavior. By falsely signaling rivals that the predator has a low cost base, below cost pricing can prompt existing rivals to exit the market and deter potential rivals from entering, by causing them to believe that they are less efficient and cannot compete with the predator. Thus, analysis of predation through behavioral strategies moves beyond the popular economic model to provide a comprehensive view of all forms of predation.

4. Scherer's Alternative to the Areeda-Turner Model

Professor Scherer points out the deficiencies in all mechanical standards for predation and argues that the only viable rule for predatory pricing is a rule of reason inquiry into all relevant variables. He rejects the more limited Areeda-Turner model because applying it to large-scale competitors produces perverse effects. The marginal cost rule allows a dominant firm to preclude entry by setting pre-entry output at such high levels that the additional post-entry output forces prices below cost.

In addition, Scherer argues that a rigid marginal cost pricing rule will force a dominant firm to reduce output following a rival's entry.
This, in turn, would discourage beneficial pre-entry output expansions, as well as predatory price reductions by dominant firms.\textsuperscript{92}

Scherer sets forth an alternative analysis of predatory pricing. He proposes a thorough examination of the factual circumstances, particularly the firm's intent and the structural consequences of the alleged predatory behavior.\textsuperscript{93} The relevant variables should include: the relative cost positions of the monopolist and fringe firms; the scale of entry required to secure minimum costs; whether fringe firms are driven out entirely or merely suppressed; whether the monopolist expands its output to replace the output of excluded rivals or restricts supply again when the rivals withdraw; and whether any long-run compensatory expansion by the monopolist entails investment in scale economy-embodying new plants.\textsuperscript{94}

While Scherer's approach does not offer a perfect alternative to the Areeda-Turner model, it does recognize the feasibility of predatory pricing analysis which accounts for the anti-competitive results of strategic behavior over time. Scherer's rule of reason approach may seem difficult to apply. However, courts have used rule of reason analysis in antitrust cases for a very long time.\textsuperscript{95} In the area of predatory pricing, such an approach is necessary to prevent the courts from interpreting the Areeda-Turner model to mean that predatory pricing is economically unfeasible.

E. Ninth Circuit Approach: Augmented Marginal Costs Standard

The Ninth Circuit has expanded upon the Areeda-Turner model by incorporating proof of subjective intent into its analysis. The Ninth Circuit thereby avoids dismissing claims against defendants who can manipulate cost and prices to meet the requirements of the Areeda-Turner model. In the leading case, \textit{William Inglis & Sons Baking Co. v. ITT Continental Baking Co.},\textsuperscript{96} the Ninth Circuit created a test which combines cost-based and intent-based evidence to determine whether predatory pricing exists.\textsuperscript{97}

Inglis, a privately-owned bakery, competed directly in the northern

\textsuperscript{92} Id.
\textsuperscript{93} Id.
\textsuperscript{94} Id. at 764-65 (citing F.M. Scherer, \textit{Predatory Pricing and the Sherman Act: A Comment}, 89 HARV. L. REV. 869, 890 (1976)).
\textsuperscript{95} SCHWARTZ, supra note 1, at 13.
\textsuperscript{96} William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981). The Ninth Circuit has decided a total of thirteen predation cases since 1975. Liebeler, supra note 5, at 1077-94.
\textsuperscript{97} Ehr, supra note 4, at 295.
California, private label bread market with ITT, one of the larger nationwide wholesale bakeries. Inglis claimed ITT used a systematic scheme of predatory pricing to eliminate independent private wholesalers. Inglis produced evidence that ITT had gradually reduced its prices over a period of several years, and claimed that this policy caused both ITT and Inglis to incur substantial losses. The policy ultimately drove Inglis out of business.

Inglis also presented evidence that ITT had made competing offers to Inglis's customers, forcing Inglis to lower its own prices. Furthermore, Inglis offered evidence that the ITT scheme was designed to eliminate Inglis from the market.

The Ninth Circuit determined that the question to be decided in predatory pricing cases was whether the plaintiff was a casualty of vigorous, but honest, competition, or the victim of unfair and predatory tactics adopted by a company intent on monopolizing the market. To decide this question, the court relied on cost-based information. It stated that: "Prices below the average total cost, but above the average variable cost, may represent a legitimate means of minimizing losses during [a] period of inadequate demand."

