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CLIENT ALERT

FTC and DOJ Hold Initial Hearing on Predatory Pricing

June 6, 2006

On June 22, 2006, the FTC and DOJ convened the first of their summer series of Joint Hearings on Single Firm Conduct Issues, with two panels focused on predatory pricing issues. The first panel dealt with sell-side predatory pricing practices and consisted of Patrick Bolton, Professor of Business at Columbia University Business School, Kenneth Elzinga, Professor of Economics at the University of Virginia, A. Douglas Melamed, Partner at Wilmer Cutler Pickering Hale & Dorr, LLP, and Janusz Ordover, Professor of Economics at New York University.

Predatory Pricing of Sales

There was general agreement on the basics of current law: the current standard in predatory pricing cases, *Brooke Group Ltd v. Brown & Williamson Tobacco Corp.* , is heavily defendant-friendly. *Brooke Group's* requirement that a plaintiff show that pricing is below some measure of cost and that recoupment of losses incurred by the predator is probable has led to significant difficulty for plaintiffs, with the first significant victory for a plaintiff coming in the appeal of *Spirit Airlines v. Northwest Airlines* to the Sixth Circuit last November. Beyond that, panelists diverged on a number of matters, including the appropriate level of deterrence in predatory pricing cases, the likelihood and frequency of successful predation, the utility of intent evidence, and the future role of the cost test.

One major rationale for *Brooke Group* was the desire not to chill aggressive price cutting where there was not a likelihood of harm to competition. Some panelists observed that the standard may be too good at serving this rationale: with almost no successful predatory pricing cases since *Brooke Group* , it can be argued that the current regime underdeters. To remedy this, Professor Bolton proposed an analysis that asks whether the market is structurally prone to predation, then analyzes the predator's strategy, focusing on evidence of intent. Other panelists strongly disfavored a focus on intent documents, pointing out that 1) well-trained firms are adept at avoiding the creation of such documents and that 2) fighting words in documents may only signal that a firm is fiercely competitive. On the other hand, Professor Elzinga argued that *Brooke Group* deters appropriately, and that most firms acquitted of predatory pricing under its standard have not gone on to dominate their industries or to amass monopoly pricing power.

There was broad consensus that a safe harbor for pricing above average total cost could be a useful tool for providing certainty, although panelists were divided on whether prices set between average variable and average total cost could be characteristic of a predatory situation. As for the recoupment test established by Brooke Group, panelists generally believed in a structural analysis that would rule out liability where market conditions were generally competitive.

With ongoing uncertainty in predatory pricing law, practical counseling remains challenging. The employment of a cost standard remains a significant hurdle to plaintiffs, but asking whether a particular pricing strategy is “below cost” is often too technical a question for the counseling context. A helpful approach is to consider generally what avoidable costs are associated with a particular pricing decision or strategy. Counsel should elicit and discuss the business reasons for undertaking such a strategy, and ultimately, decisionmakers should ensure that any new pricing regime can be rationalized as profitable in a broad sense. Of course, evidence of intent remains powerful, and care should be taken that strategic documents embody deliberate descriptions of the motivations behind pricing actions taken.

Predatory Purchasing of Inputs

The second panel dealt with predatory conduct from the buy side. Panelists were Tim Brennan, Professor of Economics and Public Policy at the University of Maryland, Baltimore County, John Kirkwood, Professor of Law at Seattle University School of Law, Janet L McDavid, Partner at Hogan & Hartson LLP, Steven C. Salop, Professor of Economics & Law at the Georgetown University Law Center, and Frederick R. Warren-Boulton, a Principal at Microeconomic Consulting & Research Associates, Inc.

Discussion in the buy-side panel focused on the May 2006 decision *Confederated Tribes of Siletz Indians of Oregon v. Weyerhaeuser Co.* , in which the Ninth Circuit declined to apply the *Brooke Group* standards for sell-side predatory pricing to a buy-side case. The panel agreed that the standard employed by the district court (which asked whether Weyerhaeuser had paid more for wood than was necessary for its competitor to be able to acquire wood for a “fair price”) was inadequate, but several felt that the *Brooke Group* standard was overly conservative for predatory conduct on the buy side. Some panelists argued that true instances of predatory buying were even more uncommon than sell-side predatory pricing, and that the literature on predatory buying is relatively less well-developed, militating against instituting a strongly pro-defendant rule like *Brooke Group* .

Panelists distinguished between two instances in which a buyer might manipulate its buying to harm rivals. In the first, classic predatory buying, the buyer attempts to take all of the available input in order to drive its buying rival to exit, then recoups costs incurred by buying at lower prices than those that attained in a competitive purchasing market. In the second, sometimes referred to as “raising rivals' costs,” a buyer tries to amass monopsony power over the input in order to disadvantage the rival in a complementary market, where the buyer hopes to attain monopoly power.

Panelists agreed that regulators should focus more on cases of raising rivals' costs than on classic predatory buying. However, Professor Salop said he felt that the current administration too often asked “what it should not do” rather than becoming involved, particularly in cases in which buying was used as an exclusionary tool. Others said that some federal enforcement in buying cases could be desirable because it would allow courts to weigh rules in cases that are brought on behalf of the public, rather than in cases carrying the “baggage” of acrimonious business disputes.

Panelists pointed out that *Weyerhaeuser* raises extreme difficulties for parties attempting to structure their purchasing programs, and can serve to prop up less efficient buyers consuming inputs at a lower price than their more efficient rivals can pay. Some advocated a clear standard like that used in *Brooke Group* , and all agreed that clarifying *Weyerhaeuser* should be a priority for the Supreme Court.

Until the fate of *Weyerhaeuser* is certain, the threat of a successful suit alleging predatory buying remains low, particularly for businesses not involved in industries requiring inputs that are exhaustible natural resources, byproducts of other industrial processes, or “captive” in the sense that there are few other available buyers. However, businesses should consider whether any changes they make in purchasing strategy appear to be profitable ones, and should continue to carefully document a clear business rationale for any such change in strategy.

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