Controlling Above-Cost Predation: An Alternative to Weyerhaeuser and Brooke Group

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I. INTRODUCTION

The result in *Weyerhaeuser*\(^1\) was widely expected. The Supreme Court had not ruled for a plaintiff in an antitrust case since 1993.\(^2\) And the principal practice at issue—predatory bidding—was similar in many respects to predatory pricing, which the Court had addressed in three prior cases and refused to condemn without proof that the defendant

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\(^2\) Andrew I. Gavil, *Antitrust Bookends: The 2006 Supreme Court Term in Historical Context*, 22 *Antitrust* 21, 22 (2007). The Court’s 2006 Term, in which it decided *Weyerhaeuser* and three other antitrust cases, extended the string of defense victories to 14. *Id.*
had priced below cost and was likely to recoup its losses. It was no surprise, therefore, that the Court decided in *Weyerhaeuser* that a predatory bidding plaintiff also had to show both below-cost pricing and recoupment. As the Court noted, predatory bidding is "striking similar" to predatory pricing.

*Weyerhaeuser* was troubling, however, for three reasons. First, the Court created a safe harbor for above-cost bidding. After *Weyerhaeuser*, aggressive bidding for inputs does not violate the antitrust laws, even if it harms suppliers and consumers, so long as the purchaser covers its costs. Second, the decision created a virtual safe harbor for all aggressive bidding, even when the purchaser may have incurred losses. *Weyerhaeuser* adopted the same legal standard as *Brooke Group*, and that standard has made it extremely difficult for plaintiffs to prevail in any predatory pricing action. As a result,

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1. See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). Predatory bidding occurs when a "purchaser of inputs 'bids up the market price of a critical input to such high levels that rival buyers cannot survive (or compete as vigorously) and, as a result, the predating buyer acquires (or maintains or increases its) monopsony power.'" *Weyerhaeuser*, 127 S. Ct. at 1075 (quoting John B. Kirkwood, *Buyer Power and Exclusionary Conduct: Should Brooke Group Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?*, 72 *Antitrust L.J.* 625, 652 (2005)). Predatory bidding is thus the mirror image of predatory pricing. See *Weyerhaeuser*, 127 S. Ct. at 1076 ("A predatory-pricing plaintiff alleges that a predator cut prices to drive the plaintiff out of business and, thereby, to reap monopoly profits from the output market. In parallel fashion, a predatory-bidding plaintiff alleges that a predator raised prices for a key input to drive the plaintiff out of business and, thereby, to reap monopsony profits in the input market.").

2. *127 S. Ct. at 1076.*

3. Indeed, the purchaser may not need to cover all its costs to escape liability. Under the *Brooke Group* standard, which the Court adopted in *Weyerhaeuser*, all the defendant must do is cover an "appropriate measure of its costs." *Brooke Group*, 509 U.S. at 223. While the Court did not define an "appropriate measure" in either *Brooke Group* or *Weyerhaeuser*, lower courts have generally picked marginal or average variable cost as the presumptive standard. See *infra* note 59. As a result, a defendant may be able to use aggressive bidding to knock out a rival and acquire monopsony power even though it does not cover its fixed costs. In this article, "above cost" means
Weyerhaeuser largely closed the door on future predatory bidding cases. Finally, the decision increased the probability that other forms of aggressive pricing, including market share discounts and bundled rebates, will also be subject to Brooke Group's permissive below-cost/recoupment standard. To date, the Court has exempted three forms of pricing from liability so long as the defendant covers its costs: predatory pricing, predatory bidding, and maximum resale price maintenance. This pattern suggests that other types of aggressive pricing will also be immunized, even when they reduce the welfare of consumers or suppliers, so long as the defendant avoids losses.

above whatever measure of cost a court deciding the issue would deem appropriate—usually marginal or average variable cost (or a comparable measure like average avoidable cost) but possibly average total cost (or a comparable measure like long-run incremental cost).

See Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, Predatory Pricing: Strategic Theory and Legal Policy, 88 Geo. L.J. 2239, 2258-60 (2000) (reporting that in 36 predatory pricing cases decided after Brooke Group, defendants won 33, typically on summary judgment or a motion to dismiss; in the other three, plaintiffs prevailed on summary judgment; plaintiffs obtained settlements in two of these cases; the outcome of the third could not be determined; plaintiffs won no final judgments in any of the 36 cases).

In Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990), the Court held that a plaintiff cannot show antitrust injury from maximum resale price maintenance unless the challenged prices were below cost. The Court stated "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels [i.e., above cost], they do not threaten competition... We have adhered to this principle regardless of the type of antitrust claim involved." Id. at 340.

Indeed, citing Brooke Group, Weyerhaeuser, and Atlantic Richfield, the Ninth Circuit recently decided to impose a below-cost test on bundled discounts. The court stated that the Supreme Court's "reasoning poses a strong caution against condemning bundled discounts that result in prices above a relevant measure of costs." Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 912 (9th Cir. 2007). Wisely, the panel rejected the test proffered by PeaceHealth, which would have compared the "discounted price of the entire bundle" of products with the "incremental cost to produce the entire bundle." Id. at 914. That test would allow a firm making substantial monopoly profits on one of the products in its bundle to exclude an equally
The Court has offered two principal justifications for its repeated reliance on above-cost safe harbors. First, above-cost safe harbors promote competition based on efficiency. With an above-cost safe harbor, a dominant firm need not hold a pricing umbrella over less efficient firms. Instead, the dominant firm can use its cost advantage to lower selling prices or raise input prices and drive these firms from the market with little fear of antitrust liability. Second, above-cost safe harbors reduce the chilling effect of antitrust law on desirable price competition. By making above-cost pricing and bidding legal, the Court has given firms almost complete assurance that they can engage in a broad range of aggressive behavior without antitrust sanction. While some of this behavior may be predatory, most of it is not, and trying to identify the predatory instances would, in the Court’s words, create “intolerable risks of chilling legitimate price-cutting.”

To prove that a bundled discount was exclusionary or predatory for the purposes of a monopolization or attempted monopolization claim under § 2 of the Sherman Act, the plaintiff must establish that, after allocating the discount given by the defendant on the entire bundle of products to the competitive product or products, the defendant sold the competitive product or products below its average variable cost of producing them.

