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## Judicial Analysis of Predation: The Emerging Trends

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# Judicial Analysis of Predation: The Emerging Trends

*James D. Hurwitz\* and William E. Kovacic\*\**

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## I. INTRODUCTION

The perception that dominant enterprises sometimes use predatory tactics—most notably below-cost pricing—to achieve and extend monopoly power is a fixture in the lore of antitrust law. Professor Sullivan, for example, has observed that in the late nineteenth century “the predatory monopolist became a figure in the national demonology.”<sup>1</sup> Congress passed the antitrust laws partly in response to the fear that the gigantic trusts, if unchecked, would abuse their dominance and develop and exploit monopoly power.<sup>2</sup>

1. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 109 (1977). See also Cassady & Brown, *Exclusionary Tactics in American Business Competition: An Historical Analysis*, 8 U.C.L.A. L. REV. 88 (1961).

2. In the debates on the then proposed Federal Trade Commission Act, ch. 311, § 1, 38 Stat. 717 (1914) (current version at 15 U.S.C. §§ 41-58 (1976 & Supp. III 1979)), Senator Reed illustrated his arguments favoring the legislation with a predatory pricing hypothetical:

Another practice calculated not to benefit the purchaser, but to destroy competition is well illustrated in certain practices attributed to the Standard Oil Co. It has been charged that the company goes into a trade territory which is occupied by a rival, drops the price of its products below their actual cost, and thus crushes and destroys the competitor, meantime selling in other communities at a higher price and gaining profits there, and out of those profits gained in other places sustaining itself, while it is selling goods at a loss in the community where their rival is located. When he is crushed it

If the volume of current predation cases and theoretical analyses provides any indication, the perception of predation is not a relic of legal history.

Despite this long-standing concern with predatory practices, a substantial divergence exists between the theoretical literature analyzing predation—especially the recent economic literature—and the actual attempts of courts to identify and redress this conduct. This is hardly surprising. A consensus has yet to emerge within either the legal or economic communities about what in theory or in law should constitute predation. While recent judicial analyses are becoming increasingly rooted in economic theory,<sup>3</sup> courts nonetheless must temper theoretical economic concerns with evidentiary, procedural, and jurisprudential considerations. Indeed, one reasonably may question how well even a broadly accepted economic definition of predation can be applied in the typical courtroom environment of incomplete facts, disputed interpretations, unsettled theories, and limited economic expertise.

Notwithstanding these difficulties, courts still must somehow address the allegations of unlawful predatory conduct with which they are presented. This Article examines the recent judicial experience in this endeavor. The purposes of the Article are twofold. The first is to describe the current state of the law regarding predation and to discern significant trends that may be developing. The second purpose is to explore the considerations that courts must weigh in evaluating the legal utility of proposed rules that may be valid as a matter of economic theory. Toward these ends, part II of the Article examines the economic and legal context in which litigants present predation claims. Specifically, this part reviews some of the academic debates that have so greatly influenced recent courtroom developments, the statutory framework within which these developments have occurred, and the legacy of *Utah*

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puts up the price. Now, that could be condemned under the provision I have drawn. 51 CONG. REC. 13231 (1914). See also Dialogue between Representatives Cooper and Stevens, 51 CONG. REC. 14936-37 (1914).

In the same year that Congress passed the Federal Trade Commission Act, 1914, it also passed the Clayton Act. Section 2 of the Clayton Act prohibits predatory geographic price discrimination. Clayton Act, ch. 323, § 2, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 13 (1976)). Congress subsequently amended and broadened this provision by enacting the Robinson-Patman Act, ch. 592, § 1, 49 Stat. 1526 (1936) (codified at 15 U.S.C. §§ 13-13b, 21a (1976)).

3. See, e.g., *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981); *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), cert. denied, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

*Pie Co. v. Continental Baking Co.*,<sup>4</sup> which is the Supreme Court's most recent predation decision. Part III then explores the standards that courts are applying in the three principal predation contexts—pricing, innovation, and promotion.<sup>5</sup>

Finally, part IV examines certain patterns of judicial analysis that are apparent in fifty-seven cases decided during and after 1975, the year in which Professors Areeda and Turner published their seminal article on predatory pricing.<sup>6</sup> These patterns are important and predictive, for they reflect the courts' views about both the frequency and competitive dangers of predation and the administrative costs of attempting to control it. This examination also includes a table summarizing the outcomes of these cases—who won, in which types of cases, at what procedural stage—and a discussion of some economic and administrative considerations underlying those outcomes.<sup>7</sup> Overall, the analysis in this Article reveals both the legal trends in one specific area of antitrust law—predation—and, more broadly, the methods by which scholarly and judicial analyses can build upon one another to promote more rapid development of an evolving field of legal inquiry.

## II. ECONOMIC AND LEGAL CONTEXT

### A. *The Battle of the Antitrust Titans*<sup>8</sup>

The traditional concept of predation was first and foremost a legal notion based primarily on analysis of the dominant firm's in-

4. 386 U.S. 685 (1967).

5. The best known and most frequently discussed form of predatory conduct, predatory pricing, refers to the use of below-cost sales to drive rivals from the market or limit their competitive initiatives. Although matters of periodic concern, predatory innovation and promotion represent less clearly established categories of business behavior. For the purposes of this Article, predatory innovation describes a firm's purposeful manipulation of product design or other use of its research and development resources to prevent existing or potential rivals from challenging its market position. Predatory promotion encompasses the use of advertising or other promotional devices to eliminate or constrain competitors.

6. Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

7. This survey includes only those cases in which pricing, innovation, or promotion were central elements of the plaintiff's predation claims, and in which the court expressly addressed the substantive propriety of the defendant's conduct. A list of the cases surveyed is contained in Appendix A. See also notes 292-329 *infra* and accompanying text. For an explanation of how the cases were selected, see note 294 *supra*. The statistics upon which this Article relies refer to the status of the investigated cases as of October 2, 1981.

8. In discussing recent academic literature on predatory pricing Judge Tuttle observed that the "classic battle among the titans of the antitrust world rages still." *Malcolm v. Marathon Oil Co.*, 642 F.2d 845, 854 n.17 (5th Cir.), *cert. denied*, 50 U.S.L.W. 3486 (U.S. Dec. 14, 1981) (No. 81-874).

tent and on the competitive effect of its conduct.<sup>9</sup> Although intent and effect are still legally relevant—indeed critical—to an evaluation of alleged instances of predation, antitrust scholars and industrial organization economists have virtually reformulated the concept. They have argued for a more economically informed view of what should constitute an unlawful purpose and an undesirable result. These theoretical works now deeply affect the way in which courts analyze allegations of predatory conduct.<sup>10</sup> This section, therefore, provides an overview of the scholarly debate to lay a foundation for reviewing and understanding the recent trends in the courts.

Before examining the various arguments in this debate, however, one important point of agreement should be emphasized: The general dynamic of predation itself. Professor Sullivan articulated this common theme as follows:

By contrast [with competitive conduct], the predator seeks not to win the field by greater efficiency, better services, or lower prices reflective of cost savings or modest profits. The predatory firm tries to inhibit others in ways independent of the predator's own ability to perform effectively in the market. Its price reduction or predatory expenditure is calculated to impose losses on other firms, not to garner gains for itself; indeed, the predation is likely to involve present losses to the predator, or at all events to foreclose profits which could currently be earned, detriments which are accepted by the predator as the cost of freeing itself for the future from the competition it now faces.<sup>11</sup>

With this observation—emphasizing the trade-off of short-term losses for greater long-term gains—industrial organization economists and other students of business behavior can examine a course of conduct to determine whether the intent to make such a trade-off, and the likelihood of success, exist.<sup>12</sup> The proper focus, however, is not merely on the trade-off of short-term profits for long-term gains; all major investment programs and research and development activities have this characteristic. Nor is the proper focus simply on the desire to be free of effective competition, since

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9. See Cassady & Brown, *supra* note 1, at 88. See generally *United States v. American Tobacco Co.*, 221 U.S. 106 (1911); *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

10. See note 3 *supra* and accompanying text.

11. L. SULLIVAN, *supra* note 1, at 111 (footnotes omitted). Sullivan observed that predation generally displays two characteristics: It will not appear as "honestly industrial" business conduct to the informed observer, and it will have a specific rival or potential competitor as a target. *Id.* at 111-12.

12. This approach assumes that businesses can predict as well as anyone else the probable consequences of their actions. It also assumes that an intent to make lawfully the maximum possible amount of profits normally guides business conduct.

all business managers seek to fulfill their fiduciary obligations to their shareholders by striving to outperform competitors, occupy their markets, and enjoy monopoly profits. The problem arises when these two factors are causally linked. While shrewd, long-term investment at the expense of short-term gains ultimately may lead to the outperformance and eventual demise of competitors, it is predatory only when its sole economic justification depends on that result. Thus, Professor Bork has defined predation as a "firm's deliberate aggression against one or more rivals through the employment of business practices that would not be considered profit maximizing" except for two expectations:<sup>13</sup> Either the conduct will drive competitors from the market, which would give the predator a sufficient market share to command monopoly profits, or the competitors will, through fear or a renewed spirit of cooperation, "abandon competitive behavior the predator finds inconvenient or threatening."<sup>14</sup>

Although Professors Joskow and Klevorick arrive at policy conclusions that differ markedly from Professor Bork's,<sup>15</sup> they view the dynamic of predation in much the same way. These authors conclude that predatory conduct entails a short-term price reduction which is designed either to drive rivals out of the market or to

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13. R. BORK, *THE ANTITRUST PARADOX* 144 (1978).

14. *Id.*

15. See note 60 *infra* and accompanying text. Although commentators seldom like to be classified into schools, in current antitrust parlance the labels "Chicago school" and "Harvard school" have become a commonly used shorthand to denote groupings of distinctive philosophical and professional perspectives. Many of the controversies and policy disagreements in the predation debate may be traced to differences in underlying assumptions. For example, one important philosophical difference between these two schools is whether the antitrust laws should be, or were intended to be, concerned with goals other than achieving the most efficient allocation of wealth to the satisfaction of consumer demand. These goals, which some Harvard school adherents regard as a rightful element of antitrust policy analysis, include protecting small business and avoiding great aggregations of economic power—and the accompanying political and social power—in the hands of a few. Prominent among the professional disagreements are whether dominant firms can deter market entry or expansion through means other than collusion, efficient competitive behavior, or market distortions caused by government intervention. Harvard school proponents tend to feel that firms can erect, maintain, and exploit nonefficiency-related entry barriers to shelter and extend market power. For one description of these two schools which suggests that they are converging, see Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979). For a contrasting view, see Nelson, *Comments on a Paper by Posner*, 127 U. PA. L. REV. 949 (1979). For recent, thorough discussions of the goals of the antitrust laws, see Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. (forthcoming) (emphasizing the preservation of opportunities to compete), and Lande, *The Goals of the Antitrust Laws*, 33 HASTINGS L.J. (forthcoming) (emphasizing the prevention of unfair distributions of wealth).

discourage the entry of new firms. They maintain that the predator in the long run intends to raise prices and reap higher profits than he would have earned had the original price reduction never occurred.<sup>16</sup> According to Joskow and Klevorick,

The predator expects that its entry-impeding, exit-inducing strategy will enable it to maintain an existing market structure in which prices are above competitive levels for a longer period of time than would be possible if entry were allowed to occur immediately. In either case, the firm pursuing such a strategy does so in the expectation that long-run profits will increase more than enough to compensate for what has been sacrificed in the short-run.<sup>17</sup>

This consensus, while limited in scope, is important because it gives courts, business managers, and others a framework within which to examine business conduct. Furthermore, the view has stimulated deeper inquiry into formerly settled assumptions about predation. The traditional approach held that a large firm with a "deep pocket" could subdue smaller rivals by pricing below cost. According to this view, the dominant firm could afford the expense and outlast the challenger. With its competitors eliminated, the dominant firm would have monopoly power and could raise its prices with impunity. Moreover, the predatory conduct's success would yield monopoly profits that in turn could subsidize further predatory activity, if the monopolist so desired.

The shift in analytical focus from the ultimate legal issues of purpose and effect to the underlying market dynamics reveals that pricing below cost does not invariably result in the economic harm that the traditional view once assumed. Profits and losses do not flow with certainty. Indeed, total losses from a price war may be higher for the predator than they are for its victim. This situation can occur because the dominant firm's successful, predatory below-cost pricing strategy, while giving it a larger and ever expanding share of the market, causes it to lose money or forego profits on every unit. By contrast, the challenger or entrant can cut production, or even mothball its plant, and then wait. When the predator seeks to recoup its losses by pricing above competitive levels, the challenger may return and renew its assault. In addition, high prices, after some time lag, may attract other firms to the market; capital arguably should be available for this purpose, since lenders presumably would finance entry or reentry attempts into a market in which their borrowers almost certainly would share in monopoly

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16. Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 *YALE L.J.* 213, 219-20 (1979).

17. *Id.* at 220.

profits. Finally, even if the victim goes bankrupt, another firm likely would acquire its assets and assume anew the role of market challenger. The dominant firm, of course, should be able to forecast this entire scenario. If so, it probably would find, *ex ante*, that traditional deep-pocket predation would not pay unless substantial barriers to entry and reentry insulate its resulting monopoly position from future attack.<sup>18</sup>

Although scholars agree on the general dynamics of predation and on the notion that the traditional concept of deep-pocket predation, without more, does not describe a serious problem, no consensus exists among them on the other issues in this complex field of law. The current predation debate focuses on a series of compound questions: (1) Does predation occur in practice, and if it does, in what form, and with what frequency? (2) If predation exists, what dangers to competition result from both the predatory conduct itself and the efforts to limit or redress that conduct? and (3) In light of the answers to these questions, how may the courts optimally address the issue of predation? The antitrust theorists vigorously disagree on the appropriate answers to each of these questions, with enlightening—though not dispositive—results.<sup>19</sup>

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18. For summaries of this argument, see R. BORK, *supra* note 13, at 144-60, and Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263 (1981).

Beyond challenging the traditional concept of deep-pocket predation from a theoretical standpoint, some scholars also have questioned it on empirical grounds. Professor McGee's reexamination of *Standard Oil Co. v. United States*, 221 U.S. 1 (1911), was one of the most influential of these criticisms. See McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J.L. & ECON. 137 (1958). See also Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST L. & ECON. REV. 105 (1971). Professor Scherer, however, argues that McGee's and Koller's analyses are faulty because of inadequate factual support. He notes, for example, that independent historical evidence strongly suggests that John D. Rockefeller personally suggested that Standard Oil seriously consider forcing rivals from the market through price cutting if Standard's market share were to decline below fifty percent. Scherer also points to theoretical evidence which shows that, under certain conditions, below-cost pricing can be long-term, profit-maximizing behavior for a dominant firm. These conditions arise when the dominant firm's cost advantage is great, and fringe firms, therefore, are likely to exit the market quickly in the face of price cutting. F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 336-38 (2d ed. 1980) (citing A. NEVINS, *STUDY IN POWER: JOHN D. ROCKEFELLER* (1953) and Darius W. Gaskins, Jr., *Optimal Pricing by Dominant Firms* 12-22 (1970) (unpublished Ph. D. dissertation, University of Michigan)). On balance, Scherer finds the evidence that deep-pocket predation is rare to be persuasive, if predation is not defined expansively to include efforts to discipline rivals, to rebuff entry by firms still seeking to acquire a market base, or to reap benefits across many markets. *Id.* at 337-40.

19. For a discussion of how the courts have addressed these questions, see part III *infra*. The inquiries, of course, present issues that are interrelated. Thus, the frequency and forms of predation could well be considered along with the question of the competitive harm from predatory activity. Similarly, the potential undesirable side effects of attempts to cur-

The argument about whether predation actually exists to any significant extent is largely a function of the disagreement over what, if anything, constitutes a barrier to market entry.<sup>20</sup> Clearly, a firm must overcome many obstacles to challenge a market leader successfully. Although all these hurdles are to some extent entry barriers, many of them—for example, economies of scale—reflect efficiencies that enhance consumer welfare. Both theorists and courts accord these efficiency-generated advantages substantial deference.<sup>21</sup> Indeed, the efficient incumbent arguably would not need to incur the costs of predation, since it presumably could compete successfully over the long term because of its own superiority.<sup>22</sup> Regardless, to proscribe as predatory any conduct or other market conditions that enhance consumer welfare in the long run would be ill-advised. By contrast, when the conduct or market conditions do not reflect ongoing superior performance, they should be subject to control if they either facilitate predation or protect the monopoly power that might result from this predation. The threshold theoretical task, therefore, is to distinguish those entry barriers that promote efficiency from those that do not.<sup>23</sup>

tail predation might be treated either separately or as part of the inquiry into the administrability of a proposed rule.

20. As used in this Article, the term "entry barrier" refers to barriers both to entry and to expansion and includes not only impediments that prevent entry or expansion, but also those that significantly reduce their magnitude and occurrence.

21. Thus, for example, whereas Williamson proposes that an established firm should not be permitted to expand output unduly for a limited period to allow a new entrant to "get up to speed," he would not impose any long-term proscription that would deny consumers the benefits of the dominant firm's efficiencies. Williamson, *Predatory Pricing: A Strategic Welfare Analysis*, 87 YALE L.J. 284 (1977) [hereinafter cited as *Predatory Pricing*]. See also Williamson, *Williamson on Predatory Pricing II*, 88 YALE L.J. 1183 (1979); note 41 *infra*. An initial grace period would shelter newcomers temporarily while they attempt to recoup their start-up costs, and it would protect them to some extent as they proceed down their experience curve, a term which describes the decline in a firm's per unit costs—at an ever decreasing rate—as its cumulative output increases. See Craswell, *A Survey of Antitrust Issues Raised by Some Business Strategy Models*, in PAPERS ON BUSINESS STRATEGY IN ANTITRUST (FTC Office of Policy Planning 1980).

22. Nevertheless, a dominant firm enjoying efficiency advantages may opt to use predation to make a possible "competitive kill" more probable, or to make a sure kill more swift. Indeed, predation arguably may be desirable—especially under the latter circumstances—if it enables a more efficient firm to serve more rapidly a larger portion of the market. Of course, opposing arguments can be made that the less efficient firm ultimately may become more efficient, develop new technology, introduce process innovations, or provide actual—as opposed to potential—limits to the efficient dominant firm's exploitation of monopoly power.

23. The kinds of conduct that scholars have identified as possible entry barriers include the following: Massive advertising, see, e.g., Comanor & Wilson, *The Effect of Advertising on Competition: A Survey*, 17 J. ECON. LIT. 453 (1979); brand proliferation, see

A detailed discussion of the entry barriers controversy is beyond the scope of this Article. It is sufficient to note that some scholars believe that barriers which prevent or delay market entry or expansion (other than those based on efficiency) are rarely, if ever, present in any given market. Consequently, these commentators tend to conclude that predation rarely will occur, since it would be economically irrational in a market with few entry barriers and competitively unnecessary for a superior firm.<sup>24</sup> Other commentators, however, disagree and argue that exploitable, nonefficiency-based entry barriers often do exist. They also maintain that predation which exploits these barriers may take forms other than those of the traditional deep-pocket variety.

Prominent among these suggested other forms of predation are those that take advantage of imperfect information, particularly the challenger's incomplete knowledge of the incumbent's costs or motives.<sup>25</sup> A new entrant can only partially understand what inspires the market and consumers to operate as they do; each business decision and market prediction, therefore, is characterized by some uncertainty. While a challenger's imperfect information generally is unrelated to an incumbent's efficiency, it can create entry barriers or otherwise benefit an incumbent in a variety of ways.

Professor Williamson, for example, suggests that prospective lenders might perceive significant risks in loaning substantial sums

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Schmalensee, *On the Use of Economic Models in Antitrust: The RealLemon Case*, 127 U. PA. L. REV. 994 (1979); and capacity expansion investment, see Spence, *Entry, Capacity, Investment and Oligopolistic Pricing*, 8 BELL J. ECON. 534 (1977). Professor Scherer suggests that a firm's conglomerate structure sometimes serves as a foundation for predation. F. SCHERER, *supra* note 18, at 335-40. In a personal communication economists Mark Fratrik and Robert Stoner have suggested a broader catalogue of entry barriers and structural market conditions that may be especially pertinent to predation: (1) product trans-shipment costs; (2) the importance of experience and the ease with which it is acquired, *i.e.*, the shape of the industry experience curve; (3) the history of the industry and the dominant firm, including the latter's reputation for predation and the frequency of previous successful predatory efforts in the relevant market; (4) the nature of manufacturer/retailer relationships in the industry; (5) the product's initial cost and its frequency of purchase; (6) the importance of test marketing; (7) the degree to which the incumbent and entrant are multiproduct, multimarket firms; and (8) the industry's maturity. Letter from Mark Fratrik to James Hurwitz and William Kovacic (November 12, 1981).

24. See R. BORK, *supra* note 13, at 314-20; R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 92-93 (1976); Demsetz, *Two Systems of Belief About Monopoly*, in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* 164, 173-74 (H. Goldschmid, H. Mann & J. Weston eds. 1974); Easterbrook, *supra* note 18, at 267-76.

25. See, *e.g.*, R. Zerbe, *The Economic and Empirical Content of Alternative Predation Rules* (1980) (unpublished manuscript on file with *Vanderbilt Law Review*). Zerbe believes that imperfect or incomplete information is necessary for all predation. *Id.* at 4.

of money to a market entrant, especially one that faces a nontrivial threat of predation.<sup>26</sup> An entrant's chances of success are predictable only to a limited extent. Furthermore, the lender reasonably might fear either that the entrant is failing because of incompetence—not predation—or that, theory notwithstanding, the predatory tactics will succeed nonetheless. The conservative lender, of course, will charge according to the maximum extent of his perceived risk. Thus, the uncertainty associated with entry at the very least will increase the entrant's capital costs vis-à-vis the established firm's costs for the same funds. To the extent that capital markets do levy a risk premium under these circumstances, a dominant firm could exploit this cost differential to deter even an equally efficient challenger.<sup>27</sup>

Professors Posner, Williamson, and Scherer suggest another form of predation that is based on imperfect information, and which is different from the traditional deep-pocket concept. They contend that a firm's reputation for predation, if credible, can deter entry into markets besides those in which the actual predation occurs.<sup>28</sup> A victim of predation in one market can serve as a chilling example to prospective entrants and challengers in all the predator's markets. Moreover, reputation effects can extend to different geographic markets, different product markets, and later time periods. If, for example, a firm is debating over which of two markets to enter, and the dominant firm in one has a credible reputation for preying upon market challengers, the prospective entrant might well decide to enter the other market. The entrant, of course, would know that predatory battles are expensive—whether in the marketplace or in courts—and that victory may provide relief that is too little and too late. Thus, a single instance of predation may yield a double dividend: even if predation in one market may not pay acceptable returns from that market alone, the effects of a general reputation for toughness may provide ample benefits across several markets.<sup>29</sup>

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26. Williamson, Book Review, 83 *YALE L.J.* 647, 656-59 (1974).

27. Professor Posner finds that this argument is valid, although he questions its magnitude. Posner, *supra* note 15, at 936 n.31, 945.

28. R. POSNER, *supra* note 24, at 184-87; F. SCHERER, *supra* note 18, at 560; Williamson, *Dominant Firms and the Monopoly Problem: Market Failure Considerations*, 85 *HARV. L. REV.* 1512, 1522 (1972).

29. R. POSNER, *supra* note 24, at 184-87; Williamson, *supra* note 28, at 1512, 1522. See also D. Kreps & R. Wilson, On the Chain-Store Paradox and Predation's Reputation for Toughness (unpublished manuscript); R. Masson & D. Eisenstadt, A Stochastic Rationale for Predatory Pricing (1975) (paper presented at 1975 Econometric Society Meeting).

Masson and Reynolds have examined imperfect information as the basis for "noisy pricing" predation, in which a firm disguises a general pattern of predatory pricing by some inconsistent signals.<sup>30</sup> They contend that this strategem may deceive a firm—or its potential lenders—into believing that the entrant's failure was due to nothing more than the market's normal, competitive rigors. Under these circumstances, entrants will either exit or go bankrupt rather than offer a defense, since they perceive no predation against which to defend. Moreover, the appearance that the market could not accommodate both the established firm and the failed challenger may also deter other potential entrants.

Imperfect information thus is essential to both reputation predation and noisy pricing predation; indeed, the two are opposite sides of the same coin. With reputation predation, the established firm wishes to disguise its secret unwillingness to prey upon every actual and potential challenger by publicly emphasizing its aggressiveness toward rivals. In contrast, an established firm that is practicing noisy pricing predation seeks to conceal the fact of its predatory conduct through signals which are designed to indicate that only natural market forces are at work. As long as the challenger does not know the dominant firm's true costs, profit details, motivations, and intentions, it will have difficulty accurately assessing what has happened—or will likely happen—and why. In sum, this uncertainty may be a substantial advantage that the dominant firm can exploit to increase the challenger's—and its shareholders' and lenders'—perception of misjudged risks and opportunity. If used effectively, this ploy may force a challenger to pay a higher risk premium for market entry, to adopt a cautious rather than an aggressive competitive stance, and perhaps to abandon effective but costly strategic defenses. Thus, imperfect information can serve as a potential entry barrier and a foundation for predation.<sup>31</sup>

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30. R. Masson & R. Reynolds, Predation: The "Noisy" Pricing Strategy (Fall 1980) (unpublished manuscript on file at Vanderbilt Law Review).

31. Salop, *Introduction to STRATEGY, PREDATION, AND ANTITRUST ANALYSIS* 19-22 (S. Salop ed. 1981) [hereinafter cited as *ANTITRUST ANALYSIS*]. Salop observes that while entrants may also engage in deception and other strategies based on imperfect information, on balance the incumbent is generally in the superior position because it typically will be economically less vulnerable and will have more detailed cost, profit, and other market information.

Salop includes information among the inputs that a firm needs—for example, raw materials, good personnel, and marketing outlets—to compete effectively. If a dominant firm can raise the cost or reduce the quality or amount of a rival's inputs without equally hurting itself, it may be engaging in what Salop terms "input predation." This situation might occur, for example, when an incumbent deliberately interferes with a rival's test mar-

This overview certainly is not intended to resolve the debate concerning the existence, form, frequency, or dangers of predatory activity. Nevertheless, these problems need to be introduced, since attempts to solve them directly affect the selection of a standard by which to measure the propriety of a firm's pricing, innovation, and promotion decisions. Obviously, the relative strictness of a suggested enforcement policy will vary in proportion to its proponent's assessment of predation's incidence and dangers. Moreover, whatever standard is chosen must be simple enough that business managers and courts can both readily understand it and apply it. In addition, the standard must not engender economically undesirable market distortions from the efforts of firms, courts, and the government to follow—or circumvent—it. Finally, for reasons of fairness and economic efficiency, the rule should not give rise to excessive false positive errors, false negative errors, or litigation costs.<sup>32</sup>

These considerations present demanding policy requirements in any context. The task is even more difficult when, as here, serious disagreement exists about whether there is a problem worth addressing at all, not to mention the debate over the problem's magnitude and implications. Notwithstanding these difficulties, the lower courts and scholars have expended substantial effort to address the issues in this area. The Supreme Court, however, has not squarely faced the predation question since 1967 in *Utah Pie Co. v. Continental Baking Co.*<sup>33</sup> While even a cursory examination of the debate suggests that still more development is needed and will be forthcoming, a comparison of the current state of learning with the level of analysis that the Supreme Court offered fifteen years ago in *Utah Pie* shows that these lower courts and commentators have made major progress.

No fewer than nine standards or frameworks for addressing

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ket efforts or seeks onerous labor regulations and contracts that will hurt its more labor-intensive rivals disproportionately.

32. False positive errors are condemnations of activity that in fact enhances consumer welfare; false negative errors are failures to condemn as predatory that activity which reduces consumer welfare. Joskow & Klevorick, *supra* note 16, at 218, 223. Each proposed standard for addressing predation has either false positive or false negative errors—most have both—and most proponents tend to criticize differing proposals for accepting the wrong mix—or wrongly calculating the mix—of these errors. Theory alone, however, cannot resolve the controversy over which proposal is the most appropriate. First, empirical inquiries must be made into the frequency and nature of the harms that result from predation. Second, the evaluator must establish a hierarchy of economic, social, and political values to assess the gravity of these adverse effects and to weigh them against the others.

