Predatory Pricing: A Comparative Study

Introduction

Predatory pricing involves pricing at levels below profit maximizing levels with the view that weaker competitors will eventually be driven from the market.[1] Once these competitors are gone, the predator raises prices and recoups the foregone profit lost during the predatory period.[2] Initially thought to be a common violation of the Sherman Act[3], predatory pricing continued to be almost universally condemned until Professor McGee published an article in the 1950s which argued that predatory pricing was not a profitable strategy.[4]

In the 1960s and 70s writers of what is now known as the Chicago school, began producing literature which espoused that allocative efficiency and consumer welfare are the only goals of antitrust law.[5] According to the these writers, a business practice which promotes allocative efficiency should not be hindered by the antitrust laws.[6] The Chicago school believes that

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[1] See J. Harrison, E. T. Sullivan, Understanding Antitrust and its Economic Implications, at 253 (1988).

[2] See id.

[3] See Standard Oil Co. of N.J. v. U.S., 221 U.S. 1 (1911)

In Standard Oil, the Court required a showing only that the oil company cut prices with the intent to drive rivals out of the market. Id. Predatory pricing remains an anti-competitive practice forbidden by the antitrust laws. See Cargill v. Monfort of Colorado Inc., 107 S.Ct. 484, 495 (1986). In recent years, however, predatory pricing has been considered a rarely tried and even more rarely successful practice. See Matsushita Electric Industrial Co. v. Zenith Radio Corp.., 106 S. Ct. 1348 (1986).

[4] See Mcgee, Predatory Price Cutting: the Standard Oil (N.J. Case), 1 J.L. & Econ. 137 (1958).

In this article, McGee challenged the assumption that predatory pricing was a profitable business endeavor. See infra notes 21-28 and accompanying text.

[5] See generally R. Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 Yale L.J. 373 (1966); R. Bork, The Antitrust Paradox (1978); Posner, The Chicago School of Antitrust Analysis, 127 U.Pa.L.Rev. 925 (1979).

[6] See generally, Baker, Vertical Restraints in Times of Change: From White to Schwinn to Where?, 44 Antitr. L.J. 537 (1975); Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 Yale L.J. 373 (1966); Posner, Antitrust Law: An Economic Perspective (1976).

predatory pricing should not be a concern of the antitrust laws because it is not a common business practice. Predatory pricing, the Chicago school argues, is rarely tried because it is unlikely to be successful given that the predator must sustain losses for a period of time with no real hope of recouping them. In addition, since competitors should be encouraged to lower prices, antitrust laws which punish seemingly competitive conduct are counterproductive.[7] Indeed, courts have largely agreed with the Chicago school that "predatory pricing schemes are rarely tried and even more rarely successful."[8]

Part I of this Note examines the elements of a predatory pricing claim under Section 2 of the Sherman Act. Part II provides the economic rationale behind the contention that predatory pricing is a costly endeavor and therefore rarely tried. Part III surveys predatory pricing cases which demonstrate that the Chicago school's theories on this matter have generally been accepted. Part IV ~~will~~ discuss a recent European Community Commission decision, ECS/AKZO[9] and compares how this case ~~would be decided~~ under current United States Antitrust law.

Following this assumption, the Chicago school writers attacked decisions which banned certain practices which they believed served allocative efficiency. For example, the Chicago school's view that vertical restraints may serve allocative efficiency was received favorably by the Supreme Court in the late 1970's in Continental T.V. v. GTE Sylvania, 433 U.S. 36 (1977). In Sylvania, the Court overruled a per se ban on vertical restraints employing reasoning based on the economic writings of the Chicago school which argued that such restraints should not be condemned per se because such restraints may promote allocative efficiency. See id. citing: Baker, Vertical Restraints in Times of Change: From White to Schwinn to Where?, 44 Antitr. L.J. 537 (1975); Bork The Rule of Reason and the Per Se Concept:Price Fixing and Market Division, 75 Yale L.J. 373 (1966); Posner, Antitrust Law: An Economic Perspective (1976).

[7] See detailed discussion at infra notes 21-44 and accompanying text.

[8] See Matsushita Elec. Indus. Co v. Zenith Radio Corp, 106 S.Ct. 1348,1357. See also Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104 (1986); A.A. Poultry Farms, Inc. v. Rose Acre Farms Inc., 881 F.2d 1396,1401 (7th Cir. 1989); Indiana Grocery, Inc. v. Super Valu Stores Inc. 864 F.2d 1409,1420 (7th Cir. 1989).

Judge Easterbrook, a former assistant professor of law at the University of Chicago, and author of Predatory Strategies and Counterstrategies, 262 Univ.Chi.L.Rev. 263 (1981) wrote the Poultry Farms opinion.

[9] Commission Decision, IV/30.698-ECS/AKZO.

I. Predatory Pricing: The Elements of an Offense

Predatory pricing is analyzed under section 2 of the Sherman Act.[10] Under this section the practice is treated as an attempt to monopolize. In order to find that a firm has attempted to monopolize, the generally accepted test requires the plaintiff to show three elements:

1. specific intent
2. predatory act(s) (conduct)
3. dangerous probability of success.[11]

A plaintiff bringing an attempt to monopolize case under a predatory pricing theory faces a difficult burden.[12]

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[10] Section 2 of the Sherman Act provides in part:

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or person, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony. ...