Id. at 920. While this standard would greatly limit a monopolist’s ability to exclude equally efficient rivals, it would still allow the exclusion of less efficient rivals, a situation that may result in long-run consumer harm. The alternative suggested in this article would reach that situation.

"The dominant firm can drive out a less efficient rival by reducing its selling price to a level that is above its own costs but below the costs of the less efficient rival. Similarly, the dominant firm can bid up the market price of a critical input to a level that causes the less efficient rival—but not the dominant firm—to incur losses.

Brooke Group, 509 U.S. at 223. In an oft-quoted sentence, the Court referred to both justifications for above-cost safe harbors:

As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predatory, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting.

The Court reiterated both rationales in Weyerhaeuser. See 127 S. Ct. at 1074.
Neither justification, however, compels a price-cost test. If the point of the antitrust laws is to benefit consumers and suppliers,\(^1\) it is not always desirable to allow a dominant firm to exclude a less efficient rival. If the rival supplied a constraint on the dominant firm's pricing power that would not otherwise exist, the destruction of the rival would reduce the welfare of consumers or suppliers (or both), even if it promotes competition based on efficiency. From a normative perspective, in short, competition based on efficiency is not the right goal. By immunizing above-cost predation, it is likely to generate a significant number of false negatives.\(^2\)

Likewise, a below-cost test may not be the best way of protecting desirable price competition from the risk of antitrust challenge. The alternative explored in this article—a welfare/economic sense standard—would also be a workable way of achieving that goal, and may produce a better balance of false negatives and false positives. Under this standard, a plaintiff would have to show that the challenged behavior was likely to reduce the welfare of consumers (in a predatory pricing case) or suppliers (in a predatory bidding case). Furthermore, even if the plaintiff met this burden, the defendant could escape liability by proving that its conduct made economic sense apart from its anticompetitive gains.

This standard may well generate a better mix of outcomes than the below-cost/recoupment standard of *Weyerhaeuser* and *Brooke Group*. The proposed standard would reduce the number of false negatives because it would reach above-cost pricing and bidding. At the same time, it is unlikely to cause a significant increase in the number of false positives. It would impose a heavy burden of proof on the plaintiff and would afford the defendant a complete defense for conduct that made economic sense without regard to its

\(^1\) See John B. Kirkwood & Robert H. Lande, *Chicago's Foundation is Flawed: Antitrust Protects Consumers, Not Efficiency, in Where the Chicago School Overshot the Mark: Effect of Conservative Economic Analysis on U.S. Antitrust* (Robert Pitofsky ed.) (forthcoming) (manuscript on file with author) (generally, the ultimate goal of the antitrust laws is the welfare of consumers, not economic efficiency; in monopsony power cases, the overarching objective is the welfare of suppliers).

\(^2\) See *infra* part III.
anticompetitive effects. This defense is likely to provide a workable tool for businesses and courts because, in the version recommended here, it is based on profitability calculations that a profit-maximizing firm would make in the ordinary course of business.\[^{13}\] In short, while the issue cannot be finally resolved without more empirical evidence, the welfare/economic sense standard may well be the preferable approach in predatory pricing and predatory bidding cases, and possible other types of aggressive pricing as well.

In exploring this issue, I focus on predatory bidding, in part because the article was written for a symposium on buyer power. More important, the proposed standard may be especially well suited for predatory bidding since the danger of false positives seems to be low in this area. Prior to *Weyerhaeuser*, there had been few suits challenging predatory bidding and none had been successful against a dominant firm.\[^{14}\] As a result, the Court could have departed from *Brooke Group* and applied the suggested standard to predatory bidding with relatively little fear of chilling procompetitive conduct.

Part II of this article reviews the facts and opinion in *Weyerhaeuser*. Part III indicates that the behavior immunized in *Weyerhaeuser* and

\[^{13}\] Several courts and commentators have adopted an economic sense defense to claims of predatory pricing. More than twenty years ago, in *William Inglis v. ITT Continental Baking Co.*, 668 F.2d 1014, 1035-36 (9th Cir. 1981), the Ninth Circuit stated:

> 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.

Subsequently, the Sixth Circuit endorsed this standard and continues to follow it. *See* *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917, 938 (6th Cir. 2005). *See also* *Trace X Chem. Inc. v. Canadian Indus., Ltd.*, 738 F.2d 261, 266 (8th Cir. 1984) ("conduct without legitimate business purpose [is] conduct [that] makes sense only because it eliminates competition"). Similarly, Professors Bolton, Brodley, and Riordan would allow a defendant in a below-cost pricing case to show that "a representative firm in the industry [would] have anticipated the conduct to be profit-maximizing in the absence of exclusionary effects." Bolton, Brodley & Riordan, *supra* note 6, at 2273.

\[^{14}\] *See infra* text accompanying notes 38-40.
Brooke Group—above-cost predation—is a significant concern, both theoretically and empirically. Part IV describes the proposed alternative and explains why it may well be superior to the existing below-cost/recoupment standard. Part V summarizes the argument.

II. THE WEYERHAUSEUR DECISION

Weyerhaeuser is the leading operator of hardwood sawmills in the Pacific Northwest. As of 2001, it owned six mills and purchased approximately 65% of the alder logs sold in the region.\textsuperscript{15} Ross-Simmons had operated a hardwood sawmill in the Northwest since 1962, almost twenty years before Weyerhaeuser entered by acquisition.\textsuperscript{16} After its entry, Weyerhaeuser invested almost $75 million in capital improvements and increased output at all of its mills.\textsuperscript{17} Despite the heightened competition, Ross-Simmons remained profitable until the late 1990s, when the price of alder sawlogs rose at the same time the price of finished hardwood lumber fell.\textsuperscript{18} This price squeeze caused Ross-Simmons to lose money from 1998 to 2001 and ultimately forced it to shut down its mill.\textsuperscript{19} In contrast, Weyerhaeuser’s Pacific Northwest sawmill division continued to run at a profit.\textsuperscript{20}


\textsuperscript{16} 127 S. Ct. at 1072.

\textsuperscript{17} Id.