33. 386 U.S. 685 (1967); *see* notes 81-108 *infra* and accompanying text.

predation have been proposed since 1975.<sup>34</sup> In complexity these proposals range from no standard at all—since according to these proponents no problem exists<sup>35</sup>—to a full-scale, rule of reason analysis of all pertinent factors in each individual case.<sup>36</sup> Between these extremes, some proposals recommend adoption of short-term<sup>37</sup> or long-term marginal costs<sup>38</sup> as the threshold floor for lawful pricing. Others, in balancing the need for simplicity against the need for a more sophisticated economic analysis, urge a preliminary evaluation of structural and other factors to determine at the outset whether the market in question is conducive to profitable predation.<sup>39</sup> Some approaches examine the strategic qualities of the predator's behavior to determine whether the conduct would be profit-maximizing for the predator and would enhance consumer welfare in general, even if it did not have obvious entry-detering or exit-inducing effects.<sup>40</sup> Still other proposals, also fo-

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34. For an excellent collection of much of the modern predation literature, see *Predatory Conduct and Empirical Studies in Collusion*, 10 J. REPRINTS ANTITRUST L. & ECON. 1 (1980). In addition, for two good critiques of this typically economically oriented predation literature intended for lawyers, see Hay, *A Confused Lawyer's Guide to the Predatory Pricing Literature*, in ANTITRUST ANALYSIS, *supra* note 31, at 155, and Brodley & Hay, *Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards*, 66 CORNELL L. REV. 738 (1981). Finally, for a review from a different perspective, see McGee, *Predatory Pricing Revisited*, 23 J.L. & ECON. 289 (1980).

35. See R. BORK, *supra* note 13, at 154; Easterbrook, *supra* note 18, at 336.

36. See Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 HARV. L. REV. 869 (1976). See generally notes 115-82 *infra* and accompanying text; see also Schmalensee, *supra* note 23, at 1028-29.

37. See Areeda & Turner, *supra* note 6. See also 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶¶ 710-722 (1978); Areeda, *Predatory Pricing* (1980), 49 ANTITRUST L.J. 897 (1980).

38. R. POSNER, *supra* note 24, at 184-85.

39. See Joskow & Klevorick, *supra* note 16, at 244-49. Professors Joskow and Klevorick propose a two-tier evaluation of predation. They first would analyze the relevant market's structure to determine whether "there is a reasonable probability that monopoly power has been or could be sustained by the use of price reductions." *Id.* at 244. According to Joskow and Klevorick, these structural characteristics include (1) the dominant firm's market share; (2) the size of other firms in the market; (3) the stability of market shares over time; (4) the dominant firm's profit history; (5) the elasticity of demand for the incumbent's product; and (6) any preconditions for entry into the market. As their second tier analysis, assuming that the industry seems reasonably conducive to predatory behavior, these authors would assess the incumbent's behavior according to a set of cost- and strategy-based rules that would, with exceptions, use average total cost as the threshold of illegality.

40. Ordovery & Willig, *An Economic Definition of Predatory Product Innovation*, in ANTITRUST ANALYSIS, *supra* note 31, at 301. Professors Ordovery and Willig would proscribe all activity—whether pricing, advertising, or some other form of conduct—that meets each of three conditions. First, the incumbent must have had available to it an alternative response to entry that would have been less likely to induce the new rival to exit the market.

cusing on strategic considerations, adopt a "business as usual" requirement, either limiting the established firm to its trend-adjusted output for the pre-entry period<sup>41</sup> or permitting only price decreases that will not be reversed for a substantial period.<sup>42</sup> Among these suggested standards, the cost-based proposals clearly have become the foundation for most judicial analyses and, therefore, deserve further elaboration here.

Professors Areeda and Turner initiated the recent round of predatory pricing commentary with their proposal in 1975 that prices at or above reasonably anticipated short-term marginal cost should be deemed lawful, and that prices below reasonably anticipated short-term marginal cost should be deemed unlawful.<sup>43</sup> The one exception Areeda and Turner allow is a case in which a firm's price, while below marginal cost, remains above its average cost; this situation, however, is likely to arise only when excess demand induces a firm to expand output beyond the point at which average costs are at their minimum. Because calculating the cost of producing the next additional unit of output—marginal cost—is exceedingly difficult, Areeda and Turner suggest the use of average varia-

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Second, when analyzed *ex ante* and assuming the victim's market exit, the incumbent's chosen action must have offered greater long term profits than the less onerous alternative would have provided. Last, assuming that the entrant remains in the market, the incumbent's chosen action, again analyzed *ex ante*, must have offered less long-term profits than the alternative would have produced.

Although neither proposes a specific legal standard, both Spence and Salop regard the irreversibility of an incumbent's actions as often crucial to credible, strategic entry deterrence. Spence, for example, posits that the timing and extent of capacity investment can often be superior to price manipulations as an entry-detering device. Whereas the largely irreversible nature of capacity investment decisions makes them extremely credible evidence of the incumbent's commitment to resist market challenges unrelentingly, rivals know that prices can be changed repeatedly with relative ease. See Salop, *Strategic Entry Deterrence*, 69 AM. ECON. REV. 335 (1979); Spence, *supra* note 23.

41. Williamson, *Predatory Pricing*, *supra* note 21. Professor Williamson would require a dominant firm facing new entry to refrain from expanding its output long enough to allow the entrant to recover some of its initial costs and to achieve whatever efficiencies it can. *Id.* at 296. He suggests that a 12- to 18-month restriction generally would be sufficient. *Id.* Professor Williamson would supplement this standard with an average total cost rule when the victims are established firms. *Id.* at 321-23, 336-37.

42. Baumol, *Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing*, 89 YALE L.J. 1 (1979). Professor Baumol would allow a dominant firm to lower its prices without limit in response to new entry, but he would not allow the firm to withdraw any part of the reduction for a long period—perhaps for five years. *Id.* at 4, 8.

43. Areeda & Turner, *supra* note 6. 3 P. AREEDA & D. TURNER, *supra* note 37, ¶¶ 710-722. Professor McGee notes that in 1965 he proposed a marginal or average variable cost test for predation cases brought under the Robinson-Patman Act. See McGee, *supra* note 34, at 290.

ble cost<sup>44</sup> as a surrogate. Thus, they propose that prices at or above reasonably anticipated average variable cost be presumed lawful, and that prices below that level be conclusively presumed unlawful.<sup>45</sup> Although Areeda and Turner would not permit a monopolist a defense on the ground that its pricing was "promotional" or designed to "meet competition," they would permit a nonmonopolist to engage in temporary promotional pricing below marginal cost to stimulate demand.

The Areeda/Turner formulation has deeply influenced the courts and has provided either the analytical foundation or the point of departure for most of their decisions.<sup>46</sup> This approach claims three important virtues. First, it places relatively few curbs on an incumbent's responses to entry; the standard, therefore, minimizes the risk of sheltering an inefficient firm. Areeda and Turner intend this permissiveness; it rests on their conclusion that predation is a "highly unlikely" phenomenon that does not warrant more sweeping measures.<sup>47</sup> This approach also dovetails with Areeda's and Turner's proposal of a cause of action that would permit the government to seek the dissipation of substantial and persistent monopoly power—however acquired—without also having to demonstrate that the monopolist engaged in exclusionary or anticompetitive behavior.<sup>48</sup> Second, the Areeda/Turner standard

44. A firm's variable costs are those expenses whose amount depends greatly on the firm's short-run rate of output. The costs of raw materials and wages of production employees are two major examples of variable costs. In contrast, fixed costs are expenses that remain relatively constant regardless of short-run changes in output. Fixed costs encompass expenses such as wages for management employees, real estate taxes, and physical plant costs. A firm's average variable cost is the sum of its variable costs divided by total output. See R. DORFMAN, *PRICES AND MARKETS* 42-81 (2d ed. 1972).

45. The text states the formulation of the Areeda/Turner proposal as it appears in their 1978 treatise; in their 1975 article they proposed that both presumptions be conclusive. Compare Areeda & Turner, *supra* note 6, at 732-33 with 3 P. AREEDA & D. TURNER, *supra* note 37, ¶ 711d. Areeda & Turner focus on "reasonably anticipated" average variable cost to permit firms to seek expansion to more efficient output levels.

46. See, e.g., *SuperTurf, Inc. v. Monsanto Co.*, 1981-2 Trade Cas. ¶ 64,316 (8th Cir. 1981); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116); *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

47. 3 P. AREEDA & D. TURNER, *supra* note 37, ¶ 711c.

48. *Id.* ¶¶ 614-623. The authors state,

In sum: (A) obtaining a monopoly should be lawful for all purposes to the extent the monopoly is inevitable or based on superior skill; (B) the persistent monopoly should be immune from equitable relief only to the extent that it is based on economies of scale, indivisible resources, legal license other than patents, the patents that first created it, or radically new patents that displace such patents.

*Id.* ¶ 623a(6). Areeda and Turner also assert that neither the legislative history nor the

purports to be simple enough for courts and business managers to apply readily. Last, the standard offers consumers the possibility of reaping substantial benefits from low, post-entry pricing.

Each of these purported virtues is subject to challenge.<sup>49</sup> Indeed, the process of scholarly debate has given rise to a rival average total cost<sup>50</sup> standard, which has received as much consideration in more recent court decisions as the Areeda/Turner formulation. Moreover, other proposals that courts have not applied directly nonetheless have influenced the specific ways in which courts have refined and modified the cost-based tests to make them better account for various legal, economic, factual, and administrative considerations.

Professor Posner has proffered perhaps the most notable average total cost test.<sup>51</sup> While Posner agrees that courts should condemn conduct which would violate the Areeda/Turner standard, he takes the analysis a step further. In his view established firms do not always need to price below average variable cost to prey successfully. Less dramatic action often will suffice, especially during an entrant's vulnerable start-up period.<sup>52</sup> Accordingly, Posner

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statutory language of section 2 of the Sherman Act precludes such a cause of action, which they argue is "only a modest step beyond existing precedents." *Id.* ¶ 623b. See also *Roundtable on Predatory Practices*, in *ANTITRUST ANALYSIS*, *supra* note 31, at 635.

49. Professor Joskow contends that judicial adoption of a simple per se rule was virtually inevitable, but he observes that the Areeda/Turner standard

has not been accorded generally favorable reviews by economists; the rave reviews come from the courts. It does not represent the triumph of economic efficiency over political considerations. . . . I attribute the adoption of this particular rule to the desire of the judiciary to extract itself from the chaos of existing case law, not to their "getting religion." I attribute the elegant footnotes to their law clerks.

Joskow, *Comments on Pitofsky*, in *ANTITRUST FOR THE 1980's* 201-02 (O. Williamson ed. 1980).

50. A firm's average total cost is calculated by dividing its total cost—the sum of its fixed and variable expenses—by its total output. See R. DORFMAN, *supra* note 44, at 47-48. See also note 44 *supra*.

51. R. POSNER, *supra* note 24, at 184-96.

52. Posner believes that "predatory pricing cannot be dismissed as inevitably an irrational practice." *Id.* at 186. This conclusion rests on the assumption that the challenger must commit resources that it cannot move in and out of the market without incurring some cost—in essence that the challenger faces exit and reentry barriers. Therefore, the dominant firm may be able to practice predation and still price above average variable cost. Ordover and Willig, on the other hand, observe that if either the costs of market exit are too high or the costs of reentry are de minimis, and if both the incumbent and the challenger realize these facts, then predation will be unlikely. Ordover & Willig, *supra* note 40, at 307. These latter arguments, however, should be applied with care. While an incumbent may not be able to force the challenger's permanent exit under the conditions that Ordover and Willig describe, it nevertheless may prefer an inactive or restrained rival to a vigorous one. Predation that causes such a result also may deter additional entry by providing a warning signal

would rebuttably presume that pricing is predatory if it is less than long-term marginal cost and is coupled with the intent to exclude an equally or more efficient competitor.<sup>53</sup> The logical basis for this standard is that predation has inherently long-term attributes—a sacrifice of short-term profits to reap greater rewards in the long term—and, therefore, any standard should have a long-term emphasis. The test's economic rationale is that a firm which fails to cover both its variable and fixed costs will not be a viable, efficient competitor over the long run. Like Areeda and Turner, Posner accepts average variable cost as an acceptable surrogate for marginal cost, but in his proposal, of course, the crucial measure is average total cost.

Other commentators also endorse using an average total cost standard in predation analysis. Although Professor Williamson would impose an output restriction for a limited term on dominant firms that face new entry, he would use an average total cost standard for evaluating responses to challenges from established rivals.<sup>54</sup> Similarly, once a court initially determined that the market structure itself was conducive to profitable predation, Professors Joskow and Klevorick would apply an average total cost analysis to assess an incumbent's response to entry.<sup>55</sup>

As new opinions continue to emerge in the attempt to formulate a coherent predation analysis, one recurring controversy centers on the issue of the relative merits of average variable and average total cost standards.<sup>56</sup> Average total cost tests limit the

to other firms contemplating entry. Moreover, the dominant firm may have intended only that its aggressive conduct serve as a market discipline, that is, as a threat or notice that the rival must cooperate in industry-wide pricing above competitive levels.

53. Posner defines predation as "pricing at a level calculated to exclude from the market an equally or more efficient competitor." R. POSNER, *supra* note 24, at 188. Similarly, the majority and a concurring opinion in what is popularly known as the *ReaLemon* decision urged a variation of Posner's average total cost rule. *In re Borden, Inc.*, 92 F.T.C. 669, 823-32 (1978) (Pitofsky, Commissioner, concurring), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979). See also Greer, *A Critique of Areeda and Turner's Standard for Predatory Practices*, 24 ANTITRUST BULL. 233, 235 (1979). In another concurring opinion to *ReaLemon*, however, Commissioner Clanton stated that he preferred an average variable cost test. 92 F.T.C. at 813-16 (Clanton, Commissioner, concurring).

54. See Williamson, *supra* note 28, at 1527-30.

55. See Joskow & Klevorick, *supra* note 16, at 249-55.

56. It is important to caution that loosely aggregating the various proposals into average variable cost and average total costs "camps," while useful for some purposes, risks obscuring the theoretical complexities and limitations embodied in each commentator's formulation. Presumptions, preconditions, and exceptions significantly differentiate the various academic proposals, just as the underlying facts of litigated cases serve to differentiate judicial formulations. For example, although the proposals by Posner, Williamson, and Joskow

incumbent somewhat more than average variable cost standards because these tests tend to impose greater restrictions on the incumbent's range of pricing discretion. Whether the extra limitation aids efficiency by curbing otherwise unaddressed instances of predation, or whether it harms efficiency by sheltering inefficient firms that could not otherwise compete, remains a matter of some controversy. From an economic perspective, to set a price that covers only average variable costs is abnormal long-term behavior. Nonetheless, in a post-entry price war consumers benefit more under the average variable cost standard—at least initially—because of the possibility that prices will drop to a level which is even lower than average total cost. On the other hand, consumers may obtain more overall benefit under the average total cost standard if an entrant's survival contributes to the maintenance of a more competitive market over the long term.

The two basic cost standards also can be compared from the standpoint of their administrative merits. Under the average variable cost standard, it is more difficult to allocate costs to the proper time period, for example, than under the average total cost rule.<sup>57</sup> This administrative burden is especially acute because some costs—for example, advertising—have both short- and long-term attributes.<sup>58</sup> Other allocation problems, however, are common to

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and Klevorick all assert that average total cost is the appropriate cost standard, these commentators disagree over what circumstances warrant the standard's application.

57. In defending the administrative merits of their proposal, Areeda and Turner state that

[t]here are no doubt disputable questions as to (i) which costs should be included in variable costs, (ii) proper accounting valuation of inventories, and (iii) allocations of costs in multi-product enterprises. The first can be resolved by more or less arbitrary decisions. The second has no apparent relevance to variable costs of current production. The third should not be difficult where the firm has had consistent accounting treatment of cost allocations over a substantial period of time.

Areeda & Turner, *Williamson on Predatory Pricing*, 87 YALE L.J. 1337, 1346 (1978) (footnotes omitted).

58. Allocation of promotional expenses is a key issue in computing cost. While Areeda and Turner recognized in their original article that advertising may be increased in a predatory response to entry, the authors acknowledged that they were "not wholly satisfied" with their solution, which included only *extraordinary* promotional expenses as part of average variable cost. Areeda & Turner, *supra* note 6, at 729. More recently, the authors' treatise appears to take the additional step of accepting all promotional expenses—not just extraordinary ones—as part of average variable cost. 3 P. AREEDA & D. TURNER, *supra* note 37, at 721. Some empirical basis exists for this position. Professor Scherer, for example, has suggested that the effects of advertising generally decay fairly rapidly. F. SCHERER, *supra* note 18, at 286 (citing Clarke, *Econometric Measurement of the Duration of Advertising Effect on Sales*, 13 J. MARKETING RESEARCH 345 (1976)). With this shift in position, Areeda and Turner have brought their average variable cost formulation closer to the average total

both tests. For example, firms likely will allocate costs to various geographic regions without concern for how a court subsequently may define a relevant geographic market. Similarly, it is difficult to calculate relevant prices and costs in situations in which products and product models are numerous or change frequently, or when marketing and production costs are not confined to the products that are relevant for a given case. Moreover, relative prices sometimes are difficult to ascertain because of variations in product models. The complexity of sophisticated promotional campaigns—including consumer coupons, dealer coupons, discounts, and contests—that cover a broad array of products and regions can be still another source of difficulty. Surprisingly, however, these technical problems apparently have not caused courts to hesitate in adopting the cost-based standards.<sup>59</sup>

The administrative question, however, is not entirely one of technical measurement and ease of enforcement. If the issue is viewed as an assessment of what factors the courts should examine in evaluating a claim of predation, administrability becomes fundamentally a substantive concern. The cost-based tests have been challenged on this ground from two directions. On the one hand, Professor Bork argues that predation rarely, if ever, occurs, and that the costs of trying to identify, litigate, and remedy the few possible episodes far exceed the benefits of such an effort. In Bork's view, therefore, even a strict cost-based test considers too many factors and is an administrative waste.<sup>60</sup> Professor Scherer, on the other hand, believes that cost-based tests are too simplistic. He argues that predation must be evaluated and understood in its entire market context, even if this evaluation is a complex task. According to Scherer, anything short of such an inquiry would be self-deceiving and would lead to economically perverse results. Thus, Scherer would have courts evaluate, among other factors,

the relative cost positions of the monopolist and fringe firms, the scale of entry required to secure minimum costs, whether fringe firms are driven out entirely or merely suppressed, whether the monopolist expands its output to replace the output of excluded rivals or restricts supply again when the rivals withdraw, and whether any long-run compensatory expansion by the monop-

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cost rules that others have devised. Significant differences between the approaches remain, however, especially in industries with either large, long-term research and development programs or rapid depreciation of large capital investment.

59. Of course, the courts may be choosing deliberately not to recognize or discuss these complexities. See, e.g., notes 159-63 *infra* and accompanying text.

60. R. BORK, *supra* note 13, at 154.

olist entails investment in scale economy-embodiment new plant.<sup>61</sup>

While Scherer's approach as a whole may be unwieldy,<sup>62</sup> the host of structural, strategic, and other factors that he contends are pertinent have not escaped the attention of even those courts that ostensibly apply simpler cost-based rules.<sup>63</sup>

Without question, these academic proposals have had an enormous impact on the law of predation.<sup>64</sup> The proponents of these theories, however, are neither judges nor lawmakers, and the courts in which the actual cases are decided must focus on more than economic theory. However sound a potential outcome is from the standpoint of economics, it must also reflect the existing statutes and judicial precedents. Accordingly, before the Article discusses the effect of the scholarly debate on recent judicial decisions, the following two sections review the statutory and common-law environment in which those decisions were made. Section B briefly describes the federal statutes that are the most pertinent to the predation issue, statutes whose broad language has afforded courts substantial latitude to consider, incorporate, and further develop the commentators' suggestions. Older case law similarly imposes few constraints on the judiciary because recent court cases, with their newer economic view but divergent results, virtually have superseded the older ones. Section C, therefore, discusses only *Utah Pie*, which retains lingering significance as the most recent Supreme Court case on predation, even though it contrasts sharply with some of the post-1975 decisions.

### B. The Statutory Authority<sup>65</sup>

Federal antitrust law seeks to control predation principally

61. Scherer, *supra* note 36, at 890 (footnote omitted).

62. See Areeda & Turner, *Scherer on Predatory Pricing*, 89 HARV. L. REV. 891, 897 (1976); Williamson, *Predatory Pricing*, *supra* note 21, at 288 n.16.

63. See, e.g., *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 89 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079). *Janich Bros., Inc. v. American Distilling Co.*, 570 F.2d 848, 854 n.4 (9th Cir. 1977).

64. See, e.g., *Hanson v. Shell Oil Co.*, 541 F.2d 1352 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977). The *Hanson* decision almost totally accepts Areeda's and Turner's proposed standard and supporting analysis.

65. Consistent with this Article's focus on federal cases, this section discusses only federal antitrust statutes. While the Article concentrates on federal authority, we should note that twenty-five states now have competition statutes that prohibit sales below cost: ARIZ. REV. STAT. ANN. § 44-1462 (1967); ARK. STAT. ANN. §§ 70-106, -303 (1979); CAL. BUS. AND PROF. CODE § 17043 (West 1964); COLO. REV. STAT. § 6-2-105 (1973); HAWAII REV. STAT. § 481-3 (1976); IDAHO CODE §§ 48-402 to -404 (1977); KY. REV. STAT. §§ 365.030-.050 (1970); LA. REV. STAT. ANN. § 51:422 (West 1965); ME. REV. STAT. ANN. tit. 10, § 1204-A (1964);

through the application of section 2 of the Sherman Antitrust Act,<sup>66</sup> which prohibits both monopolization and attempts to monopolize. As articulated by the Supreme Court in *United States v. Grinnell Corp.*,<sup>67</sup> the monopolization offense requires the existence of monopoly power plus some conduct indicating "the willful acquisition or maintenance of that power, as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."<sup>68</sup> A finding of an attempt to monopolize under section 2 traditionally has required proof of the following elements: (1) A specific intent to control prices or destroy competition; (2) predatory or anticompetitive conduct directed toward that end; and (3) a dangerous probability of success.<sup>69</sup> To recover damages for either monopolization or an attempt to monopolize, the plaintiff must show not only that it suffered measurable harm from the defendant's anticompetitive conduct, but also that the injury was of a type that the antitrust laws were designed to prevent.<sup>70</sup>

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MASS. GEN. LAWS ANN. ch. 93, § 14F (West 1978); MINN. STAT. ANN. § 325D.08 (West 1981); MONT. REV. CODES ANN. § 30-14-208 (1979); N.D. CENT. CODE § 51-10-03 (1960); OKLA. STAT. ANN. tit. 15, §§ 598.1-.11 (West 1965); PA. STAT. ANN. tit. 73, §§ 211-217 (Purdon 1971); R.I. GEN. LAWS §§ 6-13-1 to -8 (1969); S.C. CODE § 39-3-150 (1976); TENN. CODE ANN. § 69-109 (1976); TEX. BUS. & COM. CODE ANN. tit. 2, § 15.33 (Vernon 1967); UTAH CODE ANN. §§ 13-5-7 to -12 (1953); VA. CODE §§ 59.1-1 to -10 (1973); WASH. REV. CODE ANN. § 19.90.040 (1978); W. VA. CODE § 47-11A-2 (1980); WIS. STAT. ANN. § 100.30 (West 1973); WYO. STAT. § 40-4-107 (1977). In most—if not all—cases these statutes also prohibit price discrimination. Other states have enacted such statutes, but courts have held them unconstitutional because of procedural infirmities. *See, e.g.,* N.J. STAT. ANN. § 56:4-8 (West 1964). Still other states have statutes that prohibit below cost pricing for particular products. *See, e.g.,* CONN. GEN. STAT. ANN. § 19-242 (West 1958) (drugs); IOWA CODE ANN. § 551A.3 (West 1946) (cigarettes); MISS. CODE ANN. §§ 75-23-7 (1972) (cigarettes), -31-307 (1972) (milk products); NEB. REV. STAT. §§ 59-1501 to -1518 (1978) (cigarettes).

66. 15 U.S.C. § 2 (1976).

67. 384 U.S. 563 (1966).

68. *Id.* at 570-71. Some authorities have suggested that the statutory history, language, or purposes of § 2 do not clearly require the conduct element. 3 P. AREEDA & D. TURNER, *supra* note 37, ¶ 623a. *See also* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 298 n.57 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); SCM Corp. v. Xerox Corp., 463 F. Supp. 983, 999 (D. Conn. 1978), *aff'd*, 645 F.2d 1195 (2d Cir.), *petition for cert. filed*, 102 S. Ct. 85 (1981); NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL 151-63 (1979) [hereinafter cited as NCRALP REPORT].

69. *Swift & Co. v. United States*, 196 U.S. 375, 396 (1905). *See also* NCRALP REPORT, *supra* note 68, at 144-49.

70. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). Speaking for a unanimous Court, Justice Marshall stated that

[p]laintiffs must prove *antitrust* injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful. The injury should reflect the anticompetitive effect either of the violation or

The definition of each element of the section 2 offenses is still a matter of some controversy. These individual disagreements are particularly important because the definition that a court adopts for the specific intent and dangerous probability of success elements in an attempt to monopolize case, for example, has a direct bearing on how that court will define and interpret the anticompetitive conduct element. An additional factor potentially influencing a court's toleration or legal condemnation of allegedly predatory conduct may stem from the courts' apparent tendency to define the requisite elements of liability and damages more stringently when a successful private plaintiff has the opportunity to recover treble damages.<sup>71</sup>

Another statutory basis for a claim of predation is section 2(a) of the Clayton Act, as amended by the Robinson-Patman Antidiscrimination Act.<sup>72</sup> This provision prohibits direct or indirect discrimination "in price between different purchasers of commodities of like grade and quality, . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce."<sup>73</sup> In theory the Robinson-Patman Act could complement the Sherman Act nicely; whereas the Sherman Act has a relatively open-ended proscription of exclusionary conduct but requires specific proof of the predator's actual or probable acquisition of monopoly power, the converse is true of the Robinson-Patman Act. In practice, however, courts have not "been sympathetic to the claim that this law ought to function as part of a cohesive policy about competition."<sup>74</sup> The Robinson-Patman Act is far more detailed than most United States antitrust statutes and thus has received a correspondingly technical and formalistic construction.<sup>75</sup> The economic analysis that courts have employed in

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of anticompetitive acts made possible by the violation.

*Id.* at 489. For a recent application of this standard, see *Purex Corp. v. Procter & Gamble Co.*, 596 F.2d 881 (9th Cir. 1979).

71. Clayton Act, 15 U.S.C. § 15 (1976). See note 309 *infra*. See also *SCM Corp. v. Xerox Corp.*, 463 F. Supp. 983 (D. Conn. 1978), *aff'd*, 645 F.2d 1195 (2d Cir.), *petition for cert. filed*, 102 S. Ct. 85 (1981).

72. 15 U.S.C. § 13(a) (1976).

73. *Id.*

74. L. SULLIVAN, *supra* note 1, at 680-81.

75. These detailed requirements include the following provisions: That the alleged discrimination be revealed in the context of completed sales, as opposed to other types of transactions; that the sales be to different customers and at different prices; that the goods be tangible personal property; that the sales be either contemporaneous or made under comparable market conditions; and that the goods be of like kind and grade. 15 U.S.C. § 13 (1976). The statute also provides for some exceptions. The first arises in situations in which

applications of this statute, therefore, typically has been too shallow to distinguish effectively between economically desirable and undesirable instances of price discrimination.

The third major statute that embraces predation claims is section 5 of the Federal Trade Commission Act, which authorizes the Federal Trade Commission (Commission or FTC) to challenge "unfair methods of competition."<sup>76</sup> The courts have interpreted this authority to permit the FTC to redress not only violations of the letter of the Sherman Act and Clayton Act, but also incipient violations and violations of the spirit of those Acts.<sup>77</sup> Despite its greater substantive breadth—or perhaps because of it—section 5 is available only for public enforcement.<sup>78</sup> Of course, private plaintiffs may introduce proven section 5 violations as evidence in their private suits alleging violations of the Sherman Act and Clayton Act.<sup>79</sup> Without more, however, this proof would establish a basis for treble damage awards only if the section 5 violations also constituted violations of the letter of either the Sherman or Clayton Acts themselves.<sup>80</sup>

### C. *The Legacy of Utah Pie Co. v. Continental Baking Co.*<sup>81</sup>

As noted previously, cost-based tests have prevailed in the courts, although the debate continues over what specific cost standard the courts should apply and what additional tempering fac-

the discrimination results from cost differences that occurred because the buyers purchased in different quantities. *Id.* § 13(a). The second arises when the seller offers a low price in one locale in a good faith effort to meet competition. *Id.* § 13(b). For a good overview of these technical requirements, see L. SULLIVAN, *supra* note 1, at 676-706; ABA ANTITRUST SECTION, MONOGRAPH No. 4, I THE ROBINSON-PATMAN ACT: POLICY AND LAW (1980). In Sullivan's opinion the Robinson-Patman Act would be a far more "useful adjunct" to antitrust law if the courts would undertake a more complete analysis of structural, conduct, and performance factors. L. SULLIVAN, *supra* note 1, at 688-89 (citing F. ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 160-63 (1962)). Curiously, the Supreme Court cited Rowe in *Utah Pie* for an analogous point, but did not undertake such an analysis in that case. *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685, 696 n.12 (1967); see notes 81-108 *infra* and accompanying text.