The court declared it would focus on what a rational firm would expect its prices to accomplish. The court did not require all plaintiffs to produce evidence of the defendant's actual intent. Rather, predatory pricing could be proven by a cost and price analysis. However, the evidence of costs and pricing practices had to demonstrate that the defendant anticipated its low prices could have a destructive effect upon competition and would thus enhance its market position.

The court put forth the following test for determining when predatory pricing exists:

[T]o establish predatory pricing a plaintiff must prove that the anticipated benefits of a defendant's price depended on its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power. If the defendant's

98. William Inglis & Sons Baking Co., 668 F.2d at 1024.
99. Id.
100. Id. at 1025.
101. Id.
102. Id. at 1026.
103. Id. at 1025.
104. Id.
105. Id. at 1026.
106. Id. at 1035.
107. Id.
108. Id. at 1034.
109. Id. at 1035.
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.\footnote{110}{Id. at 1035-36.}

One year after deciding \textit{Inglis}, the Ninth Circuit again addressed predatory pricing in \textit{Transamerica Computer v. IBM Corp.}\footnote{111}{Transamerica Computer v. IBM Corp., 698 F.2d 1377 (9th Cir. 1983), aff'd, 481 F. Supp. 965 (N.D. Cal. 1979).} In that decision, the court again refused to rely solely on cost-based analysis, saying, "[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."\footnote{112}{Id. at 1397.} The court concluded that even prices set above average total cost might have predatory connotations. In such a case, the plaintiff would have to prove predation by clear and convincing evidence.\footnote{113}{Id. at 1388.}

Based upon the decisions in \textit{Inglis} and \textit{Transamerica Computer}, the Ninth Circuit has adopted the following rules:

1. If a defendant's price is above the average variable cost, the plaintiff must prove that the price was nevertheless designed to injure competition and realize monopoly profits.\footnote{114}{William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1035 (9th Cir. 1981).}

2. If plaintiff proves that defendant's price is below average variable cost, the defendant must show that its price was not designed to injure competition.\footnote{115}{Id.}

These rules reveal that price/cost evidence is at the heart of predation. However, evidence of subjective intent may support or defeat the presumptions of legality established by the cost factors. Consideration of subjective evidence avoids the dismissal of claims against defendants who can manipulate cost and prices to meet the Areeda-Turner standard. Thus, the Ninth Circuit's test does not fall prey to the weaknesses of the Areeda-Turner rule. The Supreme Court, however, takes a very different approach to predatory pricing.
F. The U.S. Supreme Court's Approach to Predatory Pricing

The Supreme Court has not ruled decisively on what test should be used in predatory pricing cases. However, the U.S. Supreme Court recently discussed predatory pricing in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*

In *Matsushita*, instead of setting forth a test, the Court raised the standard of proof for summary judgment in predatory pricing cases, reasoning that such pricing is a rare occurrence. The Zenith Radio Corporation and the National Union Electric Corporation (NUE) sued twenty-one corporations that manufactured or sold Japanese consumer electronic products, primarily television sets. Zenith and NUE claimed that the defendants violated sections 1 and 2 of the Sherman Act, section 2(a) of the Robinson-Patman Anti-Discrimination Act, section 73 of the Wilson Tariff Act, and the Antidumping Act of 1916 by conspiring to drive the plaintiffs out of the American consumer electronics market. Zenith and NUE alleged that the defendants conspired to set artificially high prices for television sets sold by defendants in Japan and simultaneously set low prices for television sets sold in the United States. According to Zenith and NUE, the defendants began this conspiracy in 1953 and had fully implemented the scheme by the late 1960s.

After several years of extensive discovery, defendants filed a motion for summary judgment on all claims. Pursuant to the district court's instructions, Zenith and NUE filed a "Final Pre-trial Statement," which contained all the documentary evidence that they planned to offer at trial. In response, defendants challenged the admissibility of the plaintiffs' evidence. The district court held that the majority of the evidence was inadmissible.

Based upon the admissible evidence, the district court found that no genuine issue of material fact existed to support Zenith and NUE's conspiracy theory. The court granted summary judgment for the defendants on the Sherman Act section 1 claims, and on the claims under the Wilson Tariff Act. The court dismissed the Sherman Act section 2 claims and ruled for the defendants on the Robinson-Patman Act claims.

