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Article 3

Intent as an Element of Predatory Pricing Under Section 2 of the Sherman Act

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NOTES

INTENT AS AN ELEMENT OF PREDATORY PRICING UNDER SECTION 2 OF THE SHERMAN ACT

INTRODUCTION

The intent requirement in predatory pricing analysis under section 2 of the Sherman Act[1] has generated significant controversy. Of the four circuit courts of appeal that have recently considered the issue, two maintained that intent is an element of the violation and two effectively abolished the intent requirement by refusing to admit evidence of intent in predatory pricing cases. The issue merits careful consideration because evidence of intent traditionally has played a major role in predatory pricing jurisprudence. Its elimination would signal a drastic change in policy away from the prohibition of predatory pricing and toward per se lawfulness of predatory pricing.

A complete test for predatory pricing must consider intent. Simply put, as a theoretical matter, some types of predatory pricing cannot be detected except through evidence of intent. Moreover, special concerns within the legal system support the utility of an intent requirement. An improved test for predatory pricing will employ intent in conjunction with two other factors, namely, the plausibility of recoupment and the relation of price to cost. This Note justifies these conclusions.[2]

Part I of this Note defines both predatory pricing and intent. Part II examines the present legal framework and the split among the circuit courts. Part III demonstrates the utility of an intent requirement in a limited group of scenarios where other tests fail to

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1 15 U.S.C. § 2 (1988).

2 Another recent Note has taken a different view of this debate. The author concluded that federal antitrust law should not consider intent evidence because federal law serves the goals of efficiency and competition, while state laws provide "shields behind which the warriors of the market place can protect themselves from their rivals' unethical tactics." Note, *Predatory Pricing Strategies: The Relevance of Intent Under Antitrust, Unfair Competition, and Tort Law*, 64 ST. JOHN'S L. REV. 607, 628 (1990) (authored by Michael C. Quinn). This Note, while essentially agreeing with Mr. Quinn as to the goals of federal antitrust law, disagrees with him as to how those goals can best be served. Through economic analysis of those goals and of various methods of detecting predatory pricing, this Note demonstrates that the goals of federal antitrust law are indeed better served by considering the defendants' intent in certain circumstances, rather than ignoring it altogether.

produce a clear outcome. Part IV proposes a new framework that utilizes intent. Finally, Part V illustrates the need for intent through application of the proposed framework to the facts of a recent case.

I
DEFINITIONS

A. Predatory Pricing

In the paradigmatic case of predatory pricing, a dominant firm charges a price lower than its short run profit-maximizing price and expands output in order to drive its rivals out of business. Once it has succeeded in eliminating its competition, the dominant firm raises its prices to a supracompetitive level, thus recouping its losses with monopoly profits.[3] Variations of the classic case exist. Instead of driving rivals out of business, the price cut may discipline rivals so that they acquiesce and follow the dominant firm's lead in raising price and lowering output.[4] Another version involves a dominant firm successfully establishing a predatory reputation that deters new entry into the market.[5] Under the right conditions, the dominant firm may exclude rivals without incurring losses.[6]

Price predation can occur in three scenarios: excess capacity, optimal capacity, and limit pricing.[7] Excess capacity exists when a firm, in order to maximize profits, must produce an output at which its average total cost curve is downward sloping.[8] A firm may deliberately build excess capacity to deter entrants by showing them that the firm is able to produce cheaply at high output levels in order to squeeze them out of the market. More often, the cause of excess capacity is a recession in the market that shrinks the market demand

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3 FREDERIC M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 335 (2d ed. 1980). The first phase is referred to as the price-cutting period; the second as the recoupment period.

4 *Id.* at 338. This variation is called price leadership.

5 *Id.* at 336-38. This version allegedly occurs in the context of a firm engaging in classic predation in one distinct market to scare off potential entrants to its other markets.

6 PHILLIP AREEDA & DONALD TURNER, ANTITRUST LAW ¶ 714 (1978); PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 714.Ib (1970 Supp.); Frederic M. Scherer, *Predatory Pricing and The Sherman Act: A Comment*, 89 HARV. L. REV. 869, 872-73, 880-82 (1976).

7 *See generally* Scherer, *supra* note 6 (describing the three scenarios).

8 *See* Scherer, *supra* note 6, at 872-73. The profit maximizing output occurs at Q*, where the marginal revenue drive (MR) intersects the marginal cost curve (MC).

curve.[9] The last possible cause of excess capacity is successful entry by a new firm. By satisfying a portion of the market demand, the new entrant shrinks the demand curve enjoyed by the entrenched firm.[10] Predatory pricing in an excess capacity scenario is rare because it is easier to detect than the other two scenarios, and because it requires the firm to incur losses rather than merely forgo profits in order to exclude an equally efficient rival.[11]

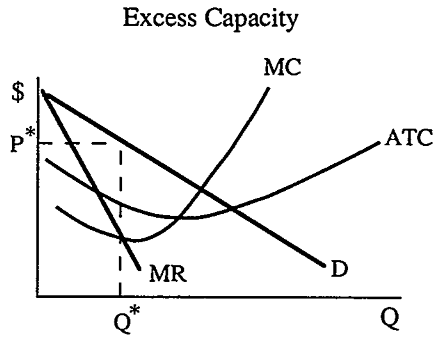

FIGURE 1

[9] Graphically, this means the demand curve will move downward and to the left.
[10] Graphically, this is represented by the same movement of the demand curve downward and to the left.

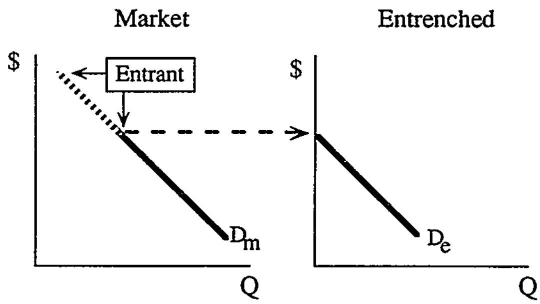

FIGURE 2

[11] Scherer, *supra* note 6, at 876-78 (predatory pricing in most excess capacity scenarios would require the dominant firm to charge a price below both marginal cost and average total cost, thereby making the strategy more conspicuous). *But see* Joseph F. Brodley & George A. Hay, *Predatory Pricing: Competing Economic Theories and The Evolution of Legal Standards*, 66 CORNELL L. REV. 738, 749-50 (1981) (price above marginal cost may be exclusionary if rivals perceive "deep pocket"). A firm incurs losses when its price is below its average total cost. Average total cost equals total cost divided by the number of units produced. Average variable cost equals total variable cost divided by the number of units. Variable costs change with levels of output; they are the costs of inputs that must be increased to increase output. Marginal cost equals the cost of producing the last unit.

For example, consider a firm that manufactures knife blades. The firm needs three things in order to produce blades: a factory, steel, and labor. In the short run, when the firm wants to produce more blades, it employs more steel and more labor, but does not build a new factory. Therefore, steel and labor are variable costs, and the factory is a fixed cost. Suppose the cost of maintaining the plant is $10. In order to produce 5 blades, the firm requires $10 of steel and $5 of labor. Total variable costs are $15 (10 +

In contrast to excess capacity, optimal capacity occurs when the dominant firm's profit-maximizing output coincides with the lowest point on its average total cost curve—the output at which the firm can operate most cost-efficiently is also the output which maximizes profits.[12] A firm with optimal capacity can successfully deter or exclude an equally efficient rival or entrant by charging a price that undercuts the profit-maximizing price but nonetheless exceeds average total cost. In this way, the optimally adapted firm can engage in successful predatory pricing without incurring losses. The key to this phenomenon is that the entrenched firm leaves the rival or entrant with an extremely small residual demand curve.[13] As the residual demand curve shrinks, rivals and entrants must build plants with increased cost-efficiency at lower levels of output. This is often impossible because in most manufacturing markets, efficiency in-

5), and average variable cost is $3 (15 / 5). Total cost is the sum of all costs, fixed and variable, which equals $25 (10 + 15), so average total cost is $5 (25 / 5). Note that if the price is $4, the firm is losing $1 on every unit sold. Now suppose that the firm wants to make another blade and it requires $2 of steel and $1 of labor to do so. The marginal cost of the sixth blade is $3.

Blades

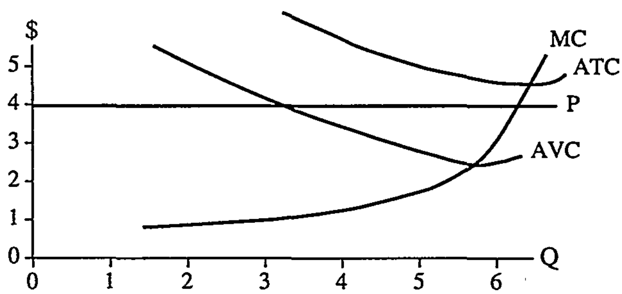

FIGURE 3

The term "equally efficient rival" connotes a firm that has the same cost curves as the dominant firm, *i.e.*, it has the same *productive* efficiency as the dominant firm.

12 Scherer, *supra* note 6, at 869-75.

Optimal Capacity

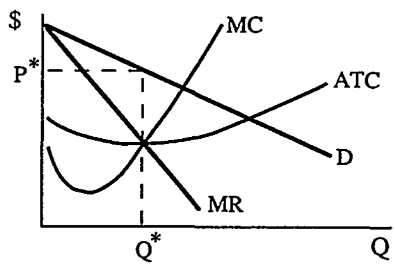

FIGURE 4

13 The residual demand curve is the portion of the demand curve to the right of the entrenched firm's output.

creases with scale. Predatory pricing with optimal capacity is "more apt to occur in the real world than the 'excess capacity' case."[14]

The limit pricing scenario[15] resembles the optimal capacity scenario except that it contemplates a larger firm operating on a more inelastic portion of the demand curve, leaving an even smaller residual demand curve for rivals.[16] Operating at such high output levels, the limit pricer can exclude equally efficient firms (*i.e.*, leave a prohibitively small residual demand curve) without lowering price below either marginal or average total cost. The limit pricing firm, like the optimally adapted firm, can successfully engage in predatory pricing without incurring losses.

Predatory pricing in the optimal capacity and limit pricing scenarios are possible without incurring losses and are therefore more rational than in the excess capacity scenario. Hence, there is reason to believe that predatory pricing in the optimal capacity and limit pricing scenarios is empirically more common than in the excess capacity scenario.[17] As a result, predatory pricing policy should emphasize the optimal capacity and limit pricing scenarios over the

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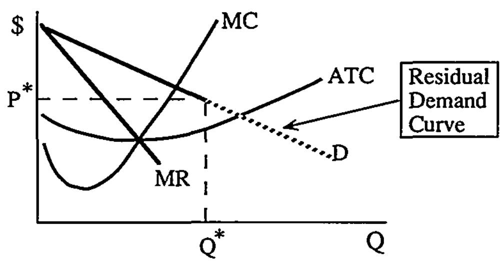

FIGURE 5

14 Scherer, *supra* note 6, at 873.

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Limit Pricing

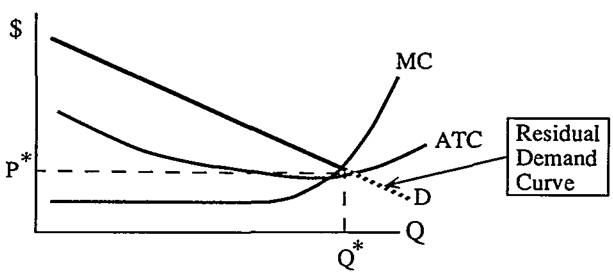

FIGURE 6

16 Elasticity of demand is the percentage change in quantity divided by the percentage change in price. It decreases as one proceeds downward on the curve. Hence, the limit pricing firm operates on a lower portion of the demand curve than the optimal capacity firm.

17 Scherer, *supra* note 6, at 883.

excess capacity scenario.[18]

Commentators have discovered some general preconditions to the occurrence of predatory pricing. First, the predator must possess significant market power before cutting price.[19] Without control over the market price, the predator's price cut will be ignored; without significant capacity, the predator will be unable to produce enough output to quench the market demand at the lower price. Second, entry into the market must be difficult.[20] If this precondition is absent, the predator would be unable to sell at a monopoly price long enough to recoup the lost profits. Soon after the predator has eliminated its old rivals and raised the price, new competitors will emerge and drive the price down.

While predatory pricing is susceptible to relatively clear theoretical definition, several practical considerations complicate its detection as a legal matter. First, courts must take care not to prohibit competitive price cuts. Antitrust law should encourage, not deter the downward movement of prices toward cost through competition.[21] Furthermore, predatory pricing is rare because of the high degree of risk involved in sacrificing profits today in hopes of uncertain profits tomorrow. To make the scheme profitable the future gains must exceed the sacrificed profits plus interest.[22] Finally, the task of differentiating predatory pricing from hard competition is quite difficult in a litigation setting. Plaintiffs often bring suit during the price-cutting stage before the alleged scheme has reached its fruition.[23] Moreover, because the defendant often already had dominant power before the alleged predatory pricing period, it is difficult to determine the effect the prices had on the defendant

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18 *See infra* subpart III (B).

19 Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 698 (1975); Paul L. Joskow & Alvin K. Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213, 224-27 (1979).