When it is alleged that a firm increased prices in a market in which it possesses market power to subsidize lower (predatory) prices in another market, Section 2 of the Clayton Act may be invoked. Section 2 of the Clayton Act provides in part:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, whether directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality. . . .

[11] See Swift & Co. v. United States, 196 U.S. 375, 396 (1905).

[12] McGee has noted that "the intent of the price cutter and the mental state of his rivals are difficult to establish and are ambiguous." McGee, Predatory Pricing Revisited, 15 J. Law and Eco. 289,292 (1980).

The issue of intent has been hotly debated.[13] ~~It has been argued that~~ Since the mere possession of monopoly power is not forbidden[14], intent to obtain a monopoly, therefore, should not be an element in an attempt to monopolize case. Nevertheless, intent remains an element in some United States Circuit Courts.[15] In other attempt to monopolize contexts (ie. price fixing), meeting this element is not difficult because intent may be inferred from the defendant's anti-competitive conduct. In the predatory pricing context, however, it is difficult to infer intent from the alleged predator's conduct because lowering prices appears to be pro-competitive behavior.[16]

In order, to determine that ~~the~~ an alleged predator's pricing practices are in fact predatory, the plaintiff may attempt to show that the defendant is selling its product below his cost to produce the product. In 1975 Philip Areeda and David Turner established a test for analyzing allegations of predatory pricing.[17] The Areeda-Turner test involves measuring a firms average variable costs. A finding that a firm's price is higher than its average variable costs leads to a presumption of legality. A finding that a firm's price is lower than its average variable costs is conclusively presumed to be predatory and hence illegal. This proves to be a complicated and expensive

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[13] Hawk, Attempts to Monopolize- Specific Intent as Antitrust's Ghost in the Machine, 58 Cornell L. Rev. 1121 (1973).

[14] See United States v. Aluminum Co. of America, 148 F.2d 416 (2nd Cir. 1945).

[15] The First and Seventh Circuits do not require a showing of intent. See e.g., A.A. Poultry Farms, Inc, v. Rose Acre Farms, Inc. 881 F.2d 1396,1400-01 (7th Cir. 1989) (intent not required in predatory pricing cases); Barry Wright Corp. v. ITT Grinnell Corp, 724 F.2d 227,232 (1st Cir. 1983) (same). But see, H.J., Inc. v. International Tel & Tel. Corp. 867 F.2d 1531, 1541-43 (8th Cir. 1989) (analyzing predatory pricing as requiring: conduct,intent and dangerous probability of success); William Inglis & Sons Baking Co. v. ITT Continental Baking Co. Inc., 668 F.2d 1014 (9th Cir. 1981) (retaining intent element in predatory pricing cases), cert. denied, 459 U.S. 825 (1982).

[16] See A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc. 881 F.2d 1396,1400 (7th Cir. 1989)(discussing the difficulty determining low prices are the result of predatory conduct instead of more efficient production).

[17] See Areeda & Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697 (1975).

analysis.[18] Most circuit courts, however, have used a cost basis test similar to the Areeda-Turner test to determine the conduct element in a predatory pricing allegation.[19]

If the plaintiff succeeds in establishing the intent and conduct elements, he must further establish the defendant's dangerous probability of success. An examination of three Chicago School writers[20] in the next part shows why predatory pricing is considered unlikely to be successful.

II. Predatory Pricing: An Economic Perspective

A. McGee

In 1958 John S. McGee concluded in an article entitled Predatory Price Cutting: The Standard Oil Case,[21] that Standard Oil did not use predatory pricing to achieve a monopoly. McGee argued that Standard Oil used mergers, not predatory price cutting to achieve its monopoly. McGee's reasoned that predatory pricing imposes greater costs on the predator than the prey and thus was not a rational strategy and that monopoly through merger provided a better alternative.[22]

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[18] See A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1400 (7th Cir. 1989).

[19] The emphasis on a firm's price in predatory pricing has been criticized. See Liebeler, infra notes 73-75 and accompanying text. The Seventh Circuit contends that a below cost price may reflect only the sacrifice that a firm needs to make to establish a presence in a particular market. See A.A. Poultry Farms, Inc., v. Rose Acre Farms, Inc. 886 F.2d 1396, 1400 (7th Cir. 1989).

[20] McGee concedes that his conclusions qualify him as a "diehard Chicagoan". See McGee, Predatory Pricing Revisited, 15 J. Law and Eco. 289,292 n.15 (1980).

[21] 1 J.Law & Econ.137 (1958).

[22] A viable alternative, because mergers at the time of Standard Oil, were not being condemned by antitrust laws.