118. *Id.* at 1135-39.
119. *Id.* at 1132.
120. *Id.*
121. *Id.*
On appeal, the Third Circuit reversed. The Third Circuit held that much of the evidence not allowed by the district court was admissible. The additional evidence rendered the district court’s ruling on the summary judgment motion improper because a fact finder could reasonably conclude from the evidence that a conspiracy existed to “depress prices in the American market in order to drive out American competitors, which conspiracy was funded by excess profits obtained in the Japanese market.”

The United States Supreme Court granted certiorari to determine whether the court of appeals had used the proper standard to evaluate the district court’s ruling on the motion for summary judgment and to ascertain whether the defendants could be held liable under the antitrust laws for a conspiracy partially compelled by a foreign sovereign. In a 5-4 decision, the Court reversed and remanded on the first issue but failed to reach the second issue.

The Court identified the claims for which Zenith and NUE could not recover. First, they could not recover antitrust damages based on an alleged cartelization of the Japanese market because the Sherman Act cannot regulate the conduct of other nations except when that conduct has an effect on American commerce. Second, Zenith and NUE could not recover for a conspiracy to charge higher than competitive prices in the United States because they would not suffer an antitrust injury as a result of such a conspiracy. Finally, Zenith and NUE could not recover for a conspiracy to impose non-price restraints that raise market price or limit output because such restraints would not injure the plaintiffs. The Court found that since Zenith and NUE standing alone could not recover on the above claims, the Third Circuit incorrectly found evidence of the alleged conspiracies to be direct evidence of a conspiracy to injure them.

Although evidence of the alleged conspiracies could not be used to recover antitrust damages, Zenith and NUE argued that the evidence

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123. Id. at 259-303.
124. Id. at 306-09.
125. Id. at 309.
128. Id. at 582 (citing United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945)).
131. Id.
could be used to support the claim that the defendants conspired to monopole the United States market by pricing below market level. The court of appeals had held that if the plaintiffs could prove this allegation, a per se violation of section 1 of the Sherman Act would result. Since defendants did not dispute the appellate court's conclusion, the only issue for decision became whether Zenith and NUE presented sufficiently probative evidence to survive defendants' motion for summary judgment.

The Supreme Court cited Cities Service, holding that if the entire record "could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.'" The Court stated that under the traditional standard for summary judgment, the plaintiffs had to show that a genuine issue of material fact existed as to whether the defendants entered into an illegal conspiracy which caused the plaintiffs' injury. To meet this standard, Zenith and NUE had to show they suffered injury. Only evidence of the monopolization of the American market could be used to satisfy this requirement because other alleged conspiracies would not have hurt these plaintiffs. Embellishing upon traditional summary judgment requirements, the Court held that the factual context of a case must be considered when determining the quantum of proof necessary to support a plaintiff's claim. The Court decided that Zenith and NUE's claim had no rational economic basis and that, consequently, they must present more persuasive evidence than usually necessary to support the claim. Only if the evidence "tends to exclude the possibility that the alleged conspirators acted independently," could plaintiffs avoid summary judgment for the defendants. To evaluate the evidence, the Court "consider[ed] the nature of the alleged conspiracy and the practical obstacles to its implementation."

To define the "nature of the alleged conspiracy," the Court first analyzed predatory pricing on a general level. The Court expressed its doubt that predatory pricing could exist under any circumstances and cited

132. Id. at 584.
135. Id. at 587 (citing First National Bank of Arizona v. Cities Service Co., 391 U.S. 253, 289 (1968)).
136. Id.
137. Id.
138. Id.
139. Id.
140. Id.
141. Id. at 588.
142. Id.
commentators among whom "there is a consensus . . . that predatory pricing schemes are rarely tried, and even more rarely successful."\textsuperscript{143}

The Court found that predatory pricing schemes are risky because the predatory firm always loses profits in the short-run and any gain in the long-run depends upon successfully driving the competition out of the market.\textsuperscript{144} Not only must the predatory firm achieve monopoly power, it must maintain that power long enough to recover its losses and earn additional profits.\textsuperscript{145}

The Court doubted that such a conspiracy would ever exist within a cartel.\textsuperscript{146} In a cartel, success depends upon each firm's "willingness to endure losses for an indefinite period."\textsuperscript{147} This gives "each conspirator . . . strong incentive to cheat, letting its partners suffer the losses necessary to destroy the competition while sharing in any gains if the conspiracy succeeds."\textsuperscript{148}