20 Joskow & Klevorick, *supra* note 19, at 228-31; Brodley & Hay, *supra* note 11, at 789-92. While it is generally accepted that entry must be difficult, there is no consensus on the exact entry conditions that are sufficient or necessary for recoupment. *See infra* text accompanying notes 166-70.

21 Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986); A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1326 (1990); Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir. 1983); William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982).

22 Cargill, Inc. v. Monfort, Inc., 479 U.S. 104, 121 (1986); Matsushita, 475 U.S. at 589; P. AREEDA & D. TURNER, *supra* note 6, ¶ 711.b; ROBERT BORK, THE ANTITRUST PARADOX 149 (1978); Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 267-69 (1981); Charles McCall, *Predatory Pricing: An Economic and Legal Analysis*, 32 ANTITRUST BULL. 1, 5 (1987).

23 *See, e.g.*, *Rose Acre*, 881 F.2d at 1400.

firm's market power.[24]

Courts and commentators continue to struggle to develop a test that adequately differentiates predatory pricing from hard competition. The relation of price to cost seems to be a helpful, yet sometimes inaccurate, indicator of the presence of predatory pricing; above-cost pricing, as well as below-cost pricing, can be exclusionary.[25] Perhaps evaluation of intent can aid in the detection of predatory pricing.

B. Intent

Critics of the use of intent in predatory pricing cases, and in antitrust generally, often argue that the intent to compete and the intent to monopolize are indistinguishable.[26] Yet some courts[27] and commentators[28] have distinguished the two. Indeed, many courts have echoed one commentator's view that the only distinction between predatory pricing and hard competition *is* motive.[29]

Two factors distinguish competitive and predatory intent: the nature of the advantage exercised and the defendant's expectations.[30] The nature of the advantage depends on whether it is efficiency-based. An efficiency advantage exists where the defendant has lower costs than competitors, and therefore can maximize short-run profits at prices lower than the prices at which its competitors can maximize short-run profits. As a policy and incentive matter, the law should allow firms to freely exercise efficiency advantages. When a firm sacrifices short-run profits, however, it should have a

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24 *See, e.g.*, *Barry Wright*, 724 F.2d at 230 (defendant already possessed market power and complaint alleged that defendant maintained its market power through predatory pricing).

25 *See infra* notes 143-62 and accompanying text.

26 *See, e.g.*, *Rose Acre*, 881 F.2d at 1402; Ball Memorial Hosp. v. Mutual Hosp. Ins., 784 F.2d 1325, 1338-39 (7th Cir.), *reh'g denied*, 788 F.2d 1223 (1986); *Barry Wright*, 724 F.2d at 232. The argument is that both the predator and the fierce competitor intend to drive rivals out of business.

27 *See infra* notes 50-82.

28 R. BORK, *supra* note 22, at 138; LAWRENCE SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 111 (1977).

29 The commentator is L. SULLIVAN, *supra* note 28, at 111. Cases citing Sullivan include Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc., 735 F.2d 884, 890 (5th Cir.), *reh'g denied*, 741 F.2d 1381 (1984); Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050, 1057 (6th Cir.), *cert. denied*, 469 U.S. 1036 (1984); Richter Concrete v. Hilltop Concrete, 691 F.2d 818, 823 (6th Cir. 1982); Malcolm v. Marathon Oil, 642 F.2d 845, 853-54 (5th Cir.), *cert. denied*, 454 U.S. 1125 (1981); Chillicothe Sand & Gravel v. Martin Marietta Corp., 615 F.2d 427, 432 (7th Cir. 1980).

30 William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1035 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982); R. BORK, *supra* note 22, at 138; L. SULLIVAN, *supra* note 28, at 111; *see also* RICHARD POSNER, ANTITRUST LAW—AN ECONOMIC PERSPECTIVE 190 (1976) (advocating search for intent by eliminating the possibility of any legitimate intents).

justifiable reason. The defendant's expectation of eliminating rivals and reaping monopoly profits is not a justifiable reason under antitrust laws that prohibit predatory pricing. The defendant possesses predatory intent when she knows that her price does not maximize short-run profits and the "anticipated benefits" of her price depend on either disciplining or eliminating rivals or deterring entry, thus "enhanc[ing] the firm's long-term ability to reap the benefits of monopoly power."[31]

One may prove intent by either direct or circumstantial evidence. Direct evidence consists of statements made by the actor regarding his mental state. Examples of direct evidence of predatory intent would include internal memoranda and minutes of meetings revealing plans to sacrifice profits to deter entry or drive a rival out of the market.[32] Circumstantial evidence includes any statement or conduct that may be used to infer intent, but does not directly reveal mental state. Circumstantial evidence also includes internal memoranda and minutes; however, unlike direct evidence, circumstantial evidence contains derogatory comments or plans consistent with predation such as pricing below cost, surveillance of rivals, sham litigation, blocking rivals' credit, disseminating misinformation, expanding output, and conduct in furtherance of such plans.[33] Other examples of circumstantial evidence include the actual conduct of below-cost pricing, surveillance, sham litigation, blocking credit, disseminating misinformation, and expanding output. The direct/circumstantial distinction is important because in addition to differing in content, the two possess different strengths and weaknesses for detecting predatory pricing. In particular, those who oppose the use of intent focus their criticisms on direct evidence and the derogatory memorandum type of circumstantial evidence.[34]

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31 *Inglis*, 668 F.2d at 1035. This definition finds support in other case law. *See, e.g.*, H.J. Inc. v. ITT, 867 F.2d 1531 (8th Cir.), *reh'g denied*, 876 F.2d 59 (1989); Directory Sales Management Corp. v. Ohio Bell Tel. Co., 833 F.2d 606 (6th Cir. 1987); Southern Pacific Comm. v. AT&T, 740 F.2d 980 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985). Professor Posner has suggested a similar approach. R. POSNER, *supra* note 30, at 190 (instructing courts "to examine the full range of possible reasons for a particular pricing policy and to infer predation only after rejecting all other possible reasons . . . , such as declining demand or obsolete plant, as implausible").

32 *E.g.*, " 'Put [Kelley] out of business. Do whatever it takes. Squish him like a bug . . . . [I]f it mean[s] give the stuff away, give it away.' " Browning-Ferris Indus. v. Kelco Disposal Inc., 492 U.S. 257, 260-61 (1989) (quoting the defendant's regional vice-president).

33 Pacific Eng'g Prod. Co. v. Kerr-McGee, 551 F.2d 790, 793 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977); Brodley & Hay, *supra* note 11, at 778; Joskow & Klevorick, *supra* note 19, at 259.

34 *See infra* text accompanying notes 187-214. This Note assumes that predatory pricing does exist. There is strong support for this assumption. *See* Cargill Inc. v. Monfort, Inc., 479 U.S. 104, 121 (1986); McCall, *supra* note 22, at 4. *But see* R. BORK, *supra* note 22, at 154; Easterbrook, *supra* note 22, at 265-318. By prohibiting predatory

Now that the reader knows a little about the nature of the beast, she is likely to ask, "why do I care?". The answer lies in the vague statutory framework, the sparse and reluctant Supreme Court guidance, and the ever-changing patchwork that looms in the lower federal courts. Each of these three sources of law has failed to authoritatively establish the proper role, if any, of intent within predatory pricing jurisprudence.

II
THE PRESENT LEGAL FRAMEWORK

A. Background

Section 2 of the Sherman Act prohibits both completed and attempted monopolization.[35] Completed monopolization entails the dual elements of monopoly power and willful acquisition or maintenance of that power.[36] By contrast, the attempt offense requires three elements: specific intent to monopolize, anticompetitive conduct, and dangerous probability of success.[37] Although the two section 2 offenses have different requirements, predatory pricing constitutes a violation under both the completed and attempted monopolization theories.[38]

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pricing, the law also makes this assumption. In addition, this Note assumes, as a policy matter, that predatory pricing does not constitute an antitrust violation unless it has the potential to exclude an equally efficient rival or a potential entrant that may become equally efficient. Both the legislative history and the case law support this assumption. *See infra* note 116. Finally, this Note assumes that prices with exclusionary effects do not give rise to a violation unless they are accompanied by a predatory intent; however, prices below some measure of cost (at the very least, average variable cost) justify an inference of intent. Prices that exclude competitors by accident or with competitive justification are legal. A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1400 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1326 (1990); Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 230 (1st Cir. 1983); *Pacific Eng'g*, 551 F.2d at 795.

35 15 U.S.C. § 2 (1988) ("Every person who shall monopolize, or attempt to monopolize . . . shall be deemed guilty of a felony."). Section 7 of the Clayton Act gives standing to private plaintiffs to sue for treble damages. *Id.* § 15a ("[A]ny person who sball be injured . . . by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages.").

36 United States v. Grinnell, 384 U.S. 563, 570-71 (1966); *cf.* U.S. Philips Corp. v. Windmere Corp., 680 F. Supp. 361, 365 (S.D. Fla. 1987) (court recognized requirement of "general intent" for completed monopolization offense), *rev'd on other grounds*, 861 F.2d 695 (Fed. Cir. 1988), *cert. denied*, 490 U.S. 1068 (1989).

37 William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014, 1027 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982); *but cf.* McGahee v. Northern Propane Gas, 858 F.2d 1487 (11th Cir. 1988) (excludes the conduct element), *cert. denied*, 490 U.S. 1084 (1989).

38 *See* Cargill, Inc. v. Montfort, Inc., 479 U.S. 104, 121 (1986) ("predatory pricing is an anticompetitive practice forbidden by the antitrust laws"); Standard Oil Co. v. United States, 221 U.S. 1 (1911) (finding liability for predatory conduct and price discrimination under § 2). The Robinson-Patman Act also prohibits predatory pricing. *See infra* text accompanying notes 180-86.

In spite of the unlawfulness of predatory pricing, the Supreme Court has failed to establish a test for predatory pricing. Two recent cases, however, lend some guidance. In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,[39] the Court indirectly expressed some approval of a price/cost test by describing predatory pricing as pricing below some level of cost,[40] but left a firm determination of the legality of above cost pricing for another day. The *Matsushita* Court also lent support to a recoupment test when it observed that predation was impossible because of fierce competition and ease of entry in the relevant market involved in that case.[41] Finally, the Court opined that predatory pricing is rare,[42] and emphasized that any legitimate test must not "discourag[e] legitimate price competition."[43]

In another case, *Cargill, Inc., v. Monfort, Inc.*,[44] the Court described predatory pricing as pricing "below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run."[45] This description supports a test with both price/cost and intent factors. Although the Court echoed the *Matsushita* sentiments regarding the rarity of predatory pricing and the need to protect legitimate price competition, it also implied that predatory pricing does exist.[46] As in *Matsushita*, the Court in *Cargill* refused to rule on the lawfulness of a price above "incremental cost" where there is evidence of intent.[47] Finally, *Cargill* clarified that intentional predation is aimed not "simply at increasing market share[, but at] elimination of competition."[48]

Through *Matsushita* and *Cargill*, the Supreme Court has indicated that although predatory pricing is rare, it may exist. Courts, however, must be careful not to chill legitimate competition while attempting to punish predators. Further, the Court implied support for the use of three tools to detect predatory pricing: the relation of

39 475 U.S. 574 (1986) (the case actually established the summary judgment standard for conspiracy under § 1).

40 *Id.* at 584-85 nn.8, 9 (citing *inter alia*, Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 232-35 (1st Cir. 1983)). This description of predatory pricing justifies an inference of support for the Areeda-Turner test. *See infra* note 50 for a description of the Areeda-Turner test.

41 *Matsushita*, 475 U.S. at 590-93.

42 *Id.* at 589.

43 *Id.* at 594 (citing *Barry Wright*, 724 F.2d at 234).

44 479 U.S. 104 (1986) (holding that plaintiff who alleged future predatory pricing had standing for merger injunction).

45 *Id.* at 117.

46 *Id.* at 121 ("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.").

47 *Id.* at 117 n.12; *see supra* note 40.

48 *Id.* at 117.

price to cost, the plausibility of recoupment, and predatory intent. Finally, the Court twice raised and left open the question of whether pricing above cost with predatory intent is unlawful.

Given only the foregoing sparse and cryptic guidance, the lower federal courts have struggled to create a test for predatory pricing. Although the courts have not agreed on a single test, some generalization about their approaches is possible. A majority of the circuit courts of appeals[49] adhere to a test that balances the results of the Areeda-Turner test[50] and intent. The majority test has three prongs: (1) a price below average variable cost justifies a presumption of intent, and thus, unlawfulness; (2) prices above average variable cost but below average total cost are lawful without some

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49 Thurman Indus., Inc. v. Pay 'N Pak Stores, 875 F.2d 1369 (9th Cir. 1989); Indiana Grocery v. Super Valu Stores, 864 F.2d 1409 (7th Cir. 1989); U.S. Philips Corp. v. Windmere Corp., 861 F.2d 695 (Fed. Cir. 1988), *cert. denied*, 490 U.S. 1068 (1989); McGahee v. Northern Propane Gas Co., 858 F.2d 1487 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989); Western Concrete Structures v. Mitsui & Co., 760 F.2d 1013 (9th Cir.), *cert. denied*, 474 U.S. 903 (1985); Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc., 735 F.2d 884 (5th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985); Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050 (6th Cir.), *cert. denied*, 469 U.S. 1036 (1984); Sunshine Books v. Temple Univ., 697 F.2d 90 (3d Cir. 1982); Richter Concrete v. Hilltop Concrete, 691 F.2d 818 (6th Cir. 1982); William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982); Malcolm v. Marathon Oil Co., 642 F.2d 845 (5th Cir.), *cert. denied*, 454 U.S. 1125 (1981); Ernest W. Hahn, Inc. v. Codding, 615 F.2d 830 (9th Cir. 1980); Chillicothe Sand & Gravel Co. v. Martin Marietta Corp., 615 F.2d 427 (7th Cir. 1980); Hanson v. Shell Oil Co., 541 F.2d 1352 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977). *But see* Ball Memorial Hosp. v. Mutual Hosp. Ins., 784 F.2d 1325 (7th Cir.), *reh'g denied*, 788 F.2d 1223 (1986).