In 1980, McGee revisited the topic of predatory pricing[23]. In his 1980 article, McGee illustrates how predatory pricing imposes a higher cost on the predator than the prey. McGee argues that if the alleged predator reduced prices below average total cost the predator would lose "the competitive rate of return [as well as] returns to be had during the same period if predatory pricing were not commenced."[24] In addition, if the prey reduced output in response to the predatory pricing, the predator would have to increase output in order to clear the market, thus incurring even greater losses.[25]

McGee argues that if the prey is certain that its rival is engaged in a predatory pricing strategy it would pay for him to "stick it out".[26] The prey will merely wait until the predator attempts to rise prices to recoup losses. At that point the prey can increase output once again and compete, or even undersell the predator's inflated prices, thus thwarting the predator's attempt to recoup its losses. McGee recognizes that this strategy may be impractical because the predator may have a "longer purse" and be able to sustain losses for a long period of time. McGee refutes this notion by arguing that having liquid financial reserves is a cost and not an advantage. Thus, firms considering a predatory pricing scheme will face costs not only from selling at a loss for a period of time, but also for having to maintain large liquid reserves to finance the scheme.

In addition to the large costs that predatory pricing places on the predator, the predator faces the specter of not being able to recoup incurred costs. To recoup its losses the predator must sell at monopoly prices. McGee, argues that the predator will be prevented from exercising such

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[23] See McGee, Predatory Pricing Revisited, 15 J. Law and Eco.,289 (1980).
[24] Id. at 296.
[25] Id. at 296.
[26] Id. This may require the prey to temporarily shut his plant or reduce output. McGee seems to ignore the cost of re-starting the factory or assumes that, even with the added costs, it will still be profitable to incur these costs.

monopoly power because, not only will the sagacious prey "stick it out", but new entrants will be attracted to the market.[27]

McGee concludes that predatory pricing attempts are rare and successes even rarer and therefore not a "significant clog on the competitive process."[28]

B. Bork

In 1978, then-professor Bork published The Antitrust Paradox. In his introduction, Bork stated that the only "legitimate goal of antitrust law as law is the maximization of consumer welfare."[29] As such, antitrust laws should be concerned only with business practices which hurt consumer welfare. Price competition promotes consumer welfare.[30] Bork, like McGee, concludes that the costs involved in a predatory pricing scheme make it unlikely that a business will engage in it. Therefore, efforts to outlaw predatory pricing, when there is already a built in disincentive to engage in it, will have the effect of hurting consumers because legitimate price competition may be inhibited.[31]

Bork offers two main reasons for believing that predatory pricing is not a credible strategy. First the losses, sustained during a price war "will be proportionately higher for the predator because he faces the necessity of expanding his output at ever higher costs, while his victim not

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[27] Id. at 299. Of course, the ability of new competitors to enter the market depends on what barriers to entry exist in the specific market. The Chicago school writers tend to de-emphasize barriers to entry. See generally, Bork, The Antitrust Paradox, 310-329 (1978) In Bork's view, barriers to entry such as capital requirements, are "ghosts that inhabit antitrust theory." See id. at 310.

[28] See McGee, supra note 23 at 300.

[29] See Bork, The Antitrust Paradox, 7 (1978).

[30] Consumer welfare is harmed by business practices which result in increased prices or reduced output.

[31] Id. at 155.

only will not expand output but has the option of reducing it and so decreasing his costs."[32] Second, the ease of entry is symmetrical with ease of exit. Bork points out that if a competitor is easily driven out, it will be as easy for that competitor or another to re-enter the market. Conversely, if entry into a market is difficult, "the more difficult it will be to drive a rival out."[33] Bork illustrates his theory by pointing to the railroad industry. Because railroading involves specialized equipment and high start up costs, the potential victim will be difficult to drive out because of the enormous stake that the prey has in his investment. From this, Bork concludes that predatory pricing is a poor investment "even if the predator has the reserves to bear the disproportional losses required."[34]

C. Easterbrook

In 1981, before his appointment to the Court of Appeals for the Seventh Circuit, Frank Easterbrook concluded that there is "no serious reason for antitrust law or the courts to take predation seriously."[35]

Easterbrook argues in "Predatory Strategies and Counterstrategies", that not only does predatory pricing impose a higher cost on the predator than the prey, but that there are market mechanisms in place to prevent predatory pricing from being successful. Easterbrook further

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[32] Id. at 149.
[33] Id. at 153.
[34] Id. Bork fails to recognize that it may make sense to incur losses to drive a competitor out of an industry which involves specialized facilities. It may take longer and cost more to drive out such a competitor, however, the predator can be more certain that new competitors will not enter because of the start up costs which may be viewed as a barrier to entry. But see supra note 27.
[35] See, Easterbrook, Predatory Strategies and Counterstrategies, 48 Chicago U. L. Rev. 263,264 (1981).

argues that a rule against predatory pricing discourages competitive conduct, and is expensive to administer and thus advocates declaring low prices per se legal.[36]

The first concern that Easterbrook raises about predatory prices is the difficulty in distinguishing "predatory pricing from ordinary competition."[37] Lower prices, although they may hurt a competitor, benefit consumers.[38] Therefore, Easterbrook believes that to prevail in an antitrust claim, the plaintiff must show, not harm to itself but harm to competition. In addition, the plaintiff should show that the defendant's conduct led to a monopoly. A price reduction that puts a competitor out of business, but does not enable the price cutter to obtain a monopoly, benefits consumers who take advantage of the lower prices. The losers in this scenario are the bankrupt competitor and the price cutter who bears the losses or forgone profit from the price cutting. Easterbrook argues that market forces cause the price cutting firm to bear its losses, thus obviating the need for intervention from the antitrust laws.