76. 15 U.S.C. § 45 (1976).

77. *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972); *FTC v. Brown Shoe Co.*, 384 U.S. 316, 320-22 (1966); see Averitt, *The Meaning of "Unfair Methods of Competition" in Section 5 of the Federal Trade Commission Act*, 21 B.C.L. REV. 227 (1980).

78. Although the statute, 15 U.S.C. § 45 (1976), does not explicitly foreclose private enforcement, the courts have held that the Commission alone may enforce this provision. See, e.g., *Holloway v. Bristol-Myers Corp.*, 485 F.2d 986 (D.C. Cir. 1973).

79. See, e.g., *Farmington Dowel Prods. Co. v. Forster Mfg. Co.*, 421 F.2d 61, 76 (1st Cir. 1969).

80. See generally 15 U.S.C. §§ 12(a), 16(a) (1976).

81. 386 U.S. 685 (1967).

tors, if any, they should weigh in the balance.<sup>82</sup> This controversy, however, is a lower-court phenomenon; the Supreme Court has yet to consider directly the theoretical and economic arguments and the host of academic proposals that have appeared since 1975.

The Court decided *Utah Pie* in 1967. The case presented many of the important issues that currently are being debated, but the opinion is more impressive for its exalted source than for the quality of its analysis. Nonetheless, the Supreme Court's expressions retain some precedential value and cannot be overlooked as a potential indication of how the Court might again address predation questions should it accept for review one or more of the cases currently proceeding through the lower courts—cases that present conflicting standards among the various district and circuit courts.<sup>83</sup> The *Utah Pie* decision is also important because the lower courts have not ignored it in their analyses of predation issues.<sup>84</sup>

Utah Pie Company was a relatively small, family-controlled pie bakery in the Salt Lake City area. In 1957 the company expanded into the frozen pie market, which placed it in direct competition with the three respondents—Continental Baking, Pet Milk, and Carnation—who already were distributing frozen pies in the region. Because Utah Pie's product was immediately successful and the market was expanding rapidly—market volume more than quadrupled between 1958 and 1961—the company built a new plant in Salt Lake City in 1958. This addition gave Utah Pie a cost advantage over its competitors because the latter did not have any local plants. With its new facility, Utah Pie quickly achieved market leadership in the Salt Lake City area and relinquished it only briefly during the complaint period. Each respondent, however, was a large national company that dominated the frozen pie market in one or more other regions of the country. Thus, despite Utah Pie's volume and overall market share leadership in the local area, it was hardly a financial power that instilled fear into the hearts of the respondents.<sup>85</sup>

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82. See notes 34-63 *supra* and accompanying text.

83. Compare *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079) with *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th Cir. 1980).

84. See, e.g., *Pacific Eng'r & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977); *Barry Wright Corp. v. ITT-Grinnell Corp.*, 1980-1 Trade Cas. ¶ 63,862 (D. Mass. 1981); *O. Hommel Co. v. Ferro Corp.*, 472 F. Supp. 793 (W.D. Pa. 1979), *rev'd*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116). See also note 92 *infra*.

85. Utah Pie's volume expanded from nearly 40,000 dozen in 1958 to over 102,000

During at least some of the relevant complaint period, which encompassed all of 1958 through August of 1961, each respondent charged less for its frozen pies in the Salt Lake City area than it did elsewhere—even taking into account cost differences such as trans-shipment expenses. Continental Baking's prices were not only geographically discriminatory, but also below its "direct cost plus an allocation for overhead" in the local market.<sup>86</sup> Pet Milk apparently also incurred larger losses on its operations in the Salt Lake City market than in other markets. Indeed, Pet acknowledged that at one time it had placed an industrial spy in Utah Pie's plant.<sup>87</sup>

The jury in *Utah Pie* failed to find a conspiracy or other Sherman Act violation, but it did find Robinson-Patman Act violations.<sup>88</sup> The Court of Appeals for the Tenth Circuit reversed, however, and held that Pet's prices for private label pies were justified because of the difference between Pet's costs in the Salt Lake City area and its costs in other markets.<sup>89</sup> The court also ruled that insufficient evidence existed from which the jury reasonably could have concluded that the other alleged geographic price discriminations by all three respondents had caused the requisite deleterious effect on competition.<sup>90</sup> The Supreme Court, with Justice White speaking for the majority, reversed the court of appeals and remanded the case for further consideration.<sup>91</sup>

The Court's opinion in *Utah Pie* may be interpreted narrowly as merely a sufficiency of the evidence case. Indeed, this interpretation may be one of the reasons why recent predation decisions generally have declined to rely heavily upon the case.<sup>92</sup> A more

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dozen in 1961. Its sales volume steadily increased from \$353,000 in 1958, to \$430,000 in 1959, to \$504,000 in 1960, and to \$589,000 in 1961. During these same years, however, Utah Pie's market share was less consistent—66.5% in 1958, 34.3% in 1959, 45.5% in 1960, and 45.3% in 1961. The market's rapid expansion may explain some of this erratic performance. In 1959, however, Pet was the market share leader with 35.5% of the market—1.2% more than Utah Pie. In the following year Pet lost over five share points, and Utah Pie gained more than eleven; Utah Pie's net income was also erratic, showing \$7,090, \$11,897, \$7,636, and \$9,216 in the four successive years of the complaint period. 386 U.S. at 689-91, 691-92 n.7.

86. *Id.* at 698.

87. *Id.* at 697.

88. *Utah Pie Co. v. Continental Baking Co.*, 349 F.2d 122, 126 (10th Cir. 1965), *rev'd*, 386 U.S. 685 (1967).

89. *Id.* at 148, 150.

90. *Id.* at 152, 153.

91. 386 U.S. at 704.

92. *See International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). The Fifth Circuit in *American Excelsior* distin-

convincing explanation for this benign neglect, however, is that, from the perspective of current economic theory, the Court's analysis in *Utah Pie* is somewhat superficial and outmoded. The opinion, therefore, is difficult to interpret meaningfully and apply. Notwithstanding these deficiencies, the Court's treatment of three issues in *Utah Pie* deserves some discussion here.

First, in recounting the evidence of Continental Baking's predatory conduct against Utah Pie Company, the Supreme Court observed not only that Continental's price was geographically discriminatory, but also that it was "less than its direct cost plus an allocation for overhead."<sup>93</sup> While this language arguably invites an interpretation that the Court was applying an average total cost standard, the Court did not indicate how this formula would be computed in practice. In particular, the Court failed to specify the amounts and types of overhead costs that would be allocated. It did not state, for example, whether promotional costs or the opportunity costs of capital would be included in the calculation. The answers to these questions cannot be discerned from the opinion because the Court provided no theoretical or other basis for its standard.<sup>94</sup> The Court also failed to articulate the standard's legal significance; that is, whether pricing above "direct cost plus an allocation for overhead" satisfies a bright-line test for lawful pricing, invokes a rebuttable presumption of legality, or merely provides one evidentiary signal that the pricing level is not unlawful.<sup>95</sup> Notwithstanding this lack of specificity, however, *Utah Pie* reasonably may be interpreted as mildly supportive of an average total cost, as opposed to average variable cost, standard.

Second, some commentators assert that "intent does not serve any useful role in arguments about predation."<sup>96</sup> The essence of

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guished *Utah Pie* on the ground that the Supreme Court in *Utah Pie* had been concerned with the quantum of proof necessary to establish a prima facie case, while the circuit court found itself concerned with the quantum of proof necessary to sustain a motion for a directed verdict. *Id.* at 724 n.30. Similarly, in *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir.), petition for cert. filed, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116), the circuit court read *Utah Pie* as limited only to geographic—as opposed to selective—price discrimination when evidence revealed both predatory intent and harm to competition. See also *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981).

93. 386 U.S. at 698.

94. At all other relevant points in the opinion, the Court referred merely to "below-cost pricing," without defining its concept of cost. *Id.* at 696 n.12, 701, 702, 702-03 n.14.

95. See *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917, 945 n.50 (9th Cir. 1981).

96. Easterbrook, *supra* note 18, at 280-81.

this position is that if certain business conduct is not economically harmful, it should be of no legal concern, regardless of the alleged wrongdoer's underlying intent. Other commentators, however, hold a different view. Professor Posner, for example, includes an intent element in his definition of predation, which focuses on the intent to exclude an equally or more efficient competitor.<sup>97</sup> Similarly, Professor Sullivan asserts that "antitrust laws need not disregard the pernicious."<sup>98</sup>

The Supreme Court's decision in *Utah Pie* clearly supports the view that intent is relevant to a claim of predation. The Court stated that

Chief Justice Hughes noted in a related antitrust context that the "knowledge of actual intent is an aid in the interpretation of facts and prediction of consequences." *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 372, and we do not think it unreasonable for courts to follow that lead. Although the evidence in this regard against Pet seems obvious, a jury would be free to ascertain a seller's intent from surrounding economic circumstances, which would include persistent unprofitable sales below cost and drastic price cuts themselves discriminatory.<sup>99</sup>

Applying this notion, the Court determined that "persistent sales below cost and radical price cuts themselves discriminatory" cannot be ascribed merely to "fierce competitive instincts."<sup>100</sup>

The Supreme Court's view in *Utah Pie* on the issue of intent represents the mainstream position of both the traditional and the more recent predation cases.<sup>101</sup> As Professor Bork described this conventional view: "Antitrust law has never clearly defined what it means by predation, but the concept clearly contains an element of wrongful or specific intent, of a deliberate seeking of market power through means that would not be employed in the normal course of competition."<sup>102</sup>

While concentrating solely on effect may be attractive either

97. R. POSNER, *supra* note 24, at 188. Easterbrook observes that Posner's concept of intent is a limited one which is designed to narrow a cost-based rule that would otherwise sweep within its purview many instances of desirable competitive conduct. Easterbrook also notes that Posner has criticized the overuse of intent evidence in other contexts. Easterbrook, *supra* note 18, at 280-81 (citing R. POSNER, *supra* note 24, at 41-77, 189-91).

98. L. SULLIVAN, *supra* note 1, at 111. See also NCRALP REPORT, *supra* note 68, at 150.

99. 386 U.S. at 696-97 n.12 (citing F. ROWE, *supra* note 75, at 141-50).

100. *Id.* at 702-03 n.14.

101. See, e.g., *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981); *SuperTurf v. Monsanto Co.*, 1981-2 Trade Cas. ¶ 64,316 (8th Cir. 1981).

102. R. BORK, *supra* note 13, at 144.

in theory or to those who urge that antitrust enforcement be used exclusively for remediation, assessing that effect in practice is hardly a mechanical process. To the extent that sales below cost are accepted as inevitably leading to the undesirable effect, it is nonetheless true that applying either of the cost-based tests is no easier for a business to perform *ex ante* than for a court to perform *ex post*. The available data is too frequently incomplete, unreliable, or ambiguous, and a business would have as much difficulty avoiding transgressions as a court would have in redressing them.<sup>103</sup> It seems fair to assume, however, as an aid to analysis, that conduct is most likely to have anticompetitive effects when it is intended from the outset to be predatory. Because sales below cost typically lack a rational business justification, they must stem either from accident or from predatory intent. Accordingly, independent evidence of intent continues to be an important interpretive factor that, along with evidence of means and competitive effects, is weighed to determine whether or not a particular course of conduct is "unreasonably exclusionary."<sup>104</sup>

Last, *Utah Pie* is probably most vulnerable to criticism for its evaluation of competitive harm. The major effect of the predation and price discriminations that the Court found was a general decline in the market's price structure. Up to a point, however, lower prices typically benefit consumers and indicate vigorous competition.<sup>105</sup> Nevertheless, the Supreme Court in *Utah Pie* looked less to the potential benefit to consumer welfare and more to Utah Pie Company's inability to generate the funds it otherwise could have obtained had prices been higher. While some below cost pricing existed, the Court neither limited its concern over the deteriorat-

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103. Determining the appropriate price and cost figures, for example, requires many judgment calls about the method of allocating costs among purportedly relevant geographic markets, product markets, and time periods.

104. The Court of Appeals for the Second Circuit, for example, echoed the *Utah Pie* approach by stating that "[w]here a course of action is ambiguous, 'consideration of intent may play an important role in divining the actual . . . conduct.'" *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 288 (2d Cir. 1979) (quoting *United States v. United States Gypsum Co.*, 438 U.S. 422, 436 n.13 (1978)), *cert. denied*, 444 U.S. 1093 (1981). See also *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981).

105. As discussed earlier, see notes 17-18 *supra* and accompanying text, a firm usually will not find it profitable to price below cost unless the situation is one in which either deep-pocket predation will be effective because strategic or structural factors such as high entry barriers are present. Thus, the assumption that the firms which charge low prices are efficient and engaging in desirable conduct from the standpoint of consumer welfare is normally correct.

ing price structure to below-cost pricing nor indicated that this type of pricing had any greater significance than the other conduct at issue. Furthermore, the record gave no indication that the respondents would have been able to achieve and exploit monopoly power in the unlikely event of Utah Pie's demise.<sup>106</sup> The Supreme Court nonetheless held,

[W]e disagree with [the court of appeals'] apparent view that there is no reasonably possible injury to competition as long as the volume of sales in a particular market is expanding and at least some of the competitors in the market continue to operate at a profit. Nor do we think that the [Robinson-Patman] Act only comes into play to regulate the conduct of price discriminators when their discriminatory prices consistently undercut other competitors. . . . We believe that the Act reaches price discrimination that erodes competition as much as it does price discrimination that is intended to have immediate destructive impact. In this case, the evidence shows a drastically declining price structure which the jury could rationally attribute to continued or sporadic price discrimination.<sup>107</sup>

The Supreme Court's evaluation in *Utah Pie* of below cost pricing was cursory at best, and its assessment of price discrimination failed to consider whether the discrimination at issue was desirable or undesirable from the perspective of maintaining a vigorously competitive market. For all its faults, however, *Utah Pie* is still a precedent that could be resurrected or interpreted anew at any time. The Court's holding that a firm does not have to be failing or unprofitable to be a victim of predation, for example, may have bearing on future cases that seek either to address strategic forms of predation or to secure a remedy before the competitive situation becomes irretrievable. Nonetheless, this potentially useful holding appears to have been an accident of shallow reasoning, and its import for future cases, therefore, is questionable.<sup>108</sup>

### III. STANDARDS AND TRENDS

While enjoying great latitude, the lower courts have not been entirely free from either statutory or precedential constraints in

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106. The Supreme Court's failure to address these considerations in *Utah Pie* has exposed the decision to harsh criticism. See, e.g., Bowman, *Restraint of Trade by the Supreme Court: The Utah Pie Case*, 77 YALE L.J. 70 (1967). For a discussion of the relevance and importance of these considerations to the existence of predation, see notes 136-42 *infra* and accompanying text.

107. 386 U.S. at 702-03.

108. Thus, the Third Circuit in *Hommel*, for example, emphasized that plaintiffs had enjoyed a stable market share during the complaint period to bolster its finding that defendants had caused no competitive harm. *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116).

their attempts to decide predation cases. Within the contours of the antitrust statutes and the traditional interpretations of predatory conduct, the courts have been struggling to grasp and incorporate the myriad new proposals for analyzing predation. Some trends and rough standards now seem to be emerging from their efforts. This part of the Article attempts to identify these standards and trends and examine them in some detail. The part focuses on the three categories of activity that the commentators and courts have regarded as the most significant subjects for predation analysis: Pricing, innovation, and promotion.<sup>109</sup> Despite the recurring themes and common economic and policy issues, the trends in each area largely have developed independently and are based on factual and theoretical considerations unique to the particular type of activity.<sup>110</sup> This part, therefore, separately addresses each of the three areas to provide an accessible guide to the practitioner who is attempting to reconcile factual, theoretical, and economic concerns about predation with the apparent diversity of judicial precedents. The recent cases that have been selected<sup>111</sup> to illustrate these trends address the substantive standards<sup>112</sup> for evaluating a defen-

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109. Other types of assertedly predatory conduct include the following: (1) exclusive dealing arrangements, *see, e.g.*, *Fleer Corp. v. Topps Chewing Gum, Inc.*, 1980-1 Trade Cas. ¶ 63,420 (E.D. Pa. 1980), *rev'd*, 1981-2 Trade Cas. ¶ 64,249 (3d Cir. 1981); (2) refusals to deal, *see, e.g.*, *Almeda Mall, Inc. v. Houston Lighting & Power Co.*, 615 F.2d 343 (5th Cir. 1980); *Byars v. Bluff City News Co.*, 609 F.2d 843 (6th Cir. 1979); *Aladdin Oil Co. v. Texaco, Inc.*, 603 F.2d 1107 (5th Cir. 1979); *Pacific Coast Agricultural Export Ass'n v. Sunkist Growers, Inc.*, 526 F.2d 1196 (9th Cir. 1975), *cert. denied*, 425 U.S. 959 (1976); *United States v. CBS Inc.*, 459 F. Supp. 832 (C.D. Cal. 1978); (3) shifting from a system of dual- to self-distribution, *see, e.g.*, *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980); *Knutson v. Daily Review, Inc.*, 548 F.2d 795 (9th Cir. 1976), *cert. denied*, 433 U.S. 910 (1977); *Coleman Motor Co. v. Chrysler Corp.*, 525 F.2d 1338 (3d Cir. 1975); (4) tying arrangements and full line forcing, *see, e.g.*, *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir.), *cert. denied*, 439 U.S. 838 (1978); *Sargent-Welch Scientific Co. v. Ventron Corp.*, 567 F.2d 701 (7th Cir. 1977), *cert. denied*, 439 U.S. 822 (1978); (5) vertical price squeezes, *see, e.g.*, *City of Mishawaka v. American Elec. Power Co.*, 616 F.2d 976 (7th Cir.), *cert. denied*, 449 U.S. 1096 (1981); *Columbia Metal Culvert Co. v. Kaiser Aluminum & Chem. Corp.*, 579 F.2d 20 (3d Cir.), *cert. denied*, 439 U.S. 876 (1978); and (6) vexatious litigation, *see, e.g.*, *Handgards, Inc. v. Ethicon, Inc.*, 601 F.2d 986 (9th Cir. 1979), *cert. denied*, 444 U.S. 1025 (1980); *Lektro-Vend Corp. v. Vendo Corp.*, 1980-2 Trade Cas. ¶ 63,444 (N.D. Ill. 1980).

110. The categories also are distinguishable according to the volume and sophistication of legal and economic literature that has appeared to treat the particular type of conduct. Pricing conduct, for example, has received careful, thorough scholarly scrutiny, but the theoretical analysis of predatory innovation is comparatively rudimentary. *See* note 207 *infra* and accompanying text.

111. For an explanation of the selection criteria, *see* note 294 *infra*. A list of the 57 cases that have been chosen is contained in Appendix A.

112. A good number of published opinions have dealt with issues unrelated to sub-

dant's pricing, innovation, or promotion conduct within the context of federal antitrust law.<sup>113</sup>

### A. Pricing

Pricing cases account for the single largest group of reported opinions that have dealt with antitrust predation claims since 1975.<sup>114</sup> Collectively, the pricing decisions are perhaps most interesting because they contain the greatest diversity of judicial views, reflect the most sophisticated economic analysis, and are sufficiently numerous to permit an identification of significant trends over time. This section first discusses generally the effects of the academic debate that was reviewed in part II upon post-1975 judicial treatments of predatory pricing claims. It then examines the evolution of legal standards governing pricing behavior, giving particular attention to the factors that judges have used to evaluate pricing practices whose long-term consumer welfare effects are subject to dispute. Finally, this section provides a suggested framework for analyzing future judicial clarifications of existing standards and emphasizes cases on which the circuit courts or the Supreme Court are likely to rely in addressing future predation claims.

#### 1. General Trends in the Interplay of Economic Analysis and Judicial Decisionmaking

One of the most striking features of antitrust case law since 1975 is the judiciary's increased reliance on economic analysis to assess the legality of business pricing behavior. The economic commentary reviewed in part II for the most part has displaced earlier

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stantive standards for judging predatory conduct. *See, e.g.*, *Heille v. City of St. Paul*, 1981-1 Trade Cas. ¶ 63,997 (D. Minn. 1981) (interstate commerce requirement); *Bangor Punta Corp. v. Marine Distribs., Inc.*, 1981-1 Trade Cas. ¶ 64,006 (E.D. Mich. 1981) (standing); *Zenith Radio Corp. v. Matsushita Elec. Indus. Co.*, 513 F. Supp. 1100 (E.D. Pa. 1981) (predatory pricing issues were not reached because the case was decided on other substantive grounds); *Litton Systems, Inc. v. AT&T Co.*, 487 F. Supp. 942 (S.D.N.Y. 1980) (effect of state and federal regulatory schemes upon court's jurisdiction to treat antitrust claims).

113. For a list of the state statutes that prohibit anticompetitive conduct, see note 65 *supra*. In addition, some of this activity, particularly in the area of promotion, may be challenged on unfair competition or trade regulation grounds under statutes other than the antitrust laws. *See, e.g.*, *National Ass'n Regulatory Util. Comm'rs v. FCC*, 525 F.2d 630 (D.C. Cir.), *cert. denied*, 425 U.S. 992 (1976) (Federal Communications Act); *National Distrib. Co. v. U.S. Treasury Dep't, Bureau of Alcohol, Tobacco and Firearms*, 626 F.2d 997 (D.C. Cir. 1980) (Federal Alcohol Administration Act).

114. Of the 57 opinions that have been singled out in this Article, 51 discuss pricing issues.

case law as the foundation for the courts' recent evaluations of various pricing practices.<sup>115</sup> The vast majority of reported opinions in the past six years—with virtually no exceptions—has attempted to analyze challenged pricing strategies and their legal consequences in fundamentally economic terms.<sup>116</sup> Although the exact boundaries of existing pricing doctrine remain ill-defined, a litigant who fails to address the current and developing economic thought in the field unquestionably runs a substantial risk of defeat.<sup>117</sup>

While microeconomic theory is now a standard tool of judicial pricing analysis, the courts' abrupt transformation of contemporary economic scholarship into legal doctrine has not been frictionless. Two major pitfalls have accompanied this rapid absorption process, which has recast a major field of antitrust law. First, as the discussion in part II demonstrates, the recent economic literature is an intricate, often technically complex, body of material. As a consequence, some courts have found it difficult to master the concepts underlying the proposed liability theories and sometimes have applied them erroneously. Although commentators in principle have approved of the courts' efforts at more sophisticated economic analysis, they have pointed to several instances in which a

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115. Although the principal figures in the academic debate disagree on the merits of the different economic tests that have guided the courts' analyses, they look favorably upon the increasingly economic orientation of judicial thought in this area. See Areeda, *supra* note 37, at 909; *Roundtable on Predatory Practices*, *supra* note 48, at 625.

116. One common example of the courts' greater sensitivity to economic theory in recent pricing opinions is their adoption of the prevailing economists' definition of the general dynamic of predation as a trade-off of short-term revenues for long-term monopoly profits. See notes 11-17 *supra* and accompanying text. The District Court for the District of Columbia underscored this point in a recent opinion that dealt with the government's challenge to certain pricing practices of the American Telephone and Telegraph Company:

[A]lthough economists disagree on the frequency with which the phenomenon of predatory pricing occurs, the conditions under which it is likely to exist, and the indicia by which it may be detected, there is consensus that the term refers to "the deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition." *United States v. AT&T Co.*, 1981-2 Trade Cas. ¶ 64,277, at 74,245 (D.D.C. 1981) (citing 3 P. AREEDA & D. TURNER, *supra* note 37, ¶ 711b, at 151 (1978)). See also *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917, 931-32, 932 n.5 (9th Cir. 1981).

117. This fact is particularly evident in the rigor with which trial judges have dismissed—with the affirmance of appellate courts—the pricing allegations of plaintiffs who either introduced no data that revealed the defendant's cost/price relationships or whose complaints transparently rested on little more than dissatisfaction with the defendant's ability to price below the plaintiff's own costs. See, e.g., *Americana Indus. Inc. v. Wometco de Puerto Rico, Inc.*, 556 F.2d 625 (1st Cir. 1977); *Flair Zipper Corp. v. Textron, Inc.*, 1980-2 Trade Cas. ¶ 63,555 (S.D.N.Y. 1980); *Outboard Marine Corp. v. Pezetel*, 461 F. Supp. 384 (D. Del. 1978); *General Communications Eng'r, Inc. v. Motorola Communications & Elecs., Inc.*, 421 F. Supp. 274 (N.D. Cal. 1976).

misapprehension of economic theory significantly affected a court's application of an economically based rule.<sup>118</sup>

A second—and more serious—problem, however, stems from the courts' attempts to give a decisive legal effect to ideas that are still maturing and that have failed to command a consensus even among economists. The swift evolution of predation literature since 1975 has made it difficult for courts to rely confidently on any single, proposed liability theory, since subsequent scholarship may well undercut or substantially refine important elements of that theory. This difficulty was evident in some of the early judicial efforts to apply the Areeda/Turner marginal cost test.<sup>119</sup> As Professors Brodley and Hay have noted, the Areeda/Turner proposal initially seemed to some courts to offer an effective, comparatively simple solution to a problem that until that time had been a "loosely structured, somewhat opaque area of law in which the generality of the legal standard left room for the exercise of judicial discretion."<sup>120</sup> The Areeda and Turner article, on the other hand, presented an alternative to this "amorphous legal doctrine" in

a well conceived economic theory joined to a proposed rule of law. Anchored squarely on the economic theory of the firm, expounded through standard economic diagrams, and exhibiting a sharp awareness of the constraints of the legal process, the Areeda-Turner proposal presented a beguilingly simple legal standard: short run marginal cost pricing. This standard simultaneously offered the axiomatic certainty of scientifically deduced truth, and the administrative advantage of a drastically simplified legal rule.<sup>121</sup>

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118. The most severely criticized opinion on this point is the trial court's decision in *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 461 F. Supp. 410 (N.D. Cal. 1978), *rev'd*, 652 F.2d 917 (9th Cir. 1981). See Brodley & Hay, *supra* note 34, at 768; Greer, *supra* note 53. Some judges have used their own opinions to identify and correct the technical errors of their colleagues. See, e.g., *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 992 & n.65 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980) (criticizing the Ninth Circuit's opinion in *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727 (9th Cir. 1979), and the district court's opinion in *Murphy Tugboat Co. v. Shipowners & Merchants Towboat Co.*, 467 F. Supp. 841 (N.D. Cal. 1979), *aff'd sub nom. Murphy Tugboat Co. v. Crowley*, 658 F.2d 1256 (9th Cir. 1981), *petition for cert. filed*, 50 U.S.L.W. 3592 (U.S. Jan. 13, 1982) (No. 81-1323).

119. For a description of the Areeda/Turner rule, see notes 43-48 *supra* and accompanying text.

120. Brodley & Hay, *supra* note 34, at 792.

121. *Id.* at 792-93. Brodley & Hay suggest that although the Areeda/Turner article in 1975 was attuned to the capabilities of the judicial process, their lucid combination of economic and legal analysis was what made their proposal especially influential, even though in the 1960s both Professor McGee and the Neal Report had suggested cost-based tests of their own for addressing predatory pricing under the Robinson-Patman Act. See REPORT OF THE WHITE HOUSE TASK FORCE ON ANTITRUST POLICY (NEAL REPORT), 411 ANTITRUST & TRADE REG. REP. (BNA) A-1 (May 27, 1969); McGee, *supra* note 34.