Most district courts addressing the question have followed the same test. U.S. Anchor Mfg. v. Rule Indus., 717 F. Supp. 1565 (N.D. Ga. 1989); Florida Fuels v. Belcher Oil Co., 717 F. Supp. 1528 (S.D. Fla. 1989); U.S. Philips Corp. v. Windmere Corp., 680 F. Supp. 361 (S.D. Fla. 1987), *rev'd on other grounds*, 861 F.2d 695 (Fed. Cir. 1988), *cert. denied*, 490 U.S. 1068 (1989); Jays Foods v. Frito-Lay, 656 F. Supp. 843 (N.D. Ill. 1987); Raul Intern Corp. v. Sealed Power Corp., 586 F. Supp. 349 (D.N.J. 1984); Double H Plastics v. Sonoco Prods. Co., 575 F. Supp. 389 (E.D. Pa. 1983), *aff'd*, 732 F.2d 351 (3d Cir.), *cert. denied*, 469 U.S. 900 (1984); Rohm & Haas Co. v. Dawson Chem. Co., 557 F. Supp. 739 (S.D. Tex. 1983); Richter Concrete Corp. v. Hilltop Basic Resources, 547 F. Supp. 893 (S.D. Ohio 1981), *aff'd*, 691 F.2d 818 (6th Cir. 1982); *In re* IBM Peripheral EDP Devices Antitrust Litig., 481 F. Supp. 965 (N.D. Cal. 1979), *aff'd*, Transamerica Computer Co. v. IBM, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983); In the Matter of General Foods Corp. 103 F.T.C. 204 (1984).

50 Areeda & Turner, *supra* note 19. The test purports to maximize allocative efficiency. *See infra* section III (A)(3) (for a description of allocative efficiency) and section III (B)(1) (showing failure to achieve goal). Although the orthodox version of the test would prohibit all prices below marginal cost, policy and evidentiary concerns led the authors to abandon the orthodox version in favor of a more practical test. The new test prohibits prices below average variable cost until the output level where average variable cost intersects with marginal cost. At outputs where marginal cost is between average variable and average total cost, the test prohibits prices below marginal cost. At higher outputs, the test prohibits only prices below average total cost. The test eliminates intent as a factor and relies solely on the price/cost relation. *See infra* subpart III (B).

independent evidence of intent; and (3) prices above average total cost are presumed lawful.

Until 1983, no circuit court of appeals had eliminated the intent requirement for predatory pricing violations. Since 1983, however, two courts have abandoned the intent requirement, while in 1981 and 1988 two others reiterated its necessity to a correct determination of predatory pricing liability. To best understand the disagreement, this Part will first examine the traditional majority position advocated by the Ninth and Eleventh Circuits, and then evaluate the criticisms of this position made by the First and Seventh Circuits.

B. The Split

In *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*,[51] the plaintiff alleged that the defendant had attempted to monopolize the private label bread market through predatory pricing in violation of Section 2 of the Sherman Act. Both the plaintiff, Inglis, and the defendant, Continental, were wholesale bakeries that sold bread under both a private label and an advertised label. Private label bread is made for a specific retailer and marketed under that retailer's label. Advertised label bread is the same product as private label bread, but it is marketed under a national brand name and is sold to any retailer willing to buy. The profit margin on advertised label bread, however, exceeded that of private label bread because the wholesale price of advertised label was higher than that of private label.

Inglis claimed that Continental had engaged in predatory pricing in the private label bread market and that, once it gained control of that market, Continental intended to raise the private label price so that sales of its advertised label bread would increase.[52] Inglis operated at a loss from 1967 until 1974 in order to meet Continental's allegedly predatory price cuts. In 1974, however, Inglis succumbed and ceased operations because of these significant, long-term losses.

At trial, Inglis presented evidence of Continental's private label prices and circumstantial evidence of Continental's intent. In September 1970, Continental lowered its price from 19 to 18 cents. The price remained there until July 1972, when Continental reduced the price to 17.2 cents. In the summer of 1973, Continental gradually began to raise its price. Inglis proved that Continental's price was below average total cost from 1971 to 1974 and also

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51 668 F.2d 1014 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982).

52 Dominance in the private label market would result in increased shelf space for advertised label bread. Moreover, a higher private label price would increase demand for the advertised label, because its price would become more attractive.

presented some evidence that the price undercut average variable cost briefly in 1972 and 1973. Inglis's circumstantial evidence of intent included a middle management memorandum written in early 1974, soon after Continental began to raise its price, stating that Inglis would not last another year; memoranda from salesmen targeting Inglis's private label buyers; offers repeatedly made to those buyers; and a report to Continental from consultants containing strategies to fight competition in the private label market.[53] Inglis presented no direct evidence of intent.

Continental offered three explanations for its pricing behavior. First, it proved that the entire wholesale bread market was extremely competitive, and presented evidence tending to show that Continental had no market power and that its pricing simply followed the lead of the biggest wholesaler, Campbell-Taggart.[54] Second, Continental showed that during the complaint period many retailers started "captive" bakeries which left all the wholesalers with tremendous excess capacity.[55] Finally, Continental showed that the federal government imposed a price freeze on all the wholesalers during the summer of 1973 and alleged that its price increase immediately after the lifting of the freeze stemmed not from the anticipation of Inglis's demise, but rather from increasing costs.[56]

The trial court granted judgment notwithstanding the verdict to the defendant because Inglis had not proved that Continental's prices were below marginal cost.[57] The Ninth Circuit Court of Appeals reversed and remanded for a new trial.[58] The Circuit Court held that a section 2 attempt entails three elements: a specific intent

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53 One of the strategies was to maintain prices "to hasten wholesaler exit." *Inglis*, 668 F.2d at 1025.

54 Campbell-Taggart settled prior to trial.

55 Therefore, each wholesaler faced a shrinking demand curve and there were too many wholesalers in the market to allow them to produce at an efficient output, *i.e.*, near the lowest point on their average total cost curve. *See supra* note 8. In order to survive, it was necessary to incur losses in the short run.

56 Continental failed to explain why it did not take advantage of opportunities to apply for a price increase in its private label bread, when it did so for its advertised label bread.

57 William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 461 F. Supp. 410 (N.D. Cal. 1978), *rev'd*, 668 F.2d 1014 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982). The court reasoned that because of excess capacity, average variable cost exceeded marginal cost, and therefore average variable cost was not a good proxy for marginal cost. *Id.* at 418. In the alternative, it granted a new trial because even if average variable cost was an acceptable proxy, Inglis's evidence was insufficient on that point. *Id.*

58 The Ninth Circuit reversed because the district court erred in holding that whether a cost is variable or fixed is not a jury question; however, the court also held that the verdict was against the weight of the evidence (*i.e.*, that the cost and intent evidence were inconclusive), and therefore remanded instead of reinstating the jury verdict. *Inglis*, 668 F.2d at 1058.

to control price or destroy competition, predatory conduct, and a dangerous probability of success. Furthermore, these elements are interdependent in that "[e]ach element interacts with the others in significant and unexpected ways."[59]

To make out a section 2 attempt claim by predatory pricing, the "plaintiff must prove that the anticipated benefits of the 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."[60] The court reiterated that the "ultimate standard" was that "[p]redation exists when the justification of these prices is based, not on their effectiveness in minimizing losses, but on their tendency to eliminate rivals and create a market structure enabling the seller to recoup his losses."[61] Thus, predatory pricing exists when the defendant consciously forgoes short run profits in order to eliminate rivals and to subsequently recoup the lost profits.

The court laid out what might be described as a sliding scale test for predatory pricing using intent and the relation of price to cost as the two variables. If the defendant's price undercuts average variable cost, the court will presume intent, and the burden shifts to the defendant to prove that its pricing was justified without regard to anticompetitive effect.[62] However, if price exceeds average variable cost but undercuts average total cost, the plaintiff must introduce independent evidence of intent in order to establish a prima facie case.[63] A later Ninth Circuit case, *Transamerica Computer v. IBM*,[64] added a third prong: even if price was above average total cost, the plaintiff could prove a prima facie case by merely producing "clear and convincing evidence"[65] of predatory intent.

The *Inglis* court initially justified the intent requirement by an analogy, steeped in Supreme Court precedent, to the criminal law of attempt, where "intent is used to confine the reach of an attempt

59 *Id.* at 1027.

60 *Id.* at 1035. "Anticipated benefits" and "justification" refer to the defendant's expectations. Therefore, predatory intent occurs when the defendant's price cannot be justified without regard to its exclusionary effect. The defendant's state of mind may be proved by direct or circumstantial evidence. When inferring intent from conduct, the court will look to the "defendant's rational expectations." *Id.* at 1034.

61 *Id.* at 1035.

62 *Id.* at 1036.

63 *Id.* at 1035-36. When it applied this framework to the case at hand, the court found that the verdict for the plaintiff was against the weight of the evidence. The weight of the evidence showed that price was not below average variable cost and the plaintiff's evidence on intent was "inconclusive." *Id.* at 1038-39. The Court evaluated the Robinson-Patman Act by the same standard as the Sherman Act claim. *Id.* at 1041.

64 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983); *see also* L. SULLIVAN, *supra* note 28, at 111 (some truly antisocial intents merit sanction on their own).

65 *Transamerica*, 698 F.2d at 1388.

claim to conduct threatening monopolization."[66] The court nevertheless acknowledged two weaknesses of direct evidence of intent in predatory pricing cases:[67] sophisticated firms will often avoid producing direct evidence of intent and those statements that are most likely to inflame a jury are merely "the clumsy choice of words to describe innocent behavior [revealing] the inveterate tendency of sales executives to brag to their superiors about their competitive prowess, often using metaphors of coercion that are compelling evidence of predatory intent to the naive."[68] The court sought to remedy these disturbing characteristics by also requiring "corroborating conduct—" intent without predatory conduct cannot constitute a violation in the Ninth Circuit.[69] The most compelling justification for the Ninth Circuit's intent requirement, however, is the court's very definition of predatory pricing—pricing in which the defendant would not engage unless the defendant expected to exclude rivals.

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While the *Inglis* court relied primarily on a logical notion that motive is the distinguishing characteristic of predation as opposed to competition, the Eleventh Circuit, in *McGahee v. Northern Propane Gas Co.*,[70] took a different tack to justify the intent requirement. In *McGahee*, the plaintiff alleged that the defendant engaged in predatory pricing to run him out of the propane retail business. After leaving defendant Northern's employ as district manager "under contentious circumstances," plaintiff McGahee entered the retail propane market with the help of an $800,000 loan from the Small Business Administration (SBA).[71] By February 1982, Northern had obtained copies of the SBA loan documents and other information regarding McGahee's finances. Before McGahee's entry, Northern reduced its prices and circulated an internal memorandum about taking the "offensive" and fighting "the former employee for the market." By 1983, McGahee had captured 23% of the market and Northern's share had dropped from 60-65% to 35%.[72] Northern's district manager referred to McGahee as " 'Floyd the S.O.B.' " in internal memoranda and set a goal for 1983 to " '[c]ontribute to

66 *Inglis*, 668 F.2d at 1027 (citing Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 626 (1953); United States v. Griffith, 334 U.S. 100, 105 (1948), *overruled on other grounds*, Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984); Swift & Co. v. United States, 196 U.S. 375, 396 (1905)).

67 *Id.* at 1028 n.6 (citing R. POSNER, *supra* note 30, at 189-90).

68 R. POSNER, *supra* note 30, at 190.

69 *Inglis*, 668 F.2d at 1028.

70 858 F.2d 1487 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989).

71 *Id.* at 1491.

72 *Id.* at 1492.

Floyd's financial problems.' "[73] Northern's price during the complaint period was below average total cost, and McGahee introduced evidence tending to show that it was below average variable cost. McGahee also presented evidence that Northern's prices in other districts were higher than in McGahee's district, and that Northern provided free storage tanks only in McGahee's district and only after McGahee's entry.