Easterbrook concedes that predation may be profitable, but, in the rare instances that it is, consumers will engage in self-help.[39] Easterbrook argues that during the predation period consumers will take note of the low prices and stockpile the goods. Stockpiling will prevent the predator from enjoying a recoupment period because consumers will already have enough of the product.[40]

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[36] Id. at 265.

[37] Id. at 266. Easterbrook notes this concern in a recent case. See, A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1400 (7th Cir. 1989).

[38] Easterbrook adopts the position of Bork, that the antitrust laws were meant to protect consumers,not competitors. See id. at 266 n.11. Bork's position appears to have been adopted by the Supreme Court. See Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979); Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1, 7-8, 19-20 (1979).

[39] Id. at 268.

[40] In this scenario, Easterbrook assumes that there is perfect information; that is "all market participants in the market have perfect knowledge of price, output and other information about the market." See H.Hovenkamp Economics and Federal Antitrust Law, (1985).

Easterbrook's scenario of customers helping themselves through stockpiling seems incredulous. Easterbrook

The consumer, Easterbrook argues, will in the face of a predation scheme, come to the aid of the victim. The consumer may spurn the predator's low price offer and continue to purchase from the victim at the higher price. This, Easterbrook concedes seems implausible because, although some consumers may purchase from the victim, others will take advantage of the predator's low prices and thus "free ride" on those supporting the victim. To solve this, Easterbrook argues that the victim will offer long-term contracts at a price lower than predator would charge if it obtained a monopoly. Creditors, will also be willing to help the victim. The creditor will realize that the victim is a good credit risk because there are "substantial profits to be had in monopolized markets."[41] These market disincentives will further discourage a predatory pricing scheme.[42]

Assuming that the predator is able to drive the competitor out of the market, Easterbrook concludes that the "predator has won only a battle not the war."[43] The predator now faces competition from a new entrant who has purchased the victim's plant for low cost.[44] Easterbrook concludes that the costs of a predation scheme are high and there is a great risk that it will not be successful.

III. United States Courts and Predatory Pricing

A. The United States Supreme Court

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proposes that consumers will be able to do something that economists cannot: tell the difference between predatory pricing and price competition. Easterbrook believes that consumers will note the low prices as a predatory scheme and go on a buying spree, thus protecting themselves. Easterbrook concedes that stockpiling of "perishable goods is not possible," but doesn't exclude high price items from his list of items which may be stockpiled. Easterbrook asks us to believe that not only can consumers detect predatory pricing but also, that they possess unlimited funds and space to stockpile the low cost goods.

[41] Id. at 287.

[42] The consumer coming to the aid of the victim scenario of course, assumes that all market participants possess perfect information and act rationally in the face of the predatory threat.

[43] See, Easterbrook, supra note 35 at 271.

[44] Easterbrook makes no mention that the predator may buy the victim's plant or bid the price of it up to artificially high levels, thus raising the new entrant's costs.

The United States Supreme Court has not yet indicated what type of test it would apply to predatory pricing.[45] The Court has indicated, however, in Matsushita and Cargill that it views predatory pricing as an implausible business strategy.

1. Matsushita

In Matsushita Electric Industry Co. v. Zenith Radio[46], the Supreme Court reported that "predatory pricing schemes are rarely tried, and even more rarely successful."[47] The plaintiffs, Zenith and National Union Electric Corporation (NUE), alleged that seven Japanese firms (Matsushita, Toshiba, Hatachi, Sharp, Sanyo, Sony and Mitsubishi) engaged in a global conspiracy to "fix and maintain low prices for [television] sets exported to and sold in the United States."[48] The plaintiffs alleged that the Japanese were funding this scheme from monopoly profits which they were reaping in Japan as a result of a price-fixing conspiracy.[49] This contention was rejected by the District court because "plaintiff. . . recognized that there is not evidence of it in the record."[50]

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[45] Both recent Supreme Court cases, Matsushita and Cargill were not tried on the merits.

[46] 475 U.S. 574 (1986).

[47] Id at 589.

[48] Id. at 574.

[49] The theory of using market power in one market to finance predatory activity in another ("war chesting") has been discredited. See generally, Kaplow, Extension of Monopoly Power Through Leverage, 85 Colum. L. Rev. 515 (1985). See also supra page 5 for discussion by McGee.

A war chesting strategy requires that the profit is invested in a predation scheme rather than in riskless opportunities like bonds.

[50] See, Matsushita v. Zenith, 513 F. Supp. 1100, 1129 (1981).

The District court rejected the plaintiff's economists interpretations of evidence as the work of "conspiracyologists" and not the work of economists.[51] The District court concluded that absent evidence of a conspiracy plaintiff would have to show proof that each individual defendant engaged in predatory pricing. Since none of the defendant possessed such power, the case was decided for the defendants on summary judgment.[52]

The case was appealed to the Court of Appeals.[53] This court did not believe that the plaintiff did not deserve a trial on the merits. The Court of Appeals ruled to admit into evidence the studies and interpretation of those studies by the plaintiff's economists. The case was appealed.