With narrowly drawn qualifications, some courts—most notably the Fifth Circuit in *International Air Industries, Inc. v. American Excelsior Co.*<sup>122</sup> and the Ninth Circuit in *Hanson v. Shell Oil Co.*<sup>123</sup>—promptly embraced the Areeda/Turner rule, at least in part because of the two courts' belief that the rule represented a widely accepted economic view.<sup>124</sup> Several years of critical commentary on this standard, however, made it clear that any presumed consensus on the marginal cost test was illusory.<sup>125</sup> Because of this sharp academic debate, the Fifth Circuit subsequently has implicitly voiced second thoughts about its *International Air* position,<sup>126</sup> and the Ninth Circuit has retreated considerably from its

122. 517 F.2d 714 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

123. 541 F.2d 1352 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977). Affirming the trial court's directed verdict for the defendant, the court adopted an especially strict interpretation of the marginal cost rule. The court stated that plaintiff's failure to show pricing below marginal or average variable cost constituted "a failure as a matter of law to present a prima facie case under Section 2." *Id.* at 1359.

124. *Id.* at 1358-59; *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 723-25 & n. 21 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

125. As discussed in part II *supra*, many scholars have taken issue with the Areeda/Turner marginal cost proposal. See, e.g., R. POSNER, *supra* note 24; Scherer, *supra* note 36; Williamson, *supra* note 21.

126. See *Malcolm v. Marathon Oil Co.*, 642 F.2d 845 (5th Cir.), *cert. denied*, 50 U.S.L.W. 3486 (U.S. Dec. 14, 1981) (No. 81-874). In *Malcolm* an independent gasoline retailer alleged that defendant oil companies conspired to discipline him for his discount marketing strategy by collusively selling their gasoline below cost. The lower court directed a verdict for defendants on the ground that Malcolm had failed to prove the fact of injury and the amount of damages. The trial judge did not address the liability standard. The Fifth Circuit reversed and remanded. For purposes of the appeal, the court assumed that plaintiff had "sufficiently alleged and proved actions in violation of the antitrust laws." *Id.* at 847. In a lengthy footnote, which cited several circuit cases—including *International Air*—the court stated that "[t]he Courts of Appeal have recently shown varying degrees of favor toward cost-based tests such as the test proposed by Areeda & Turner." *Id.* at 854 n.17. The court then recounted the debate over the desirability of various tests:

This consideration of cost-based tests meets with mixed results. Professors Areeda and Turner would generally welcome such a trend. And these developments have been hailed by others. . . . But, as noted above, Professor Sullivan has an aversion to cost-based tests, and following the beginning of this trend, scholars have voiced objections to the accuracy and hence desirability of Areeda and Turner's cost-based test. . . .

This Court need not presently offer its views on this debate. But before he may get his case to a jury, Malcolm must establish the existence of the substantive violation of predatory pricing in the time period and markets for which he intends to claim damages. On this appeal, he is greatly aided by our assumption that he proved the substantive violation alleged.

*Id.* (citations omitted).

What this footnote portends for future Fifth Circuit decisions is, of course, a matter of speculation. Judge Tuttle, who wrote the *Malcolm* opinion, and Judge Godbold, who sat on the *Malcolm* panel, were both members of the *International Air* court. On the one hand, it is not surprising that the court did not use the occasion to announce its continued adherence to the *International Air* position, since the *Malcolm* appeal did not require a ruling on

holding in *Hanson*.<sup>127</sup> The critical academic commentary and the shift in position by some circuit courts also have prompted at least two district courts to modify substantially their initial adherence to relatively firm marginal cost rules.<sup>128</sup>

These substantial and relatively rapid modifications that some courts have made of their original standards are important for two reasons. First, they graphically demonstrate the pervasive influence that academicians have exerted on the courts' analyses of predatory pricing law. Each round of commentary has stimulated corresponding attempts by courts to incorporate these new insights into their decisions. Judicial experience in applying the academic proposals in turn has prompted further scholarship to reexamine and refine previous proposals in light of their practical effects. This dialectic should continue to shape the growth of predatory pricing doctrine.<sup>129</sup>

Second, these changes have suggested that the a principal policy basis for articulating definitive per se standards—the need for both predictability, which enables businesses to plan their affairs,

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the pricing standard. On the other hand, the tone and content of Judge Tuttle's remarks, which emphasized the diversity of judicial views and the evolving, sometimes sharp debate among antitrust scholars, may indicate the court's willingness in future cases to consider approaches that depart from the *International Air* formula.

127. See *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981). Speaking for the court, Judge Sneed wrote,

[W]e hold that to establish predatory pricing a plaintiff must prove that the anticipated benefits of defendant's price depended on its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power. If the defendant's prices were below average total cost but above average variable cost, the plaintiff bears the burden of showing defendant's pricing was predatory. If, however, the plaintiff proves that the defendant's prices were below average variable cost, the plaintiff has established a prima facie case of predatory pricing and the burden shifts to the defendant to prove that the prices were justified without regard to any anticipated destructive effect they might have on competitors.

*Id.* at 940. For a discussion of this burden-shifting approach, see notes 136-42, 171-82 *infra* and accompanying text. See also *Arizona v. Maricopa County Medical Soc'y*, 643 F.2d 553, 559 n.6 (9th Cir. 1980), *cert. granted*, 450 U.S. 979 (1981).

128. Compare *Robert's Waikiki U-Drive, Inc. v. Budget Rent-A-Car Systems, Inc.*, 491 F. Supp. 1199 (D. Hawaii 1980) (summary judgment entered for failure to show pricing below average variable cost) and *Lormar, Inc. v. Kroger Co.*, 1979-1 Trade Cas. ¶ 62,498 (S.D. Ohio 1979) (suggesting a marginal cost standard and relying upon authorities endorsing such a test) with *Island Tobacco Co. v. R.J. Reynolds Indus., Inc.*, 513 F. Supp. 726, 738 (D. Hawaii 1981) (purely cost-based tests "ignore important factors going to the motive and intent of the actor") and *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947 (S.D. Ohio 1981) (allowing a presumption of legality for pricing above average variable cost that may be rebutted by evidence of intent and entry barriers).

129. Professor Easterbrook has stated that "[t]here is a highly competitive market for predatory pricing theories," and that he sees no sign which would indicate that this rivalry will diminish soon. Easterbrook, *supra* note 18, at 263.

and continuity, which helps to build a dependable body of precedent—may not be well served by rapid adoption of a per se standard in an area subject to continuing major doctrinal development. Only three years after its virtually unqualified adoption of the Areeda/Turner standard in *Hanson*, the Ninth Circuit, acknowledging the vigorous academic debate over predatory pricing, stated that “refinement of the marginal or average variable cost test will be necessary as future cases arise.”<sup>130</sup> Less than two years later, the same court abandoned its per se *Hanson* approach for a test that held pricing below average variable cost to create only a burden-shifting presumption of predation and invited a broader evaluation of the reasonableness of pricing above average variable cost.<sup>131</sup> This sort of reversal strongly suggests the undesirability of approaches that entail initial judicial acceptance of relatively rigid rules, but which require a subsequent, abrupt revision of those rules as academic understanding of the issue changes. For the future, the courts should instead rely mainly upon rebuttable presumptions that permit the parties to demonstrate, within limits, the reasonableness or unreasonableness of the different pricing strategies. This form of bounded, rule of reason inquiry is better suited to incremental change through a gradual absorption of new economic theory.<sup>132</sup> Even though such approaches admittedly would not provide the clarity of a conclusive per se standard, they at least would allow for more predictability and continuity than is now available.

## 2. Evolving Legal Standards

Although the literature and case law are likely to continue to

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130. *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727, 743 (9th Cir. 1979).

131. See note 127 *supra* and accompanying text.

132. In *William Inglis & Sons Baking Co. v. ITT Continental Baking Inc.*, 652 F.2d 917 (9th Cir. 1981), the Ninth Circuit stated that the proper method for minimizing the risks of adopting too lenient or too harsh a standard was “to eschew dogmatic adherence to a particular, rigid test and to fashion broad and flexible objective standards concerned with accurately evaluating the purposes of business behavior.” *Id.* at 935 n.18. Professors Brodley and Hay have suggested that the courts’ relatively uncritical acceptance of the Areeda/Turner test and their subsequent retreat in the face of critical commentary “raises questions, bound to become more pressing in a scientific age, of how courts should use new developments in economic or scientific theory.” Brodley & Hay, *supra* note 34, at 794. They conclude their article by asking whether it would not be appropriate to have a “renewed emphasis on the values and insights inlaid in long-standing judicial experience, built upon case-by-case adjudication, and on the advantage of incremental policy change, achieved gradually and with opportunity for self-correction.” *Id.*

undergo refinement, it is nevertheless possible to discern some general standards in the courts' development of predatory pricing doctrine. This subsection discusses these doctrinal trends, first by reviewing the broad, overall presumptions that courts have articulated for determining the legality of pricing behavior and then by examining the specific factors that judges have emphasized in the recent trend toward applying a bounded rule of reason analysis to allegedly predatory behavior. The subsection closes with a brief evaluation of both the possibility of and the potential grounds for Supreme Court review of the issue of predatory pricing.

(a) *Basic Presumptions*

Courts and commentators have identified three distinct pricing zones that facilitate judicial analyses of business conduct: Pricing at or above average total cost; pricing below marginal cost (or reasonably anticipated average variable cost); and pricing at or above marginal cost, but below average total cost. A basic starting point for classifying the predatory pricing case law is to examine the legal significance that courts have attached to pricing within each of these zones. A companion inquiry is to determine whether proof in these cases that a party priced within a particular zone in itself resulted in a finding of liability—raising a conclusive presumption of illegality—or whether it merely shifted the burden of proof to the opposing party to demonstrate the reasonableness of its conduct—raising only a rebuttable presumption.

(1) Pricing At or Above Average Total Cost: A Conclusive Presumption of Legality

To begin with the least controversial zone, no court has held pricing at or above average total cost to be in and of itself illegal. Indeed, the few opinions that have explicitly stated a legal rule for pricing in this range have accorded the conduct per se legality.<sup>133</sup> Other opinions that have stopped short of articulating a specific rule invariably have absolved defendants of liability for pricing at or above average total cost.<sup>134</sup> Collectively, these decisions indicate

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133. See, e.g., *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 723 (5th Cir. 1975), cert. denied, 424 U.S. 943 (1976); *Richter Concrete v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947, at 75,883 (S.D. Ohio 1981); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 991 (N.D. Cal. 1979), appeal docketed, No. 80-4048 (9th Cir. Jan. 31, 1980); *Weber v. Wynne*, 431 F. Supp. 1048, 1059 (D.N.J. 1977).

134. See *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th

that most courts will conclusively presume the legality of pricing above average total cost, even when the plaintiff seeks to establish the impropriety of such behavior by pointing to market conditions or independent evidence of intent. Although this trend appears to be predominant, a few courts have expressly declined to endorse a standard that would absolutely preclude all plaintiffs' attempts to rebut a presumption of legality for pricing at or above average total cost.<sup>135</sup>

## (2) Pricing Below Marginal Cost: A Rebuttable Presumption of Illegality

Judicial treatments of conduct at the other extreme—pricing below marginal cost—are slightly more complex, but still relatively clear. The fundamental rule, which a number of courts have stated in slightly different ways, treats pricing below marginal cost—or its frequently used surrogate, reasonably anticipated average variable cost—as presumptively illegal.<sup>136</sup> The courts, however, have indicated that the defendant may attempt to rebut the presumption in various ways. For example, one district court has stated that a defendant may argue that excess capacity warranted pricing below average variable cost.<sup>137</sup> Another district court has articulated a version of the Robinson-Patman Act “meeting competition” de-

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Cir. 1980); *Pacific Eng'r & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977).

135. In its recent *Inglis* decision the Ninth Circuit briefly addressed the legality of pricing above average total cost, but remarked, “We emphasize that this case does not concern the possibility of proving predatory conduct when a defendant’s prices equal or exceed average total cost. . . . We express no opinion on the permissibility of such a claim.” *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917, 939 n.30 (9th Cir. 1981).

One other possible exception to this trend is the Federal Trade Commission’s *DuPont* decision, which evaluated the respondent’s pricing above average total cost in the light of other aspects of its investment and pricing conduct. *E.I. DuPont de Nemours & Co.*, 3 TRADE REG. REP. (CCH) ¶ 21,770, at 21,981 (Oct. 20, 1980). *See also In re Borden, Inc. (ReaLemon)*, 92 F.T.C. 669, 805 n.39 (1978), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979).

136. *See, e.g., William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981); *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079); *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714 (5th Cir. 1975). *See also In re Borden, Inc. (ReaLemon)* 92 F.T.C. 669 (1978), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979). For a discussion of the situation in which marginal cost exceeds average cost, see notes 43-44 *supra* and accompanying text.

137. *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 461 F. Supp. 410, 418-19 (N.D. Cal. 1978), *aff’d in part and rev’d in part*, 652 F.2d 917 (9th Cir. 1981).

fense.<sup>138</sup> Under this principle, a firm may drop its prices as low as necessary to meet its competitor's prices, even though pricing at that level will not cover marginal costs.<sup>139</sup> Yet another way in which a defendant may be able to rebut a presumption of illegality for below marginal cost pricing is to show that ease of entry would permit actual and potential rivals to deny defendant the possible rewards of a submarginal cost pricing strategy.<sup>140</sup> Finally, the Second Circuit in *Northeastern Telephone Co. v. American Telephone & Telegraph Co.*<sup>141</sup> held that a defendant may attempt to prove that its prices were "loss minimizing," even though they were below marginal cost.<sup>142</sup>

### (3) Pricing At or Above Marginal Cost but Below Average Total Cost: A Bounded Rule of Reason Standard

The third—and most complex—zone of pricing that facilitates judicial analysis is the region between average total cost and marginal cost. Although the opinions on this subject frequently provide strong suggestions of definitive standards for evaluating pricing in this range, they also contain sufficient qualifications or ambiguities to make any firm generalization treacherous. Nevertheless, the cases give enough indications of the courts' attitudes to provide a basis for the identification of developing trends. Cases that have dealt with pricing within this range have focused upon three possible standards for legality: (1) Pricing at or above marginal cost but below average total cost is conclusively presumed legal; (2) pricing at or above marginal cost but below average total cost is presumed legal, but the plaintiff can rebut the presumption by citing factors that demonstrate an anticompetitive purpose and effect—including evidence of intent, entry conditions, or other pernicious conduct; and (3) pricing within this range is presumed illegal, but the defendant can rebut the presumption through the same type of evidence that was noted above in the discussion of below marginal cost pricing. The difference between the second

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138. See *ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp.*, 458 F. Supp. 423 (N.D. Cal. 1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3126 (1981).

139. *Id.* at 433-34.

140. See *Murphy Tugboat Co. v. Crowley*, 454 F. Supp. 847, 854 n.8 (N.D. Cal. 1978).

141. 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

142. *Id.* at 91 n.24. The court stated that loss minimizing prices "are inconsistent with the intent to forego short term revenues—a necessary element of the offense of predatory pricing." *Id.*

and third standards is that the third standard would require a lesser amount of proof for the plaintiff to establish a prima facie case and shift the burden of going forward with the evidence to the defendant.

No opinion yet has held unequivocally that firms enjoy complete immunity from liability for their pricing decisions when their prices equal or exceed their marginal costs. By the tone and reasoning of their decisions, however, some courts have come extremely close to adopting this type of absolute pricing rule. The Second Circuit's opinion in *Northeastern Telephone* illustrates the application of a nearly conclusive presumption of legality standard, one which leaves a firm that prices at or above marginal cost in virtually no legal jeopardy.<sup>143</sup> Although the court's opinion may permit some review of prices above marginal cost when entry barriers are high,<sup>144</sup> the decision is otherwise a complete endorsement of the Areeda/Turner marginal cost standard.<sup>145</sup> In *Northeastern Telephone* the Second Circuit overturned a sixteen and one-half million dollar jury verdict that plaintiff, a telephone equipment supplier, had won against defendants American Telephone & Telegraph Company (AT&T), Western Electric Corporation, and Southern New England Telephone Company (SNET)—the Bell operating affiliate serving Connecticut. The court also reversed the trial court's findings that defendants had used anticompetitive pricing, advertising, product introduction, and marketing strategies to protect their monopoly position in the sale of telephone equipment.<sup>146</sup> The most significant aspect of the Second Circuit's opinion, however, is its intimation that pricing below marginal cost is essential to a "prima facie case of predatory pricing."<sup>147</sup>

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143. *Id.* at 86-93.

144. *Id.* at 88-89.

145. See notes 43-48 *supra* and accompanying text.

146. *Northeastern* had challenged defendants' conduct under both monopolization and attempt to monopolize theories. For the purposes of its opinion, the Second Circuit assumed that defendants possessed monopoly power in the relevant market. 651 F.2d at 85. With defendants' "power to control prices and to exclude entry" assumed, the sole issue before the court was whether their conduct was anticompetitive. *Id.*

The court ordered a new trial on *Northeastern's* claims that defendants had designed an unnecessarily expensive and inconvenient protective coupling device to deter people from purchasing plaintiff's goods and connecting them to the Bell network. *Id.* at 94-95. For a discussion of the court's treatment of the coupler issues, as well as of *Northeastern's* advertising and product introduction claims, see notes 210-11, 221-28 *infra* and accompanying text.

147. 651 F.2d at 91. The *Northeastern* opinion does not contain an explicit endorsement of a conclusive presumption of legality for pricing at or above marginal cost. The court expressed its general rule of decision in terms that were not absolute:

Four considerations prompted the *Northeastern Telephone* court to adopt the marginal cost test. First, the court concluded that a marginal cost rule would best serve the Sherman Act's competition policy goals.<sup>148</sup> Second, the court accepted the view of several commentators that predation seldom occurs in practice and thus does not warrant stringent scrutiny. The court stated that "[t]here is considerable evidence, derived from historical sources and from economic teaching, that predation is rare. . . . This does

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We agree with Areeda and Turner that *in the general case at least*, the relationship between a firm's prices and its marginal costs provides the best single determinant of predatory pricing. Thus prices below reasonably anticipated marginal cost will be presumed predatory, while prices above reasonably anticipated marginal cost will be presumed non-predatory.

*Id.* at 88 (emphasis added). This sort of modestly qualifying language is characteristic of the opinions that have adopted a rigid marginal cost rule most completely. *See, e.g.*, *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1358-59 & n.5 (9th Cir. 1976) (discussing, but not deciding, the availability of an entry barriers exception to an otherwise conclusive presumption of legality for pricing at or above marginal cost), *cert. denied*, 429 U.S. 1074 (1977). Thus, *Northeastern* would appear to permit—at least in principle—a litigant in the Second Circuit to argue that the special circumstances of its case warrant scrutiny of prices at or above marginal cost. For the reasons mentioned in the text accompanying notes 148-56, *infra*, however, it is also apparent that the *Northeastern* panel would place an especially heavy burden of persuasion on the party which sought to prove the illegality of pricing at or above marginal cost. Unlike other recent circuit court decisions dealing with predatory pricing, *Northeastern* gave only the faintest indication of what—if any—conditions would create liability for pricing above marginal cost.

148. The court suggested,

Adopting marginal cost as the proper test of predatory pricing is consistent with the procompetitive thrust of the Sherman Act. When the price of a dominant firm's product equals the product's marginal costs, "only less efficient firms will suffer larger losses per unit of output; more efficient firms will be losing less or even operating profitably." [Areeda & Turner, *supra* note 6, at 711]. Marginal cost pricing thus fosters competition on the basis of relative efficiency. Establishing a pricing floor above marginal cost would encourage underutilization of productive resources and would provide a price "umbrella" under which less efficient firms could hide from the stresses and storms of competition.

*Id.* at 87 (footnote omitted). The court did acknowledge that allowing a monopolist to drop its prices to its marginal costs could cause even a more efficient firm to lose money, but it concluded that such losses were "unlikely to have any serious anticompetitive effects" because the predator would suffer even greater losses. *Id.* at 87 n.14. The court reasoned that

[i]f the monopolist's marginal-cost price is below its average cost, not only will it be incurring greater losses per unit of output than the more efficient firm, but it will suffer those losses over a much greater range of output, since it will be making the vast majority of sales in the market. That the monopolist will suffer more than its rival will tend to negate whatever competitive benefits the monopolist may derive from its presumably superior wealth. Moreover, since the monopolist will have to raise his price eventually, the rival has a strong incentive to stay in the market, because its profits will exceed those of the monopolist at the new, higher price. *See generally* [McGee, *supra* note 34, at 295-97].

*Id.* at 87 n.14.

not mean, of course, that this behavior should no longer be deemed anticompetitive. But the rarity of the phenomenon informs our decision as to the appropriate legal definition."<sup>149</sup>

Third, the court believed that a strict marginal cost test could be applied simply and expressed concern about the ability of courts to implement correctly a standard that is any more complex. Emphasizing the "limits of the judicial process and the realities of the marketplace,"<sup>150</sup> the court pointed out that "[c]ourts occasionally err in applying even the clearest legal rules. The more complicated the standard, the greater the chance for misapplication."<sup>151</sup> Specifically, the court questioned the administrability of rules that would require judges to assess the probable long-term effects of a firm's pricing strategy<sup>152</sup> and proposed that an average total cost test also might raise technical accounting problems that would be considerably more difficult than those presented under a marginal cost standard.<sup>153</sup>

Last, the court found that entry into the telephone equipment market was relatively unimpeded.<sup>154</sup> To support its finding, the court pointed out that two businessmen had formed Northeastern in 1972 with a capital investment of \$1000, and the company's an-

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149. *Id.* at 88. On this point, the court appears to have attached great importance to the Areeda/Turner treatise, as well as to Professor McGee's 1980 predatory pricing article. *See* 3 P. AREEDA and D. TURNER, *supra* note 37; McGee, *supra* note 34.

150. 651 F.2d at 88.

151. *Id.*

152. *Id.* at 87-88 n.15. The court conceded in principle that a rule which considered long-run factors would be superior to a standard such as the Areeda/Turner test that focused solely on short-term consumer welfare. The court, however, stated that "we despair that economists will ever formulate workable criteria for reaching this goal. Certainly Scherer's approach [a full rule of reason analysis] cannot be applied in a judicial setting." *Id.* Nevertheless, beyond dismissing Scherer's method, *see* notes 61-63 *supra* and accompanying text, which arguably is the most intricate and complicated approach, the court's opinion failed to address other recent proposals such as the Joskow and Klevorick test, which seeks to enable judges to assess long-term effects at a tolerable administrative cost. *See* notes 15-17, 39 *supra* and notes 320-29 *infra* and accompanying text. The absence in the *Northeastern* opinion of any discussion of the Joskow/Klevorick approach for weighing long-term effects is curious in the light of the frequency with which the court drew upon other elements of the Joskow/Klevorick article to support its reasoning. *See, e.g.,* 651 F.2d at 86-89.

153. The court stated that

the more demanding average cost test of predatory pricing gives rise to serious problems when applied to a diversified enterprise. This is because the accounting conventions used to allocate joint costs, *i.e.,* those costs that are not directly attributable to a particular product, are all arbitrary to a degree.

651 F.2d at 89 n.19. For a further discussion of allocation and measurement problems, *see* notes 57-59 *supra* and accompanying text.

154. 651 F.2d at 89.

nual revenues had grown to \$3 million by 1978.<sup>155</sup> Plaintiff's experience indicated to the court that "barriers to entry into the business telephone equipment market were relatively low," and that the market "was not conducive to a policy of unremunerative pricing."<sup>156</sup>

Although *Northeastern Telephone* makes extensive use of modern developments in economic theory in analyzing allegedly predatory behavior, the case today represents a minority view among courts that have addressed the legality of pricing between marginal cost and average total cost. Most recent opinions have acknowledged that marginal cost is an important benchmark for analyzing claims of predation, but they have refused to make it an almost exclusive measure of lawfulness. In *Pacific Engineering & Production Co. v. Kerr-McGee Corp.*,<sup>157</sup> for example, the Tenth Circuit gave considerable attention to the marginal cost test, but it also found that other elements were relevant to its analysis. Speaking for the court, Judge Hill stated,

We believe that evidence of marginal cost or average variable cost is extremely beneficial in establishing a case of monopolization through predatory pricing. . . .

. . . .

Although we do not intend to adopt a solely cost-based test, there are no other relevant factors indicating [this defendant's] conduct was anticompetitive even in the long run.<sup>158</sup>

Thus, the content and depth of plaintiff's case, and not any reluctance to evaluate other pertinent criteria—including those factors that might help predict long-run effects—apparently was what limited the scope of the court's inquiry.

Similarly, the Seventh Circuit in *Chillicothe Sand & Gravel*

155. *Id.* at 80, 89 n.18.

156. *Id.* at 89. This conclusion, however, is inconsistent with the court's assumption that defendants possessed the "power to control prices and exclude entry" in the relevant market. *Id.* at 85.

157. 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977). In *Pacific Engineering*, the Tenth Circuit reversed a nonjury verdict that Kerr-McGee had monopolized and attempted to monopolize the market for ammonium perchlorate, a major component of solid rocket fuel. Among other practices, Pacific Engineering alleged that defendant had priced below cost to obtain supply contracts with the federal government, which was the fuel's sole purchaser.

158. *Id.* at 797. The court did not expressly indicate what other factors might be relevant, but its extensive discussion of the substantial excess capacity in the industry—the capacity of each firm exceeded total demand—suggests that it excused defendant's sales at prices below average total cost because they were simply a means of minimizing losses. *Id.* at 796-97.

*Co. v. Martin Marietta Corp.*<sup>159</sup> rejected the notion that otherwise relevant factors should be ignored in a predation case because they are too difficult to apply. The court observed that marginal cost indeed was "a relevant and an extremely useful factor," but it rejected a pure marginal cost test.<sup>160</sup> Instead, the court stated that it would "consider the presence of other factors" in determining whether plaintiff had made an adequate prima facie showing of attempted monopolization.<sup>161</sup> The court criticized Areeda's and Turner's willingness, through application of a marginal cost standard, "to allow damage to competition and the destruction, by one competitor, of equally efficient competitors as long as prices remain at or above marginal costs."<sup>162</sup> Unpersuaded by the two scholars' argument that no administrable test could be developed to eliminate this risk, the court noted that "Section 2 of the Sherman Act makes no exceptions for cases involving administrative difficulty."<sup>163</sup>

As discussed above,<sup>164</sup> the Fifth and Ninth Circuits recently have expressed misgivings about their earlier decisions that largely had adopted the Areeda/Turner approach. The Ninth Circuit's opinion in *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*<sup>165</sup> placed the burden of proof on plaintiff to show that defendant's pricing between average variable and average total cost was predatory.<sup>166</sup> In explaining its position, the court pointedly rejected arguments that average variable cost alone was an appropriate standard by which to judge predation. Instead of an either/or approach based on "rigid adherence to a particular cost-based rule,"<sup>167</sup> the court chose to evaluate the "reasonableness" of prices below average total cost and above average variable cost.<sup>168</sup>

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159. 615 F.2d 427 (7th Cir. 1980).

160. *Id.* at 432. In *Chillicothe* the Seventh Circuit affirmed the trial court's directed verdict for Martin Marietta, which plaintiff had accused of attempting to monopolize the central Illinois sand and gravel market.

161. *Id.*

162. *Id.*

163. *Id.* For Professor Areeda's response to the court's comment, see Areeda, *supra* note 37, at 900.

164. See notes 122-28 *supra* and accompanying text.

165. 652 F.2d 917 (9th Cir. 1981).

166. See note 127 *supra*.

167. 652 F.2d at 939. Cf. *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir. 1981) (announcing a preference for the Areeda/Turner test, but declining to endorse formally a specific standard), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116).

168. The court used average variable cost as a surrogate for marginal cost. 652 F.2d at 939; see notes 43-45 *supra* and accompanying text.

The court found that, in a particular case, "[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."<sup>169</sup> Several major, recent district court opinions have taken the same general approach as the Ninth Circuit in *Inglis* and adopted a bounded rule of reason analysis that uses a rebuttable presumption to evaluate prices between marginal cost and average total cost.<sup>170</sup> The specific grounds upon which courts have relied in this trend toward evaluating the reasonableness of pricing above marginal cost and below average total cost is discussed next.

(b) *Reasonableness of Pricing Between Marginal Cost and Average Total Cost*

The controversy over the appropriate standard for evaluating allegedly predatory behavior has focused increasing attention on a defendant's pricing between marginal cost and average total cost. As a preface to reviewing judicial analysis of pricing in this intermediate range, it is useful to note again two consistent principles of judicial evaluations of predatory pricing allegations to date. On the one hand, no court has adopted the position suggested by Bork, Easterbrook, and others that antitrust law should completely disregard predatory pricing.<sup>171</sup> On the other hand, no decision has openly accepted Scherer's rule of reason analysis, which considers a wide variety of potentially relevant factors and essentially rejects all purely cost-based standards.<sup>172</sup> Instead, courts on the whole have avoided both these extremes and have followed an approach that treats prices above average total cost as presumptively legal, prices below marginal cost as presumptively illegal, and prices between these two boundaries as presumptively legal, but subject to a rule of reason analysis.