The trial court found that the market had low entry barriers, that the defendant's price exceeded variable cost, and that no dangerous probability of success existed. Based on these findings, the trial court granted summary judgment to Northern,[74] deeming direct evidence of intent irrelevant.[75]

The Eleventh Circuit Court of Appeals reversed, finding that there were genuine issues of fact as to both dangerous probability of success and predatory intent. The court held that a section 2 attempt violation requires only two elements: specific intent to achieve a monopoly and a dangerous probability of success.[76] The court further held that derivation of profit from predatory pricing satisfies the requirement of specific intent. The Eleventh Circuit then laid out a three prong test for predatory pricing quite similar to the Ninth Circuit's test. First, a price above average total cost justifies no inference of intent; in such a case, the intent requirement must be met by independent evidence. Second, a price below average total cost constitutes some evidence of intent, but the plaintiff must adduce additional independent evidence of intent to survive summary judgment. And third, a price below marginal cost gives rise to a rebuttable presumption of intent.[77] To justify the intent requirement, the court turned to the language and history of the antitrust statutes, as well as to relevant Supreme Court precedent.[78] The court concluded from the legislative history, the "public outcry

73 *Id.* Like *Inglis, McGahee* involved no direct evidence of intent.

74 McGahee v. Northern Propane Gas, Co., 658 F. Supp. 189, 195-97 (N.D. Ga. 1987), *rev'd*, 858 F.2d 1487 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989).

75 *Id.* at 192.

76 *McGahee*, 858 F.2d at 1493. Other courts have imposed a conduct element; the Eleventh Circuit, in allowing a showing of predatory pricing to fulfill the intent element, has an implicit conduct element.

77 *Id.* at 1504 (average variable cost may serve as a proxy for marginal cost). When the court applied the test, it found genuine issues of fact as to both elements. *Id.* at 1504-05. Regarding specific intent, the court found that the price was clearly below average total cost, and possibly below average variable cost; even assuming price was above average variable cost, there was sufficient independent evidence of intent to get to a jury. *Id.* As to dangerous possibility of success, the court found Northern's 60-65% share at the beginning of the complaint period (the time during which McGahee alleged Northern engaged in predatory pricing) sufficient to justify a jury finding. *Id.* at 1505-06. Therefore the court reversed and remanded for a new trial.

78 *Id.* at 1496-1502.

in 1890 against monopolies," the "Congressional concern with the economic and political power of large combinations[,]" and from "common sense[,] . . . that Congress intended for subjective [read 'direct'] evidence of a defendant's intent to be relevant."[79] The court found additional support for its view on intent from early Supreme Court precedent,[80] and the criminal law of attempt.[81] As for the role of modern economic theory, the court stated:

> an original Congressional intent of using evidence of a defendant's subjective [read "direct"] intent is not to be ignored today just because the science (art?) of economics has made great strides since original passage of the statutes. Economics provides the means for evaluating the facts, not the elements of an antitrust violation.[82]

Finally, the court considered "[t]hree recent Supreme Court cases" on predatory pricing.[83] The Eleventh Circuit found two of these cases, *Cargill, Inc. v. Montfort, Inc.*[84] and *Matsushita Electric Industries Co. v. Zenith Radio Corp.*,[85] to be neutral on the issue of intent. In the third case, *Utah Pie Co. v. Continental Baking Co.*,[86] the Supreme Court relied on intent evidence in imposing liability for predatory pricing under the Robinson-Patman Act.[87] From the *Utah Pie* decision the Eleventh Circuit inferred Supreme Court support for an intent requirement for predatory pricing under the Sherman Act.

In sum, the Ninth and Eleventh Circuits both require an intent element for predatory pricing violations under section 2 on the grounds of logic, legislative history, and Supreme Court precedent.

* * *

Contrary to the Ninth and Eleventh Circuits, the First and Seventh Circuits believe that countervailing concerns outweigh the factors supporting an intent requirement. In *Barry Wright Corp. v. ITT Grinnell Corp.*,[88] the First Circuit Court of Appeals became the first federal circuit court of appeals to find intent irrelevant to predatory pricing. Plaintiff, Barry Wright Corporation (Barry), alleged that defendant, Pacific Scientific Company (Pacific), had monopolized

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79 *Id.* at 1500. The court also found that Congress intended that average total cost be the highest level of price that could be used to infer any specific intent.

80 *Id.* at 1497.

81 *Id.* at 1496 n.23, 1497. Recall that the *Inglis* court also relied on the law of attempt and early Supreme Court precedent. *See supra* note 66 and accompanying text.

82 *Id.* at 1500 n.29.

83 *Id.* at 1501.

84 479 U.S. 104 (1986).

85 475 U.S. 574 (1986).

86 386 U.S. 685 (1967). This case is not terribly recent.

87 *See infra* text accompanying notes 180-86.

88 724 F.2d 227 (1st Cir. 1983).

the market for "snubbers."[89] Grinnell, a major snubber user alarmed by growth in Pacific's already large market share, endeavored to create an alternative source of snubbers by entering into a contract with Barry to produce snubbers. Barry fell drastically behind the contract schedule. Seeing an opportunity to prevent entry, Pacific offered Grinnell a long-term contract to supply Grinnell's snubber requirements at very attractive prices. Grinnell, correctly interpreting Barry's delays as a material breach, cancelled its contract with Barry and accepted Pacific's offer. Barry ceased its efforts to produce snubbers and brought suit.[90] The district court entered judgment for Pacific and the First Circuit affirmed.

The parties did not dispute that Pacific possessed monopoly power, or that it had acquired that power in a lawful manner.[91] Thus, the sole issue before the court was whether Pacific had maintained its power through "exclusionary" means.[92] Barry's evidence showed that Pacific gave special discounts to Grinnell and insisted on a long-term contract with a non-cancellation clause. The parties stipulated, however, that Pacific's price was always above both average total and marginal cost, and the First Circuit held that that alone justified a defense verdict.

In so holding, the court specifically rejected the Ninth Circuit's *Transamerica* ruling that clear and convincing evidence of intent may constitute a predatory pricing violation, despite a price above average total cost.[93] Judge Breyer, writing for the court, reasoned

> that such above-cost price cuts are typically sustainable; that they are normally desirable (particularly in concentrated industries); that the "disciplinary cut" is difficult to distinguish in practice; that it, in any event, primarily injures only higher cost competitors; that its presence may well be "wrongly" asserted in a host of cases involving legitimate competition; and that to allow its assertion threatens to "chill" highly desirable procompetitive price cutting.[94]

The court asserted that pricing above average total cost cannot deter or eliminate an equally efficient rival, and that limit pricing is not

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89 *Id.* at 229 (snubbers are shock absorbers for pipe systems, used here in nuclear power plants).

90 It seems Barry never produced a single snubber. *Id.*

91 During the complaint period, Pacific's share rose from 47% to 94%. *Id.*

92 *Id.* at 230.

93 *Id.* at 231 (rejecting Transamerica Computer Co. v. IBM, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983)). *See supra* note 64 and accompanying text.

94 *Barry Wright*, 724 F.2d at 235-36. *But see supra* notes 12-14 and accompanying text (arguing that prices above total cost can exclude equally efficient competitors in some instances).

anticompetitive.[95] Furthermore, even assuming that a price above total cost can be anticompetitive, surely the disadvantages of prohibiting such prices (*i.e.*, administrative difficulties in enforcement and disincentives to cut prices) outweigh the very rare benefit, and therefore justify a rule of per se lawfulness where price exceeds average total cost.[96]

Although the First Circuit provides for an affirmative defense of non-predatory intent, it will not consider evidence of intent to support a prima facie case of predatory pricing.[97] The court banished direct evidence of intent for three reasons: mere "intent to harm" is too "vague;"[98] the defendant's predatory expectations may be incorrect because the effect of one firm's prices partially depends on the reactions of its competitors;[99] and sophisticated defendants will engage in strategic behavior so as not to produce any direct evidence of predatory intent.[100] Having disposed of direct evidence, the court proceeded to kill off intent altogether: "[i]f [intent] is meant to refer to a set of objective economic conditions that allow the court to 'infer' improper intent, . . . using Occam's razor, we can slice 'intent' away."[101] In other words, the costs of direct evidence outweigh the benefits, and circumstantial evidence of intent is essentially evidence of conduct, not of intent, and should be admitted only as such.

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In *A.A. Poultry Farms, Inc. v. Rose Acre Farms Inc.*,[102] the Seventh Circuit Court of Appeals joined ranks with the First Circuit in effectively eliminating intent as an element of predatory pricing violations. The plaintiffs apparently alleged that the defendant, Rose

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95 *Barry Wright*, 724 F.2d at 233-34. For a discussion of limit pricing, see *supra* notes 16-18 and accompanying text.

96 *Barry Wright*, 724 F.2d at 234-35 (this is arguably dicta because Pacific's prices were also above marginal cost, and no commentator suggests that serious anticompetitive effects can result from such prices).

97 *Id.* at 232 (price below marginal cost lawful if intended as "promotional" or if firm "expects costs to fall when sales increase"). Although the court's holding is limited to prices above both average total and marginal costs, the court's language implies that it will not consider evidence of intent in any predatory pricing case. *Id.*

98 *Id.*

99 *Id.* (citing Richard O. Zerbe, Jr. & Donald S. Cooper, *An Empirical and Theoretical Comparison of Alternative Predation Rules*, 61 TEX. L. REV. 655, 659-77 (1982)).

100 *Id.*

101 *Id.* (citations omitted). Applying these principles to Pacific, the court found that even under *Transamerica* there was no violation. It appeared likely that Pacific's price cuts were profitable in the short run because they enabled Pacific to use more of its excess capacity at a lower cost. Hence, there was no clear and convincing evidence that Pacific's prices could not be justified without regard to their exclusionary effect. *Id.* at 236 (the court seems to leave open the possibility that objective indicators of intent may be admissible if they are relevant to conduct).

102 881 F.2d 1396 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1326 (1990).

Acre, attempted to monopolize the egg processing market.[103] The trial judge granted Rose Acre's motion for judgment notwithstanding the verdict,[104] and the Seventh Circuit Court of Appeals affirmed.

Between 1978 and 1982, Rose Acre, a "vertically integrated egg producer and processor,"[105] more than doubled its sales.[106] Because total sales in the market grew at the modest rate of approximately 1% per year, one can infer that most of Rose Acre's growth resulted from business it lured away from competitors. Plaintiffs presented evidence of price, cost, and intent. Plaintiffs' expert testified that Rose Acre's price was below average total cost for the entire complaint period, and that during 1980 it was below average variable cost. Plaintiffs also produced direct evidence of intent, including a statement by Rose Acre's president to one of the plaintiffs: " 'We are going to run you out of the egg business. Your days are numbered.' "[107]

Judge Easterbrook, writing for the court, struggled with how to distinguish predation from hard competition. He started from the premise that the antitrust laws exist solely for the benefit of consumers.[108] If this is absolutely correct, then the distinction between predation and competition becomes very important; the law must not deter any price cuts that will not be successfully predatory, because *all* price cuts benefit consumers in the short run and are therefore prima facie lawful. The court identified three possible tools for detecting predatory pricing: cost, intent, and recoupment. The court concluded that cost-based tests have definite disadvantages: prices below cost often have competitive justifications, and the different types of costs are very difficult to measure, especially marginal cost

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103 The opinion never characterized the § 2 claim as either an attempt or a completed offense. However, since Rose Acre never acquired monopoly power it is fair to assume an attempt claim. *Id.* at 1399-1400.

104 A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 683 F. Supp. 680 (S.D. Ind. 1988), *aff'd*, 881 F.2d 1396 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1326 (1990). According to the district court, the plaintiffs did not demonstrate Rose Acre's long-run incremental cost, the market was competitive, the plaintiffs' revenues grew markedly during the complaint period, and several other firms entered the market and prospered. *Id.* at 687-91.

105 *Rose Acre*, 881 F.2d at 1397. Because the plaintiffs were all merely "processors," we may conclude Rose Acre was one of the first to vertically integrate backward into egg production. *Id.* at 1398. Furthermore, it appears that Rose Acre was the first firm to automate production. *Id.* at 1404.

106 *Id.* at 1398.

107 *Id.*

108 *Id.* at 1400. This goal is inconsistent with an allocative efficiency goal (the traditional Chicago School goal) when price is lower than both marginal cost and average total cost. The evidence in the case does not reveal whether Rose Acre's prices fell within this zone of conflict. Note also that this is clearly not a unanimously accepted view of the goals of the antitrust laws. *See infra* subpart III (A).

and variable cost. Moreover, the appropriate type of cost varies with both market structure and mode of production. The court eventually concluded that the best place to start when testing for predation is with the likelihood of successful recoupment: an unsuccessful predatory scheme should be lawful because consumers will be better off than if there had been no predation attempt at all.[109]

The court found intent to be useless in evaluating a predatory pricing claim. First, where recoupment is impossible, intent evidence is unnecessary. Furthermore, even where recoupment is possible, intent is of no use. Direct evidence is too vague, and thus presents a high risk of penalizing legitimate competition.[110] Direct evidence also increases the complexity and cost of litigation by encouraging scavenger hunts through reams of documents and introduction of many of them into evidence; the increased complexity confuses judge and jury, clouds the "real economic questions," and leads to inaccurate application of the antitrust laws.[111] Judge Easterbrook acknowledged the traditional use of intent in antitrust to "disambiguate . . . evidence."[112] However, because intent evidence is likely to be just as ambiguous and costly as conduct evidence, he concluded that the burden outweighs the benefit of even the traditional use of intent.[113] On a more basic level, Judge Easterbrook implied that there can be no predatory intent inconsistent with a competitive intent, and therefore any "smoking gun" memo is unfairly prejudicial to the defendant, not to mention irrelevant.[114] This definitional ambiguity apparently convinced the court to eliminate circumstantial evidence of intent as well.