The Supreme Court reversed the Court of Appeals on the issue of whether "it applied the proper standards in evaluating the District Court's decision to grant petitioners' motion for summary judgment."[54] The Court found that the district court's granting of summary judgment was correct. The Court noted that the defendants could not be found to have violated the Sherman Act for conduct which took place in Japan. Therefore, the Court found that the "Court of Appeals . . . erred to the extent that it found evidence of alleged [foreign] conspiracies to be `direct evidence' of a conspiracy.'"[55]

The Court held that in order for the plaintiffs to survive the defendant's motion for summary judgment, the respondent must establish that a genuine issue of material fact exists. Under United States antitrust law there is a limit on the range of permissible inferences that may be drawn from ambiguous evidence.[56] The Court required the plaintiff to meet the Monsanto[57] standard in order

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[51] Id. at 1138.
[52] See id. at 1231.
[53] 732 F.2d 238 (3d. Cir. 1983).
[54] See, Matsushita Elec. Indus. Co. v. Zenith Radio, 475 U.S. 574,582 (1986).
[55] Id. at 583.
[56] The normal standard in United States courts for summary judgment allows inferences to be drawn from the underlying facts, . . . viewed in the light most favorable to the party opposing the

to survive the motion of summary judgement. The Monsanto standard requires the plaintiff to present "evidence that tends to exclude the possibility that the alleged conspirators acted independently."[58] Thus, Matsushita, required the plaintiffs to show that the inference of conspiracy was reasonable "in light of the competing inferences of independent action or collusive action that could not have harmed respondents."[59]

The defendants argued that the alleged conspiracy is "one that is economically irrational and practically infeasible."[60] Based on this premise the defendants argued that they were entitled to summary judgment. The Court agreed. The Matsushita Court, noted that a predatory pricing conspiracy is by its nature speculative.[61] A finding that a predatory pricing scheme was speculative precluded any possibility the plaintiffs may have had of meeting the rigorous Monsanto standard.

To support the notion that predatory pricing was a speculative endeavor, the Matsushita Court cited McGee, Bork and Easterbrook.[62] Justice Powell, writing for the Court, noted that for a predatory pricing conspiracy to be considered a rational business strategy, the participants must have reasonable expectations of recouping their losses. Citing, the economic rationale of Bork and McGee[63], Powell concluded that such an expectation was unreasonable. In a predatory pricing scheme, "short-run loss is definite, but the long-run gain depends on successfully neutralizing the

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motion. See United States v. Diebold, Inc., 369 U.S. 654, 655 (1962). In the antitrust context, however, courts are encouraged not to permit factfinders to infer conspiracies when such inferences are implausible because the effect of such an inference may deter pro-competitive behavior. See, Matsushita, 475 U.S. at 593.

[57] See, Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984).

[58] See, Matsushita 475 U.S. at 588. (citing Monsanto).

[59] Id. at 588.

[60] Id.

[61] Id.

[62] Id. at 589-90.

[63] See supra notes 21-24 and accompanying text.

competition"[64] and maintaining monopoly power long enough to recoup losses. Powell noted that monopoly pricing "breeds quick entry"[65] and therefore "predatory pricing schemes are rarely tried and even more rarely successful"[66] because the "`predator must make a substantial investment with no assurance that it will pay off.'"[67]

2. Cargill

In Cargill, Inc. v. Monfort of Colorado, Inc.,[68] the Supreme Court was less skeptical of predatory pricing as they were in Matsushita. In Cargill, the plaintiff challenged the merger of two rivals arguing that once merged, the new firm could more easily engage in predatory practices.[69] The Court, in granting standing, noted that although "firms may engage in [predatory pricing] only infrequently, there is ample evidence suggesting that the practice does occur. It would be novel indeed for a court to deny standing to a party seeking an injunction against threatened injury merely because such injuries rarely occur."[70]

B. Predatory Pricing Since Matsushita and Cargill

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[64] See Matsushita, 475 U.S. at 589.
[65] Id.
[66] Id.
[67] Id. (citing, Easterbrook, Predatory Strategies and Counterstrategies, 48 U.Chi.L.Rev. 263,268 (1981)).
[68] 107 S.Ct. 484 (1986).
[69] Id. at 491-92.
[70] Id. at 495.

Before Matsushita and Cargill, plaintiffs were the overwhelming losers in predatory pricing cases.[71] Not surprisingly, this trend has continued after Matsushita and Cargill.[72] Professor Liebeler of the University of California has argued that the price/cost tests which courts have been using to find for the defendant should be de-emphasized.[73] Instead, Liebeler, argues courts should focus first on whether it appears that the defendant has a dangerous probability of achieving a monopoly and maintaining it long enough to recoup its predatory losses.[74] Since predatory pricing is implausible, it makes little sense to go through the expense of determining the defendants costs to come to the almost inevitable conclusion-a finding for the defendant. Such determinations, Liebeler concludes may be made at summary judgment after examining the dangerous probability of success element.[75]

Professors Hanusz Ordover and Daniel Wall (Ordover) have noted that in the wake of Matsushita and Cargill, plaintiffs' attorneys are faced with "the difficult task of determining when a threat of predation is sufficiently credible."[76] These commentators argue that many of the economic assumptions of the Chicago school are not uniformly shared by economists. They posit that firms behave strategically by making business decisions which will influence strategic choices by their rivals.