\textsuperscript{18} Id. at 1073.

\textsuperscript{19} Id. Other sawmills also closed. See Confederated Tribes of Siletz Indians v. Weyerhaeuser Co., 411 F.3d 1030, 1044 n.57 (9th Cir. 2005), rev’d, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007) (31 sawmills went out of business). Although four new mills opened, they did not achieve a significant market share. Id. at 1044.

\textsuperscript{20} See Brief for the Petitioner, supra note 15, at 6 (“it is undisputed that Weyerhaeuser and its alder sawmills in the Pacific Northwest operated at a profit throughout the alleged predation period”). Ross-Simmons contended that one of Weyerhaeuser’s mills failed to cover its costs during part of the
Ross-Simmons sued Weyerhaeuser for monopolization and attempted monopolization, arguing, among other things, that "Weyerhaeuser had overpaid for alder sawlogs to cause sawlog prices to rise to artificially high levels as part of a plan to drive Ross-Simmons out of business."\(^{21}\) Weyerhaeuser contended that its payments for sawlogs were not predatory because they did not violate the below-cost and recoupment tests established in *Brooke Group*. The district court disagreed. It instructed the jury that it could find that Weyerhaeuser's payments were anticompetitive if they met the following criteria:

One of Plaintiffs' contentions in this case is that the Defendant purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent the Plaintiffs from obtaining the logs they needed at a fair price. If you find this to be true, you may regard it as an anti-competitive act.\(^{22}\)

The jury found for Ross-Simmons and returned a verdict (after trebling) of approximately $79 million.\(^{23}\)

The Ninth Circuit sustained this verdict. It held that *Brooke Group* did not apply because "the concerns that led the *Brooke Group* Court to establish a high standard of liability in the predatory-pricing context do not carry over to this predatory bidding context with the same force."\(^{24}\) The court observed, for example, that "because predatory bidding cases attack a firm's decision to increase prices, not reduce them, they do not represent a direct assault on price cutting."\(^{25}\) The price squeeze. According to Ross-Simmons, the Weyerhaeuser mill at Longview, Washington, adjacent to Ross-Simmons' mill, received sawlogs from a nearby Weyerhaeuser tree farm at below-market prices. Had this subsidy been eliminated, Ross-Simmons argued, the mill would have operated at a loss for part of the period 1997-2001. See Brief for Respondent at 13-14, *Weyerhaeuser*, 127 S. Ct. 1069 (No. 05-381).

21 127 S. Ct. at 1073.

22 The district court's instructions also included a set of general principles for distinguishing anticompetitive from procompetitive conduct. See 411 F.3d at 1039 n.30.

23 127 S. Ct. at 1073.

24 411 F.3d at 1038.

25 Id. at 1037 n.14 (quoting Kirkwood, *supra* note 3, at 667). Chief Justice Roberts made the same point during oral argument at the Supreme Court:
Ninth Circuit held, therefore, that Weyerhaeuser's liability was properly determined by the jury instructions given below. The court stated that these instructions were "consistent with Supreme Court precedent" and "as a whole provided sufficient guidance regarding how to determine whether conduct was anticompetitive."

The guidance provided by the instructions, however, was questionable. Only one instruction appeared to apply to predatory bidding, and it was vague. This instruction made liability turn on whether the defendant paid "more than necessary" for logs in order to prevent the plaintiff from purchasing logs at a "fair price," but it did not define either "necessary" or "fair." Nor did it refer the jury to the other instructions, which contained general principles for deciding whether Weyerhaeuser's behavior was anticompetitive. Instead, the predatory bidding instruction simply declared that if "you find this to be true" (i.e., if you find that Weyerhaeuser paid "more than necessary" in order to prevent Ross-Simmons from buying at a "fair price"), "you may regard it as an anti-competitive act." Professor Hovenkamp called this instruction "an antitrust disaster of enormous proportions."

This instruction made it easy, therefore, for the Supreme Court to reverse. If the Court had rejected Brooke Group, it would have had to

"Well, it's a little different here in that in the Brooke Group cases, of course, the alleged anticompetitive conduct was pricing too low, which is at least a direct benefit to consumers... while here... that's not the form the anticompetitive conduct takes." Transcript of Oral Argument at 7, Weyerhaeuser, 127 S. Ct. 1069 (No. 05-381). This point needs to be qualified, however, for a predatory bidding complaint would usually represent an "indirect attack" on lower consumer prices. Kirkwood, supra note 3, at 655 n.85. That is because higher input prices frequently lead to lower output prices. By bidding up the market price of a key input, a buyer is likely to increase the supply of that input, which is likely to cause more output to be produced, which is likely to lower the market price of that output, which would benefit consumers. See id. at 653. The Supreme Court recognized this linkage when it stated: "Failed predatory-bidding schemes can also... benefit consumers." 127 S. Ct. at 1077.

26 411 F.3d at 1040.
27 Id. at 1039.
choose another standard and the only one the Ninth Circuit approved was amorphous. At oral argument, Justice Souter made precisely this point. When counsel for Ross-Simmons noted that Weyerhaeuser had argued that "the instruction was so standardless that the verdict cannot stand," Justice Souter responded: "But isn't that something we have to consider because if . . . we disagree with them on Brooke Group, we've got to do it in the course of making a choice between a Brooke Group instruction and something else, and the only something else we've got right now is what we have in this case" and "that basically left the jury on . . . a free float, didn't it?"

Not surprisingly, the Supreme Court reversed. In a unanimous opinion by Justice Thomas, the Court ruled that predatory bidding was so similar to predatory pricing that Brooke Group's below-cost and recoupment requirements had to be satisfied. While the Court noted some differences in the two practices, it concluded that the similarities dominated. In many respects, the opinion was well crafted; it relied heavily, for example, on published scholarship. But in extending Brooke Group to predatory bidding, it neglected two significant issues.