Moreover, the Court also found evidence that the conspiracy did not exist because the plaintiffs' shares of the retail television market\textsuperscript{149} had not appreciably declined in the twenty years after the alleged conspiracy began.\textsuperscript{150} Because the defendants did not have a good chance to recoup their losses by achieving and maintaining monopoly power, the Court reasoned that it was very unlikely that the defendants had engaged in a predatory pricing conspiracy.\textsuperscript{151}

The Court, relying on Cities Service and Monsanto, found that without a definite motive to conspire, the defendants' conduct did not support an inference of conspiracy if there was another plausible explanation for their actions.\textsuperscript{152} Allowing courts to find conspiracies when such inferences were implausible would deter competition.\textsuperscript{153} In so holding, the Court balanced the need to protect legitimate price competition\textsuperscript{154} against the desire to punish illegal conspiracies\textsuperscript{155} and concluded that granting summary judgment in cases with ambiguous evidence would not

\textsuperscript{143} Id. at 589.
\textsuperscript{144} Id.
\textsuperscript{145} Id.
\textsuperscript{146} Id. at 590.
\textsuperscript{147} Id.
\textsuperscript{148} Id.
\textsuperscript{149} Id. at 591.
\textsuperscript{150} Id.
\textsuperscript{151} Id. at 591-92.
\textsuperscript{152} Id. at 593-95; see First National Bank of Arizona v. Cities Service Co., 391 U.S. 253, 278-80 (1968); Monsanto v. Spray-Rite Serv. Corp., 465 U.S. 752, 762-64 (1983).
\textsuperscript{153} Matsushita Elec. Indus. Co., 475 U.S. at 593 (citing Monsanto, 465 U.S. at 762-64).
\textsuperscript{154} Id. at 594
\textsuperscript{155} Id.
Encourage such conspiracies. Furthermore, the Court reasoned that predatory pricing schemes are self-deterring because, unlike other schemes that violate antitrust laws, failed predatory pricing schemes are costly to conspirators.

Justice White dissented in *Matsushita*, criticizing the majority's opinion on several grounds. First, White argued that the majority's discussion did not conform with traditional summary judgment doctrine. White stated that the majority had interpreted *Monsanto* to hold that courts could not allow fact finders to find conspiracies when such an inference would be implausible. In contrast, White believed that *Monsanto* really held that "a particular piece of evidence standing alone was insufficiently probative to justify sending a case to the jury." By requiring a judge to decide whether the inference of conspiracy is more probable than not, he argued that the Court invaded the role of the fact finder and overturned settled law.

Second, White disagreed with the majority on the requirements for a violation of section 2 of the Sherman Act. The majority required the plaintiffs to show that the defendants had conspired to drive them out of the relevant markets by pricing below cost. This argument assumes that any other type of agreement could not have injured the plaintiffs. The testimony of one of the plaintiffs' expert witnesses, which was excluded erroneously by the district court, directly contradicted this assumption. The expert testified that the defendants' conduct had harmed the plaintiffs. White found this testimony alone sufficient to create a genuine issue of fact. White argued that the Court invaded the role of the fact finder by ignoring the expert's report and assuming that the defendants favored profit-maximization over growth.

Third, White agreed with the Third Circuit's disposition of the case. The Third Circuit had found that a fact finder could reasonably
conclude that the five-company rule was not merely a device to raise prices. The majority of the Supreme Court, however, claimed that the Third Circuit erred by treating evidence of price-fixing in Japan, the five-company rule, and check prices as direct evidence of a conspiracy.

White stated that contrary to the Supreme Court's holding, the fact finder could find that use of the five company rule "combined with price-fixing in Japan, was intended to permit concentration of the effects of dumping upon American competitors while eliminating competition among Japanese manufacturers in either market." Because a fact finder could find the five-company rule was not used solely to raise prices, a material issue of fact existed and summary judgment was, therefore, inappropriate.

Finally, White criticized the Court for seeming to require the Third Circuit to "engage in academic discussion about predation." A court's role is to decide, after viewing the evidence in the light most favorable to the plaintiffs, whether a fact finder could conclude that the defendants engaged in long-term, below-cost sales. White argued that since the Third Circuit had originally taken this course, the Court should not remand the case so that the lower court could repeat this process.

In addition to the weaknesses in the majority's decision described by White, commentators have found Matsushita disappointing because the Supreme Court failed to establish a test for predatory pricing and thereby refused to resolve a split among the circuit courts. The U.S. courts of appeal are split over the importance of intent, but they all use variations of cost analysis. Instead of resolving this split of authority, the Supreme Court raised the standard of proof for surviving a summary judgment motion.