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[71] For a list of predatory pricing cases see Liebeler, Whither Predatory Pricing? From Areeda and Turner to Matsushita 61 Notre Dame L. Rev. 1052, appendix (1986). There were but a few plaintiff who prevailed. See D & S Redi-Mix v. Sierra Redi-Mix and Contracting Co., 692 F.2d 1245 (9th Cir. 1982) and Sunshine Books, Ltd. v. Temple Univ., 697 F.2d 90 (3d Cir. 1982).

[72] See e.g., H.J., Inc. v. International Tel. & Tel. Corp., 867 F.2d 1531 (8th Cir. 1989); Indiana Grocery, Inc. v. Super Valu Stores, Inc., 864 F.2d 1409 (7th Cir. 1989); Michigan Citizens v. Thornburgh, 868 F.2d 1300 (D.C. Cir.1989).

[73] See, Liebeler supra note 71 at 1056.

[74] Id.

[75] Id.

[76] See, Ordover and Wall, What the "New Learning" Has to Offer (1987).

In the predatory pricing context, Ordover challenges the concept of perfect information. Ordover argues that in "realistic market situations"[77] perfect information does not exist and therefore, strategies such as predating to create a reputation for toughness or false signalling become credible.[78] Ordover points out that a "even a costly investment in reputation building proves profitable in the long run if it both eliminates and disciplines an existing rival and deters, scares or disciplines other competitors or potential entrants."[79] Thus far, strategic theories such as predation to create a reputation for toughness, or price signalling, have not been accepted in the United States courts.

IV. Europe and Predatory Pricing

In 1958 the Treaty of Rome, signed by six European nations went into effect.[80] The purpose of the treaty was to create a European Economic Community (EEC) which would have as one of its goals, the promotion of a "harmonious development of economic activities"[81] To further this goal

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[77] Id. at 7.

[78] Id. These theories, however, have not been accepted in any United States courts. Courts seem to be comfortable with the Chicago school's price theory economics. In spite of its limitations, price theory economics is a powerful analytical tool which lends it self to judicial efficiency. The "new learning" economics, on the other hand would require extensive discovery and judicial analysis. It would also require courts to delve into the illusive issue of intent.

[79] Id. at 6. Easterbrook comments that this argument although not preposterous, is not compelling either. See Easterbrook, Predatory Strategies and Couterstrategies, 48 U.Chi. L.Rev. 263, 283. (1981). Easterbrook argues that the threat is only profitable if it is believed. In order for the threat to be believed that predator must have engaged in an expensive predatory campaign. If the predator's bluff is called and must carry out the plan, money will be lost Id.

[80] Italy, Belgium, Holland, Luxembourg, Germany and France were the original six. Since 1958, Denmark, Ireland, the United Kingdom, Greece, Spain and Portugal have become members of the EEC.

[81] See, Treaty establishing the European Economic Community, Article 2.

the treaty contains rules on competition.[82] Article 86 of the treaty contains a provision which may be used to challenge predatory practices.[83]

The Treaty assigns to the Commission the power to investigate an alleged infringement of the treaty. The Commission is also empowered with the ability to issue reasoned opinions concerning alleged infringements of the treaty. Commission decisions are binding in their entirety. Although the Commission has taken an active role in monitoring the competition law of the treaty, it has seen relatively few predatory pricing cases.

A. AKZO

In a Commission decision[84], ECS, a small, British producer of organic peroxide benzoyl peroxide, alleged that AKZO a multinational corporation, abused its dominant market position in the EEC, contrary to Article 86. ECS contended that AKZO priced its product below cost with the intent of driving ECS out of business.

1. Background

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[82] See generally, "Treaty" supra note 81 at articles 85-99.

[83] Article 86 provides in relevant part:

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:
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> a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions.

[84] See, Commission Decision, ECS/AKZO (December 14, 1985)

In 1979 ECS complained to the High Court of London, that representatives of AKZO visited ECS and threatened to cut prices in the peroxide market unless ECS abandoned its polymer export market. An injunction was granted preventing AKZO from engaging in a systematic campaign of price cutting. The terms of the injunction required AKZO not to reduce its normal selling prices for peroxide in the United Kingdom or elsewhere, "with the intention of eliminating ECS as competitors."[85]

In 1982 the Commission investigated AKZO, London and ordered it to return to profit levels which it had been applying before the alleged threats were made and implemented.[86] AKZO did not appeal the order to the European Court of Justice and apparently continued its price cutting. ECS then brought its complaint to the Commission.

2. The Decision

The Commission concluded, largely on the basis of AKZO's own internal documentation found during the 1982 investigation, that AKZO had a dominant position in the European peroxide market. In the United Kingdom and Ireland, the market in which ECS competes with AKZO, AKZO had in 1982 approximately 33% of the market to ECS's 52%. By the time of the Commission decision these market position were reversed.[87] A third competitor, Diaflex, controlled the remainder of the market. ECS complained that this shift was achieved by AKZO through a process of attrition had taken from ECS its most important customers. ECS further

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[85] Id. at 7. (emphasis added).
[86] See id. at 2.
[87] Id. at 5.

claimed that it was only able to keep its remaining customers by matching the very low prices of AKZO.