First, the Court relied exclusively on the analytical similarities between predatory bidding and predatory pricing to conclude that "the risk of chilling procompetitive behavior . . . is as serious here as it was in Brooke Group." The Court never examined the empirical evidence. In particular, it did not ask whether firms engaging in

29 Transcript of Oral Argument, supra note 25, at 49.

30 Id.

31 Id. at 39. Years earlier, then-Judge Breyer had also objected to the vagueness of a "fair price" standard. See Town of Concord v. Boston Edison Co., 915 F.2d 17, 25 (1st Cir. 1990) (asking "how . . . a judge or jury [is] to determine a 'fair price'?").

32 See 127 S. Ct. at 1076–78.

33 See id. at 1075–77 (citing, for example, Steven C. Salop, Anticompetitive Overbuying by Power Buyers, 72 Antitrust L.J. 669 (2005); Roger G. Noll, "Buyer Power" and Economic Policy, 72 Antitrust L.J. 589 (2005); Roger D. Blair & Jeffrey L. Harrison, Monopsony: Antitrust Law and Economics (1993); and Kirkwood, supra note 3).

34 127 S. Ct. at 1078.
aggressive bidding were as likely to be sued—and sued successfully—as firms engaging in aggressive price cutting. In fact, the historical record showed sharp differences. Prior to 1975, when Areeda and Turner first advocated a price-cost test,35 plaintiffs brought numerous cases challenging predatory pricing and won a large percentage.36 Even after Brooke Group was decided, a substantial amount of litigation continued over predatory pricing, although the plaintiffs' success rate plummeted.37 In contrast, in the century after the passage of the Sherman Act, Blair and Harrison found only three suits challenging predatory bidding.38 And although two were successful, both involved conspiracies.39 Prior to the cases against Weyerhaeuser, no plaintiff had ever obtained a final judgment or settlement in a predatory bidding case against a dominant firm.40 Given this record, the Court had less reason to fear false positives and more reason to choose an alternative to Brooke Group.

The Court's second error was to extend Brooke Group to predatory bidding claims without considering whether an alternative standard would have been preferable. While the jury instruction given below should not have been adopted, the Court did not ask whether there was an approach between that instruction and Brooke Group, an approach that would achieve a better balance of false positives and


36 Bolton, Brodley & Riordan, supra note 6, at 2250 ("[o]ut of a total of 123 federal cases from 1890 to 1971, the prey was legally adjudged to have suffered predatory injury in 95 cases, or 77% of the cases brought") (citing Roland H. Koller II, The Myth of Predatory Pricing: An Empirical Study, ANTITRUST L. & ECON. REV., Summer 1971, at 105, 110).

37 See supra note 6.

38 See BLAIR & HARRISON, supra note 33, at 66–69, 154–56.

39 See Am. Tobacco Co. v. United States, 328 U.S. 781 (1946); Reid Bros. Logging Co. v. Ketchikan Pulp Co., 699 F.2d 1292 (9th Cir. 1983).

40 See also Brief for the American Antitrust Institute as Amicus Curiae in Support of Respondent at 25–26, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007) (No. 05-381) [hereinafter AAI Brief] (prior to Weyerhaeuser, there were no litigated cases “involving single-firm monopsony conduct [of any type] under Section 2”).
false negatives. At oral argument, Justice Breyer suggested just such a standard. In discussing the overbuying allegation in the case, he offered his own "key" to distinguishing anticompetitive from procompetitive behavior:

If you’re trying to decide whether people are hogging goods unnecessarily for bad purposes, or rather storing up nuts for winter for good purposes, then a very good key to that is do these people expect in the long run to make money out of this without driving those victims out?

Later, he rephrased his test in more general terms: "whether it was in their economic interest in the absence of any intent to monopolize these people to buy all these logs or not.” Justice Breyer was of course proposing the "no economic sense" test, a test that has been much discussed recently. This article suggests that the optimal approach to controlling predation may involve a combination of the no economic sense test and a welfare test. In Weyerhaeuser, however, the Court did not address whether the no economic sense test, a welfare/economic sense standard, or any other alternative was superior to Brooke Group.

One reason why a welfare/economic sense standard may be preferable is that it would reach above-cost predation.

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41 Transcript of Oral Argument, supra note 25, at 31–32.
42 Id. at 41.
44 In Justice Thomas' defense, none of the parties or their amici advocated an alternative test. Weyerhaeuser and its amici recommended that the Court reverse the Ninth Circuit and apply Brooke Group. See, e.g., Brief for the Petitioner, supra note 15, at 10–12, 50; Brief for the United States as Amicus Curiae Supporting Petitioner at 7–9, 30, Weyerhaeuser, 127 S. Ct. 1069 (No. 05-381); Brief for Amici Curiae Business Roundtable and National Association of Manufacturers in Support of Petitioner at 3–4, 20, Weyerhaeuser, 127 S. Ct. 1069 (No. 05-381). Ross-Simmons and its amici urged the Court to affirm the Ninth Circuit’s decision. See, e.g., Brief for Respondent, supra note 20, at 24–27.
III. ABOVE-COST PREDATION

As this article noted at the outset, the below-cost/recoupment test of *Weyerhaeuser* and *Brooke Group* has substantial benefits: it promotes competition based on efficiency and it reduces the chilling effect of antitrust liability on desirable pricing and bidding. It also has one major drawback: it protects above-cost pricing and bidding even when they are predatory. This drawback is significant for two reasons. First, above-cost predation is a well-recognized theoretical possibility. As numerous commentators have emphasized, above-cost predation can occur and can reduce the welfare of consumers and/or suppliers. Second, recent cases have revealed several plausible examples of it.

50; *AAI Brief, supra* note 40, at 4–5, 29; Brief of Amicus Curiae States of California, Oregon, Arizona, Iowa, Louisiana, Montana, West Virginia, and Wisconsin in Support of Respondent, at 7–10, 30, *Weyerhaeuser*, 127 S. Ct. 1069 (No. 05-381) [hereinafter *States Brief*]. No party or amicus recommended that the Court reverse the Ninth Circuit and adopt a test other than *Brooke Group*. Although AAI and the States argued that the Ninth Circuit’s analysis was consistent with the no economic sense test, *AAI Brief supra* note 40, at 8, *States Brief, supra*, at 29, neither contended that the Court should adopt the no economic sense test in lieu of the jury instructions given below.