In short, the First and Seventh Circuits eliminated the intent element for several ideological and practical reasons. The traditional use of direct intent evidence is misguided because direct evi-

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109 *But see* Zerbe & Cooper, *supra* note 99, at 665. Note also that consumers pay the economic dislocation costs if the predator drives himself out of business.

110 *Rose Acre*, 881 F.2d at 1402 ("a desire to extinguish one's rivals is entirely consistent with . . . competition").

111 *Id.*

112 *Id.*; *see also* Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).

113 *Rose Acre*, 881 F.2d at 1402.

114 *Id. But see* Indiana Grocery v. Super Valu Stores 864 F.2d 1409, 1413 (7th Cir. 1989) (court held there was a specific intent element to predatory pricing § 2 attempt violation); Chillicothe Sand & Gravel Co. v. Martin Marietta Corp. 615 F.2d 427, 432 (7th Cir. 1980) (court explicitly considered "other factors" besides cost). Both of these cases found no violation, so Judge Easterbrook is correct in characterizing their treatment of intent as dicta. *Rose Acre*, 881 F.2d at 1402. However, this dicta is clearly and unabashedly contrary to the *Rose Acre* holding. Applying these principles, the court found that Rose Acre, an expanding firm without market power, could never have recouped in an unconcentrated and stagnant market characterized by low entry barriers. Therefore, the granting of defendant's motion for judgment notwithstanding the verdict was affirmed. *Id.* at 1403-04.

dence is vague, unfairly prejudicial, burdensome, confusing, and likely to encourage many non-meritorious claims by overly litigious plaintiffs; the definition of predatory intent is too vague; the defendant's expectations may be implausible; and sophisticated defendants will avoid producing such evidence. Having established the evil of direct evidence, circumstantial evidence quickly falls for one of two reasons: either because the circumstantial evidence is already admissible as evidence of conduct, as the *Barry Wright* court implied, or because predatory intent is indistinguishable from competitive intent, as the *Rose Acre* court stated.[115]

The split among the circuit courts of appeals asks whether there is a role for intent to play in predatory pricing analysis under section 2. If there is, then how and when should intent be used? As this Note will show, the answer to the first question suggests the answer to the second. The first question, however, poses several threshold issues: What prices are predatory under section 2? Is intent useful in finding those prices? Do any considerations unique to the legal process prohibit an intent element?

III
Analysis

The goals of antitrust law support the utility of intent and they also reveal what types of pricing practices the antitrust laws proscribe. Once antitrust goals isolate those prices that are predatory, economic theory dictates that, in a world of perfect information, intent is a helpful and necessary tool in detecting some of those predatory prices. Finally, legal factors such as consistency, administrability, and truth-finding confirm the theoretical conclusion on the utility of intent. In sum, intent is necessary and beneficial to predation analysis in certain situations.

A. Goals of Antitrust

The goals of antitrust fall into three categories: political, wealth transfer, and allocative efficiency. Of these three, only the political goal directly supports an intent requirement. All three goals, however, indirectly further the intent debate by isolating certain pricing practices as violative of the Sherman Act, the detection of which is aided by considering the defendant's intent.

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115 Note that the *Barry Wright* opinion is both more vague and more flexible than *Rose Acre* as it seems to hold open the possibility of admissible circumstantial evidence as evidence of the conduct prong. In contrast, the *Rose Acre* opinion clearly bans all evidence of intent and considers price and cost data to be the only relevant evidence of conduct. Therefore, despite its literal harshness, the *Barry Wright* opinion would allow a much broader inquiry than the *Rose Acre* court.

1. *Political Goal*

The political goal contains two prongs, fairness and economic democracy. The fairness prong directly supports the utility of intent by focusing concern on the prey's well-being. The economic democracy prong indirectly supports intent by identifying a preferred market structure and disfavored pricing practices that cannot be successfully attacked without using intent.

The fairness prong derives from the legislative history of the Sherman Act, and has been noted by many commentators[116] and cited by the *McGahee* court.[117] At its core, the fairness prong seeks to preserve a "national morale,"[118] created by competition, through protection of small firms and entrants in their justifiable reliance on prior pricing practices of dominant firms.[119] The small competitor and entrepreneur must be encouraged and not excluded by unfair means.[120] The fairness concept focuses on price cuts that are malicious reactions to entrants and rivals. Only the dominant firm's intent can capture the reactive nature of a price cut.

Danger lurks, however, in overemphasizing the fairness prong. To be sure, one commentator has expressed the view that some extremely anticompetitive intents ought to be unlawful even when the accompanying conduct is not very anticompetitive.[121] The antitrust goals, however, tend toward a broader social policy. Clearly, the

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116 RICHARD HOFSTADTER, THE PARANOID STYLE IN AMERICAN POLITICS AND OTHER ESSAYS 199-200 (1965); William J. Baumol, *Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing*, 89 YALE L.J. 1 (1979); Brodley & Hay, *supra* note 11, at 786-88; Kenneth G. Elzinga, *The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?*, 125 U. PA. L. REV. 1191, 1191-94 (1977); Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284 (1977).

117 McGahee v. Northern Propane Gas Co., 858 F.2d 1487, 1497-98 (11th Cir. 1988), *cert. denied*, 490 U.S. 1024 (1989).

118 R. HOFSTADTER, *supra* note 116, at 200.

119 Brodley & Hay, *supra* note 11, at 776-78. Senator Sherman described the Sherman Act as a "bill of rights" and a "charter of liberty." 21 CONG. REC. 2461 (1890). Some have gone so far as to liken the Sherman Act to the Due Process Clause and assert that it was intended to protect local firms from absentee ownership. *See* Thurman Arnold, *The Economic Purpose of Antitrust Laws*, 26 MISS. L.J. 207 (1955). It seems to be understood that the Sherman Act does not protect inefficient rivals; however, efficiency is left undefined. *See* Harlan M. Blake & William K. Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377, 383-84 (1965).

120 More direct support for an intent element can be found in the inclusion of the attempt offense in section 2. This can be viewed as expressing the sentiment that trying to monopolize is illegal, even without the effect of monopoly. The evil here may not be an anticompetitive effect, but moral culpability. However, because case law requires a "dangerous probability of success," *see, e.g.*, *McGahee*, 858 F.2d at 1505, for an attempt claim to be made out, one goal of the attempt offense is additional deterrence. Still, in all other areas of the law of attempt, the requirement of intent serves as something of a substitute for the conduct or effect required in the completed offense.

121 L. SULLIVAN, *supra* note 28, at 111.

Sherman Act was not meant to be an intentional tort for rivals.[122] The common law of many states provides for business torts.[123] The antitrust laws provide private plaintiffs with standing to sue mainly in order to increase enforcement, not to compensate them as victims of tortious behavior.

The economic democracy prong stresses decentralization of economic power.[124] Some scholars have phrased the focus of this prong as the competitive process: preservation of rivals pushing one another to their least cost output.[125] Essentially, economic democracy seeks to protect a societal interest, rather than a rival's interest, in competition and against massive accumulations of economic power. In Senator Sherman's words, "[i]f we will not endure a king as a political power we should not endure a king over the production, transportation, and sale of any of the necessaries of life."[126] This theory finds support in the early case law.[127] Furthermore, the legislative history clearly expresses a fear of concentration and a desire for democracy and decentralization in the marketplace.

The main import of this prong, translated into modern economic terms, lies in its preference for an atomistic market structure with firms no larger than necessary to achieve the minimum efficient scale. This preference counsels against all pricing practices that may exclude efficient rivals or potentially efficient entrants.[128] In brief, the political goal directly supports the utility of intent via the fairness prong's characterization of antitrust as an intentional tort for rivals, and provides a preference for a decentralized market structure via the economic democracy prong. The wealth transfer and allocative efficiency goals also support similar structures, protect similar firms, and therefore proscribe similar pricing practices. Subpart III (B) will show that intent is necessary to detect these prices.

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122 Interview with Daniel Booker, head of Antitrust Litigation Group at Reed, Smith, Shaw & McClay in Pittsburgh (Oct. 8, 1989).

123 *See, e.g.*, Browning-Ferris Indus. v. Kelco Disposal, Inc., 492 U.S. 257 (1989) (Vermont tort for predatory pricing); Old Colony Donuts v. American Broadcasting Cos., 368 F. Supp. 785, 787 (D. Mass. 1974) (providing business tort for interference with contract under Massachusetts state law if "conducted with malice"). *See generally*, Note, *supra* note 2, at 622-28 (discussion of state law business torts).

124 R. Hofstadter, *supra* note 116, at 199-200; Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 Cornell L. Rev. 1140, 1153-54 (1981); *see also* Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 Mich. L. Rev. 213, 242 (1985) (societal interest in economic democracy ought to be a factor in the broader wealth transfer goal).

125 Blake & Jones, *supra* note 119, at 383-84; Fox, *supra* note 124, at 1154.

126 21 Cong. Rec. 2457 (1890), *quoted in McGahee*, 858 F.2d at 1498.

127 *See, e.g.*, Standard Oil Co. v. United States, 221 U.S. 1 (1911).

128 *See supra* subpart I (A) (such undesirable pricing practices include setting prices above average total cost in optimal capacity and limit pricing scenarios).

2. *Wealth Transfer Goal*

The wealth transfer view maintains that Congress primarily intended consumers to have a "rightful entitlement" to the consumer surplus triangle[129] that exists at the perfect competition price.[130] This theory has recently been stressed in reaction to both the curtailed enforcement of antitrust laws regarding mergers by the Reagan administration and the continuing rise of the Chicago School theories to prominence in the law. The wealth transfer goal also relates to monopolization, because a necessary prerequisite to the competitive price is the presence of enough firms in the market, operating at their least cost output, to clear the market.[131] The wealth transfer goal advocates decentralization and preservation of a certain number of smaller firms without sacrificing productive efficiency.[132]

By negative implication the wealth transfer school proscribes the elimination of firms that would tend to contribute to a competitive market. This class of firms includes equally efficient firms that appear to be less efficient because of a lag time associated with entry, and even some inefficient firms that would put downward pressure on the dominant firm's price.[133] As has been shown, prices above average total cost in optimal capacity and limit pricing scenarios can exclude such firms.[134] Subpart III (B) will show that these prices, proscribed by the wealth transfer theory, are undetectable

129 The consumer welfare triangle is the amount of money consumers would pay for goods, but do not have to. Graphically, it is the triangle under the demand curve whose base is the price line.

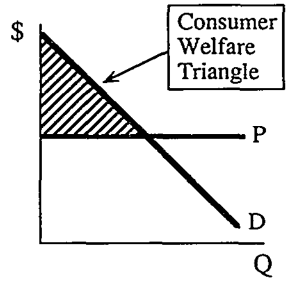

FIGURE 7

130 Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 70 (1982).

131 In other words, the goal contemplates enough firms operating at their lowest costs to satisfy the quantity demanded when the price equals the lowest cost.

132 Interestingly enough, the opinions in *Barry Wright* and *Rose Acre* appear to espouse a wealth transfer theory as well. Both opinions stress the goals of consumer welfare maximization and, in *Rose Acre*, lowest price or, in *Barry Wright*, competitive price.

133 Brodley & Hay, *supra* note 11, at 745, 790.

134 *See supra* text accompanying notes 9-11; *see also* Brodley & Hay, *supra* note 11, at 745 (price above both marginal and average total cost can exclude firm that would push price downward).

without intent. A similar analysis applies to the allocative efficiency school.

3. *Allocative Efficiency Goal*

The chief proponent of the wealth transfer theory maintains that there was no Congressional intent favoring allocative efficiency.[135] However, some commentators[136] assume, and Professor Bork has attempted to prove,[137] that in passing the Sherman Act Congress primarily intended to achieve an efficient allocation of resources, where the cost to society of producing a good equals the price society is willing to pay for it. Allocative efficiency refers to the socially optimal allocation of resources, and exists when the price of a good equals the social cost of producing the last unit (marginal cost). When allocative efficiency is achieved, the total welfare of society is maximized. Any variation from allocative efficiency produces a deadweight loss and calls for dedicating more or less resources to the production of the good.[138] If price exceeds marginal cost, then more resources should be dedicated to the production of the good; output will rise, price will drop, and marginal cost will rise.[139] In contrast, when price is lower than marginal cost, resources should be diverted from the production of the good; output will drop, price will rise, and marginal cost will drop.[140]

Allocative efficiency has dominated predatory pricing analysis as a goal of section 2, especially in academic commentary. Although none of the cases in the split explicitly espouses this theory, courts that use a variation of the Areeda-Turner test do so at least implicitly, since the Areeda-Turner test purports to further the goal of allocative efficiency. These courts include the Ninth Circuit (*Inglis* and *Transamerica*) and the Eleventh Circuit (*McGahee*).

While the economic democracy prong of the political goal and the wealth transfer goal seem to prefer more drastic price cuts (all the way down to the lowest point on the average total cost curve) than the allocative efficiency goal (only down to marginal cost, which exceeds the lowest point on the average total cost curve except in markets characterized by perfect competition or extreme ex-

135 Lande, *supra* note 130, at 83.

136 *See, e.g.*, Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1075 (1979) (efficiency is primary goal).