AKZO originally contended that the price cuts were merely responses to competitive prices first charged by ECS, and that ECS had no evidence of AKZO's intent to eliminate ECS. The 1982 Commission investigation turned up evidence of direct intent of AKZO to engage in predatory pricing. An internal memorandum contained evidence to the effect that if ECS did not respond to AKZO's threats, each of ECS' customers would be offered peroxide at prices far below market price and at a considerable loss.[88]

AKZO dismissed the memorandum as the "personal impressions of a salesman prone to exaggeration."[89]

AKZO argued, that the prices which it offered were "not abusive since they included an element of profit".[90] AKZO commented in general that the complainant's charges were merely an attempt to "shift the blame for its own poor performance and bad investment decisions on to other participant in the market and ultimately on to the consumer."[91]

The Commission found for ECS. The Commission

rejected AKZO's argument that their low prices were a response to competition form ECS and Diaflex.[92] In addition, the Commission placed great weight on the internal memorandum which evidenced AKZO's intent to destroy ECS. The Commission noted that although the memorandum

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[88] Id. at 9.
[89] Id. at 11.
[90] Id.
[91] Id.
[92] The Commission actually found evidence that there was no competition between AZKO and Diaflex and that the two companies may have engaged in a price fixing conspiracy. The Commission found a note written by AZKO to Diaflex discussing prices. In addition, Diaflex acknowledge an "unwritten law that it would not try to take business from AZKO." See, AZKO supra note 84 at 12.

dated back to 1979, there were no later internal documents which established that the intent to destroy ECS had been abandoned. The Commission held that any unfair commercial practices undertaken by a dominant firm with the intent to eliminate, discipline or deter small competitors falls within the scope of the prohibition of Article 86.[93]

The harm to ECS factored into the Commission's decision. The Commission concluded that as a result of AKZO's pricing ECS's margin on its remaining business was reduced and that ECS had to increase bank borrowing. Because ECS incurred these losses, it had to reduce its budget for research and development.

The Commission also examined AKZO's costs in the English peroxide market. The Commission noted that Article 86 did not prescribe a cost-based legal rule to define when price cutting by a dominant firm is abusive, reasoning that not only is determining costs difficult, but that such a test would not be able to give "sufficient weight to the strategic aspect of price cutting behavior."[94] The Commission concluded, however, that the prices that AKZO offered represented prices below their average variable cost. Based on this finding, the Commission rejected AKZO's argument that the lower prices were a result of its superior efficiency. The Commission also noted that in many cases AKZO did not have to supply the "material at prices which it offered, leaving it to ECS to drop its prices so as to keep the customer and thus incur the loss."[95]

Having found that AKZO occupied a dominant position in the market, the Commission found that, through "examining the behavior of AKZO as a whole"[96] that it had abused that position in violation of Article 86.

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[93] Id. at 19. After placing great emphasis on the intent of AZKO, the Commission stressed that the case was not being decided on the issue of AZKO's intent. See id. at 21.
[94] Id. at 20.
[95] Id. at 15.
[96] Id. at 21.

B. Analysis-The Commission Decision:

Lack of Economic Analysis or Different Economic Assumptions?

Due to the lack of predatory pricing cases in Europe, the reasoning of the AKZO decision may or may not represent the "European" position on predatory pricing. The AKZO decision, however, may be indicative of how the European Court of Justice[97] eventually comes to view predatory pricing.[98]

The Commission's decision that AKZO abused its dominant position in violation of article 86, perhaps would have been decided differently under Section 2 of the Sherman Act. Article 86 's prohibition of abuse of a dominant market position is similar to the Sherman Act's prohibition of monopolizing conduct.[99] Under the Sherman Act the obtaining of a monopoly in itself is not considered monopolizing conduct and hence not illegal.[100] Likewise, in Europe, the mere possession of a dominant market position is not a violation of article 86. Abuse of that position is required. The standard for finding an abuse of market position in Europe, however, is not stringent. The Commission noted "the strengthening of a dominant position may constitute an abuse of that dominant position irrespective of the means adopted."[101] Thus, under European

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[97] The European Court of Justice is analogous to the highest courts of appeals of Member States of the EEC, or to, the Supreme Court of the United States.

[98] The European Court of Justice tends to defer to Commission decisions.

[99] Compare supra note 10 with supra note 83.

[100] See American Tobacco Co. v. United States, 328 U.S. 781, 811-14 (1946); United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

[101] See AKZO at 16 (citing Europemballage Corporation and Continental Can Company Inc. v. Commission).

Community analysis, a dominant firm may be found to have abused its position merely by engaging in otherwise legal business practices if those practices have as their effect the strengthening of the firm's market position.

Unlike the United States courts, the European Community is concerned with fairness and protecting the small trader.[102] In AKZO, the Commission never required ECS to show that consumers were harmed. Under current United States antitrust law, in order to obtain standing the plaintiff must show competitive harm.[103]

A showing of harm to a competitor alone is not sufficient to confer standing. Conversely, in AKZO, ECS prevailed upon a showing of harm to itself and that AKZO intended that harm.