45 See *supra* notes 9–10 and accompanying text.

46 The below-cost test adopted by *Weyerhaeuser* and *Brooke Group* also has another drawback. In some cases, it requires courts to address thorny issues of cost measurement and allocation, raising the expense of litigation and reducing business certainty. See, e.g., Herbert Hovenkamp, *The Harvard and Chicago Schools and the Dominant Firm*, in *WHERE THE CHICAGO SCHOOL OVERSHOT THE MARK: EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* 132 (Robert Pitofsky ed.) (forthcoming) (manuscript on file with the author) (“[i]n some cases measuring [price-cost relations] is extraordinarily difficult, particularly if the defendant produces multiple products with common costs”); *LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 167 (2d ed. 2006) (“determining average variable cost has proven difficult and costly”). As a result, the below-cost test may not provide clear guidance in a significant number of cases. In both *American Airlines* and *Spirit*, for example, there was considerable dispute over the relevant measure of cost. See *infra* notes 87–88 & 98–101 and accompanying text. To be sure, an economic sense defense would present comparable problems, since it too would require courts and businesses to assess the profitability of particular conduct. There appears to be no reason, however, why an economic sense test would entail more difficult problems of cost measurement and allocation than a below-cost test. See *infra* part IV.
While none of these cases is definitive, together they suggest that the phenomenon deserves the attention of antitrust policymakers.

A. Widely recognized possibility

As numerous scholars have written, pricing above costs can be predatory. Professor Hovenkamp states: "Manifestly, the law of predatory pricing does not rest on the premise that anticompetitive, above cost pricing strategies are implausible. In fact, such theories are quite numerous and varied."\(^4\) Professors Bolton, Brodley, and Riordan concur: "A [below-cost] standard can be faulted as . . . under-inclusive, because prices above cost can be both predatory and injurious to competition."\(^5\) Professor Baker agrees: "A firm can deter aggressive competition with a low price, even if the low price exceeds the price-cutter's average cost, so long as the price is sufficiently low relative to its rivals' cost. Hence, it is possible that competition can be harmed by low prices even if those prices are not below the price-cutter's cost."\(^6\)

\(^4\) Hovenkamp, supra note 46, at 148-49 (citing JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 367-74 (1992); FREDERIC M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 356-66, 405-06 (3d ed. 1990); JOE S. BAIN, INDUSTRIAL ORGANIZATION 269-76 (2d ed. 1968)).


\(^6\) Jonathan Baker, Predatory Pricing after Brooke Group: An Economic Perspective, 62 ANTITRUST L.J. 585, 591 (1994). Accord, Joseph P. Guiltinan & Gregory T. Gundlach, Aggressive and Predatory Pricing: A Framework for Analysis, 60 J. MARKETING 87, 94 (1996) ("scholars adopting a dynamic perspective of competition have shown that the aims of predation may be achieved even at above-cost prices"). In their framework for analyzing predatory pricing, which combines price theory with insights from marketing, Professors Guiltinan and Gundlach would not exempt above-cost price cuts that are likely to harm consumer welfare. Id. at 95. They also emphasize that in evaluating the impact of aggressive price cuts on consumer welfare, courts should recognize that rivals may react not by exiting but by "nonprice responses, such as reducing research and development, advertising, customer service, or variety." Id. at 96.
Professors Sullivan and Grimes declare: "[U]nder some circumstances even prices above full cost may intentionally discourage entry or aggressive price competition, or drive out a rival." Professor Edlin elaborates: "An incumbent monopoly with a significant cost or noncost advantage over entrants—a situation this Essay argues is common for monopolies—can use these advantages to drive entrants from the market by pricing below their cost, above its own. . . . [T]his strategy is quite credible and effective" and harms consumers. Professor Elhauge agrees that above-cost pricing is a serious concern.

As Edlin explains, above-cost pricing or bidding can be predatory when a dominant firm possesses significant advantages over entrants. These advantages allow the dominant firm to maintain its own

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50 SULLIVAN & GRIMES, supra note 46, at 168. Professors Sullivan and Grimes would use a "structured rule of reason" to evaluate claims of price predation. Id. at 174–78. Like the standard suggested in this article, their approach would not demand proof of below-cost pricing. Instead of an economic sense defense, however, they would allow a multiplicity of other defenses—for broad-based and durable price reductions, promotional pricing, meeting competition, and cost savings.


52 See id. ("higher-cost rivals will not even attempt entry, and consumers may never enjoy low prices. If entrants who would price below the monopoly are excluded from the market, consumers are worse off than if the low-cost monopoly did not exist"). See also id. at 991 ("consumers often need inefficient entrants").

53 Einer Elhauge, Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory—and the Implications for Defining Costs and Market Power, 112 YALE L.J. 681, 686 (2003) ("The concern is that [above-cost] price cuts not only drive out entrants, but deter similar entry in the future, and thus allow the more efficient incumbent to perpetuate monopoly prices that exceed the price the next most efficient firm would charge. . . . This is a serious concern."). Elhauge disagrees, however, with Edlin's policy prescription. In contrast to the approach suggested in this article, Edlin would deal with above-cost predation by making it impossible for a monopolist to respond at all to low-priced entry for a significant period of time. See Edlin, supra note 51, at 946 (normally, "if an entrant prices twenty percent below an incumbent monopoly, the incumbent's prices will be frozen for twelve to eighteen months"). Elhauge opposes this proposal on numerous grounds.
profitability while forcing the entrant to incur losses. For example, if the dominant firm has lower variable costs, it can bid up input prices to a level that prevents the entrant from covering its average variable costs while the dominant firm continues to cover its own. Similarly, if the dominant firm has lower fixed costs, it can reduce its selling price to a level just above average total cost and prevent the entrant from recovering its fixed expenses. When combined with the other elements of a credible predatory strategy, such advantages allow a dominant firm to engage in successful predation without violating the Weyerhaeuser/Brooke Group below-cost test.5

A dominant firm can also engage in successful above-cost predation where its advantages over entrants are only temporary, provided they are large enough in magnitude and duration that the entrant exits or competes less aggressively. Suppose, for example, that a dominant firm markets a differentiated product that commands considerable brand loyalty. As a result, an entrant would have to charge a significantly lower price for a substantial period of time, inducing enough consumers to switch to its product that it attains the scale required for profitability. Alternatively, the entrant may have to incur significantly higher production costs than the dominant firm for a substantial period of time because of learning-by-doing economies. Under either circumstance, the dominant firm can react to entry with above-cost prices (or payments for inputs) that cause the entrant to incur significant losses for a substantial period of time. These losses may induce exit, deter future entry, or discourage further investment in the industry, permitting the dominant firm to preserve its pricing power without triggering liability under Weyerhaeuser or Brooke Group.6

54 See infra note 112.

55 As Hovenkamp notes, this means that Judge Posner’s definition of exclusionary conduct—conduct capable of excluding an equally or more efficient rival—is under inclusive. While above-cost pricing and bidding may not exclude an equally efficient entrant, such conduct can reduce consumer welfare “where the rival that is most likely to emerge is less efficient than the dominant firm.” Hovenkamp, supra note 46, at 142.