Yet another weakness of Matsushita is the Supreme Court's assumption that predatory pricing rarely occurs because it is economically un-

170. Id. at 605. The term "five-company rule" refers to a practice whereby each Japanese producer was permitted to sell only to five American distributors. Id. at 575. Such a practice limits distribution in the United States. Id. at 583.

171. Id. at 605. The term "check prices" refers to a minimum price fixed by agreement with the Japanese government for CEPs exported to the United States. Id. at 575.


174. Id.

175. Id.


177. Brodley & Hay, supra note 18, at 768-69.

178. Levine, supra note 176, at 541.
feasible. This assumption appears to underlie the Court's decision to raise the standard for survival of a summary judgment motion. 179

III. EUROPEAN COMMUNITY APPROACH TO PREDATORY PRICING

A. Statutory Basis

The Treaty of Rome, signed in 1957, which established the European Economic Community, forms the basis of the prohibition of predatory pricing in the EC. Article 85(1) of the Treaty of Rome prohibits all agreements which prevent, restrict, or distort competition and which have an adverse effect on trade between Member States. 180 For example, a cartel agreement seeking to carry on predatory conduct against outside manufacturers would clearly fall within this per se prohibition. 181

Predatory pricing is also illegal under article 86 of the Treaty of Rome. The drafters intended article 86 to act as a device for maintaining free competition in the European common market by prohibiting abusive conduct by a dominant undertaking. 182 Article 86 states that predatory pricing by a dominant firm constitutes dominant abuse. 183 Subsection (a) of article 86 defines abusive conduct as the practice of a dominant undertaking directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions. 184

B. Akzo Chemie BV

In Akzo, 185 the EC Commission decided its first case involving predatory pricing. In this case, Engineering and Chemical Supplies (Epsom and Gloucester) Ltd. (ECS) and the United Kingdom alleged that Akzo Chemie had violated article 86 of the Treaty of Rome by abusing its dominant position in the EC organic peroxides market. 186 The alleged conduct took the form of systematic predatory and discriminatory pricing by Akzo, executed through its subsidiary Akzo UK Ltd. (Akzo

179. The Supreme Court did not discuss cost/price evidence. However, the Court did cite the consensus among commentators that predatory pricing is economically impractical. This citation indicates the influence of economic analysis incorporated in the Areeda-Turner Model.

180. EEC TREATY art. 85(1).


182. EEC TREATY art. 86(a).


184. EEC TREATY art. 86(a).


186. Id.
ECS complained that Akzo implemented its pricing policy in response to ECS' expansion into the plastics sector of the organic peroxides market in the United Kingdom and Germany. ECS also claimed that Akzo UK intended for its low prices to eliminate ECS as a competitor in the EC organic peroxide market.

The EC Commission investigated the complaint in 1982 and issued an interim measure decision in 1983 ordering Akzo UK to raise its profits to the levels realized before it began the alleged predatory and discriminatory pricing.

On December 14, 1985, the Commission issued its final decision on the matter, holding that Akzo had abused its dominant position in the EC organic peroxide market by pursuing a strategy of predatory pricing in the United Kingdom flour additives sector. The Commission determined that Akzo's strategy was designed to eliminate ECS from the larger, more lucrative plastics sector of the EC organic peroxides market and, therefore, constituted abusive conduct prohibited by article 86. The Commission imposed a fine of 10 million European Currency Units (ECU) upon Akzo, describing Akzo's behavior as "of a particularly serious nature."

To determine the merits of ECS's claims, the Commission had to answer three questions. First, did Akzo hold a dominant position as defined by article 86? Second, did the alleged conduct constitute an abuse of a dominant position? Third, was there an appreciable effect upon trade between Member States?

The Commission first found that the relevant market was the organic peroxides sector of the EC as a whole. The Commission found Akzo held a dominant position because it had a fifty percent share of this market.