137 Robert Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966).

138 F. SCHERER, *supra* note 3, at 459-64.

139 This type of allocative inefficiency is associated with monopolies.

140 This type of allocative inefficiency occurs during the price cutting period of predatory pricing.

cess capacity),[141] these three goals actually coincide. Economic democracy and wealth transfer prefer a price equal to minimum average total cost only when the market is near perfect competition and that situation *is* allocatively efficient. Hence, economic democracy and wealth transfer are actually subsets of allocative efficiency. All three goals approve of the perfect competition price and output, but that combination can be reached only by a critical mass of small firms operating at their lowest cost points, not by a dominant firm cutting price to *decrease* the number of firms in the market.

How is one to know if a firm's price cut, especially one that keeps price above average total cost (as will often be the case in optimal capacity and limit pricing scenarios), constitutes predation or competition? To be sure, the distinction is difficult to draw in practice. As a general matter, the predator's output will increase, while the competitor's output will decline. Sometimes, however, a competitor's output will initially increase, making the competitor appear to be a predator. While the *Barry Wright* court did not even attempt it, the *Transamerica* court felt that intent might aid in drawing the line. Subparts III (B) & (C) of this Note will show that the *Transamerica* court triumphs in both theory and practice.

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Only the fairness prong of the political goal directly supports the utility of an intent requirement. On the other hand, careful analysis will reveal that an intent element fulfills the economic democracy prong of the political goal, the wealth transfer goal and the allocative efficiency goal.

B. Theoretical Tools for Detecting Predatory Pricing and the Vital Role of Intent

A court may employ any or all of three possible tools in a predatory pricing case: the relation between price and cost, the plausibility of recoupment, and predatory intent. This subpart will show that the inability of the price/cost relation and the recoupment test to isolate certain proscribed pricing practices necessitates consideration of intent evidence in predatory pricing cases.[142] The main difficulty with the price/cost relation is that courts tend to employ it as a bright-line test, while it works best when used as one factor in rule of reason analysis. As a test, recoupment fails—both in and of itself

141 One commentator has shown that even pricing that excludes only inefficient rivals can be allocatively inefficient. Scherer, *supra* note 6, at 883-89. *But see* Easterbrook, *supra* note 22, at 297-304.

142 The distinction between direct and circumstantial evidence of intent is irrelevant to subpart III (B) because this theoretical inquiry assumes perfect information with no evidentiary difficulties. We simply know whether intent exists.

and in conjunction with price/cost—because it is a negative indicator; it merely tends to show where predation does not occur. Intent is a positive indicator: where predation is possible, intent tends to show that it actually is present.

1. *Relation Between Price and Cost*

> The Areeda and Turner test is like the Venus de Milo: it is much admired and often discussed, but rarely embraced.[143]

Areeda and Turner, other commentators, and most circuit courts advocate a price/cost relationship test for predatory pricing.[144] The Areeda-Turner test deems a price below average variable cost as predatory, when output is in the range where marginal cost exceeds average total cost. At greater outputs, however, the test deems prices below average total cost as predatory. Areeda and Turner adopted allocative efficiency as their goal, which led to them select marginal cost as the trigger for predatory pricing. However, since marginal cost is very difficult to determine in litigation, Areeda and Turner advocated the use of average variable cost as a proxy. Areeda and Turner abandoned marginal cost as a trigger at outputs where it exceeds average total cost, because they believed that predatory pricing in such a form was very rare, and even more rarely anticompetitive.[145]

The Areeda-Turner test, by itself, has many problems from a theoretical standpoint.[146] First, average variable cost is not a good proxy for marginal cost; it starts above, then converges with, and finally falls below marginal cost.[147]

> [Areeda and Turner] argue that a marginal cost test will optimize

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143 McGahee v. Northern Propane Gas, 858 F.2d 1487, 1495 (11th Cir. 1988), *cert. denied*, 490 U.S. 1024 (1989).

144 *See supra* notes 49 & 50.

145 Areeda & Turner, *supra* note 11, at 704-09. Some say that average variable cost is a good test on its own (not as a proxy for marginal cost) because a rational firm will shut down in the short run if price is below average variable cost. When price is below average variable cost the firm cannot cover its fixed costs if it operates.

146 *See* Brodley & Hay, *supra* note 11, at 756 (the test ignores the "essence" of predation—a communication to deter firms from competing).

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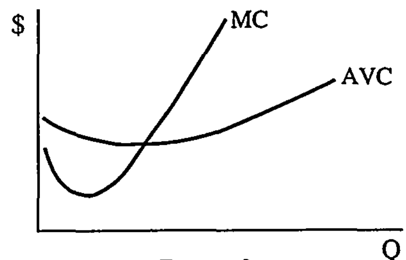

FIGURE 8

> social welfare. Then they admit that it will not. They argue that a marginal cost test is easier to apply then [sic] a long-run welfare maximizing test; then they suggest surrogates because marginal cost data is impossible to come by.[148]

The test focuses on allocative efficiency in the short run, but it is a matter of some doubt whether firms plan for the short run or the long run, and it is certainly better policy to maximize efficiency in the long run.[149] When one tries to find a price level that maximizes long run allocative efficiency, the analysis becomes much more complex. There will be cases where total welfare will be maximized by price above marginal cost, and there will also be cases where welfare will be maximized by a price below marginal cost.[150]

Areeda and Turner deliberately made their test underinclusive; they consciously designed the test not to catch all forms of predatory pricing. It successfully identifies most predatory pricing in an excess capacity situation,[151] where the test deems predatory prices below average variable cost. At these prices a nonpredatory explanation is very unlikely because it is irrational for a profit maximizer to operate at such prices. However, the test fails to identify predatory pricing in an optimal capacity or limit pricing scenario,[152] because at these output levels Areeda and Turner require a price below average total cost in order to find predation. It is possible, however, that a price above average total cost here will deter entry by efficient firms.[153]

Areeda and Turner did not mean to say that predatory pricing can not take place outside their test, rather they believed it a better

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148 *In re* IBM Peripheral EDP Devices Antitrust Litig., 481 F. Supp. 965, 994 (N.D. Cal. 1979), *aff'd sub nom.*, Transamerica Computer Co. v. IBM, 698 F.2d. 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983).

149 *See* Scherer, *supra* note 6, at 880, 885; *see also* Darius W. Gaskins, Jr., *Dynamic Limit Pricing: Optimal Pricing under Threat of Entry*, 3 J. ECON. THEORY 306 (1971).

150 Scherer, *supra* note 6, at 883-89.

151 *See supra* text accompanying notes 144-45.

152 *Compare* Brodley & Hay, *supra* note 11, at 750 (arguing that if a deep pocket is perceived, a predator with excess capacity may be able to deter an equally efficient rival without violating the test) *with* Pacific Eng'g & Prod. Co. v. Kerr-McGee Corp., 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977) (where court found no liability against defendant with excess capacity whose price exceeded average variable and marginal cost, but was below average total cost). *See also* In the Matter of E.I. duPont de Nemours, 96 F.T.C. 653 (1980) (no liability for limit pricing); William G. Shepherd, *Anatomy of a Monopoly (II): The Power to Control Prices*, 12 ANTITRUST L. & ECON. REV. 73 (1980).

153 *See supra* notes 13-16 and accompanying text. Areeda admits this. P. AREEDA & H. HOVENKAMP, *supra* note 6, at ¶ 714.1b. The Ninth Circuit also agrees. Transamerica Computer Co. v. IBM, 698 F.2d 1377, 1387-88 (9th Cir. 1983), *cert. denied*, 464 U.S. 955 (1983). *Compare* In the Matter of E.I. duPont de Nemours, 96 F.T.C. 653 (1980) (no liability for limit pricing) and California Computer Products v. IBM, 613 F.2d 727, 743 (9th Cir. 1979) (reserving possibility that limit pricing above average variable cost may be unlawful).

policy choice to let predatory pricing outside their test go unpunished because they felt it would be rare and not anticompetitive.[154] However, predatory pricing in these scenarios is much more likely to occur than is excess capacity predatory pricing. Excess capacity usually results from a recession in the market, when entry is already unlikely. Also, predatory pricing is much easier and more rational when no losses are incurred and the requisite increase in output is minimal. Finally, limit pricing is more rational if management's goal is increasing market share rather than maximizing profits.[155]

Areeda and Turner retorted that if entry does occur and price drops below average total cost, their test will catch it.[156] This retort fails because it requires a potential entrant to risk exclusion and enter the market to trigger the rule. In addition, it is not the monopolist, but the entrant, who causes the price to undercut average total cost. It is problematic to punish the monopolist for something it did not cause, and if we enforce the rule strictly, severe excess capacity could develop in the market. On the other hand, if we do not enforce the rule at all, then the regime will deter efficient potential entrants. Therefore, the law needs an additional element to distinguish predatory from competitive pricing in such cases—the element of intent.[157]

The *Barry Wright* court asserted that, in the optimal capacity and limit pricing scenarios where the test is triggered by average total cost, those potential entrants that may be lawfully excluded are only those that are less efficient than the monopolist. The assertion holds only if the efficient potential entrant can depend on the unlawfulness of price dipping below average total cost. The dangers of this rule have already been explored.[158] By contrast, if the efficient potential entrant can not count on this illegality (*i.e.*, believes the monopolist will maintain its output level), it may be deterred from entering because it will be stuck with the residual demand left by the monopolist which will usually be insufficient to support a new entrant.[159]

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154 Phillip Areeda & Donald Turner, *Scherer on Predatory Pricing: A Reply*, 89 HARV. L. REV. 891, 892 (1975); *see also In re* IBM Peripheral EDP Devices Antitrust Litig., 481 F. Supp. 965, 995 (N.D. Cal. 1979), *aff'd sub nom.*, Transamerica Computer Co. v. IBM, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983) ("Areeda and Turner have made a policy judgment. The economic analysis used to justify that judgment is incomplete, and the judgment itself stands contradicted by the economic, political, and social policies of the Sherman Act.").

155 *See* F. SCHERER, *supra* note 3, at 35 n.68 and sources cited therein.

156 Scherer, *supra* note 6, at 873 (recounting communication with Areeda and Turner).

157 *Id.* at 875.

158 *See supra* text accompanying note 127.

159 Scherer, *supra* note 6, at 872-75.

Predatory jurisprudence must consider the inefficient entrant who may become efficient, especially in light of the political goal of the Sherman Act. A lag time due to a learning curve or need for brand identity tempts one to label a potentially efficient entrant inefficient.[160] This lag time makes the entrants more vulnerable to predatory prices that do not violate the Areeda-Turner test. Therefore, intent can be useful in ferreting out this type of predatory pricing.

The *Barry Wright* and *Rose Acre* courts asserted that predation moves price in the right direction as far as the antitrust laws are concerned and, therefore, courts should be loathe to deter price cutting.[161] This of course begs the question: what constitutes the "right direction" as far as the antitrust laws are concerned? If we are referring to allocative efficiency, then price cuts toward marginal cost, but not below it, constitute the "right direction." As stated above, the Areeda-Turner test does not actually use marginal cost as the trigger; it uses average variable and average total cost, and neither is a good proxy. If wealth transfer is the goal, the right direction is toward the least cost point (the lowest point on the average total cost curve), to where a perfectly competitive market would lead firms. But to get to this point, a monopolist must allow entry by equally efficient firms; otherwise the monopolist can continue to reap supracompetitive profits. Entry, and therefore perfect competition, is more likely if the dominant firm charges higher, profit maximizing prices. So, while it is generally beneficial in the short run under any goal when the dominant firm lowers prices, it is indeed possible for the price to be too low in light of long run consequences.

In sum, "ease of application is a poor argument for adopting a rule that admittedly iguores important considerations of economic efficiency, especially when the main justification for that rule is economic efficiency."[162] In fact, there is no version of a price-cost test which could, on its own, fulfill any of the antitrust goals.

2. *Recoupment*

The *Rose Acre*[163] and *Matsushita*[164] cases point out that assessing

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160 Brodley & Hay, *supra* note 11, at 745 n.15, 789-90.

161 A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1400 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1326 (1990); Barry Wright v. ITT Grinnell Corp., 724 F.2d 227, 231 (1st Cir. 1983).

162 *In re* IBM Peripheral EDP Devices Antitrust Litig., Inc., 481 F. Supp. 965, 993 (N.D. Cal. 1979), *aff'd sub nom.*, Transamerica Computer Co. v. IBM, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983).

163 *Rose Acre*, 881 F.2d at 1401.

164 Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588-90 (1986).

the plausibility of recoupment can be quite helpful in the detection of predatory pricing.[165] To determine recoupment plausibility, one must look at the structure of the market and the defendant's capacity and market power. Substantial entry barriers, risky nature of the business, inelastic demand, specialized assets that are difficult to sell, practical requirement of entry through sequential submarkets, and a dominant, non-innovative firm all tend to render a market more susceptible to recoupment.[166]

However, there are problems with the plausibility of recoupment as a test by itself. First of all, recoupment analysis is a negative indicator. Recoupment analysis can identify whether predatory pricing can succeed, but the potential success of a predatory pricing scheme does not mean that the defendant actually engaged in predatory pricing. Therefore, recoupment is best used as a threshold test.[167]

Equally important, courts[168] and scholars[169] have reached no consensus on what conditions are necessary for recoupment. Because economists can not say with any certainty what conditions absolutely must be present to make recoupment a possibility, borderline cases will arise where other relevant factors must tip the balance.