56 See Schmalensee, supra note 48, at 1021 (brand loyalty and learning-by-doing economies allow a dominant firm to exclude an entrant without pricing below cost). Accord, Bolton, Brodley & Riordan, supra note 6, at 2271; Ashutosh Dixit, Gregory T. Gundlach, Naresh K. Malhotra & Fred C. Allvine,
Several types of advantages can allow a dominant firm to engage in above-cost predation. In addition to brand loyalty and learning-by-doing economies, a dominant firm may possess patents or trade secrets that enable it to produce a better product than the entrant or a comparable product at lower costs. A dominant firm may also benefit from demand-side network effects that enhance the value of its product. For example, if the dominant firm's product is widely used, consumers may also be able to purchase an extensive array of

*Aggressive and Predatory Pricing: Insights and Empirical Examination in the Airline Industry, 25 J. PUB. POL'Y & MARKETING 1, 8 (2006)* (above-cost pricing may exclude an entrant "when customers are not familiar with competitors' offerings or their decisions are heavily influenced by attributes such as brand equity or previous experience with the dominant brand"). Schmalensee and Melamed point out, moreover, that it is not entirely correct to call an entrant subject to such temporary disadvantages a "less efficient" entrant. If the entrant is likely to attain cost parity with the dominant firm if allowed to remain in the market, the entrant could be viewed as an "equally efficient" entrant from a dynamic perspective. Schmalensee, *supra* note 48, at 1021; Melamed, *supra* note 43, at 388 ("a rival that is less efficient today might become equally or more efficient if permitted time to develop learning-by-doing economies or if its sales grew and enabled it to gain scale economies"). In this sense, above-cost pricing can exclude equally efficient entrants.

Professor Elhauge asserts that a monopolist cannot use above-cost pricing to exclude an entrant with temporary disadvantages. He acknowledges that "the initially less efficient entrant will suffer start-up losses if the incumbent's above-cost price is below the entrant's initial costs," Elhauge, *supra* note 53, at 782, but he argues that the capital markets will fund these losses "if entry by an initially less efficient firm is itself efficient and desirable." *Id.* at 783. He concedes, however, that the only way the capital markets would fund these losses is if the entrant is likely to earn a sufficient return to cover all its costs, including its start-up losses. *See id.* Yet the very point of the incumbent's predatory price cuts is to prevent the entrant from covering all its costs. What Elhauge is really arguing, therefore, is not that a temporarily inefficient entrant cannot be excluded, but that it ought to be excluded where its entry would reduce economic efficiency. Elhauge contends that its entry may reduce efficiency because, to the extent the entrant captures business, production would be shifted from the efficient incumbent to the inefficient entrant. *Id.* From a consumer welfare perspective, however, this temporary inefficiency is desirable if entry leads to lower consumer prices. The ultimate problem with Professor Elhauge's argument, in short, is that it rests on the judgment that antitrust policy ought to be driven by economic efficiency rather than by the welfare of consumers and suppliers.
complementary products, while it may take years before a similar array is developed to support the entrant's product. On the supply side, a dominant firm may possess economies of scale or scope that an entrant cannot easily duplicate, given its other disadvantages. A dominant firm may also possess superior access to capital, possibly because of its size but more likely because it has a track record in the industry than no entrant can match.57

Economic theory indicates, in short, that dominant firms can engage in successful above-cost predation, injuring not only the rivals they exclude but consumers and suppliers as well. Recent case law suggests, moreover, that above-cost predatory pricing and predatory bidding are not just theoretical concerns.

B. Plausible instances of above-cost predation

In four recent cases, two from the timber industry and two from the airline industry, a dominant firm (or combination of dominant firms) excluded one or more significant rivals by aggressively bidding up the price of a critical input or aggressively reducing the price of its output.58 In all of these cases, moreover, the dominant firms did not, or arguably did not, violate the prevailing below-cost test. To the contrary, the courts found or there was substantial evidence that these firms continued to earn revenues sufficient to cover their marginal or average variable costs.59 Finally, after the rivals were excluded, the

57 See, e.g., Edlin, supra note 51, at 943 n.12 & 959 (describing numerous advantages); Hovenkamp, supra note 46, at 15 (noting that a dominant firm can typically finance litigation more readily than an entrant).

58 In the airline cases, the dominant carriers also aggressively expanded capacity on the relevant routes, offering more flights or larger planes than they had before the rivals appeared.