Next, to determine whether an abuse of this position had occurred, the Commission first reviewed the purpose of article 86. Article 86 is "based primarily on Article 3(f) of the Treaty, which requires that the

187. Id. at 1-2. The U.S. equivalent of the Commission award is $11 million.
188. Id. at 2.
189. Id.
192. Id.
193. Id.
194. Id.
195. Id. at 16.
196. Id. at 17.
197. Id. at 18.
Community pursue the institution of a system of effective competition. “198 Article 86 attempts to fill the requirement that the Commission institute a system of effective competition by prohibiting practices which "might damage consumers or customers directly but also those which are indirectly detrimental to them." 199

In defining the standard to be used to determine abuse, the Commission expressly avoided tests employed by courts in the United States. The Commission stated that “[a]rticle 86 does not prescribe any cost-based legal rule to define the precise stage at which price-cutting by a dominant firm may become abusive and indeed the broad application of the concept of abuse to different forms of exclusionary behavior would argue against such a narrow test.” 200

The Commission rejected Akzo's defense which was based upon the Areeda-Turner model. Akzo had argued that its prices were legal because they were above its average variable costs, which served as a proxy for marginal costs. 201 The Commission identified this argument as an application of the Areeda-Turner model and rejected it as a per se test. 202

The Commission discussed the weaknesses of a per se test based on marginal or variable costs. 203 The Commission faulted the static and short-term concept of “efficiency” because it does not take into account the broad objectives of EC competition. 204 The Areeda-Turner model ignores longer term strategic considerations and the element of discrimination among different groups of customers. 205 Thus, the Commission concluded that a firm need not price below average variable costs to achieve anti-competitive results. 206

The Commission emphasized that intent is a very important element of predatory pricing. 207

There may be circumstances where the exclusionary consequences of a price cutting campaign by a dominant producer are so self-evident that no evidence of intention to eliminate a competitor is necessary. On the

198. Id. at 19.
199. Id.
200. Id.
201. Id.
202. Id. at 20.
203. Id.
204. Id.
205. Id.
206. Id. The Commission did acknowledge that analysis of the aggressor’s costs may be important in establishing the reasonableness of the pricing conduct and in determining the underlying purpose. Id. at 20-21.
207. Id.
other hand, where low pricing could be susceptible of several explanations, evidence of an intention to eliminate a competitor or restrict competition might also be required to prove an infringement. Such evidence may exist in the form of internal documentation of the dominant company pointing to a scheme to damage competitors. In the absence however of direct documentary evidence an exclusionary intention might be inferred from all the circumstances of the case.208

In sum, the Commission looked at pricing conduct which is based on the Areeda-Turner model, but also reviewed evidence of intent, which is not considered in the Areeda-Turner model. The Commission found adequate evidence of Akzo's predatory intent. To support this finding, the Commission cited documentary evidence of a detailed plan by Akzo to eliminate ECS as a competitor, the selective nature of the price cuts to regular customers of ECS, Akzo UK's departure from its previous pattern of full cost recovery in flour additives, and the subsidizing of loss in the flour additives sector by transfer of profits from the plastics and elastomers division.209

The Commission also cited numerous instances of Akzo's behavior, which proved that Akzo had abused its dominant position. For example, Akzo had made direct threats, offered products to customers of ECS at unreasonably low prices, offered potassium bromate and vitamin mix at bait prices to ECS's customers, obtained price quotes of other suppliers from customers and offered prices just below competing quotations.210

Finally, the Commission found that the strategic objective of eliminating ECS as a competitor constituted an abuse of a dominant position in the market and had a direct causal link to trade between Member States.211

The rationale for the Akzo decision demonstrates that the EC and the United States perceive competition differently. In Akzo, the Commission rejected allocative efficiency as the sole objective of competition.212 The Commission focused upon the defendant's discriminatory practices. In particular, the Commission criticized Akzo's attempt to recover full costs from its regular customers while tempting its rival's customers with lower prices. The Commission considers cost relevant in determining predatory pricing, but focuses upon the dominant firm's intent.

The Akzo decision has been criticized for failing to set forth objec-
tive criteria for defining predatory pricing. Unlike the Areeda-Turner model, the test does not establish a purely objective standard for identification of predatory pricing. Rather, the Commission incorporates the subjective criteria of intent. Therefore, resolution of each case depends on a weighing of evidence which suggests or refutes predatory intent.

To determine whether predatory pricing exists, the Commission will review a variety of evidence of predatory intent. The Commission thereby recognizes that economic models do not prohibit many strategic forms of predation. The Commission refuses to limit its analysis to evidence of costs and prices because it is concerned with objectives other than allocative efficiency, such as fairness and impact on potential and actual firms. Following this rule of reason approach allows the Commission to take a broader look at all the implications of a predatory pricing scheme.