The courts have stated that several factors are relevant to an evaluation of the reasonableness of a defendant's pricing between

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169. 652 F.2d at 939.

170. See, e.g., *United States v. AT&T Co.*, 1981-2 Trade Cas. ¶ 64,277 (D.D.C. 1981); *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947 (S.D. Ohio 1981).

171. See notes 35 & 60 *supra* and accompanying text. Even courts that believe predation is rare—for example, the Second Circuit in *Northeastern Telephone*—have expressly refused to dismiss it altogether. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 88 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

172. See notes 61-62 *supra* and accompanying text.

marginal cost and average total cost. The first of these factors is proof of market conditions, particularly entry barriers. The court in *International Air*, which was the first opinion to adopt the Areeda/Turner proposal, recognized the potential usefulness of entry conditions for evaluating the competitive consequences of pricing within this range.<sup>173</sup> The Fifth Circuit in *International Air* held that a plaintiff must show that its competitor either is pricing below average variable cost or "is charging a price below its short-run, profit-maximizing price and barriers to entry are great enough to enable the discriminator to reap the benefits of predation before new entry is possible."<sup>174</sup>

Although some courts have expressly declined to decide the legal relevance of an entry barrier analysis,<sup>175</sup> others have followed the lead of the *International Air* court and have held that these conditions are an important factor for assessing the competitive effects of pricing in the intermediate range.<sup>176</sup> Moreover, some opinions are particularly noteworthy for their care and sophistication in evaluating the height and significance of entry barriers in the pertinent markets.<sup>177</sup> The courts' experience to date suggests that if courts assess market conditions and entry barriers as part of an analysis of market power in monopolization and attempt-to-monopolize cases, then they most likely will incur only a modest additional administrative burden in applying the results from that inquiry to examine the long-term effects of a particular pricing strategy.

A second important factor for reviewing prices above marginal cost but below average total cost has been the defendant's intent. Many decisions have held that plaintiffs may introduce evidence, in addition to proof of below-cost pricing, that purports to show a

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173. *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

174. *Id.*

175. *See, e.g., William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917, 937 n.26 (9th Cir. 1981).

176. *See, e.g., Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947, at 75,885 n.4, 75,892 (S.D. Ohio 1981); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 988-89 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980); *In re Borden, Inc. (ReaLemon)*, 92 F.T.C. 669, 791 (1978), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979).

177. The *Richter* court's analysis, for example, included a review of minimum scale capital requirements, the history of entry and exit during the complaint period, and the disposition of assets owned by firms that had left the market. *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947, at 75,892 (S.D. Ohio 1981).

predatory design behind the defendant's pricing practices.<sup>178</sup> Finally, although intent and entry conditions are the most frequently mentioned factors, some opinions have declined to "foreclose the possibility that . . . other aspects of its conduct"<sup>179</sup> may also be relevant to the permissibility of a firm's pricing activity.

These opinions suggest that a particular court is likely to adopt one of two approaches in its assessment of the reasonableness of pricing within this middle range. A court that is largely unconvinced of the need for heavy policing of pricing activity is more likely to choose a standard that is, with a few exceptions, based solely on marginal cost and to evaluate a relatively small number and variety of additional factors. This approach generally will require the plaintiff to make a stronger showing of particular harms caused by the alleged predatory conduct. By contrast, a court that is more sympathetic to the potential harms of predation is more likely to evaluate a wider range of factors.<sup>180</sup> This difference may reflect deeper, theoretical disagreements about the frequency and competitive harms of predatory activity.<sup>181</sup> As a standard for adjudication, the broader analysis may be better adapted to producing more accurate results in a wide range of factual situations than a strict per se approach. The question whether the apparent difficulties in administering the more complex test outweigh its advantages,<sup>182</sup> however, can be answered only by its implementation in resolving predatory pricing claims.

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178. See, e.g., *SuperTurf, Inc. v. Monsanto Co.*, 1981-2 Trade Cas. ¶ 64,316, at 74,415-16 (8th Cir. 1981); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 348-49 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917, 942-43 (9th Cir. 1981); *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427, 433 (7th Cir. 1980). See also notes 96-104 *supra* and accompanying text.

179. *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727, 742 (9th Cir. 1979). The court noted that "limit pricing by a monopolist might, on a record which presented the issue, be held an impermissible predatory practice." *Id.* at 743. See also *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427, 432 (7th Cir. 1980); *Pacific Eng'r & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790, 797 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977).

180. Compare *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947 (S.D. Ohio 1981) and *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727 (9th Cir. 1979) with *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079) and *Hanson v. Shell Oil Co.*, 541 F.2d 1352 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977).

181. See note 15 *supra*.

182. See notes 150-53 *supra* and accompanying text.

(c) *Supreme Court Review*

Given the rapidity with which the trends in predatory pricing analysis have developed, the various federal circuit courts predictably are not in full agreement on the appropriate standards for evaluating pricing claims. In terms of analytical sophistication alone, however, the circuits that have decided a greater number of cases—especially the Second Circuit and the Ninth Circuit—have developed a more comprehensive legal and economic approach. Since the publication of Areeda's and Turner's article in 1975, courts in every circuit except the Fourth Circuit have addressed the issue of the appropriate economic analysis for claims of predation.<sup>183</sup> No circuit has accorded the Supreme Court's 1967 *Utah*

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183. Only district court opinions are available in the Sixth Circuit and the District of Columbia Circuit. Apparently, the new Eleventh Circuit will adopt as governing precedent the decisions of its parent, the Fifth Circuit. A summary of the current standards for each circuit are set out below to put into context this Article's discussion of the developing trends in predation analysis.

The First Circuit has not expressly endorsed any specific cost-based pricing rule. It has suggested, however, that a plaintiff at least must allege that the defendant possesses market power or is engaged in "persistent pricing below short-run out-of-pocket costs." *Americana Indus., Inc. v. Wometco de Puerto Rico, Inc.*, 556 F.2d 625, 628 (1st Cir. 1977).

The leading opinion in the Second Circuit is *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079). See notes 143-56 *supra* and accompanying text. The court in *Northeastern Telephone* created a rebuttable presumption of liability upon proof that pricing was below marginal cost. Pricing at or above marginal cost, on the other hand, was presumed lawful, except perhaps in a market with high entry barriers.

The Third Circuit's opinion in *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116), suggests a rebuttable presumption of illegality for pricing below marginal cost and a rebuttable presumption of legality for pricing at or above marginal cost. Under the Third Circuit's standard, evidence of intent—or a lack thereof—is sufficient to rebut either presumption. *Id.* at 349-50.

The Fourth Circuit has no reported opinions on the question of predation since 1975.

The Fifth Circuit has adopted a marginal cost test in which prices below marginal cost are rebuttably presumed to be unlawful. Pricing at or above marginal cost, however, is lawful, unless the plaintiff can prove that the defendant is pricing below its "short-run," profit-maximizing price and that substantial entry barriers exist. *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). A more recent case, however, suggests that the circuit may be receptive to a more flexible reasonableness standard. *Malcolm v. Marathon Oil Co.*, 642 F.2d 845 (5th Cir.), *cert. denied*, 50 U.S.L.W. 3486 (U.S. Dec. 14, 1981) (No. 81-874); see note 126 *supra*.

Although the Sixth Circuit has not addressed the issue, several district court opinions have adopted a rebuttable presumption test, in which prices equal to or above average variable cost are presumed legal. See, e.g., *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947 (S.D. Ohio 1981); *Hillside Dairy Co. v. Fairmont Foods Co.*, 1980-2 Trade Cas. ¶ 63,313 (N.D. Ohio 1980).

The Seventh Circuit in *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th Cir. 1980), found marginal cost to be "a relevant and an extremely useful

*Pie* decision a dominant role in evaluating the propriety of the defendant's conduct.<sup>184</sup> Thus, the time appears ripe for the Supreme Court to clarify its position further.

The judicial development of predatory pricing standards poses at least two possible grounds for Supreme Court review. The first would be to resolve the differences among the circuits in their use of cost standards. The Court, for example, could examine the important differences in emphasis and approach in the circuits' application of presumptions to examine pricing in the zone between average total cost and marginal cost. The Court might also wish to identify the nature and significance of those market conditions and business motivations that justify pricing in this range.<sup>185</sup>

Regardless of whether the Supreme Court is concerned with harmonizing the various lower court opinions, it may want to grant certiorari to reconcile the recent wave of predation decisions with *Utah Pie*.<sup>186</sup> As discussed above,<sup>187</sup> *Utah Pie's* doctrinal significance for predatory pricing law is unclear. Nevertheless, the recent

factor," but added that it would also "consider the presence of other factors" in assessing pricing conduct. *Id.* at 432. Apparently, these other factors include intent and market conditions evidence. See notes 159-63 *supra* and accompanying text.

The Eighth Circuit has adopted a rebuttable presumption of legality for prices at or above marginal cost. *SuperTurf, Inc. v. Monsanto Co.*, 1981-2 Trade Cas. ¶ 64,316 (8th Cir. 1981). In *United States v. Empire Gas Corp.*, 537 F.2d 296 (8th Cir.), *cert. denied*, 429 U.S. 1122 (1976), the court placed a premium on both intent and entry barriers as factors showing the likely success of the practice and, therefore, the legality of different pricing strategies.

Both the Ninth and Tenth Circuits have adopted reasonableness standards based on average variable or marginal cost tests, but each court accepts evidence of other relevant factors to demonstrate the anticompetitive effect of the defendant's prices that are below average total cost but equal or exceed average variable or marginal cost. See *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981); *Arizona v. Maricopa County Medical Soc'y*, 643 F.2d 553 (9th Cir. 1980), *cert. granted*, 450 U.S. 979 (1981); *Pacific Eng'r & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 977 (1977).

The District of Columbia Circuit has not adopted a predation standard, but the district court has endorsed a rule of reason analysis for pricing between average variable cost and average total cost. *United States v. AT&T Co.*, 1981-2 Trade Cas. ¶ 64,277 (D.D.C. 1981).

184. Although several district court decisions have given *Utah Pie* substantial weight in analyzing pricing conduct, *see, e.g.*, *Barry Wright Corp. v. ITT-Grinnell Corp.*, 1980-81 Trade Cas. ¶ 63,862, at 78,572 (D. Mass. 1981), most circuit courts, however, have gone to great lengths to distinguish the case and thereby limit its applicability. *See, e.g.*, *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981).

185. See notes 143-82 *supra* and accompanying text.

186. *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967).

187. For a discussion of the current vitality of *Utah Pie*, see notes 92-108 *supra* and accompanying text.

cases in the area, particularly those that appear to require pricing below marginal cost as essential to a prima facie predatory pricing case,<sup>188</sup> cannot be considered consistent with *Utah Pie's* language or intent. Even if the Court still regards the result or reasoning of the decision favorably, it may choose nonetheless to clarify *Utah Pie's* applicability to modern pricing doctrine. In any event, given the procedural status of current cases in the appellate courts, the lower courts and commentators will have to struggle with the issues concerning predatory pricing for at least one more year before the Supreme Court has an opportunity to clarify the appropriate doctrine in this area of the law.

### B. Innovation

Recent predation cases have raised three especially noteworthy issues concerning the development and introduction of new products or processes by dominant firms. The first deals with a dominant firm's ability to make product design decisions that enable it to block entry into certain markets or to obtain a competitive edge in markets for goods that are necessarily compatible with its principal product. The suits in which Eastman Kodak Company (Kodak),<sup>189</sup> International Business Machines Corporation (IBM),<sup>190</sup> and AT&T<sup>191</sup> were involved have focused extensively on the competitive implications of design changes. The second major issue is the question of "predisclosure"—whether an innovating firm must give its competitors substantial information about its anticipated design changes well before the changes are implemented.<sup>192</sup> The

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188. See, e.g., *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), cert. denied, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

189. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980); *GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203 (S.D.N.Y. 1981).

190. *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727 (9th Cir. 1979); *Telex Corp. v. IBM Corp.*, 510 F.2d 894 (10th Cir.), cert. denied, 423 U.S. 802 (1975); *ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp.*, 458 F. Supp. 423 (N.D. Cal. 1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), cert. denied, 101 S. Ct. 3126 (1981); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), appeal docketed, No. 80-4048 (9th Cir. Jan. 31, 1980).

191. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), cert. denied, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079); *United States v. AT&T Co.*, 516 F. Supp. 1237 (D.D.C. 1981); *Litton Systems, Inc. v. AT&T Co.*, [1981] ANTITRUST AND TRADE REG. REP. (BNA) No. 1019, at A-24 (S.D.N.Y. 1981); *MCI Communications Corp. v. AT&T Co.*, [1980] ANTITRUST AND TRADE REG. REP. (BNA) No. 969, at A-3 (N.D. Ill. 1980), appeals docketed, Nos. 80-2171 and 80-2288 (7th Cir. Aug. 25, 1980 and Sept. 28, 1980).

192. The first and second issues are often closely related. A dominant firm's rivals may be less likely to object to design changes if they receive detailed information about them

Second Circuit's opinion in *Berkey Photo, Inc. v. Eastman Kodak Co.*<sup>193</sup> contains the most thorough analysis of this question.<sup>194</sup> The third issue concerns the dominant firm's research and development investments in patenting that protect the firm's chief product from possible substitutes. Patent accumulation, commonly known as "blocking," has been an important element in attacks upon Xerox Corporation's (Xerox) conduct in the plain paper office copier market.<sup>195</sup>

Before examining each of these issues individually, several distinctive features about both the substance and sources of judicial thinking on innovation questions deserve mention. Compared with the case law on pricing and promotion, the existing legal standards for dominant firm, innovation-related conduct are relatively clear and simple. The courts have immunized virtually all product development efforts that yield goods which have some demonstrable technical merit or consumer appeal. To date, only two types of conduct have drawn judicial censure. First, several decisions have condemned, at least in principle, dominant firm design changes that were plainly intended to injure rivals and completely lacked any technological justification. Second, the court in *Berkey* proscribed a dominant firm's efforts in a joint venture to use its market power to prevent its co-venturers from disclosing or introducing new products.<sup>196</sup>

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long before the new products reach the market.

193. 457 F. Supp. 404 (S.D.N.Y. 1978), *aff'd in part and rev'd in part*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980). In *Berkey* plaintiff claimed that Kodak violated § 2 of the Sherman Act (1) by using its monopoly in film to improve its position in the amateur camera and photofinishing services markets, and (2) by using its monopoly in film and color paper to extract supra-competitive prices for both of these goods. In addition, plaintiff alleged that Kodak had violated § 1 of the Act by conspiring with flashlamp manufacturers to limit unlawfully the disclosure of a new flashcube. On appeal, the Second Circuit overturned all but a small portion of the \$87 million judgment that *Berkey* had won at trial. 603 F.2d at 309-10. For a brief, useful discussion of *Berkey's* claims, see 93 HARV. L. REV. 408 (1979).

194. Some dominant firms also have come under attack for the *content* of the information that they released prior to the introduction of a new product. Plaintiffs in *Berkey* and *Northeastern Telephone*, for example, claimed that defendants had promoted the appearance of new products in ways that unjustifiably exaggerated their qualities and deterred purchases of plaintiffs' existing product lines. For a discussion of the issues concerning the appropriate bounds of dominant firm promotional activities, see notes 260-91 *infra* and accompanying text.

195. *Van Dyk Research Corp. v. Xerox Corp.*, 478 F. Supp. 1268 (D.N.J. 1979), *aff'd*, 631 F.2d 251 (3d Cir. 1980), *cert. denied*, 101 S. Ct. 3029 (1981); *SCM Corp. v. Xerox Corp.*, 463 F. Supp. 983 (D. Conn. 1978), *aff'd*, 645 F.2d 1195 (2d Cir.), *petition for cert. filed*, 102 S. Ct. 85 (1981). See also *In re Xerox*, 86 F.T.C. 364 (1975) (consent decree).

196. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. de-*

Beyond these relatively narrow restrictions, the courts have placed few apparent limits on either a dominant firm's choice of product design changes or the timing and content of information disclosures that precede new product introductions. The judiciary's current tendency to allow dominant firms substantial flexibility in the innovation area has at least three significant, possible explanations. First, the courts regard innovation as a process with which antitrust law should not interfere. The *Berkey* court perhaps articulated this view most clearly when it stated that "[b]ecause . . . a monopolist is permitted, and indeed encouraged, by § 2 to compete aggressively on the merits, any success that it may achieve through 'the process of invention and innovation' is clearly tolerated by the antitrust laws."<sup>197</sup> The FTC also emphasized this policy goal in its recent decision in *In re DuPont de Nemours Co.*,<sup>198</sup> which absolved DuPont of any liability for using a technological cost advantage to increase its share of the titanium dioxide market. Speaking for the Commission, Commissioner Clanton stated that DuPont's manufacturing innovation, which was accomplished in the 1940s and 1950s but only became advantageous in the 1970s, "reflect[ed] the kind of skill and foresight that should be encouraged."<sup>199</sup> The Commissioner explained the policy tensions between permitting unlimited innovation—whatever its eventual effect on competition—and enforcing the antitrust laws:

It may be that DuPont ultimately will achieve a monopoly share of the market. As its share increases, other firms may find it harder to capture the efficiencies enjoyed by DuPont due to the scale economies associated with . . . [DuPont's manufacturing] process. Those effects should be weighed carefully, and we have done so. Antitrust policy wisely disfavors monopoly, but it also seeks to promote vigorous competitive behavior. Indeed, the essence of the competitive process is to induce firms to become more efficient and to pass the benefits of the efficiency along to consumers. That process would be ill-

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nied, 444 U.S. 1093 (1980). Justice Rehnquist seriously questioned the wisdom of this holding in his dissent from the Supreme Court's denial of certiorari in *Berkey*. See note 239 *infra*.

197. 603 F.2d at 281 (citations omitted). Later in the opinion, the court stated that "any firm, even a monopolist, may generally bring its products to market whenever and however it chooses." *Id.* at 286. The court also noted that although Congress' central concern in passing the Sherman Act was monopoly power, judicial decisions virtually always have held that Congress did not proscribe the mere possession of monopoly power. Instead, Congress intended liability to be imposed only when anticompetitive conduct created or maintained such power. *Id.* at 274-75. In the *Berkey* court's view this legislative mandate stems from congressional recognition of the importance both of preserving incentives for growth through competitive behavior and innovation, and of ensuring fair treatment of firms that have become dominant as a result of engaging in these practices. *Id.* at 274.

198. 3 TRADE REG. REP. (CCH) ¶ 21,770 (1980).

199. *Id.* at 21,984.

served by using antitrust to block hard, aggressive competition that is solidly based on efficiencies and growth opportunities, even if monopoly is a possible result.<sup>200</sup>

Thus, courts tend on grounds of policy to disfavor interpretations of the antitrust laws that might restrain innovation-related conduct.

A second plausible explanation for the courts' approach to innovation issues is their perception that few manageable standards exist for evaluating claims of predatory innovation. Particularly in the product design area, innovation-related allegations often require courts to weigh a product's benefits against its anticompetitive characteristics. This task can often be an evaluation of imponderables, predominantly because the benefits are largely a matter of consumer taste. Indeed, courts clearly are wary of pursuing such an inquiry beyond examining the performance of the product in the market. Judge Kaufman in *Berkey* explained the dangers of evaluating the superiority of one product over another as follows:

A product that commends itself to many users because superior in certain respects may be rendered unsatisfactory to others by flaws they considered fatal. . . .

[I]n such circumstances no one can determine with any reasonable assurance whether one product is "superior" to another. Preference is a matter of individual taste. The only question that can be answered is whether there is sufficient demand for a particular product to make its production worthwhile, and the response, so long as the free choice of consumers is preserved, can only be inferred from the reaction of the market.<sup>201</sup>

Beyond applying this type of market test, no court has attempted to second-guess a dominant firm's product design decision in light of possible alternative designs with arguably less exclusionary potential. Judge Conti in *ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp.*<sup>202</sup> expressed this prevailing judicial disposition to restrict severely such engineering disputes in the courtroom when he stated that if both alternatives arguably are justified from an engineering perspective, then "the court will not allow itself to be enmeshed 'in a technical inquiry into the justifiability of product

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200. *Id.* at 21,985. The language in *DuPont* and *Berkey* is consistent with a longstanding judicial solicitude for innovation. Judge Learned Hand, for example, earlier had expressed the need to protect the businessman who "may be the survivor out of a group of active competitors . . . by virtue of his superior skill, foresight and industry." *United States v. Aluminum Co. of America*, 148 F.2d 416, 430 (2d Cir. 1945).

201. 603 F.2d at 286-87.

202. 458 F. Supp. 423 (N.D. Cal. 1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3126 (1981).

innovations.'<sup>203</sup>

The third possible reason for the courts' extreme caution in analyzing innovation issues stems from an extensive body of economic literature which supports the view that technological progress is the chief source of consumer welfare.<sup>204</sup> According to this view, the benefit of these advancements to consumer welfare in the long run outweighs any allocative losses that consumers might suffer because of monopolistic output restrictions. As Professor Scherer has stated,

Making the best use of resources at any moment in time is important. But in the long run, it is dynamic performance that counts. . . . [A]n output handicap amounting to 10 percent of gross national product owing to static inefficiency is surmounted in just five years if the output growth rate can be raised through more rapid technological progress from 3 to 5 percent per annum, or in 20 years if the growth rate can be increased from 3 to 3.5 percent.<sup>205</sup>

In sum, the courts have been reluctant to restrain innovation-related activity even though it may sometimes have predatory effects. The reasons for this judicial hesitancy stem from policy and practical considerations, as well as from economic theory.<sup>206</sup> In general, predatory innovation issues have received relatively little empirical or theoretical analysis from either courts or commentators.<sup>207</sup> Nevertheless, beyond judicial reluctance to interfere with

203. *Id.* at 439 (quoting *Response of Carolina, Inc. v. Leasco Response, Inc.*, 537 F.2d 1307, 1330 (5th Cir. 1976)). *But see* notes 215-20 *infra* and accompanying text, discussing *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980), which suggested a somewhat broader inquiry on this point.

204. For perhaps the most famous exposition of this view, see J. SCHUMPETER, *CAPITALISM, SOCIALISM, AND DEMOCRACY* 81-86 (3d ed. 1950). *See also* F. SCHERER, *supra* note 18, at 407-38.

205. F. SCHERER, *supra* note 18, at 407. *See also* Markham, *Concentration: A Stimulus or Retardant to Innovation?*, in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* 247 (H. Goldschmid, H. Mann, & J. Weston eds. 1974). Judge Schnacke in *Transamerica* also noted the relevance of this principle:

This is not the story of a stagnant, dominated industry. There is no doubt that the pace of technological progress in the computer industry is extraordinary. Commentators are fond of saying that had the auto industry kept the same pace over the last 30 years, a Rolls-Royce would cost \$2.50 today and would have an EPA gas rating of 2,000,000 miles per gallon.

*Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 982 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980).

206. Courts may also be aware of the current, widely held concern that the United States may be losing its position as the world's technology leader. *See* U.S. DEP'T OF COMMERCE, *FINAL REPORT OF THE ADVISORY COMMITTEE ON INDUSTRIAL INNOVATION* (1979).

207. *See* Gilbert, *Patents, Sleeping Patents, and Entry Deterrence* in *ANTITRUST ANALYSIS*, *supra* note 31, at 205; Ordovery & Willig, *supra* note 40, at 301. Of all the recent commentary by academicians, the Ordovery/Willig paper is the only contribution to propose

innovation generally, significant trends concerning various aspects of the innovation process are discernible. The following subsections examine these trends as they have developed in cases presenting design change, predisclosure, and patent accumulation issues.

### 1. Design Change

Courts that have faced the issue agree in principle that a dominant firm in one market can alter the design of its product and thereby obtain an advantage in the markets for necessarily compatible goods. These courts, moreover, perceive a difference between genuine product improvements and design changes that are purely for the purpose of predation. The question is whether this theoretical distinction can be applied in practice. The opinions suggest several possible criteria or tests for differentiating between procompetitive and anticompetitive design changes.

As the Second Circuit in *Berkey* indicated, "the reaction of the market" has been an elementary starting point for measuring a product's quality<sup>208</sup> and, by inference, the genuineness of a product improvement. The *Berkey* court, however, also hinted that a market test alone sometimes may be inadequate to determine the legality of a defendant's design change when that defendant exercises substantial market power in the line of products under scrutiny and, therefore, can manipulate "the reaction of the market." In a unanimous decision Judge Kaufman stated that "[i]f a monopolist's products gain acceptance in the market, . . . it is of no importance that a judge or jury may later regard them as inferior, so long as that success was not based on any form of coercion."<sup>209</sup> Two years later, Judge Kaufman in *Northeastern Telephone* relied upon this "coercion" qualification to hold that the jury should decide whether AT&T had designed certain products to make interconnection with plaintiff manufacturer's telephone equipment exceedingly difficult. The court granted a new trial on the product design issue because of the pervasiveness of the defendant's market domination and stated that

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comprehensive tests—beyond according per se legality to all product design and introduction decisions—for assessing the predatory potential of innovation-related activity.

208. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 287 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980). See also notes 146-47 *supra* and accompanying text. Sales data for the product in question and testimony of major users—particularly for goods other than mass-distribution consumer products—would serve as two indices of the market's reaction.

209. 603 F.2d at 287 (emphasis added).

[i]n other circumstances, we might be reluctant to allow a jury to second-guess engineers' decisions as to the proper construction of a sophisticated piece of equipment. But in this case we cannot look to the reaction of the competitive market to determine whether one design is superior to another, *compare Berkey, supra*, 603 F.2d at 287. As noted previously, ATT's post-Carterfone tariffs gave it the exclusive right to provide protective couplers. Market forces cannot operate under such circumstances. Thus, we see no alternative to entrusting the matter of coupler design to the judgment of the jury.<sup>210</sup>

Thus, even if the market "accepts" a defendant's design change, a showing that the defendant exercises coercive, exclusive control over that market may warrant the use of further evaluative techniques. Specifically, a court in this situation might refer the case to the jury for a determination on the reasonableness of the defendant's innovation-related activity.<sup>211</sup>

A second method that courts have used, albeit cautiously, for evaluating design changes is to weigh a given design's technical strengths and weaknesses. Courts have taken at least two different approaches to making such an evaluation, the more deferential of which is exemplified by the Northern District of California's decision in *Memorex*.<sup>212</sup> In that case the trial court held that a design change is lawful as long as a good faith engineering dispute exists over whether the innovation had a legitimate aim. In response to *Memorex*' claim that IBM should have designed one of its computers in a manner that provided greater compatibility with *Memorex*' peripheral equipment, the court found that plaintiff's proof showed merely that alternatives existed to IBM's design choice. Judge Conti stated that "[when] the approach chosen was at least as justifiable as the alternative, . . . courts should not get

210. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 95 n.29 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

211. See *GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203 (S.D.N.Y. 1981). The court in *GAF* applied this principle in reviewing Kodak's motion for summary judgment on plaintiff's claim that Kodak had manipulated the design of its products to advance its dominant position in the film market. The court ruled that a jury could evaluate the reasonableness of Kodak's design behavior if it first "found coercive conduct by the monopolist or coercive use of the firm's monopoly power." *Id.* at 1228. Restating the holdings of *Berkey* and *Northeastern Telephone* the court said,

[T]he "reasonableness" of the design of a monopolist's new products . . . may be scrutinized under § 2 in cases in which "market forces cannot operate"—that is, in cases in which a single firm controls the entire market or in which a monopolist engages in coercive conduct to affect consumer choice.

*Id.* (quoting *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 95 n.29 (2d Cir. 1981)).

212. *ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp.*, 458 F. Supp. 423 (N.D. Cal. 1978), *aff'd per curiam sub nom.*, *Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3126 (1981); see notes 202-03 *supra* and accompanying text.

involved in second guessing engineers."<sup>213</sup> Thus, under the *Memorex* test, a defendant can satisfy its burden of proof by introducing evidence that shows a technical purpose beyond merely frustrating suppliers of compatible goods, or which indicates in some rough sense that the chosen design represented a plausible engineering decision despite the availability of arguably superior designs.<sup>214</sup>

A year after *Memorex* was decided, the same court in *Transamerica*<sup>215</sup> proposed a second, somewhat broader standard for evaluating the technical strengths and weaknesses of design changes. Judge Schnacke in *Transamerica* specifically rejected the *Memorex* approach as "overprotective"<sup>216</sup> of innovation and adopted a test that required the balancing of a variety of relevant factors, which he outlined as follows:

If the design choice is unreasonably restrictive of competition, the monopolist's conduct violates the Sherman Act. This standard will allow the factfinder to consider the effects of the design on competitors; the effects of the design on consumers; the degree to which the design was the product of desirable technological creativity; and the monopolist's intent, since a contemporaneous evaluation by the actor should be helpful to the factfinder in determining the effects of a technological change.<sup>217</sup>

Although this test potentially is more flexible and less deferential than the *Memorex* standard—indeed, it closely resembles a rule of reason approach—the implication of the court's ultimate holding was that a product change must lack virtually any redeeming qualities to result in antitrust liability.<sup>218</sup> The *Transamerica* court did

213. 458 F. Supp. at 440-41.