59 Brooke Group declared that a plaintiff challenging predatory pricing must show that the defendant's prices were "below an appropriate measure of costs." Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993). While the Court did not specify the appropriate cost measure in either Brooke Group or Weyerhaeuser, lower court decisions have generally ruled that pricing below average variable or marginal cost creates a presumption of predatory pricing. See, e.g., Spirit Airlines, Inc. v. Northwest Airlines, Inc., 431 F.3d 917, 938 (6th Cir. 2005) (proof of pricing below average
dominant firms reduced input prices or raised selling prices substantially, or there was a dangerous probability that this would happen. All these cases, in short, represent plausible instances of above-cost predation.\(^6\)

1. PREDATORY BIDDING

(a) Reid Brothers.\(^6\) In the 1960s and early 1970s, Ketchikan Pulp Company, a subsidiary of Georgia-Pacific, and Alaska Lumber and Pulp Company were the leading operators of pulp plants and

variable cost establishes prima facie case of predatory pricing, shifting burden to defendant to justify its pricing). Some courts, moreover, require pricing below marginal cost or a comparable measure. See, e.g., Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 920 (9th Cir. 2007) ("we hold that the appropriate measure of costs for our cost-based standard is average variable cost"), id. at n.19 (criticizing average total cost as "inconsistent with the Supreme Court's instruction in Brooke Group that predatory prices are those below 'some measure of incremental cost'") (quoting Brooke Group, 509 U.S. at 223 (emphasis added)); United States v. AMR Corp., 335 F.3d 1109, 1116 (10th Cir. 2003) (appropriate measure is marginal cost or an accurate and reliable proxy for marginal cost; commonly accepted proxy is average variable cost). See also Hovenkamp, supra note 28, at 22 ("while the U.S. Supreme Court has never passed judgment on the correct price/cost test for predatory pricing, the U.S. Circuit Courts have generally agreed that either marginal cost or average variable cost is the correct number"); ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 276–81 (6th ed. 2007) (most circuits presume that prices below marginal or average variable cost are predatory; no presumption attaches if prices are below average total cost, though a plaintiff may show that such prices were in fact predatory; some circuits insist on pricing below marginal or average variable cost). In all the instances described below, the courts found or there was substantial evidence that the defendants covered their marginal or average variable costs.

\(^6\) These cases are plausible rather than definitive instances of above-cost predation for three reasons. First, because the defendants did not, or arguably did not, cover their full costs, some courts might have held that they violated the below-cost test. Second, none of the decisions reached a final judgment as to whether the challenged conduct was profitable for the defendant or harmful on balance to consumers or suppliers. Third, the facts of the cases are drawn from the appellate opinions cited below, not a review of the underlying records.

\(^6\) Reid Bros. Logging Co. v. Ketchikan Pulp Co., 699 F.2d 1292 (9th Cir. 1983).
sawmills in southeastern Alaska. Together, they accounted for over 90% of the output in the area. Acting in concert, they drove out independent sawmills and foreclosed new entry through a variety of tactics, including bidding up the price of timber. When a Japanese paper company built a mill in the area, for example, the Ketchikan timber manager noted that it was causing trouble by "offering higher prices for logs." In response, he suggested that Ketchikan "run [the bidding] up on [the Japanese mill] to the point it will really hurt." Later, the Ketchikan general manager declared that "we should bid all [timber] sales to keep [the Japanese mill and other actual and potential operators] out." Ketchikan and Alaska Pulp carried out this plan, bidding up the price of timber and eliminating six competing mills. In the process, the defendants covered their marginal costs and possibly their other costs as well, since the court never indicated they had to lose money in order to accomplish their predatory scheme. After competition had been suppressed, the

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62 Id. at 1295, 1299. The Ninth Circuit referred to them as "the two giants of the southeast Alaska lumber industry." Id. at 1297.

63 Id. at 1297–98.

64 Id. at 1297.

65 Id. While the general manager cautioned against "the danger of making one bid too many," id., it does not appear that Ketchikan and Alaska Lumber simply induced their rivals to pay higher prices for logs. Instead, the defendants paid higher prices themselves. See id. at 1298 n.5 (referring to "the high prices paid for standing timber" by the defendants) & 1298 (describing defendants' use of front corporations "to bid preclusively on [government] timber sales").

66 Id.

67 See supra note 65.

68 699 F.2d at 1297.

69 Id. at 1298 n.5 ("there was no evidence that the high prices paid for standing timber would prevent the defendants from covering their marginal costs on the ultimate sale of the processed timber").

70 Ruling before Brooke Group, the Ninth Circuit rejected the application of a price-cost test to the defendants' predatory bidding, id., sustaining the jury verdict for Reid Brothers. Id. at 1298–99.
defendants lowered their payments for timber to "artificially depressed
levels.""

Although Reid Brothers involved a conspiracy, rather than a dominant
firm, a single sawmill with a 90% share could have carried out the
predatory scheme at least as easily as the two defendants did. And the
scheme may well have been profitable to the defendants and harmful to
the long-run welfare of timber owners and consumers. While the Ninth
Circuit did not address the recoupment and welfare issues directly, it did
conclude that the defendants had reduced payments for timber to
"artificially depressed levels." It also found that the defendants had not
only "eliminate[d] existing independent mills" but "prevent[ed] the
establishment of new operations [and] frustrate[ed] the efforts of
potential entrants," which would have allowed noncompetitive timber
payments to persist for a significant period of time.

(b) Weyerhaeuser. As described above, Weyerhaeuser, the dominant
operator of hardwood sawmills in the Pacific Northwest, bid up the price
of alder sawlogs while the price of finished hardwood lumber fell,
eliminatibg many competing mills. This conduct created a dangerous
probability of monopsony power, but did not cause Weyerhaeuser's

71 Id. at 1297:
The evidence clearly shows a well-orchestrated and successful effort by
[the defendants] to eliminate existing independent mills and prevent the
establishment of new operations through control of the timber supply. By
frustrating the efforts of potential entrants into the market, the defen-
dants were able to minimize competition and keep stumpage rates and
payments to purchase loggers at artificially depressed levels.

72 Id.
73 Id.

74 Accord, Richard O. Zerbe, Jr., Monopsony and the Ross-Simmons Case: A
Comment on Salop and Kirkwood, 72 ANTITRUST L.J. 717 (2005) (Reid Brothers
presented the circumstances in which predatory bidding is most likely to
succeed and injure consumers: a relatively inelastic input supply in the short
run, a more elastic supply in the long run, and a relatively elastic (but not
perfectly elastic) demand for the final product).
75 See supra text accompanying notes 15–20.
76 See Weyerhaeuser, 411 F.3d at 1043–45 (sustaining the jury's finding
based on Weyerhaeuser's market share, its past ability to influence timber
prices, and the existence of entry barriers).

hardwood sawmill division to lose money. Although the Ninth Circuit did not address whether Weyerhaeuser was likely to exercise this power for long enough to recoup its earlier profit sacrifice and inflict net harm on timber owners or consumers, the case is sufficiently similar to Reid Brothers that Weyerhaeuser may well have engaged in successful above-cost predation.