In the United States the intent element in a predatory pricing case has either been eliminated or de-emphasized.[104] The Commission, on the other hand, placed great emphasis on the arguably weak evidence that AKZO intended to drive ECS out of business. Although the Commission noted that intent alone is not enough to find for the plaintiff[105], the Commission's fiercely guarded its contention that AZKO intended to drive ECS out of business. The Commission noted that AZKO's intent to drive ECS from the market as evidenced by a 1979 internal memorandum

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[102]The Treaty includes prohibitions against "unfair"
pricing see article 86 as well as the promotion of competition see Article 3. Article 3 of the Treaty provides in part:

The activities of the Community shall include. . .the institution of a system ensuring that competition in the common market is not distorted.

The United States, on the other hand has adopted as the main goal of antitrust law the protection of competition not competitors. See supra note 38. The United States once included protection of competitors as a goal of the Antitrust laws. See, e.g. United States v. Von's Grocery, 384 U.S. 270 (1966) (striking down merger because would have effect of eliminating small competitors).

[103]See Cargill v. Monfort, 107 S.Ct. 484 (1986).

[104]See supra notes 134 and accompanying text.

[105]See supra note 93.

(before the injunction was granted against AZKO), did not change because no internal memorandum was found which indicated that AZKO had abandoned that intention.

As noted earlier[106], strategic theories have not been basis for a successful predatory pricing claim in the United States. The European Commission, however, explicitly allowed for strategic considerations.[107] In rejecting a cost-based test for analyzing predatory pricing cases, the Commission held that costs are difficult to determine and more importantly such tests do not take into account the strategic considerations of the alleged predator.

The behavior of AKZO and ECS would seem to be irrational under United States law. In the United States, predatory pricing is considered expensive, even for a monopolist. AKZO began the scheme when it possessed only 33% of the market. AKZO, therefore, would have had to drastically increase its output of peroxide and sell it at a considerable loss to obtain superiority over ECS. In addition, ECS contended, based on the alleged threats from AKZO, that AKZO financed its predatory pricing from profits it was reaping in other industries. This is viewed by the Chicago school as implausible because such behavior further adds to the alleged predator's costs.[108] The Commission, however, did not find that AZKO's costs would prevent it from engaging in predatory pricing. Indeed, the Commission found it credible that AKZO could use its profits in other industries to finance the scheme.[109]

ECS's behavior would seem equally irrational under United States Antitrust law. When faced with the threat of predatory pricing, ECS did not enter into long-term contracts with their

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[106]See supra notes 76-79 and accompanying text.
[107]See supra note 94 and accompanying text.
[108]See supra page 5.
[109] This finding gives credence to Ordover's position that a predator may be willing to incur excessive costs if can drive competitors out and scare new entrants away. See Ordover, supra note 79. The Commission held that this was the effect of the scheme. The Commission noted that other companies did not enter the market, not only because of high start up costs, but because they had seen AZKO's behavior in the market and refused to enter. See AZKO at 18. AZKO's scheme itself became a barrier to entry.

customers as Easterbrook suggests they might.[110] Nor did ECS "stick it out" as McGee suggests they should but instead, tried to match AZKO's low prices. ECS did receive financing from banks as Easterbrook claimed the victim would, but the Commission viewed this as an additional cost that predatory pricing imposed on the ECS, instead of a competitive advantage.

Why would ECS act in such a seemingly irrational manner and believe AKZO's threats? Perhaps because perfect information did not exist. There is evidence that ECS did not understand its true position in the market. This is plausible because there was evidence that perfect information did not exist in the relevant market. For example, Pursuant to Article 21 (2) of Commission Regulation No. 17 , business secrets such as market share are not published in official journals.[111] This may have made it difficult for ECS to determine its true market position so that it could better analyze AZKO's threat and react accordingly.

Or perhaps there was sufficient information available (albeit not perfect) from which to make rational business judgments, but ECS lacked the sophistication to cut back output[112] or to enter into long-term contracts with its customers.

The United States antitrust laws protect competition not competitors from each other. Certainly a United States court, following the economic assumptions of the Chicago school,

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[110]It appears in a real business context that had ECS's approached its customers and notified them of the scheme it would not be believed. ECS's customers would in effect be asked to pay a higher price in order to prevent alleged conduct which may result in higher prices. Absent clear and convincing proof, ECS's customers would probably view such an offer as merely an attempt to extract more money.

[111]See AZKO n.2 at 2.

[112]It would seem rational for ECS to cut back output since at the time of the scheme, ECS had the dominant position and would have realized that it would have been very costly for AZKO to be successful. In this situation, even if ECS had made this determination, cutting back might have meant going out of business since supplying its customers with peroxide was its main source of income. AZKO, on the other hand, had income from other industries to finance its price cutting. Thus, under this view, ECS's decision to meet AZKO's price may have been rational.

would not protect ECS from itself. Indeed, a United States court would be inclined to agree with AZKO's general comment that ECS "sought to shift the blame for its own performance and bad investment decisions on to other participants in the market and ultimately on to the consumer."[113]

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[113]See supra note 91.