214. Every court that has addressed the issue has agreed with the rationale that was implicit in *Memorex*: Design changes should not be vulnerable to antitrust attack merely on the ground that the defendant failed to select the design which was the least restrictive in terms of competition. See, e.g., *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727, 744 (9th Cir. 1979); *GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203, 1228 (S.D.N.Y. 1981); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 1003 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980).

215. *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980).

216. *Id.* at 1003. Judge Schnacke interpreted the *Memorex* standard to suggest "that where there is a valid engineering dispute over a product's superiority the inquiry should end." *Id.*

217. *Id.* (footnote omitted).

218. The *Transamerica* court was faced, *inter alia*, with evaluating some design changes that the court found IBM had instituted primarily to subdue its competitors, but which demonstrated some technical advantages over the new product's predecessors and caused only negligible harm to the corporation's rivals. Finding competitive effect to be more important than a defendant's intent—particularly under the circumstances before it—the court declared that IBM's acts were lawful. *Id.* at 1002-05. In *Berkey*, however, Judge Kaufman intimated that a dominant firm's purposeful efforts to create technological incompatibilities with its own products may itself warrant close scrutiny. *Berkey Photo, Inc.*

find that in one instance IBM clearly had degraded the capacity and quality of a component solely to render its central processing units incompatible with its rivals' peripheral equipment.<sup>219</sup> The court, however, failed to hold that this act constituted either monopolization or an attempt to monopolize. According to the court, if IBM had exercised monopoly power in either of these markets, which in Judge Schnacke's view it did not, then the conduct would have resulted in liability for monopolization.<sup>220</sup> Similarly, the court did not consider this conduct sufficiently predatory to constitute an attempt to monopolize—presumably because the court did not believe that degrading the capacity and quality of a component, without more, would create a dangerous probability of attaining monopoly power in the market.

Despite the deference that courts traditionally have given to dominant firms' design choices, the Second Circuit's recent decision in *Northeastern Telephone*<sup>221</sup> suggests at least one significant limitation on these firms' discretion in this type of innovation-related activity. Plaintiff in *Northeastern Telephone* challenged several practices by SNET—a Bell System Connecticut affiliate—that purportedly were intended to exclude it from the market for business telephone equipment.<sup>222</sup> Specifically, Northeastern claimed that SNET intentionally had overdesigned “protective couplers”—which a Bell System tariff required Northeastern's customers to use on their telephone equipment from 1969 to the mid-1970s<sup>223</sup>—so that they would be expensive to purchase and maintain. This high cost in turn would have the intended effect of diminishing the attractiveness of Northeastern's equipment vis-à-vis the equipment that the Bell System produced and sold.<sup>224</sup>

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v. Eastman Kodak Co., 603 F.2d 263, 283 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

219. 481 F. Supp. at 1004-05.

220. *Id.* at 1010.

221. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

222. In its 1968 *Carterfone* decision the Federal Communications Commission invalidated an existing AT&T ban on the interconnection of customer-owned terminal equipment to the Bell network. *In re Use of Carterfone Device*, 13 F.C.C.2d 420, *reconsideration denied*, 14 F.C.C.2d 571 (1968). Northeastern was one of many companies that responded to the *Carterfone* ruling by entering the telephone equipment market, which Bell previously had occupied virtually alone.

223. The couplers' stated purpose was to protect the Bell network from problems that might arise as a result of the interconnection of technically incompatible or flawed equipment. *See* 651 F.2d at 81.

224. *See id.* Northeastern claimed that the couplers were incompatible with its equipment and required an external power source. *Id.*

Although the Second Circuit flatly rejected all Northeastern's other claims of predatory conduct, it remanded the case for a new trial on the interconnection issues. The court expressed no view on the ultimate merits of Northeastern's allegations, but it did state that plaintiff's claim against SNET for "intentionally design[ing] the protective coupler in an unreasonable manner is not totally unsubstantiated."<sup>225</sup> The court noted that at the initial trial, Northeastern had introduced a study which the National Academy of Sciences (NAS) had conducted for the Federal Communications Commission. The NAS report recommended that the Commission register equipment which met certain minimal standards in lieu of allowing AT&T to insist on the use of the couplers.<sup>226</sup> Furthermore, in the court's view certain testimony from a Bell System engineer also supported Northeastern's claim that AT&T intentionally had designed its couplers to maximize their cost and inconvenience for potential users. According to the Second Circuit, the weight of all this evidence was sufficient to warrant a retrial on the product design issue.<sup>227</sup>

Whether the *Transamerica* and *Memorex* courts would have reached the same result under the facts in *Northeastern Telephone* is unclear. The NAS study called AT&T's coupler an "adequate" solution to the interconnection problem, even though the report ultimately endorsed the registration system alternative.<sup>228</sup> Thus, under the *Memorex* "valid engineering dispute" test, the NAS report conceivably might show that the coupler design—though ambiguous in its purpose and technical quality—was not unquestionably predatory. On the other hand, the protective coupler design would be less likely to pass muster under the *Transamerica* test because of the evidence of monopolistic intent and the effects of the design on both competitors and consumers. Of course, both these suggested conclusions are speculative. Although all three decisions propose general standards for evaluating

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225. *Id.* at 96. The court ordered a new trial because it could not determine whether the jury had based their finding of liability on claims of predatory conduct that the Second Circuit subsequently rejected.

226. *Id.* at 94.

227. *Id.* at 95. Two federal juries have returned verdicts for plaintiffs on similar interconnection issues. *See, e.g.,* *Litton Systems, Inc. v. AT&T Co.*, [1981] ANTITRUST AND TRADE REG. REP. (BNA) No. 1019, at A-24 (S.D.N.Y. 1981); *MCI Communications Corp. v. AT&T*, [1980] ANTITRUST & TRADE REG. REP. (BNA) No. 969, at A-3 (N.D. Ill. 1981), *appeals docketed*, Nos. 80-2171 and 80-2288 (7th Cir. Aug. 25, 1980 and Sept. 28, 1980).

228. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 81 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079).

design changes, they provide little guidance about how meritorious a defendant's new design must be, or what relative burdens of proof either party must bear during the lawsuit.

## 2. Predisclosure

The reported decisions are unanimous in holding that firms acting alone have virtually no duty to predisclose anticipated design changes to their competitors. The leading opinion on this issue is *Berkey*, in which the Second Circuit rejected Berkey's claim that Kodak had a duty to disclose certain camera design changes before their commercial introduction.<sup>229</sup> Berkey had argued that such predisclosure was necessary to afford firms competing with Kodak in satellite markets for compatible goods an adequate opportunity to redesign their production and other facilities. The court, however, expressed fear that a disclosure obligation would enable rivals of an innovative, dominant firm to forego innovation, wait, and then take advantage of the dominant firm's research and development efforts. This possibility would diminish the dominant firm's incentive to innovate.<sup>230</sup> Significantly, the court did not rest its refusal to require disclosure entirely on the importance of preserving incentives to compete, but rather stated that the administrative difficulty of "discerning workable guidelines" for courts and businesses to follow in determining when predisclosure would be procompetitive was an equally important consideration.<sup>231</sup> Although some language in the opinion arguably implies that a dominant firm's failure to predisclose its own innovations might be a matter of antitrust concern in some circumstances,<sup>232</sup> the court did not specify what conditions—if any—would warrant such a different attitude. Irrespective of these possible implications, the court

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229. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 281, 285 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980). The courts in *Telex*, *Memorex*, *CalComp*, *GAF*, and *Transamerica* all reached similar—if not identical—results on the facts before them.

230. *Id.* at 281-82. The court stated, "If a firm that has engaged in the risks and expenses of research and development were required in all circumstances to share with its rivals the benefits of those endeavors, this incentive would very likely be vitiated." *Id.* at 281.

231. *Id.* at 281-83.

232. *Id.* at 282. The court stated that "[w]ithholding from others advance knowledge of one's new products . . . ordinarily constitutes valid competitive conduct." *Id.* at 281 (emphasis added). Other courts also have articulated predisclosure rules in terms that stop short of giving dominant firms absolute discretion to select predisclosure policies. See *GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203, 1228 (S.D.N.Y. 1981) ("[O]nly in the rarest case will a monopolist's failure to disclose technical information concerning its new product support a claim for treble damages under § 2 of the Sherman Act.").

based its decision at least in part on the lack of sensible, administrable standards. The logical inference, therefore, is that the courts might welcome such standards if they could be developed.

Although firms acting alone may have no predisclosure duty, they may face liability if they attempt to prevent joint venturers from making voluntary disclosures in certain circumstances. In *Berkey*, for example, the court of appeals affirmed a one million dollar award for Berkey on the ground that Kodak had violated section one of the Sherman Act by extracting agreements from Sylvania and General Electric that required those two firms to remain silent about flashcubes they were developing in separate joint ventures with Kodak.<sup>233</sup> The court rejected Kodak's argument that the claim concerning its joint ventures with Sylvania and General Electric was identical to Berkey's attack upon Kodak's disclosure practices for its own cameras and film. Judge Kaufman wrote that "[t]here is a vast difference . . . between actions legal when taken by a single firm and those permitted for two or more companies acting in concert."<sup>234</sup> He added that "[w]here a participant's market share is large, . . . we believe joint development projects have sufficient anticompetitive potential to invite inquiry."<sup>235</sup>

The *Berkey* court held that joint venture agreements between a monopolist and firms in complementary markets are not per se section one violations. Among the factors that the court found relevant in evaluating the agreements' reasonableness were: (1) Kodak's dominance in cameras had given it leverage that it could use to control the terms of the flashcube's disclosure<sup>236</sup>; (2) Kodak's technological contributions to the development projects were "arguably minimal"<sup>237</sup>; and (3) the agreements' effect was to keep a "desirable innovation" off the market for an unnecessarily long time "solely to suit Kodak's convenience."<sup>238</sup> The *Berkey* court's analysis on this issue is not universally accepted; in particular, Justices Rehnquist and Powell sharply questioned its soundness in their dissent from the Supreme Court's denial of certiorari.<sup>239</sup>

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233. 603 F.2d at 299-305.

234. *Id.* at 301.

235. *Id.*

236. *Id.* at 302 n.67.

237. *Id.* at 304.

238. *Id.* at 302.

239. 444 U.S. 1093, 1094-95 (1980). Justice Rehnquist stated that some of Judge Kaufman's observations appeared "little less than bizarre." *Id.* at 1094. Justice Rehnquist added, "If the Sherman Act requires 'predisclosure' by one competitor to another before a new product can be marketed, I think that the raised eyebrows resulting from such a hold-

### 3. Patent Accumulation

In 1950 the Supreme Court stated in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*,<sup>240</sup> that "[t]he mere accumulation of patents, no matter how many, is not in and of itself illegal."<sup>241</sup> Recently, two cases have tested the breadth of the *Hazeltine* doctrine through challenges to Xerox' activities in the plain paper copier market. In *Van Dyk Research Corp. v. Xerox Corp.*<sup>242</sup> a bankrupt office copier manufacturer claimed that Xerox had obtained and protected its dominant position in the office copier market by building a patent "barricade" around its innovative, dry paper technology. The trial court rejected Van Dyk's claim, holding that Xerox' internal patenting activity could not support a cause of action for monopolization.<sup>243</sup> The court's rationale for the decision was based on the lack of an anticompetitive intent or purpose in the adoption and execution of Xerox' patent program. The court, however, did not indicate how a showing that Xerox' research and development efforts had been "adopted or pursued with anticompetitive intent or purpose" would have affected its analysis of the liability question. Instead, the court stressed earlier in the opinion that Xerox' goal had been to develop a new product, and that, by virtue of its "foresight" and "willingness to take a risk," it had succeeded.<sup>244</sup> The court noted that the dominant corporation's accumulation of its own patents was protected conduct because it was the result of product research and development efforts; it stated that Xerox "could and did no more than lawfully protect itself against competitor copying of its products and insure that it would not be blocked from the use of inventions which might prove useful in the future."<sup>245</sup>

A federal district court in Connecticut engaged in a more extensive discussion of the patent barricading issue in *SCM Corp. v. Xerox Corp.*<sup>246</sup> As in *Van Dyk*, plaintiff accused Xerox of mono-

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ing should come from this Court, and not from extrapolations by other federal courts of the decisions of this Court interpreting the Sherman Act.

*Id.* at 1095.

240. 339 U.S. 827 (1950).

241. *Id.* at 834.

242. 478 F. Supp. 1268 (D.N.J. 1979), *aff'd*, 631 F.2d 251 (3d Cir. 1980), *cert. denied*, 101 S. Ct. 3029 (1981).

243. *Id.* at 1300, 1302-03.

244. *Id.* at 1324.

245. *Id.*

246. 463 F. Supp. 983 (D. Conn. 1978), *aff'd*, 645 F.2d 1195 (2d Cir.), *petition for cert. filed*, 102 S. Ct. 85 (1981).

polizing the dry paper copier market by, *inter alia*, using its research and development efforts to accumulate patents on all possible dry paper processes. The jury ultimately found for Xerox on this claim,<sup>247</sup> but the trial court's opinion provides an insightful discussion of the legal theory on which its charge to the jury rested. The court explained to the jury that although the *Hazeltine* doctrine normally applied to internally developed patents, "an exception existed in the case of a company that had acquired monopoly power in a relevant market."<sup>248</sup> The court thus charged the jury that a company was barred from acquiring new patents on internally developed innovations if they were "primarily for the purpose of blocking the development and marketing of competitive products rather than primarily to protect its own products from being imitated or blocked by others."<sup>249</sup>

The *SCM* court conceded that the case law provided no authority for this exception, but it reasoned that the standard struck an appropriate, albeit delicate, balance between society's interests in stimulating innovation by established dominant firms, on the one hand, and new entrants, on the other.<sup>250</sup> According to the court, the only risk to patent law policies that this approach raised was a "possible inhibition on research investment" because of a fear that bona fide product development research might later be "found to have been motivated primarily by a desire to block [competitive product development]."<sup>251</sup> The court stated that this potential risk "is a reasonable cost to avoid the substantial market control that would ensue if a company with monopoly power were free to continue its dominant position by patenting, for blocking purposes, alternative methods of competition."<sup>252</sup> In a later portion of the opinion the court also suggested that a judicially imposed rule limiting relief to prospective, equitable measures could serve "to achieve the competitive purposes of the antitrust laws . . .

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247. *Id.* at 1024.

248. *Id.* at 1007.

249. *Id.*

250. *Id.* The court stated,

While there is no case law authority for this standard, it appears to make a reasonable accommodation between the policies of the patent and antitrust laws, unless there is to be no limitation whatsoever on the purposes for which a monopolist can add to its exclusionary power through generation of new patents.

*Id.* (footnote omitted).

251. *Id.*

252. *Id.*

without undue impairment of the objectives of the patent laws."<sup>253</sup> It added that exposing a defendant to treble damages for internal research and development activities might severely frustrate the objectives of the patent laws and unacceptably reduce incentives to innovate.<sup>254</sup>

In affirming the trial court's holdings, the Second Circuit only briefly addressed the patent barricading issue. It noted that "*ordinarily* there is no limitation on a company's freedom to generate its own patents."<sup>255</sup> The court of appeals then added that the jury verdict against SCM on this issue had "laid to rest any suspicion that Xerox's internal R&D program . . . was driven principally by anticompetitive animus."<sup>256</sup> As in *Van Dyk*, however, the Second Circuit's opinion provided no indication of how it would treat the issue had the jury found an anticompetitive purpose.

In sum, the treatment of patent accumulation issues in both the *SCM* and the *Van Dyk* cases does not provide a sound basis for predicting whether an internal research and development program that is intended mainly to block entry would be free from challenge under all circumstances. The *SCM* opinion correctly proposes that the pertinent factors to be considered in developing any legal standard for evaluating allegations of patent accumulation are: (1) The preservation of innovation incentives; (2) the relative contributions of entrants and incumbent firms to the innovation process; (3) the availability of procompetitive remedies; and (4) the predictability of results under the standard. The existing case law, however, gives little support for the view that the phrase "mere accumulation of patents"<sup>257</sup> in the Supreme Court's *Hazeltine* formula actually will allow an exception for purely internal patenting activity that is the result of an unambiguously predatory or exclusionary intent.

#### 4. Summary

The judiciary's treatment of the three specific issues discussed above permits several conclusions about innovation as predatory conduct. The case law generally leaves dominant firms relatively free to conduct innovation-related activities when they are acting alone. At present, the only real danger to a dominant firm—and

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253. *Id.* at 1013.

254. *Id.* at 1014.

255. 645 F.2d at 1207 (emphasis added).

256. *Id.* at 1207-08 (citations omitted).

257. See note 240 *supra* and accompanying text.

even this danger is remote—is that it will be held liable for a design change that cannot even colorably be justified as a genuine improvement, but which is made with demonstrably predatory intent. The courts' rationales for this position are that inexpert intervention might diminish a dominant firm's innovation incentive, and that no apparent manageable guidelines exist for identifying genuinely pernicious behavior. These concerns, coupled with the high value that judges attach to innovation generally, have led courts to devote relatively little attention to the frequency with which dominant firms arguably use innovation strategies for principally predatory ends. This pattern is in contrast to the recent judicial treatment of pricing behavior, in which courts increasingly view the potential frequency of predatory pricing as a guide to selecting a legal standard.

Beyond these broad trends, the innovation cases contain two other common features that could be useful in predicting future legal developments. First, all the cases discussed above deal with high technology industries that the courts are likely to view favorably. The defendant in each case enjoyed a reputation either as an industry founder, such as Xerox, or as a technologically progressive leader whose work has been essential to modern growth in its particular field, namely, both IBM and Kodak. Courts may be less prone to apply these lenient tests in certain consumer goods industries, for example, in which the innovations at issue usually result more from product differentiation efforts based only on modest quality gains than from startling process or product quality advances. Second, those defendants whose activities have sparked some degree of judicial disapproval—for example, Kodak on the joint venture issue and AT&T on the coupler issue—actually hindered rather than aided the flow of new products to the market. Although current law allows dominant firms wide latitude in innovation-related activity, these companies are more likely to risk liability if their activities cast them as defenders of outdated products rather than as risk-taking innovators. Similarly, if plaintiffs can convince the court that they represent either a fresh source of innovative ideas, or, in Scherer's words, a remedy for the "technological arteriosclerosis" that sometimes accompanies the long-term domination of an industry by a small, fixed set of incumbents,<sup>258</sup> then their chances of prevailing on the merits likely will

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258. Scherer, *Comments on "Patents, Sleeping Patents, and Entry Deterrence,"* in ANTITRUST ANALYSIS, *supra* note 31, at 291.

improve.<sup>259</sup>

### C. Promotion<sup>260</sup>

Despite the tremendous effort to distinguish predatory conduct generally from legitimate, competitive behavior, the status of promotion as a predatory device remains relatively unclear. Very few predatory promotion cases have proceeded to a final judgment on the merits. One reason is that the nature and variety of promotional activities make legal analysis particularly difficult. Indeed, much of the critical economic learning needed to inform this legal analysis is not yet far beyond the issue-framing stage. The case law reflects this insubstantial foundation, since courts generally have proceeded on an ad hoc basis. Accordingly, before examining the cases for those standards and trends that may be discerned, it will be helpful to review briefly some of the key issues and controversies that underlie, and will continue to influence, most predatory promotion claims.

Although sometimes treated analytically as a species of predatory pricing, predatory promotion allegations present issues and problems that typically do not arise in predatory pricing claims. Initially, even identifying and distinguishing among the many different types of promotional activity can be problematical. Questions arise, for example, about whether advertising, as opposed to promotional pricing or long-term investment in goodwill, should include activity such as contests, coupons, discounts to distributors in return for shelf space preferences, and sponsorship of public television programs.

Advertising's special qualitative elements, which are reflected

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259. One possible theoretical basis on which plaintiffs might seek to develop the arguments that are outlined in this paragraph is the considerable academic literature that places a heavy emphasis on the contribution which entrants make to society as sources of innovation. Students of innovation stress the importance of entrants both as developers of new goods and processes and as sources of refinement and improvement for existing products. Scherer summarizes this view as follows:

There is abundant evidence from case studies to support the view that actual and potential new entrants play a crucial role in stimulating technical progress, both as direct sources of innovation and as spurs to existing industry members. Established producers often develop physical and psychological commitments to the customary way of doing things. Because they lack such commitments, new entrants contribute a disproportionately high share of all really revolutionary new industrial products and processes.

F. SCHERER, *supra* note 18, at 437-38.

260. The authors are particularly grateful to John B. Kirkwood and David P. Frankel for their contributions to this section of the Article.

in its content, timing, and target audiences, present problems that distinguish it from pricing as a potential tool for predation. Assessing the competitive significance of these elements is largely a matter of interpretation that resists systematic analysis. In addition, the variety of subtle yet substantial effects that promotion may have in different situations greatly complicates the tasks of identifying any underlying predatory intent and of tracing any anticompetitive impact.

Another distinction between promotion and pricing predation arises because advertising has both short- and long-term attributes. Particularly if a cost-based test is applied to promotional activity, some determination must be made about whether advertising costs, which are often substantial, should be expensed or capitalized. This allocation problem must be faced directly when using a standard that focuses on short-term marginal cost. By contrast, a long-term, total cost rule generally will permit greater flexibility on this question, since it likely would encompass all advertising costs except those for activity whose effects decay particularly slowly.<sup>261</sup>

Additional allocation issues arise if the promotion is restricted to a localized area such as a test market. If the alleged predator uses a mix of national, regional, and local advertising campaigns, it may be necessary, particularly under cost-based rules, to apportion the advertising expenditures among geographic regions to determine how much of any increase reflects the incumbent's response to entry in the relevant geographic market. This measurement, like the decay rate computation, is difficult to perform reliably without substantial expertise and sound judgment. Both, however, are crucial to ascertaining the incumbent's overall costs and the magnitude of any allegedly predatory shifts in advertising.<sup>262</sup>

Because of these differences between predatory promotion and predatory pricing, promotion claims cannot be resolved effectively

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261. Professor Scherer, however, has suggested that, as a general rule, advertising effects decay fairly rapidly. F. SCHERER, *supra* note 18, at 286 (citing Clarke, *Econometric Measurement of the Duration of Advertising Effect on Sales*, 13 J. MARKETING RESEARCH 345 (1976)). Nevertheless, before making this determination, a court in any given case may want to consider the type of advertising and the firm-specific and industry-specific decay rates.

262. The need to allocate expenses to the appropriate models or products in a full product line further complicates the difficulty in apportioning promotional expenditures to relevant time periods and geographic markets. Of course, some analogous apportionment and measurement problems also arise in the treatment of pricing claims. See notes 150-53 *supra* and accompanying text.

by applying the cost-based rules discussed in the subsection on pricing.<sup>263</sup> Furthermore, the need for an independent promotion analysis is likely to increase, since, as some respected commentators have argued, promotion in some instances may be a more cost-effective predatory instrument than pricing.<sup>264</sup> At least seven, potentially interrelated factors provide support for this proposition. First, a dominant firm may enjoy economies of scale or experience in advertising that give it a relative advantage over a new entrant, while price cutting over a large-unit volume might work to the incumbent's disadvantage.<sup>265</sup> Second, in addition to their short-term impact, advertising and promotion have certain fixed-cost, investment-like attributes. These qualities, which may provide long-term advantages to the dominant firm over and above any predatory benefits resulting from the behavior, include increased product differentiation, expanded market penetration, and broader consumer acceptance. Although price cuts may have some promotional aspects, across-the-board price reductions that are withdrawn after they have served their purpose probably do not create the longer term promotional benefits of an equivalent amount of advertising.

Third, Professor Porter and others assert that an entrant "must match [the dominant firm] in absolute message volume to remain [at parity]."<sup>266</sup> If so, a dominant firm may choose to increase its promotional intensity in response to entry, knowing that it can apportion its increases across a much larger product volume base than can its rival.<sup>267</sup> Fourth, advertising experience and prod-

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263. See notes 133-88 *supra* and accompanying text.

264. See, e.g., Porter, *Strategic Interaction: Some Lessons from Industry Histories for Theory and Antitrust Policy*, in *ANTITRUST ANALYSIS*, *supra* note 31, at 479-80. Because a pricing response may often be less cost-effective than another response, Porter concludes that "the form of competitive behavior often attacked in antitrust investigations of predatory aggressive price cutting may be the most benign in terms of the exercise of market power." *Id.* at 480.

265. See, e.g., note 18 *supra* and accompanying text. For example, an eight percent advertising increase by a dominant firm enjoying scale or other economies in promotion may force a new entrant to increase its advertising by, perhaps, ten percent just to maintain parity. This situation may reflect desirable advertising efficiencies, or it may be a function of the established firm's already entrenched position in the market. In either event, these economies are not likely to be as readily available in the implementation of pricing strategies; the dominant firm employing a predatory pricing scheme typically will be able to induce an entrant to drop its prices only to the extent that the dominant firm itself is willing to undertake a proportionately equal price reduction.

266. See, e.g., Porter, *supra* note 264, at 500 fig. 2.

267. With this strategy, an incumbent can cause its rival to suffer a disproportionately large increase in its cost-per-unit and corresponding reductions in its profit margin and cash flow.

uct identification may offer incumbent firms certain tactical advantages over newcomers. The dominant firm can tailor its advertising campaign specifically either to highlight the existence or nonexistence of significant differences between the entrant's product and its own or to distract attention from the entrant's product entirely. A newcomer, however, may have to conduct a less focused campaign that stresses a broader array of product or service qualities in order to build a viable base of customer and market acceptance. This potential tactical advantage is particularly strong in test markets, in which a product's success may determine whether an entrant will attempt a broad market challenge to the dominant firm. In this situation a dominant firm might increase drastically its advertising expenditures for an existing product in an attempt to invalidate or distort a rival's test marketing efforts and results. This increase also may signal an intention to respond aggressively to any extended market challenge. Similarly, a dominant firm might heavily promote a "fighting brand," not principally in response to consumer demand, but "as shock troops to absorb the brunt of a competitive attack."<sup>268</sup>

Fifth, promotional campaigns may be better customized than pricing strategies to fit the individual characteristics of particular demographic, geographic, and product markets. In particular, a dominant firm may focus its most intense promotional efforts on the most critical markets and market segments, without any concern of violating the Robinson-Patman Act, since that Act deals only with price discrimination and not cost discrimination. Sixth, advertising may be a more efficient predatory tactic than price cutting because it avoids the problem of distributors, intermediate wholesalers, and retailers not passing on the benefits of a dominant firm's price reductions. Thus, advertising allows a more direct relationship with the consumer. It may be initiated, pursued for a while, and then abruptly discontinued. Moreover, all these options typically are within the incumbent's exclusive control. Last, the antitrust case law is far more developed in the area of predatory pricing than in predatory advertising. Accordingly, a pricing re-

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268. M. PORTER, *COMPETITIVE STRATEGY* 85 (1980). The fighting brand can "run interference" for the predator's main product by temporarily crowding the available product space, confusing consumers, or otherwise creating "noise" in the test market. The entrant consequently may find either that its expected return has diminished or that the risks of its venture have increased to the point that exit from the market is necessary or planned expansion is infeasible. See Howard, *Fighting It Out in the Test Market*, *DUN'S REV.*, June 1979, at 69; Salop, *supra* note 31, at 1-42.

sponse to entry may entail a greater risk of legal action by the entrant or government enforcement agencies.<sup>269</sup>

Notwithstanding all these apparent advantages of promotional predation over pricing predation, several arguments support the contrary proposition that dominant firms will not engage in predatory advertising;<sup>270</sup> even these contentions, however, are subject to countervailing considerations. First, promotion arguably does not have any anticompetitive effects, since an entrant conceivably can negate any attempts at predation with its own advertising. On the other hand, an established firm in many cases may be better able than a new entrant to bear the burdens of an advertising war because of its generally stronger financial position. Even an entrant with equal access to capital and, thus, no cash flow or risk premium problems typically would have trouble overcoming the incumbent's credibility and advertising effectiveness per dollar. Nevertheless, the very novelty of the entrant's presence may make consumers more willing to make experimental purchases of a new product.<sup>271</sup> If so, the entrant may benefit from a temporary, receptive attitude that enhances its advertising effectiveness.