In fact, the actors in the market may be the ones best situated to evaluate recoupment plausibility.[170] Because they operate daily in the market, they have seen firms come and go as well as thrive and dominate. They certainly are much more familiar than are judges and academicians with the factors that tend to make a market more prone to recoupment. This argument gains force when one considers that if courts do not admit the actor's belief about recoupment, the trier of fact must make the judgment on its own or with the guid-

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165 *See also* Inter City Oil Co. v. Murphy Oil Corp., 1976-1 Trade Cases ¶ 60,948 (D. Minn. 1976).

166 Joskow & Klevorick, *supra* note 19, at 223-34; *see* Brodley & Hay, *supra* note 11, at 742-43.

167 Joskow & Klevorick, *supra* note 19, at 242-58.

168 Note that *Rose Acre* gives only sparse guidance for subsequent cases. The court merely found (correctly I think) that on the facts of the case before it, recoupment was impossible. *Rose Acre*, 881 F.2d at 1403 (determinant factors were "persistent entry," "stagnant market," and an "unconcentrated" market structure).

169 *Compare* P. Areeda & H. Hovenkamp, *supra* note 6, ¶ 711.2a *with* Zerbe & Cooper, *supra* note 99, at 674-77. Each of these pieces supplies a slightly different list of conditions and method of weighing them.

170 *See In re* IBM Peripheral EDP Devices Antitrust Litig., 481 F. Supp. 965, 996 (N.D. Cal. 1979), *aff'd sub nom.*, Transamerica Computer Co. v. IBM, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983) ("The monopolist's own evaluation of the situation, whether it thought it was cutting losses or cutting throats, can help to clarify the nature of the acts under taken.").

ance of an expert witness who may be a novice to the particular market.

3. *Intent*

As the discussions of price/cost and recoupment illustrate, these indicators, without more, constitute an incomplete test for predatory pricing schemes. Beyond the very rare case where price is below average variable cost, the price/cost relation can show merely that predatory pricing is more or less likely, but not whether it is truly present. When recoupment analysis works well it reveals where predation cannot exist, but it is useless as a positive indicator. When these two tests can only say that predation is possible, and when they cannot conclusively pronounce impossibility, intent can help immensely in the final determination as a positive indicator.

The *Barry Wright* court asserted that intent cannot shed light on the likelihood of successful predation because the effect of pricing behavior depends on the reactions of the monopolist's competitors and not on the defendant's expectations.[171] But even the proponents of this view acknowledge that the reaction of competitors is merely one factor of many in markets with some measure of concentration.[172] Indeed, the traditional use of intent in antitrust is to disambiguate conduct.[173] That is, where conduct can be characterized either as lawful or unlawful, intent can help break the tie. As applied in a predatory pricing case, intent can help when recoupment is plausible and where the price/cost relation is consistent with both predation and hard competition: "The monopolist's own evaluation of the situation, whether it thought it was cutting losses or cutting throats, can help to clarify the nature of the acts under taken."[174]

Moreover, predatory pricing may be aimed at excluding not existing competitors but rather potential entrants; the monopolist can control the reactions of potential competitors with relative ease through preemptive entry deterrence.[175] In such a case, potential competitors' reactions are, for the most part, dictated by the dominant firm's intent. Logically, it is easier to deter a potential entrant, who has no sunk costs to lose, than an established rival who does have sunk costs it may lose by exiting. Furthermore, there are cer-

171 Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 232 (1st Cir. 1983) (citing Zerbe & Cooper, *supra* note 99, at 659-77).

172 Zerbe & Cooper, *supra* note 99, at 660-61.

173 Board of Trade v. United States, 246 U.S. 231, 238 (1918); MCI v. AT&T, 708 F.2d 1081, 1123 n.59 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983) (cited in A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1402 (7th Cir. 1989), *cert. denied*, 110 S.Ct. 1326 (1990).

174 *IBM Antitrust Litig.*, 481 F. Supp. at 996.

175 Limit pricing falls into this category.

tain scenarios where competitors' reactions may make little difference, or where the competitors have no choice but to exit or, in the case of a potential entrant, not to enter.[176] This may occur when the predator has a much larger scale plant or a brand name advantage. Therefore, the *Barry Wright* court erred in relying on the reactions of competitors to obfuscate the need for an intent element.

Moreover, even assuming the predator's expectations are incorrect, unsuccessful predation may have harmful effects. It can increase costs and decrease total welfare by taking from producer and consumer surplus.[177] In an extreme case, the unsuccessful predator may put himself out of business. This afflicts the market with economic dislocation costs that consumers will ultimately pay.

In brief, a test including price-cost and recoupment but not intent fails to detect some predatory pricing that the Sherman Act prohibits. As a theoretical matter, intent aids in filling the gaps left by the other two tools.

C. Legal Factors

In theory, intent is a necessary factor in the detection of some predatory pricing, but can it fit through the courtroom doors? The legal system possesses its own unique concerns relating to the use of intent. The most relevant concerns are consistency, administrability, and truth-finding.[178] Precedent and consistency in the law weigh heavily in favor of the intent element. Valid criticisms exist regarding the administrability mostly of direct evidence of intent,[179] but countervailing reasons undercut the use of price/cost and recoupment as substitutes, making it unclear under an administrability rubric whether the law should use all or none of the tools. Likewise, criticisms have arisen with regard to the truth-finding value of direct evidence of intent, but countervailing factors counsel for its use.

1. *Consistency*

Predatory pricing is proscribed not only by the Sherman Act, but also by the Robinson-Patman Act.[180] The Supreme Court in

176 Scherer, *supra* note 6, at 882-83.

177 Zerbe & Cooper, *supra* note 99, at 665.

178 Subpart III (B) assumed perfect information, but the legal system does not conform to that assumption. Evidence of intent may be hard to find and difficult to interpret.

179 Much of the criticism also goes to the derogatory memo type of circumstantial evidence.

180 The Robinson-Patman Act provides that "[i]t shall be unlawful . . . to discriminate in price . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly." 15 U.S.C. § 13 (1988).

Utah Pie Co. v. Continental Baking Co.[181] held intent relevant to predatory pricing under the Robinson-Patman Act. Scholars and lower courts have almost uniformly criticized the *Utah Pie* opinion, but it is still the law under the Robinson-Patman Act.[182] To have a single fact situation analyzed in two different ways under the antitrust laws makes no sense. The *McGahee, Inglis,* and *Rose Acre* courts recognized this problem. *McGahee* and *Inglis* reconciled the two approaches by analyzing the Robinson-Patman Act claims with the use of intent evidence. The *Rose Acre* court, however, distinguished *Utah Pie* on its facts.[183] Since *Utah Pie* remains viable, consistency favors an intent element.

Furthermore, the policy of stare decisis within the Sherman Act weighs heavily in favor of intent. Intent has always been an element of section 2 attempt claims. Until 1981, it had always been an element of predatory pricing claims.[184]

> Courts have been unwilling to drop intent as a standard entirely, perhaps because of an understandable reluctance to never say never when the universe is unpredictable, perhaps in deference to the past, or perhaps in recognition that commercial megalomania, even without market power, is, still, without redeeming virtue.[185]

By effectively reading the intent element out of section 2 predatory pricing claims, the First and Seventh Circuits have added to the confusion in predatory pricing jurisprudence. Parties have a right to expect clear and consistent guidance from the courts. By breaking the rule that "[i]nferior federal courts, in order to provide equal justice under law, must apply the holdings of cases still on the books," the First and Seventh Circuits have violated the parties' right to guidance.[186]

2. *Administrability*

> Section 2 of the Sherman Act makes no exceptions for cases involving administrative difficulty.[187]

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181 386 U.S. 685 (1967) (predatory pricing may be used to prove lessened competition required under the Robinson-Patman Act).

182 A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1404 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1326 (1990) ("*Utah Pie* employed the Robinson-Patman Act to condemn the process by which competition creeps into oligopolistic markets and undercuts excessive prices.").

183 *Id.* at 1406-08 (no price discrimination).

184 *See supra* note 49 and cases cited therein.

185 Jays Foods v. Frito-Lay, 656 F. Supp. 843, 845 (N.D. Ill. 1987), *aff'd*, 860 F.2d 1082 (7th Cir. 1988), *cert. denied*, 489 U.S. 1014 (1989).

186 *Rose Acre*, 881 F.2d at 1405 (referring to *Utah Pie*).

187 Chillicothe Sand & Gravel Co. v. Martin Marietta Corp., 615 F.2d 427, 432 (7th Cir. 1980).

Critics of intent fear for judicial efficiency,[188] and indeed when intent is an element one would expect that fewer cases would terminate via summary judgment for the defendant because intent is a question of fact. However, ease of summary judgment is a poor reason to exclude evidence that is administrable and helps the trier of fact. Furthermore, an intent element may actually conserve judicial resources: fewer litigants will appeal and still fewer will obtain reversals because of the difficulty in reversing a decision on a question of fact, like intent.[189] Indeed, the greatest need for preservation of federal judicial resources is at the circuit court of appeals level.[190]

The *Barry Wright* and *Rose Acre* courts criticized the intent element as encouraging a very costly scavenger hunt for the "smoking gun" memo that quite often does not exist. Meanwhile, the discovery burden results in wasted resources by both parties and the trial judge, and overburdening the trier of fact with a huge number of documents. There are two partial cures for this criticism and three retorts. First, to ease the discovery burden, courts may bifurcate discovery by requiring some threshold showing of price/cost and recoupment evidence before ordering discovery for intent evidence. Second, to avoid overburdening the trier of fact, courts may exercise the balance prescribed in Federal Rule of Evidence 403 to exclude intent evidence if its "probative value is substantially outweighed by . . . considerations of undue delay, waste of time, or needless presentation of cumulative evidence." Moreover, intent need not be proven by statements; conduct such as surveillance and sham litigation can justify an inference of intent. In addition, the burdens regarding discovery and the trier of fact caused by the intent requirement are not huge in proportion to the same concerns as they relate to price/cost and recoupment. The price/cost and recoupment factors also mandate huge and costly discovery, including payments to expert witnesses, a cost not associated with intent.[191] Finally, proof of intent adds complexity to all causes of

188 *See* Poller v. Columbia Broadcasting Sys., 368 U.S. 464, 473 (1962) (summary judgment "should be used sparingly in complex antitrust litigation where motive and intent play leading roles.").

189 *See* Brodley & Hay, *supra* note 11, at 779.

190 Richard A. Posner, The Federal Courts: Crisis and Reform 62-65 (1985); Louis H. Pollak, *Amici Curae* (Book Review), 56 U. Chi. L. Rev. 811, 822-26 (1989).

191 Another criticism from *Barry Wright* of the intent requirement as it is now employed is that it is useless and confusing where intent is automatically inferred when price is below average variable cost. Yet this is simply an application of the circumstantial method of proof of intent by conduct. Juries are often charged with evaluating intent by circumstantial evidence in other areas of the substantive law; it is unclear why this method of proof suddenly must overwhelm an antitrust jury. Simply dispensing with the intent element when price is below average variable cost easily overcomes this criticism.

action with a scientific element, and critics have failed to justify special treatment for section 2 predatory pricing.

Much of the administrability-oriented criticism of intent also comes from satisfaction with the recoupment and price-cost tests.[192] However, these tests have administrability problems themselves. Four aspects of the price/cost test present difficulties in a litigation setting: (1) average variable cost bears little resemblance to marginal cost;[193] (2) there is no agreement as to which costs constitute variable costs;[194] (3) it is "a very difficult task" to determine if the appropriate test is average variable or total cost;[195] and (4) costs are calculated by accounting measures which may not coincide with economic theory (in particular the concept of opportunity cost). The recoupment plausibility test will be quite helpful in cases where there is an economic consensus that the conditions make recoupment impossible. However, there will be close cases and cases where recoupment is clearly possible. Where the question is close, a judge or jury should not decide the question on recoupment alone, because not even economists can agree on the necessary conditions for recoupment. The court in *Rose Acre* gave minimal guidance, and the average district court judge probably cannot shoot from the hip with anything approaching Judge Easterbrook's accuracy, although they surely can be as deadly. Wisdom counsels us not to "set sail on a sea of doubt" by allowing trial judges to tinker with close questions of recoupment.[196] When both the recoupment factor and the price-cost relation are ambiguous, other relevant evidence ought to come in to break the tie.

3. *Truth-Finding*

Critics fear that it is impossible to isolate whose intent is relevant, that sophisticated defendants will escape liability by avoiding the distribution of incriminating memoranda, and that intent evidence is too ambiguous to help the trier of fact. These factors lead critics to believe that incorrect results and undesirable incentives will result from the use of intent. These criticisms carry little weight in and of themselves. Furthermore, truth-finding difficulties associ-

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192 McGahee v. Northern Propane Gas Co., 658 F. Supp. 189, 195 n.9 (N.D. Ga. 1987), *rev'd*, 858 F.2d 1487 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989) (intent is "less likely to yield an efficient economy . . . . [It] might be justified if predatory pricing were a serious problem, but . . . it is not.").

193 Brodley & Hay, *supra* note 11, at 751-55.

194 *See* U.S. Philips Corp. v. Windmere Corp. 861 F.2d 695 (Fed. Cir. 1988), *cert. denied*, 490 U.S. 1068 (1989); Areeda & Turner, *supra* note 19, at 701-02.