IV. COMPARISON OF STANDARDS FOR PREDATORY PRICING IN THE UNITED STATES AND THE EUROPEAN COMMUNITY

Commentators have observed that U.S. and the EC courts will come to different conclusions when given similar facts in a predatory pricing case. Several factors explain this difference in outcome.

A. Statutory Differences

The EC has specific prohibitions against predatory pricing whereas the United States statutes under which predatory pricing claims are brought consist of broad language which lends them to different interpretations at different times. Article 86 of the Treaty of Rome expressly forbids abuse of a dominant position such as unfair pricing. Section 2 of the Sherman Act merely prohibits monopolization and any attempts to monopolize. The Sherman Act's broad language gives the U.S.

213. Ehr, supra note 4, at 289-90.
214. The Commission has also demonstrated a willingness to consider both short-term and long-term purposes of predatory pricing. Commission Decision 85/609, 1985 O.J. (L 374) 1, 20-22.
215. Id.
217. Id. at 307.
218. EEC TREATY art. 86.
courts considerable room to limit the conduct they will consider illegal under section 2.

Procedural differences also exist. The statutory framework in the EC does not provide for private actions; parties must rely on the Commission to pursue their claims. In the United States, private parties have an incentive to bring actions because of the prospect of treble damages and attorney fees if they are successful.

B. Public Policy and Social Values

Another reason for the differing approaches to predatory pricing is divergent views about competition and the goals that public policy should serve. The concept of competition in the EC encompasses political and social values, such as fairness, which are virtually excluded from antitrust analysis in the United States. Moreover, the EC rejects allocative efficiency as the exclusive objective of competition policy. Distributional concerns, such as the transfer of income from consumers to producers, are included as well as consumer welfare. Also reflected in the EC competition policy is a concern for "individual traders, fairness in the marketplace, equality of opportunity for all commercial operators, and the legitimate interests of workers, users, and consumers." These policy objectives are reflected in the prohibition in article 86 against dominant firm behavior that unfairly exploits other traders. The focus upon allocative efficiency in the U.S. forecloses explicit incorporation of these concerns.

V. PROPOSAL

The use of allocative efficiency as the standard for deciding predatory pricing cases in the U.S. is not sensitive to many aspects of predatory pricing. The reliance of U.S. courts on the Areeda-Turner model precludes the detection of strategic behavior such as predation through reputation, which has strong anti-competitive effects upon actual and potential market participants. Recognizing the deficiencies of the cost analysis approach would allow the courts to consider more types of evidence in deciding predatory pricing cases.

220. Hawk, supra note 216, at 308.
221. Id.
222. Id. at 307.
223. Id.
224. Id.
225. Id.
226. Ordover & Wall, supra note 84, at 6-7.
Three possible approaches exist which would remedy the deficiencies of the Areeda-Turner model by including evidence of intent. First, the Ninth Circuit Court of Appeals in *Inglis*\(^2\) and *Transamerica Computer*\(^2\) has articulated a test which incorporates both cost and intent analysis and allocates the burdens of proof in presenting evidence at trial. If a defendant’s price is above the average variable cost, the plaintiff must prove that the price was nevertheless designed to injure the competition and produce monopoly profits.\(^2\) If the plaintiff proves that the defendant’s price is below average variable cost, the defendant must show that its price was not designed to injure competition.\(^2\) The plaintiff can introduce evidence of intent, market power, market structure, and long-run behavior that influenced pricing decisions to prove that a price which is above average variable cost caused injury.\(^3\) While this model does not resolve all the theoretical problems inherent in the Areeda-Turner model, it does allow a plaintiff who cannot show injury under the Areeda-Turner model to survive a summary judgment motion.

Second, Professor Joseph Brodley of Boston University and Professor George Hay of Cornell University suggest a different approach, which would allow a plaintiff with a meritorious claim to avoid a summary judgment motion. Brodley and Hay advocate a two-step approach.\(^2\) The first step is to determine whether various economic tests\(^3\) indicate uniformly or overwhelmingly the existence of predatory pricing or whether one economic test emerges as factually most appropriate.\(^2\) If the first step does not reveal a clear result, the courts could then undertake a second step by evaluating the pricing conduct under a more extensive balancing approach.\(^2\) The second step analysis involves balancing the anticompetitive and output-restrictive consequences of the alleged predatory conduct against the potential competitive and output-increasing effects generated by the challenged activity.\(^2\) Such an approach is required to avoid the dangers of blindly adhering to a single

\(^{227}\) See *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014 (9th Cir. 1981).