Second, predatory advertising theoretically should fail if it does not respond to real consumer needs. As many firms have discovered to their detriment, aggressive promotion alone cannot create a market for an otherwise unwanted product. Thus, according to this analysis, a product's success is based not on the predatory character of its promotion, but on how consumers perceive its benefits. This argument, however, assumes that purchasers are perfectly aware of all that benefits them. Effects of an incumbent's actions that appear beneficial in the short term often may injure consumers in the long run. Indeed, this principle is the very essence of predation. An established firm may find it well worth the cost to respond to real but short-term consumer needs if such a scheme can eliminate an entrant, deter future market challenges, and give the firm durable market power. Under these circumstances, the opportunity for long-term consumer choice may be

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269. Of course, both promotion and pricing are subject to myriad local, state, federal, and industry-imposed constraints, many of which are independent of the antitrust laws.

270. If predation is not profitable for a dominant firm in a particular case, then arguably the firm will not attempt it. Firms, however, do not always evaluate their self-interest correctly. Thus, a contention that predation did not occur because it would not have been remunerative should not be dispositive of all claims of predatory behavior.

271. See Lawrence, *How to Test Advertising*, *MANAGEMENT TODAY*, May 1968, at 86.

lost before consumers have a chance fully to assess their options.<sup>272</sup>

A final argument supporting the proposition that dominant firms will not engage in predatory advertising is that incumbents cannot make a substantial investment in advertising and then attempt to recoup their costs without ultimately charging monopoly prices, which would invite either additional entry or reentry.<sup>273</sup> This argument has merit in those situations in which entry barriers are low and serious potential competitors are waiting in the wings. On the other hand, if entry is difficult, or if potential competitors are scarce, a dominant firm can profitably engage in predatory advertising to rebuff a rival who attempts to mount a serious market challenge. When the successful incumbent subsequently raises its prices to recoup its advertising costs, few firms will be able to take advantage of the opportunity to enter the market. Moreover, the initial challenger's experience may serve to discourage further any new entry.

In sum, it is at least arguable, although certainly not a matter of consensus among commentators, that advertising and other forms of promotion may be profitable predation devices.<sup>274</sup> Never-

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272. In many circumstances, it will be important to the manufacturer and valuable to the purchaser for a retailer to make available to the consumer certain services and information as well as to sell him the product. Classic examples arise in the markets for luxury or highly technical consumer goods when the manufacturer needs the retailer to maintain its product's image or to educate the consumer. The retailer, of course, can do this by maintaining an attractive store and employing knowledgeable sales personnel, but not without cost. In these circumstances, retailers who do not provide similar amenities and can, therefore, charge lower prices than the full-service dealers, are said to be "free riding." Professor Posner points out that "free rider" problems substantially reduce the possibility that consumers will organize to protect themselves from exploitation, especially if the product in question has a large number of purchasers. R. POSNER, *supra* note 24, at 184-85.

273. See, e.g., R. BORK, *supra* note 13, at 314-20 (1978); R. POSNER, *supra* note 24, at 92-93; Demsetz, *supra* note 24, at 164, 173-74; Easterbrook, *supra* note 18. This argument echoes the analysis that some of these same commentators make in evaluating the profitability of the traditional concept of deep-pocket predation. See note 18 *supra* and accompanying text.

274. Although only the recent cases are reviewed below, courts traditionally have recognized the possibility of predatory promotion. The Supreme Court first expressly discussed predatory advertising in *American Tobacco Co. v. United States*, 328 U.S. 781 (1946): "Such tremendous advertising, however, is also a widely published warning that these companies possess and know how to use a *powerful offensive and defensive weapon against new competition*. New competition dare not enter such a field, unless it be well supported by comparable national advertising." *Id.* at 797 (emphasis added). In 1968 a court and jury held Chrysler Corporation liable for attempted monopolization that was based on price cutting and "massive" advertising. *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453 (W.D. Pa. 1968), *aff'd per curiam*, 417 F.2d 622 (3d Cir. 1969). Six years later, in an analogous case, the Third Circuit found insufficient evidence for manufacturer's liability, but acknowledged the validity of the *Mt. Lebanon* decision. *Rea v. Ford Motor Co.*, 497 F.2d 577,

theless, whether legal recourse should be available to restrain these activities is an entirely different question. By protecting an entrant, courts risk meddling in the operation of a proven enterprise in order to shelter a firm that otherwise may be too inefficient to compete on its own. Moreover, assuming that some intervention is desirable, it remains exceedingly difficult to fashion a standard for evaluating predatory promotion that is sufficiently broad in scope, that is not easily circumvented, and that does not inject anticompetitive distortions of its own into the market. Thus, courts that are presented with allegations of predatory promotion not only must face the usual difficulties of evaluating and interpreting the conduct at issue, but they also must address the threshold, complex policy questions of how to respond to that conduct.

In the few recent cases that have dealt with predatory advertising or promotion, the promotion allegations usually have been supplemental to claims of predatory pricing or innovation.<sup>275</sup> Although distinct trends are difficult to identify with any certainty in this small class of cases, the courts appear to have decided most of these claims on an ad hoc "rule of reason" basis. In *Buffalo Courier-Express, Inc. v. Buffalo Evening News, Inc.*,<sup>276</sup> for example, the publisher of Buffalo's morning newspaper, the Courier-Express, sued the publisher of the city's evening newspaper, the Evening News, claiming that the latter was about to promote its new Sunday edition predatorily. The challenged conduct consisted primarily of the Evening News' announcement that each of its subscribers would receive a Sunday paper at no additional charge for five consecutive weeks. At the end of this period, anyone wishing a Sunday Evening News could continue to receive it for only thirty cents per week above the regular subscription rate for weekdays and Saturdays.

The district court in *Buffalo Courier-Express* preliminarily

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590 (3d Cir. 1974). The authors are indebted to Ross Petty for this point. See also *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 600-01 (1967) (Harlan, J., concurring); *Bailey's Bakery, Ltd. v. Continental Baking Co.*, 235 F. Supp. 705 (D. Hawaii 1964), cert. denied, 393 U.S. 1086 (1969).

275. Even though the courts apparently did not attach legal significance to their statements, many early predation decisions noted that large increases in advertising accompanied predatory pricing. See, e.g., *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 129-30 (1961); *United States v. American Tobacco Co.*, 221 U.S. 106, 160 (1911); *Porto Rican American Tobacco Co. v. American Tobacco Co.*, 30 F.2d 234, 237 (2d Cir. 1929); *Gerber Prods. v. Beech-Nut Life Savers, Inc.*, 160 F. Supp. 916, 918 (S.D.N.Y. 1958); *In re Golden Grain Macaroni Co.*, 78 F.T.C. 163, 166-67 (1971).

276. 441 F. Supp. 628 (W.D.N.Y. 1977), vacated, 601 F.2d 48 (2d Cir. 1979).

enjoined this free sampling campaign for any period that was longer than two weeks.<sup>277</sup> The Court of Appeals for the Second Circuit, however, vacated the injunction and held not only that the Courier-Express had failed to introduce proof that sampling in excess of two weeks was unusual, but also—and perhaps more important—that “there was no sufficient evidence that the five week sampling would produce even a short-term loss for the News’ operations taken as a whole.”<sup>278</sup> According to the court, therefore, plaintiff had not shown that the Evening News had violated any of the cost-based predation standards.<sup>279</sup>

The Second Circuit’s holding in *Buffalo Courier-Express* intuitively appears reasonable. Even if the Evening News had intended predatorily to usurp its rival’s customers, the Courier-Express, in the spirit of vigorous competition, easily could have prepared for the well-publicized sampling period. The two factors that made predation unlikely in *Buffalo Courier-Express* were that the Evening News announced its promotion campaign in advance of implementing it, and that the promotion was to last for only a short period. Indeed, the Second Circuit expressly noted that had the Evening News offered free copies to subscribers for ten weeks, the district court could have held, even without evidence that the sampling produced a short-term loss, that the publisher had gone too far.<sup>280</sup>

Another Second Circuit case, which was issued soon after *Buffalo Courier-Express*, provides further clarification of the permissi-

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277. *Id.* at 646.

278. 601 F.2d at 55 (citing Areeda & Turner, *supra* note 6, at 728-30). Indeed, the Evening News cited two similar instances in which newspapers had offered a free sampling for four-week periods upon introducing a new Sunday edition.

279. *Id.* at 57-58. Consequently, the court held that the Courier-Express had failed to demonstrate either a probable success on the merits or any sufficiently serious questions reaching the merits to provide a fair ground for litigation and tip the “balance of hardships” in its favor.

280. *Id.* at 55. The Eighth Circuit’s decision in *Morning Pioneer, Inc. v. Bismarck Tribune Co.*, 493 F.2d 383 (8th Cir. 1974), which was issued shortly before the publication of the Areeda and Turner article, provides an instructive counterpart to *Buffalo Courier-Express*. In *Morning Pioneer* the larger of two newspapers, the *Bismarck Tribune*, conducted a lengthy and extensive free sampling campaign in the geographic area that its potential rival, the *Morning Pioneer*, dominated. In affirming the district court’s holding for plaintiff, the Court of Appeals for the Eighth Circuit stated that “[t]he blanketing condemned by the court clearly exceeded that permissible in furtherance of a legitimate attempt by the Tribune to enter [Morning Pioneer’s] market and properly served as a basis for the court’s implicit finding of an intent to monopolize by the Tribune.” *Id.* at 387. Thus, the magnitude of a promotional sampling campaign may mark the difference between a legitimate market entry effort and an unlawful attempt to monopolize.

ble scope of a dominant firm's promotional efforts. In addition to addressing the claims of predatory innovation that were discussed above,<sup>281</sup> the court of appeals in *Berkey* faced an allegation that Kodak had monopolized or attempted to monopolize a camera and film submarket.<sup>282</sup> Berkey contended that Kodak had committed predation by introducing a new film, Kodacolor II, that was compatible only with defendant's new camera, the Pocket Instamatic. Berkey also claimed that Kodak had excessively "puffed" the technical merits of the new film to depress the sales of plaintiff's older format cameras. The Second Circuit rejected the predatory advertising claim, holding that "in its advertising, a producer is ordinarily permitted, much like an advocate at law, to bathe his cause in the best light possible."<sup>283</sup> As the Supreme Court had done previously,<sup>284</sup> however, the Second Circuit acknowledged the possibility that advertising could create entry barriers leading to a violation of section two of the Sherman Act.<sup>285</sup> Nevertheless, this case illustrates not only the strategic use of promotion by a dominant firm against a marginal rival, but also how promotion may be combined with other conduct—in this case new product introduction—to maximize the competitive impact of both.

In contrast to the *Buffalo Courier-Express* and *Berkey* decisions, a recent Ninth Circuit case held that a dominant firm may violate the Sherman Act by engaging in various nonprice promotional activities. In *Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc.*<sup>286</sup> Hunt entered into the spaghetti sauce market by offering a novel "Extra Thick and Zesty" product. Ragu, the dominant firm, responded to Hunt's entry with tactics that, Hunt alleged, violated the Sherman Act by: (1) Granting price reductions in Hunt's test market areas; (2) announcing plans to market its own "Extra Thick and Zesty" product shortly before Hunt was scheduled to

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281. See notes 189-259 *supra* and accompanying text.

282. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

283. *Id.* at 287 (footnote omitted).

284. See *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967). In this case the Court held that Procter & Gamble's product extension acquisition of Clorox violated § 7 of the Clayton Act, in part because the acquisition tended to raise barriers to a new entrant who "would be much more reluctant to face the giant Procter than it would have been to face the smaller Clorox." *Id.* at 579. See also *Purex Corp. v. Procter & Gamble Co.*, 596 F.2d 881, 889-90 (9th Cir. 1979).

285. The court stated that "[a] monopolist is not forbidden to publicize its product unless the extent of this activity is so unwarranted by competitive exigencies as to constitute an entry barrier." 603 F.2d at 287.

286. 627 F.2d 919 (9th Cir. 1980).

begin its national promotion; (3) appropriating the phrase "thick and zesty," which impeded consumer identification of that phrase with Hunt's product; (4) copying a figure that was used in each of Hunt's advertising layouts—a spoon pouring sauce over spaghetti—for use in a Ragu national advertisement; and (5) labeling the Ragu sauce to conceal that it actually was thickened by starch, rather than by long simmering.<sup>287</sup> In sum, Hunt alleged that Ragu was guilty of predation both in its pricing and in the timing and content of its promotional activities.

In granting defendant's motion to dismiss, the district court held that Ragu's nonpricing activity, even if proved, would not violate the Sherman Act. The Court of Appeals for the Ninth Circuit, however, disagreed and held that

the question presented here is whether any market could exist, consistent with the allegations of Hunt's complaint, in which Ragu's non-price related activities could have contributed to an anticompetitive effect. Assuming the existence of some market power, Ragu's conduct could have made Hunt's entry into the market more difficult and costly, to the detriment of competition generally.<sup>288</sup>

The court then remanded the case for a determination on the merits of the nonprice predation claims.<sup>289</sup>

Several conclusions can be drawn from these predatory advertising and promotional decisions. First, since pure advertising or promotion cases are rare, attorneys for dominant firms can distinguish the legal authority that appears to support predatory advertising claims rather easily by emphasizing the nonpromotional aspects of that authority. Second, because many courts have discussed advertising or promotion as only a secondary issue or an afterthought, their discussions have tended to lack the force and depth of analysis found in the treatment of other predation issues. Last, the decisions have tended to place an even higher burden of persuasion on the plaintiff in predatory advertising or promotion cases than in pure predatory pricing cases. This trend may have developed in part because of the inherent difficulties in identifying and distinguishing between competitive and predatory promotional activity. While this distinction is hard to draw in pure pricing cases under the cost-based, bright-line standards, the task is even more formidable when promotional and other nonpricing factors are included in the calculus. Nonetheless, the predatory advertis-

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287. *Id.* at 923.

288. *Id.* at 927.

289. *Id.* at 929.

ing and promotion cases generally have recognized, albeit in dictum, that nonpricing activity can be an instrument of unlawful predation. Indeed, no decision has suggested that advertising or promotion cannot or should not be declared predatory under the proper circumstances.

Courts have gone little further than making this acknowledgment, however, and the threshold of proof is high. Perhaps *Berkey* best articulated the prevailing standard when it stated that to be unlawful, promotional activity must be "so unwarranted by competitive exigencies as to constitute an entry barrier."<sup>290</sup> This general test graphically demonstrates the uncertain status of advertising and promotion, for it no more than reformulates the pivotal legal—and theoretical—question in any predation analysis: What dominant firm conduct that is detrimental to actual and potential rivals nonetheless is warranted by "competitive exigencies?"<sup>291</sup> For additional guidance, therefore, one must look, at least for the present, beyond the province of federal antitrust doctrine to the various private and public regulatory programs, including state and common-law unfair competition principles, industry self-regulation standards, and consumer protection regulation, when applicable.

#### IV. PATTERNS

The field of predation provides a classic example of how the interplay of scholarly debate and judicial decisionmaking can furnish a foundation for the courts to transform economic proposals into legal norms. Not surprisingly, therefore, the courts' treatment of predation issues can be divided into three broad categories that parallel the series of compound questions around which the current academic debate revolves.<sup>292</sup> These categories, which are discussed seriatim below, are: (1) The frequency with which the truly objectionable conduct may be expected to occur; (2) the likelihood that either the objectionable conduct or the efforts to proscribe it

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290. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 287 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980) (citing *American Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946)). Judge Kaufman, who was the author of the *Berkey* opinion, recently reiterated this view in *Northeastern Telephone. Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 93 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079). The Federal Trade Commission in *Borden* found that Borden's ReaLemon trademark was so well established and highly promoted that it constituted an entry barrier. *In re Borden, Inc., (ReaLemon)*, 92 F.T.C. 669, 791 (1978), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979).

291. See notes 20-24 *supra* and accompanying text.

292. See notes 19-64 *supra* and accompanying text.

will have significant anticompetitive or procompetitive effects; and (3) the extent to which business managers and courts can understand and apply the pertinent legal standard without undue costs or administrative burdens.<sup>293</sup>

### A. Frequency of Occurrence

The courts disagree as sharply as do the commentators about how frequently predation occurs. This discord stems in part from the controversies over the appropriate definition of predation, as well as over whether entry barriers exist that are sufficient to insulate a monopolist from market challenges long enough to enable it to recoup the cost of its predatory behavior. Thus, both in the scholarly journals and in the courts, predation remains a concept of shifting contour and dimension. Despite its elusiveness, however, courts still must face the issues of the frequency and magnitude of predation, since the resolution of these issues often determines whether courts, as a matter of policy, should ignore alleged predation, treat it summarily, fashion bright-line rules of conduct, or subject each alleged instance to the fullest possible scrutiny.

Those judicial opinions that have addressed the issue since 1975 provide some initial indication of how often predation has occurred. The cases selected<sup>294</sup> for examination present a pattern in which defendants typically have prevailed,<sup>295</sup> and thus the logical inference is that predation is not a frequent or a widespread phenomenon. To draw a firm conclusion based solely on the results of reported cases, however, would be a mistake. These statistics alone cannot account for the number or quality of cases that were set-

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293. See Kirkwood, *Comments from the Federal Trade Commission*, 49 ANTITRUST L.J. 953 (1980).

294. Fifty-seven cases were selected. They were drawn from those reported opinions since 1975 in which pricing, innovation, or promotion were major ingredients of the plaintiff's monopolization, attempt to monopolize, or price discrimination claims. Those cases in which judges or litigants concentrated on the predatory or nonpredatory nature of conduct other than pricing, innovation, and promotion were examined, but they ultimately were excluded from the analysis in the Article. Also excluded were cases in which the courts' opinions failed to address the substantive standards for evaluating the defendant's pricing, innovation, or promotion conduct. Finally, this analysis excludes those reported decisions in which the court analyzed predatory pricing allegations under statutes other than the federal antitrust laws. For a list of the cases selected, see Appendix A.

295. Of the 57 cases selected, nine still await a decision on the merits at the trial stage. Seven others—all judgments for the defendants—were reversed on appeal and have not yet been tried again on the merits. Of the remaining 41 cases, plaintiffs have won four at trial, all of which have been appealed. Defendants have won all 16 final judgments from which no further appeals are possible. For a classification of these cases, see Appendix B.

tled, unnecessarily pursued, or never filed. Cases of clear predation, of course, are very likely to be settled before trial. Moreover, many of the selected cases were instituted before 1975, and thus the plaintiffs' decisions to file suit were made without the benefit of recent theoretical developments.<sup>296</sup> In essence plaintiffs may have sensed predation, but not known what to look for. As plaintiffs become more accustomed to the type and quantum of evidence that they must produce to meet their burdens of proof, defendants may begin to suffer defeat more regularly.

The cases clearly indicate more than an indifferent perception that predation is occurring. On the other hand, the strong pattern of outcomes favoring defendants does raise a powerful inference that true predation is in fact rare.<sup>297</sup> These recent patterns are especially striking when contrasted with a previous study by Professor Koller,<sup>298</sup> in which he found that in cases decided prior to 1971 the plaintiff was "legally adjudged" to have suffered from predatory pricing behavior in ninety-five cases, whereas the defendants had won only twenty-eight.<sup>299</sup> This statistic gives rise to two possible, though not necessarily conflicting, inferences. First, the cases decided since 1975 may have been more meritorious than their outcomes would suggest. Second, the Areeda/Turner standard and its progeny may have made the applicable predation standards far tougher on plaintiffs who perceive themselves injured by predatory

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296. In addition, a problem exists in assessing the encouraging or discouraging impact of prior decisions on the size and composition of current cases.

297. The presence of factually similar cases against IBM and AT&T may have inflated the number of defendants' victories, although several different courts each had the opportunity to apply its own analysis. See, e.g., *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079); *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727 (9th Cir. 1979); *Greyhound Computer Co. v. IBM Corp.*, 559 F.2d 488 (9th Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978); *Telex Corp. v. IBM Corp.*, 510 F.2d 894 (10th Cir.), *cert. denied*, 423 U.S. 802 (1975); *MCI Communications Corp. v. AT&T Co.*, [1980] ANTITRUST & TRADE REG. REP. (BNA) No. 969, at A-3 (N.D. Ill.), *appeals docketed*, Nos. 80-2171 & 80-2288 (7th Cir. Aug. 25, 1980 & Sept. 28, 1980) (judgment for plaintiff); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980); *ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp.*, 458 F. Supp. 423 (N.D. Cal. 1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3126 (1981).

298. Koller, *supra* note 18.

299. *Id.* at 110. Altogether, Koller examined 123 predation cases. Defendants won 28, private plaintiffs won 12, the Justice Department won 8, the FTC prevailed in 25, another 32 resulted in consent decrees, and 18 were decided on procedural issues. *Id.* at 110-11, 111 n.8. Arguably, however, Koller should have excluded these last two categories from his computation.

behavior.<sup>300</sup>

One change that certainly has occurred since Koller's study, which would support the second of these inferences, is that the theoretical concept of a meritorious case has matured. Predation analysis recently has become more sophisticated, and plaintiffs now must meet more preconditions to establish a successful claim than courts previously required. Thus, at least as the courts' opinions have described them, many plaintiffs' cases have been remarkably weak. Some plaintiffs, for example, have not attempted to relate the defendant's prices to the defendant's costs, which suggests that the plaintiff's true source of dissatisfaction is that, for whatever reason, the defendant has been able to undercut him in the market.<sup>301</sup> Some of the plaintiffs who do relate the defendant's prices to the defendant's costs still fail to demonstrate even that these prices are lower than the defendant's average total cost.<sup>302</sup> Moreover, neither private plaintiffs nor the government, except in *In re Borden, Inc.*,<sup>303</sup> has been able to establish that the predation occurred in an industry with high entry barriers. Some plaintiffs also have failed to help the court interpret ambiguous pricing evidence by introducing admissible, independent evidence of the defendant's intent.<sup>304</sup> Nevertheless, these possible explanations for

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300. This conclusion should be restricted to private plaintiffs. The government brought only four of the selected cases, which is too small a sample from which to draw any conclusions. See, e.g., *United States v. Empire Gas Corp.*, 537 F.2d 296 (8th Cir.), cert. denied, 429 U.S. 112 (1976); *In re ITT Continental Baking Co.*, [1981] 3 TRADE REG. REP. (CCH) ¶ 21,823; *In re DuPont de Nemours*, 3 TRADE REG. REP. (CCH) ¶ 21,770 (1980); *In re Borden (ReaLemon)* 92 F.T.C. 669 (1978), appeal docketed, No. 79-3028 (6th Cir. Jan. 10, 1979). In fact, this private plaintiff/government plaintiff breakdown should serve to qualify any conclusions about the impact of the Areeda/Turner test on general liability standards, since courts in private plaintiff cases either may have been reluctant to subject a defendant to treble damages or may have perceived only a weak causal link between the defendant's conduct and the private plaintiff's alleged injury.

301. See, e.g., *Pierce Packing Co. v. John Morrell & Co.*, 633 F.2d 1362 (9th Cir. 1980); *Americana Indus., Inc. v. Wometco de Puerto Rico, Inc.*, 556 F.2d 625 (1st Cir. 1977); *Flair Zipper Corp. v. Textron, Inc.*, 1980-2 Trade Cas. ¶ 63,555 (S.D.N.Y. 1980).

302. See, e.g., *Chilicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th Cir. 1980); *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947 (S.D. Ohio 1981). *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), appeal docketed, No. 80-4048 (9th Cir. Jan. 31, 1980).

303. *In re Borden, Inc. (ReaLemon)*, 92 F.T.C. 669 (1978), appeal docketed, No. 79-3028 (6th Cir. Jan. 10, 1979).

304. See, e.g., *Buffalo Courier-Express, Inc. v. Buffalo Evening News, Inc.*, 601 F.2d 48, 54-55 (2d Cir. 1979); *Janich Bros., Inc. v. American Distilling Co.*, 570 F.2d 848, 856-60 (9th Cir. 1977), cert. denied, 439 U.S. 829 (1978); *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1358-59 (9th Cir. 1976), cert. denied, 429 U.S. 1074 (1977); *Lonmar, Inc. v. Kroger Co.*, 1979-1 Trade Cas. ¶ 62,498, at 76,913 (S.D. Ohio 1979). In some cases courts have ruled that the plaintiff's offer of proof was inadmissible. See *Janich Bros., Inc. v. American Distilling Co.*,

the trend in favor of defendants do not entirely explain the disparity, since even when plaintiffs have demonstrated that the defendant's price is below its average variable cost, the plaintiffs have lost.<sup>305</sup>

In theory, conclusions about the frequency of predation must remain tentative so long as the definition of predation remains subject to continuing controversy and development. In practice the implications of the post-1975 predation cases on the question of frequency likewise are ambiguous. While the sheer volume of recent predation cases may tend to belie the Areeda/Turner view that predation is rare, defendants clearly have enjoyed overwhelming success in this recent litigation. Very few of these cases have presented the market structure conditions—particularly high entry barriers—that economists believe to be necessary for true, welfare-reducing predation. Before concluding, however, that predation never occurs, one should remember that in the interval between the filing and the deciding of these cases, theoretical, economic, and legal developments changed the “rules of the game.” Thus, if predation had occurred, then proving its existence required a more complex and less clear-cut analysis than most plaintiffs were prepared to present. Moreover, the current spate of scholarly commentary that criticizes the Areeda/Turner position and emphasizes the strategic aspects of predation suggests that the possibilities of sophisticated predatory conduct should not yet be ignored.

### B. *Competitive Dangers*

In evaluating the competitive dangers that any challenged activity poses, courts must examine not only the harm to competition that the conduct itself threatens, but also the harm to competition engendered by judicial attempts to prevent that conduct. The first component of this examination, the harm stemming from predation itself, includes both quantitative and qualitative aspects. While the quantitative aspects are directly related to the frequency

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570 F.2d at 853. The court in *Janich*, however, recognized that *direct* evidence could be used to establish the presence of the requisite specific intent. *Id.*

305. See, e.g., *William Inglis & Sons Baking Co. v. IPT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981); *Robert's Waikiki U-Drive, Inc. v. Budget Rent-A-Car Systems, Inc.*, 491 F. Supp. 1199 (D. Hawaii 1980); *Foremost Int'l Tours, Inc. v. Qantas Airways, Ltd.*, 478 F. Supp. 589 (D. Hawaii 1979), *aff'd per curiam*, 649 F.2d 867 (9th Cir. 1981). The possibility should not be overlooked, of course, that none of the current or prior legal tests of predation adequately distinguishes true economic predation from competition that enhances long-run consumer welfare. If this is so, then no mere analysis of outcomes will shed light on questions regarding the actual frequency of predation.

of predatory behavior, the qualitative aspects relate to the magnitude and nature of the effects of any given instance of predation. For this latter issue, the finder of fact and, *ex ante*, the policymaker, must resolve and balance several crucial questions, which include: Whether the conduct rebuffs specific entry challenges, deters entry generally, or both; whether the conduct forces existing rivals to exit the market, or whether it allows them to persist, albeit in a quiescent rather than a competitive mode; whether the victims of the alleged predation can survive in the long run irrespective of the alleged predation; and whether the victim either is as efficient as the predator or has a short-term prospect of becoming so. The answers to these questions help illuminate the competitive dangers that the incumbent's conduct threatens. Rather than considering only these rather specific factors, however, courts also should have at least some idea of which outcomes are more desirable than others from a public policy perspective. For example, engaging in predation against a firm that is not viable in the long run, or which is less efficient than the incumbent, arguably might strengthen the economy by promoting a natural, competitive process in which only the most efficient firms survive. On the other hand, even firms that are less efficient than the dominant firm may perform a useful market function by providing at least some check on the exploitation of otherwise poorly bridled monopoly power.<sup>306</sup> In addition, by approaching the market with a different combination of skills and perspectives than their rivals, these firms possibly may develop or inspire innovations that create new markets or improve the economic performance of existing ones.

Without clear answers to these critical questions of market dynamics,<sup>307</sup> courts must face their own limitations. Forced by their own jurisdiction to choose between permitting or forbidding the challenged activity despite their uncertainty about the economic effects that will result, courts have been especially aware of the possibility that an ill-advised or inept attempt to limit predation may present its own dangers to competition. Courts, for example,

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306. Compare, e.g., R. POSNER, *supra* note 74, at 180-89 with *In re Borden, Inc. (ReaLemon)*, 92 F.T.C. 669, 805 n.39 (1978) *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979).