195 Brodley & Hay, *supra* note 11, at 756 n.52 and accompanying text.

196 United States v. Addyston Pipe & Steel Co., 85 F. 271, 284 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899) (rejecting reasonableness standard for naked price fixing agreements).

ated with price-cost and recoupment reveal that if intent goes, so must price-cost and recoupment.

If the law makes intent an element, the more sophisticated predators may engage in strategic behavior and avoid creating any memoranda reflecting a predatory intent, arguably leaving plaintiffs without redress against all but the sloppiest of predators.[197] While this is a plausible scenario, upper level management may expose themselves by monitoring and admonishing regional sales managers with control over price about harmful memoranda. Plaintiffs may use evidence of such activity circumstantially to infer intent. In addition, evidence of other conduct can justify an inference of intent.

The *Rose Acre* court criticized the use of intent to disambiguate conduct because direct evidence of intent may be as ambiguous as the conduct it is supposed to clarify.[198] Ambiguity of direct evidence of intent arises wherever intent is an element of a case. Where the danger of confusion outweighs the probative value of the evidence it can be excluded under Federal Rule Evidence 403, but there is no reason to forgo Rule 403 analysis for an across-the-board prohibition of intent evidence.[199] In a similar vein, the *Rose Acre* and *Barry Wright* courts also expressed fear that direct evidence improperly influences juries.[200] First of all, the Rule 403 balance takes prejudice into account. Moreover, the defendant may employ other types of evidence such as recoupment plausibility and expert testimony on the exclusionary effect of the pricing behavior to rebut intent evidence. Finally, the defendant and the judge may emphasize to the jury that there is a fine line between a predatory and a competitive intent.

The *Barry Wright*[201] and *Rose Acre*[202] courts also asserted that the intent element supplies incentives to defendants that are undesirable from a policy standpoint, such as not to cut prices and to collude on price. This criticism overlooks that section 1 of the Sherman Act[203] and section 5 of the FTC Act[204] prohibit collusion. With

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197 R. POSNER, *supra* note 30, at 189.

198 A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396, 1401 (7th Cir. 1989); *see* R. POSNER, *supra* note 30, at 190; In the Matter of General Foods, 103 F.T.C. 204, 342 (1984).

199 *See, e.g.*, Thurman Indus., Inc. v. Pay 'N Pak Stores, 875 F.2d 1369 (9th Cir. 1989).

200 *Rose Acre*, 881 F.2d at 1402; Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 235 (1st Cir. 1983). The derogatory memo type of circumstantial evidence is also subject to this criticism.

201 *Barry Wright*, 724 F.2d at 231-32.

202 *Rose Acre*, 881 F.2d at 1402.

203 15 U.S.C. § 1 (1988) ("Every . . . conspiracy . . . in restraint of trade . . . is declared to be illegal.").

204 15 U.S.C. § 45 (a)(1) (1988) ("Unfair methods of competition . . . are declared unlawful . . . .").

limiting instructions to the jury requiring a high burden of proof on intent, such as those advocated in *Transamerica*, legitimate price cutting is unlikely to be deterred. Indeed, incentives with an intent element are likely to be clearer, because defendants can control their intent, whereas the vagaries of determining costs are beyond their control.

The *Barry Wright* court also feared that making intent an element of predatory pricing would bring a tidal wave of plaintiffs with frivolous suits.[205] Because all circuits except the First and the Seventh currently have an intent requirement, the number of plaintiffs is unlikely to increase unless the whole test for predatory pricing becomes intent.[206] The particular court advocating this critique favors preservation of the Areeda-Turner test alone, and rejects the *Inglis-Transamerica* view that some overwhelming intent evidence might provide a meritorious case when price exceeds average total cost.[207] The criticism is valid in the context presented; however, add the safeguard of a recoupment threshold, and the danger of overly litigious plaintiffs may significantly decrease. In addition, this criticism too quickly assumes that wrong results will flow from intent evidence. Moreover, intent is not a one-sided factor; it can work for the defendant if he can rebut it with his own evidence or impeach it by showing the ambiguous nature of the evidence. In fact, most courts allow a defendant to justify his behavior with intent-like evidence,[208] such as proof that the price was promotional.

Indeed, the Areeda-Turner test gives defendants the best of both worlds, because, as many theorists have shown and Areeda and Turner have conceded, the test is underinclusive. The test makes it easy for the defendant to dispose of the case at the summary judgment stage because it is an objective bright-line rule. One recent survey has demonstrated the overwhelming success rate of defendants in predatory pricing cases.[209] This may imply that plaintiffs are losing cases that they should win. However, considerable controversy surrounds the issue of whether the success rate of litigated cases truly reflects the success rate of all cases, and therefore

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205 *Barry Wright*, 724 F.2d at 233-36.

206 A recent study shows that predatory pricing is the main claim in only 3.1% of filed antitrust cases. PRIVATE ANTITRUST LITIGATION: NEW EVIDENCE, NEW LEARNING 6 (Lawrence J. White ed. 1988) [hereinafter PRIVATE ANTITRUST LITIGATION].

207 *Barry Wright*, 724 F.2d at 233-36.

208 *E.g.*, *id.* at 232; Hanson v. Shell Oil, 541 F.2d 1352, 1358 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977).

209 PRIVATE ANTITRUST LITIGATION, *supra* note 206, at 42 (Table 1.17). Using a broad definition of plaintiff success (including settled cases), predatory pricing plaintiffs are the second-least successful of all antitrust plaintiffs with a success rate of 23.1%. *Id.* Using a narrow definition (excluding settlements) predatory pricing plaintiffs are the least successful group of antitrust plaintiffs with a rate of 7.3%. *Id.*

whether the system is succeeding in getting to the truth.[210] As a matter of common sense though, the overwhelming litigation success of defendants must have an effect on the success rate in settlements.[211]

Lastly, considerable danger lurks in incorporating a theory in flux into law.[212] Yet that is exactly the state of predatory pricing law at this time. Most courts follow some version of the Areeda-Turner test, yet that test has incurred a wealth of deserved criticism.[213] In addition to the criticisms already noted, the Areeda-Turner test ignores the economic concept of opportunity cost, by measuring cost through accounting practices which can not measure opportunity cost. The economic theory of allocative efficiency contemplates that opportunity cost be included in marginal cost.[214] Moreover, although a growing minority of courts consider recoupment, the commentary and cases about plausible recoupment do not draw a bright line; all they can do is suggest factors. While these theories may aid in determining the outcome of a case, unless the economics community can agree that the fact situation in a certain case cannot have an anticompetitive effect, the parties ought to be allowed to bring in more relevant evidence, such as intent, with which the courts have considerable experience.

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Altogether, the goals of antitrust law, in addition to expressing a direct preference for the intent element, target pricing practices that theoretically cannot be detected without inquiring into intent. Consistency within the antitrust laws lends strong support to the use of the intent element, while the administrability and truth-finding factors reveal that if the intent element is unworkable, the price-cost and recoupment elements may also be. At this stage of predatory

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210 Theodore Eisenberg & Stewart J. Schwab, *What Shapes Perceptions of the Federal Court System?*, 56 U. CHI. L. REV. 501, 503 (1989) ("published opinions are a skewed subset of filed cases") (citing George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984)). The Priest & Klein article also notes that cases that result in final judgment may be a skewed subset of those filed. Priest & Klein, *supra*, at 6. Moreover, it is extremely difficult to assess success rates in settled cases. Theodore Eisenberg & Stewart Schwab, *The Reality Of Constitutional Tort Litigation*, 72 CORNELL L. REV. 641, 683-84 (1987).

211 *See also* Brodley & Hay, *supra* note 11, at 793 (circuit courts' adaptation of Areeda-Turner test has shifted litigation advantage "drastically in favor of the defendants").

212 *Id.* at 741, 793-94.

213 *See supra* text accompanying notes 143-62.

214 EDGAR K. BROWNING & JACQUELENE M. BROWNING, MICROECONOMIC THEORY AND APPLICATIONS 185-86 (1983). *But see In re* IBM Peripheral EDP Devices Antitrust Litig., 459 F. Supp. 626, 631 (N.D. Cal. 1978), *aff'd sub nom.*, Transamerica Computer Co. v. IBM, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983).

pricing jurisprudence, discretion and prudence dictate the retention of the intent element.

IV
Proposal

Courts should continue to employ recoupment as a threshold test in predatory pricing cases under section 2. When the characteristics of the relevant market clearly reject recoupment as a possibility, the court need not look further. When the court cannot rule out the possibility of recoupment, the court should inquire into the price/cost relation. A price below average variable cost should remain presumptively predatory. However, when recoupment is a possibility and price/cost evidence does not clearly reveal predation, the inquiry must be widened. Courts should use all of the available evidence, including intent, to determine if a violation has occurred. In order to more clearly illustrate this conclusion, an application to a recent circuit case is appropriate.

V
Application

In *U.S. Philips Corp. v. Windmere Corp.*,[215] the plaintiff, Windmere, alleged that the defendant, Philips, had illegally maintained its monopoly position in the rotary shaver market through predatory pricing. Recoupment was clearly possible. Philips had almost total control of the market with a 90% market share. In fact, until Windmere's entry, Philips's brand was the only one in the market. Clearly, Philips had the capacity to supply the full market demand. Furthermore, the court found "that a recognized brand name was critical to successful entry into the electric shaver market."[216] The brand name requirement constitutes a barrier to entry, one of the factors necessary for recoupment. The price/cost data were inconclusive.[217] While Philips clearly lowered its prices and

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215 861 F.2d 695 (Fed. Cir. 1988), *cert. denied*, 490 U.S. 1068 (1989) (the court of appeals reversed the directed verdict for the defendant and remanded).

216 *Id.* at 697.

217 *Id.* at 700, 704-05. A caveat is appropriate here. In response to Windmere's entry, Philips dumped older models into the market at prices far below their expected retail price. This complicates the analysis because the expected retail price relied upon by the court was set four years prior to Windmere's entry. If these shavers could not fetch the same price at the time of Windmere's entry (because of technological advances, for example) and Philips's plans were to let them sit or dump them into foreign markets at give-away prices anyway, then an element of predation, namely the sacrifice of short run profits, is not present. However, because there is no evidence of this, this application will assume that Philips did sacrifice short run profits. In fact, it is plausible that Philips had held on to these shavers for four years in order to have a weapon against potential entrants.

increased output in response to Windmere's entry, the litigation failed to show the exact price/cost relation because neither party could conclusively prove which of Philips's costs were variable. In Windmere's opinion, price was below average variable costs, while Philips contended price exceeded average total cost.[218]

Finally, there was evidence pertaining to Philips's predatory intent. Memos stated an intention to " 'kill this stone dead by introducing old models at very low prices' " and an exhortation to " 'pound them into the sand.' "[219] Circumstantial evidence included a memorandum suggesting that " 'legal measures' . . . should make life difficult for Ronson [Windmere's brand] on every front where it is at all possible[,]"[220] Philips's purchase of the Schick brand name after it learned about Windmere's negotiations with Schick, and Philips's prompt discontinuance of its older models when Windmere exited the market.[221]

Ignoring intent, the evidence clearly fails to prove predatory pricing. Recoupment was a possibility, but the parties' price/cost evidence was hopelessly contradictory; the price could have been below average variable cost or above average total cost. All that can really be said with certainty is that soon after Windmere's entry, Philips introduced a large number of older models at reduced prices. Philips could justify its dumping as clearing out its old stock to save on inventory costs. The evidence, however, supports an optimal capacity or limit pricing scenario where prices above average total cost can be predatory.[222] Aside from intent, the evidence raises suspicion, but certainly does not prove a violation.

Add the intent evidence, however, and only predation can explain Philips's conduct. The evidence clearly showed Philips's intent to eliminate Windmere by various means including lowering prices and, presumably, sacrificing profits. This bore no resemblance to the sympathetic case of one firm surviving in a shrinking market with excess capacity. As the court stated,

> [e]vidence that a firm holding 90 percent of a market that has substantial entry barriers drastically slashes its prices in response to the competition of a new entrant, for the purpose and with

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218 *Id.* at 700. This is a prime example of the practical problems of the Areeda-Turner test. The parties disputed which costs were variable and they argued over how to allocate advertising costs reimbursed by Philips's parent corporation.

219 *Id.* at 703.

220 *Id.* at 699.

221 *Id.* at 703.

222 Because Philips had controlled the entire market until recently, it is fair to assume that it had been able to conceptualize and build the optimal scale firm. Furthermore, any attorney worth his salt would have raised excess capacity if there was a colorable argument to be made.

> the effect of eliminating that entrant, is sufficient to show monopolization.[223]

Market demand could have accommodated Windmere, but Philips shut Windmere down before it could surmount the brand name barrier to entry.

CONCLUSION

Courts should continue to move toward imposing a threshold test of recoupment plausibility. Further, although courts should continue to use price/cost evidence to evaluate predatory pricing, they should discontinue its use as a bright line test, except where price is below average variable cost. However, when price/cost and recoupment yield no conclusion, the law should inquire further into all three factors—price/cost, recoupment plausibility, and intent—to correctly characterize the defendant's conduct.

Steven R. Beck†

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223 *Windmere*, 861 F.2d at 704.

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