\(^{228}\) See *Transamerica Computer v. IBM Corp.*, 698 F.2d 1377 (9th Cir. 1983).

\(^{229}\) See *William Inglis & Sons Baking Co.*, 668 F.2d at 1035-36.

\(^{230}\) Id. at 1036.

\(^{231}\) Transamerica Computer, 698 F.2d at 1391.


\(^{233}\) These tests include the Areeda-Turner model, the Posner rule, the Joskow-Klevorick rule, the Boumol rule and the Scherer rule. *Id.* at 774-79.

\(^{234}\) *Id.* at 791.

\(^{235}\) *Id.* at 791-92.

\(^{236}\) *Id.* at 792.
economic model which lacks empirical validity and does not include policy considerations.

Third, the Akzo\textsuperscript{237} decision also reflects an awareness that relying solely upon a single economic model could be misleading. This awareness led the EC Commission to review evidence of intent and behavior to determine abuse of a dominant position. The Commission may pursue other policy goals, such as fairness and impact on potential and existing firms. Incorporation of the Akzo approach reveals different types of predatory behavior which are not detectable under the Areeda-Turner model.

If the Supreme Court had adopted any one of the three approaches discussed above to decide \textit{Matsushita}, it is clear that plaintiffs in that case would have survived a summary judgment motion by introducing evidence of a long-term scheme to facilitate predatory pricing. All three approaches take a broad view of the types of evidence which can be used to demonstrate predatory pricing. Given the fact that no plaintiff has prevailed under the Areeda-Turner model,\textsuperscript{238} changes incorporating an expansive view of relevant evidence of all facets of predatory behavior are necessary to insure that predatory pricing remains a viable claim. Instead of using a strict economic standard which holds many undesirable pricing practices per se legal, a broad rule of reason approach is needed to allow consideration of all the dangers of predatory pricing.

\section*{VI. CONCLUSION}

Since 1975 the federal courts in the United States have viewed economic efficiency as the primary goal of companies.\textsuperscript{239} Based on this value judgment, the courts have examined narrowly the behavior of firms to determine whether predatory pricing has occurred. They have relied upon the Areeda-Turner economic model which uses average price as the legitimate floor for pricing. The Supreme Court, influenced by the adoption of this model by the lower courts and by the endorsement of this model by commentators,\textsuperscript{240} raised the standard for a plaintiff to survive a summary judgment motion.\textsuperscript{241} The Supreme Court has not recognized the fact that predatory pricing is rarely proven because economic tests do not detect all predatory conduct.

The Areeda-Turner model, which has widely influenced federal

\begin{footnotes}
\item[238] Brodley & Hay, supra note 18, at 768. See also Liebeler, supra note 5, at 1077-94.
\item[239] Liebeler, supra note 5, at 1053.
\item[241] Id.
\end{footnotes}
courts, is not completely accurate.\textsuperscript{242} Even if it did correctly reflect the cost and pricing behavior of a firm, it is limited to a static portrayal of a firm's short-run behavior. Furthermore, it allows dominant firms to achieve strategic goals of predation by deterring other firms through its reputation and signaling prices and levels of output. A firm might not be pricing below average variable cost, but it may still be achieving strategic anti-competitive effects.

The approach taken by the European Economic Commission takes into account the weaknesses of the Areeda-Turner model. The Commission closely examines all evidence demonstrating predatory intent.\textsuperscript{243} The Commission rejects economic orthodoxy and holds that strategic behavior through predation is dangerous to competition. In \textit{Akzo} the Commission demonstrates a concern with policing a dominant firm to detect any anti-competitive behavior. Thus, the Commission has made predatory pricing a viable claim. The Commission's broad view of policing behavior demonstrates a commitment to encouraging competition which is not evident in the Supreme Court's narrow review of firms' efficiency.

The United States has much to learn from the EC's treatment of predatory pricing. Specifically, U.S. courts should recognize the weaknesses of the economic model which they often adopt uncritically. They should also recognize that predatory pricing involves more than inefficiency. If the Supreme Court ignores these points and continues to follow \textit{Matsushita}, it will cripple judicial review on the merits and thereby ignore many forms of predation.

\textsuperscript{242} See Brodley & Hay, \textit{supra} note 18.

\textsuperscript{243} Commission Decision 85/609, 1985 O.J. (L 374) 1, 20-22.