307. Although resolving these types of issues is in large part the province of the anti-trust scholars and industrial organization economists, *see* part II *supra*, their conclusions are hardly dispositive. Indeed, the current status of the scholarly debate over predation sometimes seems most aptly described by Duggan's Law: "To every Ph.D there is an equal and opposite Ph.D." P. DICKSON, *THE OFFICIAL RULES* 41 (1978).

display substantial deference both to innovators and to firms that have developed their respective industries.<sup>308</sup> Similarly, the prospect of large treble damage awards seems to have diminished the sympathies of some district courts toward plaintiffs.<sup>309</sup> Thus, courts generally are reluctant to risk inhibiting a dominant firm's operations unless both the need for such action and the method for accomplishing it are clear.

To some extent, plaintiffs are faced with a dilemma. The cases suggest that competitively unsuccessful plaintiffs may bear an additional, unspoken burden of demonstrating that they are not just blaming others for their own failings.<sup>310</sup> Although some courts have recognized that under the proper circumstances a strong dominant firm might be able successfully to engage in predation against even a more efficient challenger,<sup>311</sup> courts are wary of protecting the inefficiencies of disgruntled challengers at the expense of proven enterprises. On the other hand, courts also are suspicious of firms that maintain a profit and at the same time allege predation.<sup>312</sup> Although *Utah Pie* unambiguously contemplated the possible co-existence of predation and positive earnings,<sup>313</sup> some district courts apparently have assumed that the absence of failure implies the absence of predation.<sup>314</sup>

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308. See, e.g., *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 281-83 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 982 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980); *In re DuPont de Nemours*, 3 TRADE REG. REP. (CCH) ¶ 21,770, at 21,977-78 (1980).

309. See, e.g., *SCM Corp. v. Xerox Corp.*, 463 F. Supp. 983, 1013-14 (D. Conn. 1978), *aff'd*, 645 F.2d 1195 (2d Cir. 1981), *petition for cert. filed*, 102 S. Ct. 85 (1981) (No. 80-2092); *ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp.*, 458 F. Supp. 423, 434-36 (N.D. Cal. 1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3126 (1981).

310. See, e.g., *Blair Foods, Inc. v. Ranchers Cotton Oil*, 610 F.2d 665, 669-70 (9th Cir. 1980); *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1358-59 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977); *Flair Zipper Corp. v. Textron Inc.*, 1980-2 Trade Cas. ¶ 63,555, at 76,958 (S.D.N.Y. 1980).

311. See, e.g., *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947, at 75,889-90 (S.D. Ohio 1981); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980).

312. See, e.g., *Co-Opportunities, Inc. v. NBC*, 510 F. Supp. 43, 50 (N.D. Cal. 1981); *Hoyt Heater Co. v. American Appliance Mfg. Co.*, 502 F. Supp. 1383, 1390 (N.D. Cal. 1980); *Foremost Int'l Tours, Inc. v. Qantas Airways, Ltd.*, 478 F. Supp. 589, 600-01 (D. Hawaii 1979), *aff'd per curiam*, 649 F.2d 867 (9th Cir. 1981); *Lormar, Inc. v. Kroger Co.*, 1979-1 Trade Cas. ¶ 62,498, at 76,912-13 (S.D. Ohio 1979).

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

314. See note 312 *supra*. This assumption, however, may be too narrow, since the purpose of predation may not always be to deter entry or induce market exit. Instead, predation may serve as a signal or threat that the targeted party should be more cooperative. For example, if firm A tries to encroach on firm B's strong market, firm B, rather than—or in

Despite this judicial caution in redressing claims of predation, courts generally have inquired beyond strictly price/cost relationships. As noted previously, courts and economists apparently believe that the competitive dangers of a dominant firm's response to entry are few if the barriers to entry are low.<sup>315</sup> Precisely how courts will treat cases in which entry barriers are high is still uncertain, since no judicial opinion has found them to exist.<sup>316</sup> In general, however, courts do perceive a greater competitive threat in these situations than do Areeda and Turner, who intend their proposal to apply regardless of the height of the industry barriers.<sup>317</sup>

In addition to examining entry barriers, courts also are recognizing strategic market considerations as important to evaluating the dangers to competition from predation. A few recent opinions have indicated that the interrelationships among markets can provide a strategic lever for competitive advantage, particularly when a monopolistic supplier in one market is a competitor in another.<sup>318</sup> Moreover, at least one court has noted that a firm's reputation as a

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addition to—resisting in its own market, might well choose to commit predation in firm A's stronghold. This action might effectively signal to firm A that B fears a competitive, mutual self-destruction and would prefer to proceed—or to return—to a more cooperative relationship in which each party respects the other's sphere of influence. Professor Porter refers to such a strategy as a "cross-parry." M. PORTER, *supra* note 268, at 84-85 (1980).

The predatory conduct also may put an entrant or maverick rival on notice that it either should cooperate with industry-wide, supracompetitive pricing or face the prospect of an expensive competitive war of attrition. In either instance the predation need only threaten—not eliminate—the victim's earnings. *Cf.* notes 25-31 *supra* and accompanying text (effects of imperfect information).

315. See notes 20-24 *supra* and accompanying text. Even in the recent *Northeastern Telephone* case, which is one of the strictest circuit court applications of the Areeda/Turner test, the court considered the issue of entry barriers. *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 89 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079). Although it found entry barriers to be low, the Second Circuit noted that this fact did not completely eliminate the possibility of predation. Therefore, the court proceeded to review the specific conduct under challenge. *Id.* at 93-95.

316. The Federal Trade Commission, however, found in *Borden* that the respondent's ReaLemon trademark was so well established and highly promoted that it did constitute a barrier to entry. *In re Borden Inc. (ReaLemon)*, 92 F.T.C. 669 (1978), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979).

317. 3 P. AREEDA & D. TURNER, *supra* note 37, § 714c. Interestingly, the selected cases reflect little of the controversy that exists among economists about the nature and existence of entry barriers. The courts usually simply assume that entry barriers may be a significant factor. See, e.g., *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 89 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079); *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

318. See *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1981).

predator—whether justified or not—effectively may deter competition from equally efficient, potential rivals.<sup>319</sup> Nevertheless, the strategic implications of business conduct remain largely uncertain. Consequently, the only lasting inference to be drawn from the courts' attention to strategic and entry barrier considerations in assessing the dangers to competition may be that factors other than cost/price relationships will be held to be relevant to such an assessment. Still, many courts at the moment seem to feel that the competitive dangers of predation are greatest when entry barriers are high and strategic considerations are plainly operative.

### C. Administrability

Assuming that predation occurs more than rarely and that it sometimes presents a significant competitive danger, courts must decide what to do about it. Of course, they may decide to do nothing; they may fear, as discussed above, that inexpert judicial intervention into the market will cause more problems than it will cure, possibly by sheltering inefficient firms, discouraging innovation, or chilling valuable and informative promotional campaigns.<sup>320</sup> Assuming, however, that courts are faced with situations which require intervention often enough to warrant some general rule, the ideal would be a standard that is sufficiently sensitive to distinguish between economically desirable and undesirable conduct, but which also is clear and simple enough that courts and business managers can apply it accurately and with a minimum of expense.<sup>321</sup> The courts recognize both these goals, as well as the natural tendency for conflict between the two. Consequently, the cases reflect an ongoing tension between bright-line, *per se* approaches and a broader, rule of reason analysis.

While cost-based tests are clearly the accepted foundation for analysis, the prevailing trend among courts is to augment this analysis with additional considerations.<sup>322</sup> Thus, one promised vir-

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319. *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965, 988-90 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1981). *See also* *F.T.C. v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

320. *See* notes 306-09 *supra* and accompanying text.

321. Of course, part of the ideal is also that the standard as applied should not have deleterious side-effects. This point, however, was addressed in the previous discussion of the harm to competition from efforts to prevent and redress predation. *See* notes 306-19 *supra* and accompanying text.

322. The tendency of courts to balance the stringency of the definition chosen for one of the elements of liability and damages against the stringency of the definitions chosen for the other elements may well be contributing toward the movement of courts away from rigid

tue of the Areeda/Turner test—simplicity—has been elusive in the courtroom.<sup>323</sup> Whereas Areeda and Turner discourage analysis of entry barriers and assessment of long-term considerations,<sup>324</sup> courts nonetheless have undertaken the former and therefore have opened the door to the latter. Areeda and Turner also suggest that average variable cost may be computed without undue difficulty.<sup>325</sup> As litigators gain experience with cost-based tests and concentrate their efforts on this critical issue, however, they probably will seek to discover fully and then reconstruct in court the defendant's complete cost accounts.<sup>326</sup> Moreover, even under the most basic cost/price test, questions of allocation and measurement poten-

adherence to bright-line standards for predatory pricing. This trend also may be one factor that has allowed the courts to remain as responsive as they have been to the flurry of analysis that presently is occurring.

323. The courts in both *Transamerica* and *Richter* explicitly state that the Areeda/Turner standard is not as easy to apply as it initially appears to be. *Richter Concrete Corp. v. Hilltop Basic Resources, Inc.*, 1981-1 Trade Cas. ¶ 63,947, at 79,885-87 (S.D. Ohio 1981); *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No. 80-4048 (9th Cir. Jan. 31, 1980). See also Greer, *supra* note 53, at 238-52.

324. Areeda & Turner, *supra* note 62, at 896-97.

325. See, e.g., Areeda & Turner, *supra* note 57, at 1345-47, 1351-52.

326. In *Transamerica Computer Co. v. IBM Corp.*, 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed* No. 80-4048 (9th Cir. Jan. 31, 1980), plaintiff asked the court to reallocate certain of defendant's expenses, in effect raising defendant's cost figures for some of its products. *Id.* at 998-1001. The court relied heavily upon the consistency of defendant's accounting methodology over time to reject plaintiff's claims that defendant's books and profit projections understated its costs. *Id.* Although the court ultimately accepted the regularity of defendant's accounts, the court and the parties appear to have devoted a substantial amount of time to these issues at trial and in pretrial proceedings. See *Transamerica Computer Co. v. IBM Corp.*, 459 F. Supp. 626 (N.D. Cal. 1978). See also *California Computer Prods., Inc. (CalComp) v. IBM Corp.*, 613 F.2d 727, 740 n.19 (9th Cir. 1979); *Island Tobacco Co. v. R.J. Reynolds Indus., Inc.*, 513 F. Supp. 726 (D. Hawaii 1981).

Recent court of appeals' opinions also raise two other points about the treatment of accounting issues in predatory pricing cases. In *Broadway Delivery Corp. v. United Parcel Serv.*, 651 F.2d 122 (2d Cir. 1981), the Second Circuit stated that the plaintiff bears the burden of assembling and presenting cost data that support its pricing allegations. *Id.* at 131. The court held that the plaintiff must supply sufficient proof to enable the factfinder to make "a careful assessment of the relationship between the defendants' prices and costs." *Id.*

In *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 652 F.2d 917 (9th Cir. 1981), the Ninth Circuit held that "the determination of fixed and variable costs is a matter for the jury under appropriate instructions." *Id.* at 942. This holding thus gives the jury a potentially significant role in deciding how the defendant's costs are to be calculated—an important step in assessing the defendant's liability under cost-based pricing tests. In reaching this conclusion, the court declined to follow "the recommendation of Professors Areeda and Turner that such categories [of fixed and variable costs] be fixed to avoid case-by-case dispute," notwithstanding the "administrative convenience" such an approach might offer. *Id.* at 941 & n.38. See also *Pierce Packing Co. v. John Morrell & Co.*, 633 F.2d 1362, 1365 (9th Cir. 1980).

tially raise myriad theoretical and factual problems that are inherent in defining the relevant product market, geographic market, and time frame. The courts, therefore, may find that using the information elicited on these issues to seek a fuller understanding of other issues presents little increased difficulty. Regardless of the reason, courts typically have extended their analyses beyond pure cost/price relationships to consider evidence and arguments regarding intent, entry barriers, market structure and conditions, comparative efficiencies, and the strategic implications of the defendant's conduct.<sup>327</sup>

Despite the presence of these additional considerations, no published opinion has adopted a pure, unbounded rule of reason approach. The court in *Berkey*, for example, feared that placing some nonspecific duty upon Kodak to predisclose its new product introductions would not give Kodak adequate guidance regarding the exact nature and extent of product changes covered by the duty, the extent of the information that had to be supplied, or the time requirements for supplying it.<sup>328</sup> Similarly, while a firm may find it difficult to determine exactly when its price dips below average variable cost, a standard that includes other factors as well could be even more difficult for firms to follow.<sup>329</sup> If businesses cannot predict the application of predation rules to their activities, they may either retreat from vigorous competition or find that the risk of litigation jeopardizes their rewards for such aggressiveness. Nevertheless, courts generally seem to find an analysis that is more complex than pure cost/price margins—an approach more in line

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327. See, e.g., *Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc.*, 627 F.2d 919, 926 (9th Cir. 1980) (strategic implications of a defendant's conduct), *cert. denied*, 450 U.S. 921 (1981); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 285-91 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); *United States v. Empire Gas Corp.*, 537 F.2d 296, 299-302 (8th Cir.), *cert. denied*, 429 U.S. 112 (1976); *Structure Probe, Inc. v. Franklin Inst.*, 450 F. Supp. 1272, 1286-89 (E.D. Pa.) (intent), *aff'd*, 595 F.2d 1214 (3d Cir. 1979); *Weber v. Wynne*, 431 F. Supp. 1048, 1060 (D.N.J. 1977) (comparative efficiencies); *Inter City Oil Co. v. Murphy Oil Corp.*, 1976-1 Trade Cas. ¶ 60,948, at 69,189 (D. Minn. 1976) (entry barriers).

328. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 282-83 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980). The court in *Berkey*, however, did go so far as to condemn Kodak for preventing a joint venturer from disclosing the nature of the flashlamp upon which they were working, a view that Justice Rehnquist later criticized. See note 239 *supra*.

329. See, e.g., *Schmalensee*, *supra* note 23, at 1028-29 (commenting on Scherer's proposed multiple-factor analysis of predatory pricing). Courts have not yet attempted to apply proposals suggesting restriction of a dominant firm's output in the face of new entry, see *Williamson*, *supra* note 21, at 284-86, nor have they attempted to prevent incumbents from making nonpermanent price reductions in such a situation. See *Baumol*, *supra* note 42, at 2-6.

with most economists' proposals—to be both administrable and consistent with their own sense of where the greatest dangers to competition lie.

## V. CONCLUSION

Firm conclusions remain elusive. Although some trends are now evident, the jurisprudential and theoretical tensions remain and will continue to result in the refinement of judicial inquiry and analysis. For the present, however, there are still relatively clear, almost *per se*, protections for innovation. By contrast, no specifically formulated test for predatory promotion has gained ascendancy, and, therefore, the rule of reason prevails. Judicial treatment of pricing has been moving toward a hybrid solution, with one presumption against pricing below marginal cost, another in favor of pricing at or above average total cost, and a limited rule of reason analysis for pricing between marginal cost and average total cost. This hybrid approach has appeal because it reduces the range of situations that require complicated analysis, but allows fuller analysis in borderline cases. As economists, courts, and commentators expand their understanding of competitive relationships and behavior, they undoubtedly will reduce the range of uncertainty still further and single out more precisely the cases presenting the greatest danger to competition and consumer welfare.

## VI. APPENDICES

## APPENDIX A

## A Predation Case List: 1975-1981

*First Circuit*

- A. *Americana Industries, Inc. v. Wometco de Puerto Rico, Inc.*, 556 F.2d 625 (1st Cir. 1977).
- B. *Barry Wright Corp. v. ITT-Grinnell Corp.*, 1980-81 Trade Cas. ¶ 63,862 (D. Mass. 1981).

*Second Circuit*

- C. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980). *See also* 457 F. Supp. 404 (S.D.N.Y. 1978). This suit subsequently was settled.
- D. *Brager & Co., Inc. v. Leumi Securities Corp.*, 451 U.S. 987 (1981) (reporting the Supreme Court's denial of certiorari from an unpublished order by the Second Circuit affirming the jury verdict for defendant). *See also* 84 F.R.D. 220 (S.D.N.Y. 1979).
- E. *Broadway Delivery Corp. v. United Parcel Service of America, Inc.*, 651 F.2d 122 (2d Cir. 1981).
- F. *Buffalo Courier-Express, Inc. v. Buffalo Evening News, Inc.*, 601 F.2d 48 (2d Cir. 1979).
- G. *Flair Zipper Corp. v. Textron Inc.*, 1980-2 Trade Cas. ¶ 63,555 (S.D.N.Y. 1980).
- H. *GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203 (S.D.N.Y. 1981).
- I. *Litton Industries, Inc. v. AT&T Co.*, 1981-1 Trade Cas. ¶ 64,027 (2d Cir. 1981).
- J. *Northeastern Telephone Co. v. AT&T Co.*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (U.S. Feb. 23, 1982) (No. 81-1079). *See also* 497 F. Supp. 230 (D. Conn. 1980).
- K. *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195 (2d Cir. 1981), *petition for cert. filed*, 102 S. Ct. 85 (1981). *See also* 599 F.2d 32 (2d Cir. 1979); 474 F. Supp. 589 (D. Conn. 1979); 463 F. Supp. 983 (D. Conn. 1978).

*Third Circuit*

- L. O. Hommel Co. v. Ferro Corp., 472 F. Supp. 793 (W.D. Pa. 1979), *rev'd*, 659 F.2d 340 (3d Cir.), *petition for cert. filed*, 50 U.S.L.W. 3516 (U.S. Dec. 15, 1981) (No. 81-1116).
- M. Outboard Marine Corp. v. Pezetel, 461 F. Supp. 384 (D. Del. 1978). *See also* 474 F. Supp. 168 (D. Del. 1979).
- N. Structure Probe, Inc. v. Franklin Institute, 450 F. Supp. 1272 (E.D. Pa. 1978), *aff'd*, 595 F.2d 1214 (3d Cir. 1979).
- O. Weber v. Wynne, 431 F. Supp. 1048 (D.N.J. 1977).
- P. Van Dyk Research Corp. v. Xerox Corp., 631 F.2d 251 (3d Cir. 1980), *cert. denied*, 101 S. Ct. 3029 (1981). *See also* 478 F. Supp. 1268 (D.N.J. 1979).

*Fifth Circuit*

- Q. International Air Industries, Inc. v. American Excelsior Co., 517 F.2d 714 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).
- R. Malcolm v. Marathon Oil Co., 642 F.2d 845 (5th Cir.), *cert. denied*, 50 U.S.L.W. 3486 (U.S. Dec. 14, 1981) (No. 81-874).

*Sixth Circuit*

- S. Hillside Dairy Co. v. Fairmont Foods Co., 1980-2 Trade Cas. ¶ 63,313 (N.D. Ohio 1980).
- T. Lormar, Inc. v. Kroger Co., 1979-1 Trade Cas. ¶ 62,498 (S.D. Ohio 1979).
- U. Richter Concrete Corp. v. Hilltop Basic Resources, Inc., 1981-1 Trade Cas. ¶ 63,947 (S.D. Ohio 1981).

*Seventh Circuit*

- V. Chillicothe Sand & Gravel Co. v. Martin Marietta Corp., 615 F.2d 427 (7th Cir. 1980).
- W. MCI Communications Corp. v. AT&T Co., [1980] ANTI-TRUST AND TRADE REG. REP. (BNA) No. 969, at A-3 (N.D. Ill. 1980), *appeals docketed*, Nos. 80-2171 and 80-2288 (7th Cir. Aug. 25, 1980 and Sept. 28, 1980). *See also* 462 F. Supp. 1072 (N.D. Ill. 1978).

*Eighth Circuit*

- X. Inter City Oil Co. v. Murphy Oil Corp., 1976-1 Trade Cas. ¶ 60,948 (D. Minn. 1976). This case was subsequently settled and dismissed without prejudice by stipulation of the parties.
- Y. SuperTurf v. Monsanto Co., 1981-2 Trade Cas. ¶ 64,316 (8th Cir. 1981).
- Z. United States v. Empire Gas Corp., 537 F.2d 296 (8th Cir.), *cert. denied*, 429 U.S. 112 (1976). *See also* 393 F. Supp. 903 (W.D. Mo. 1975).

*Ninth Circuit*

- AA. Anpak Drug, Inc. v. Whitworth, Inc., 1976-1 Trade Cas. ¶ 60,921 (C.D. Cal. 1976). This case was subsequently settled.
- BB. Arizona v. Maricopa County Medical Soc'y, 643 F.2d 553 (9th Cir. 1980), *cert. granted*, 450 U.S. 979 (1981).
- CC. Blair Foods, Inc. v. Ranchers Cotton Oil, 610 F.2d 665 (9th Cir. 1980).
- DD. California Computer Products, Inc. (CalComp) v. IBM Corp., 613 F.2d 727 (9th Cir. 1979).
- EE. California Steel & Tube v. Kaiser Steel Corp., 469 F. Supp. 265 (C.D. Cal. 1979), *rev'd*, 650 F.2d 1001 (9th Cir. 1981).
- FF. Co-Opportunities, Inc. v. National Broadcasting Co., 510 F. Supp. 43 (N.D. Cal. 1981).
- GG. Foremost International Tours, Inc. v. Qantas Airways Ltd., 478 F. Supp. 589 (D. Hawaii 1979), *aff'd per curiam*, 649 F.2d 867 (9th Cir. 1981).
- HH. General Communications Engineering, Inc. v. Motorola Communications & Electronics, Inc., 421 F. Supp. 274 (N.D. Cal. 1976).
- II. Greyhound Computer Corp. v. IBM Corp., 559 F.2d 488 (9th Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978). This case has been settled. *See* Washington Post, Jan. 27, 1981, § D, at 7, col. 6. JJ. Ernest W. Hahn, Inc. v. Coddling, 615 F.2d 830 (9th Cir. 1980).
- KK. Hoyt Heater Co. v. American Appliance Mfg. Co., 502 F. Supp. 1383 (N.D. Cal. 1980).
- LL. Hanson v. Shell Oil Co., 541 F.2d 1352 (9th Cir.), *cert. denied*, 425 U.S. 959 (1976).

- MM. Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc., 627 F.2d 919 (9th Cir. 1980), *cert. denied*, 450 U.S. 921 (1981).
- NN. ILC Peripherals Leasing Corp. (Memorex) v. IBM Corp., 458 F. Supp. 423 (N.D. Cal. 1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 101 S.Ct. 3126 (1981).
- OO. William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 652 F.2d 917 (9th Cir. 1981). *See also* 461 F. Supp. 410 (N.D. Cal. 1978).
- PP. Island Tobacco Co. v. R.J. Reynolds Industries, Inc., 513 F. Supp. 726 (D. Hawaii 1981).
- QQ. Janich Bros., Inc. v. American Distilling Co., 570 F.2d 848 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978).
- RR. Murphy Tugboat Co. v. Shipowners & Merchants Tugboat Co., 467 F. Supp. 841 (N.D. Cal. 1979), *aff'd sub nom. Murphy Tugboat Co. v. Crowley*, 658 F.2d 1256 (9th Cir. 1981), *petition for cert. filed*, 50 U.S.L.W. 3592 (U.S. Jan. 13, 1982) (No. 81-1323).
- SS. Pierce Packing Co. v. Morrell & Co., 633 F.2d 1362 (9th Cir. 1980).
- TT. Purex Corp. v. Procter & Gamble Co., 596 F.2d 881 (9th Cir. 1979).
- UU. Robert's Waikiki U-Drive, Inc. v. Budget Rent-A-Car Systems, Inc., 491 F. Supp. 1199 (D. Hawaii 1980).
- VV. Symbolic Control, Inc. v. IBM Corp., 643 F.2d 1339 (9th Cir. 1980). *See also* 1976-1 Trade Cas. ¶ 60,723.
- WW. Transamerica Computer Co. v. IBM Corp., 481 F. Supp. 965 (N.D. Cal. 1979), *appeal docketed*, No 80-4048 (9th Cir. Jan. 31, 1980). *See also* 459 F. Supp. 626 (N.D. Cal. 1978).
- XX. Valerio v. Boise Cascade Corp., 80 F.R.D. 626 (N.D. Cal. 1978).

### Tenth Circuit

- YY. Natrona Service, Inc. v. Continental Oil Co., 435 F. Supp. 99 (D. Wyo. 1977), *aff'd*, 598 F.2d 1294 (10th Cir. 1979).
- ZZ. Pacific Engineering & Production Co. of Nevada v. Kerr-McGee Corp., 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 977 (1977).

- AAA. *Telex Corp. v. IBM Corp.*, 510 F.2d 894 (10th Cir.), *cert. denied*, 423 U.S. 802 (1975). *See also* 367 F. Supp. 258 (W.D. Okla. 1973).

*District of Columbia Circuit*

- BBB. *United States v. AT&T Co.*, 516 F. Supp. 1237 (D.D.C. 1981).

F.T.C. Cases

- CCC. *In re Borden, Inc. (ReaLemon)*, 92 F.T.C. 669 (1978), *appeal docketed*, No. 79-3028 (6th Cir. Jan. 10, 1979).
- DDD. *In re DuPont de Nemours*, 3 TRADE REG. REP. (CCH) ¶ 21,770 (1980).
- EEE. *In re ITT Continental Baking Co.*, 3 TRADE REG. REP. (CCH) ¶ 21,823 (1981).

## APPENDIX B

## A Classification of Reported Opinions

1. Dispositions on the Merits (including pending appeals)		Pricing Cases	Innovation Cases	Promotion Cases
a. By defendant's pretrial motions	D won	A <sup>1</sup> , M <sup>3</sup> , CC, FF <sup>1</sup> , HH <sup>2</sup> , KK, UU <sup>7</sup> , XX, YY		
b. By defendant's trial or post-trial motions	D won	E, G, S, U, V, LL, QQ, RR	DD <sup>8</sup> , NN <sup>9</sup>	
c. Final decision on the merits				
i. Jury verdict	<u>P won</u>	<u>I<sup>1,10</sup>, W<sup>3,10</sup></u>		
	D won	D, L, Q, Y, SS		
	<u>P won</u>	<u>CCC<sup>3</sup>, EEE<sup>3</sup></u>		
ii. Nonjury verdict	D won	J <sup>1,2,10</sup> , N, O, Z, GG, ZZ, DDD <sup>10</sup>	<u>C<sup>1,2</sup>, K<sup>3,4</sup>, P, WW<sup>3,9</sup>, AAA<sup>9</sup></u>	
2. Nonfinal Dispositions				
a. Plaintiff survived defendant's pretrial motions		B, H, AA <sup>11</sup> , PP, BBB		MM
b. Defendant defeated plaintiff's motion for temporary or preliminary injunctive relief		T <sup>1</sup> , X <sup>5</sup> , BB <sup>6</sup>		F
c. Appeal reversed and remanded trial court's decision for	<u>P</u> D	<u>R, EE, II, JJ<sup>12</sup>, OO, TT<sup>1</sup>, VV<sup>1</sup></u>		

The categories "plaintiff won" and "defendant won" indicate which side substantially prevailed on the central predation issues before the court. The following are notes that clarify the classification of cases which might fall into more than one category.

1. Plaintiff also alleged predatory promotion.
2. *Berkey* and *Northeastern* are treated as nonjury verdicts for defendants because the court of appeals in both cases reversed, without remand, the principal predation-based verdicts for plaintiff. In each case the appellate court remanded some predation issues for further consideration. These issues are still before the respective trial courts.
3. Currently on appeal.
4. Plaintiff attacked Xerox's accumulation of patents and refusal to grant licenses. The jury rejected some of SCM's predation claims, and the trial judge ruled that plaintiff could not recover any damages. Plaintiff has sought Supreme Court review of the Second Circuit's ruling on damages.
5. The trial court granted defendant's motion for summary judgment on plaintiff's predatory pricing claims. The trial is proceeding on defendant's alleged use of territorial restrictions.
6. The trial court denied plaintiff's motion for a preliminary injunction. At the same time, the court also denied defendant's motion for summary judgment on plaintiff's pricing claims.

7. The trial court granted defendant's motion for summary judgment on plaintiff's federal antitrust claims.
8. The court of appeals reversed, without remand, the trial court's judgment for plaintiff.
9. Important predatory pricing allegations are also at issue.
10. Important predatory product design allegations and other innovation issues are also at issue.
11. The court granted plaintiff's motion for a preliminary injunction.
12. The court of appeals reversed and remanded the trial court's dismissal of defendant's counterclaim that plaintiff had engaged in below cost pricing.