2. PREDATORY PRICING
   (a) American Airlines. By May 2000, American Airlines had preserved its status as the dominant carrier at the Dallas/Fort Worth airport (DFW), accounting for more than 70% of the passengers boarding at that terminal. Delta Airlines, which also maintained a hub at DFW, had a share of 18%. While eight low-cost airlines had begun offering flights into and out of DFW in the period between 1995 and

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77 See supra note 20.

78 As Professor Zerbe noted, Ross-Simmons’ complaint included “allegations of consumer harm in the form of reduced plantings of alder seedlings by industrial and small woodland owners, with the obvious long-term effects on future supplies of log inputs and lumber outputs.” Zerbe, supra note 74, at 723. At trial, however, “Ross-Simmons did not present direct evidence in support of these allegations.” Id. at 724. In its brief to the Supreme Court, Ross-Simmons explained that it did not introduce evidence of these long-run effects because Weyerhaeuser successfully withheld significant documents from discovery. These documents were later unsealed in other cases against Weyerhaeuser. See Brief for Respondent, supra note 20, at 2–3.

79 See Zerbe, supra note 74, at 725 (noting the parallels between Reid Brothers and Weyerhaeuser and concluding that the “evidence presented in [Weyerhaeuser] was sufficient to support a finding of consumer harm, particularly since consumer benefit was not established”). Contra, Salop, supra note 33, at 709–14 (asserting that Weyerhaeuser’s behavior was procompetitive and, at a minimum, was unlikely to harm consumers since the relevant output market was found to be all hardwood lumber, not alder lumber, and Weyerhaeuser’s share of this market was just 3%). Professor Zerbe testified for Ross-Simmons at trial, Professor Salop consulted for Weyerhaeuser, and I advised Ross-Simmons at the Ninth Circuit and Supreme Court.

80 United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003).

81 Id. at 1112.

82 Id.
their entry had not captured a significant volume of the traffic. As of May 2000, their total market share was just 2.4%, much less than the shares of low-cost carriers at several other major airports.\textsuperscript{84}

American had responded aggressively to the entry of these discount airlines. First, it matched their fares on the routes they served,\textsuperscript{85} even though travelers tended to prefer American at an equal fare because of its multiple advantages.\textsuperscript{86} Second, American expanded its capacity on these routes, increasing the number of its flights or the size of its planes. Third, American raised the proportion of its seats that were available at the new, lower prices. Despite these moves, American’s revenues continued to cover its average variable costs,\textsuperscript{87} and the Tenth Circuit concluded that the government had not shown that American’s prices had fallen below any “appropriate measure of cost.”\textsuperscript{88}

Because of American’s behavior, however, the low-cost carriers ceased or curtailed their operations and American raised fares and reduced flights to approximately their pre-entry levels.\textsuperscript{89} As a result,

\textsuperscript{83} Id.

\textsuperscript{84} Id. at 1112 & n.2 (low-cost carriers accounted for more than 15% of the passengers boarding at Denver, for example, and almost 17% boarding at Atlanta).

\textsuperscript{85} Id. at 1112.

\textsuperscript{86} See Edlin, supra note 51, at 943 n.12 (American has “many advantages over entrants like Vanguard” [one of the low-cost carriers], including a superior brand-name reputation, more flights per day, and a more valuable frequent flyer program; as a result, “at an equal price . . . American’s flights will be fuller”).

\textsuperscript{87} 335 F.3d at 1120 (“it is uncontested that American did not price below [average variable costs] for any route as a whole”).

\textsuperscript{88} Id. at 1120. See also id. at 1116–20 (rejecting the government’s alternate cost measures).

\textsuperscript{89} Id. at 1112:

In each instance, American’s response produced the same result: the competing [low-cost carrier] failed to establish a presence, moved its operations, or ceased its separate existence entirely. Once the [low-cost carrier] ceased or moved its operations, American generally resumed its prior marketing strategy, reducing flights and raising prices to levels roughly comparable to those prior to the alleged episode of predatory activity.
American restored its "hub premium," the higher price that major airlines can charge at concentrated hubs when they do not face discount competition. Although the court did not address whether American could charge this premium long enough to recoup the profit sacrifice it made when it cut prices, expanded capacity, and reduced the revenue yield of each flight, both recoupment and consumer harm were plausible outcomes in this case, since American's position was protected by barriers to entry and mobility. American had numerous cost advantages over the cheaper airlines, and it had established a reputation for aggression by responding vigorously to the entry of several of them, forcing them to retrench.

(b) Northwest Airlines. In 1995, Northwest Airlines was the dominant carrier at the Detroit Metro airport, controlling 64 of its 86 gates and carrying 78% of the passengers who traveled from the airport. In late 1995 and early 1996, Spirit Airlines, a discount carrier, began offering service on two routes that Northwest dominated, Detroit-Boston and

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See supra note 86. The district court disagreed, granting summary judgment for American on the recoupment issue. 335 F.3d at 1113. The Tenth Circuit did not reach the question, however, affirming only on the below-cost issue. Id. at 1120–21. In a comparable case, the Sixth Circuit found that a reasonable fact-finder could conclude that the defendant's hub was protected by significant barriers to entry—barriers high enough to enable the defendant to recoup its profit sacrifice. See infra note 103 (noting, for example, that a dominant carrier may be in a position to limit competitors' access to airport space). See also Dixit et al., supra note 56, at 7 (entry barriers can exist when an entrant must pay fees to an incumbent to lease access to gates or landing slots).


Id. at 923.
Detroit-Philadelphia. Northwest responded with dramatic fare reductions and increased flight capacity on both routes, undercutting Spirit. Within months, Spirit exited both markets and Northwest curtailed the number of flights on these routes and raised fares sharply.

The district court ruled that Northwest had not engaged in predatory pricing because its revenues had exceeded its average variable costs. Reversing, the Sixth Circuit held that a reasonable trier of fact could find that Northwest had priced below its variable costs on both routes. The issue was close, however, as an extensive concurring opinion by Judge Moore made clear. Laying out the arguments on both sides, she concluded that both sides' experts have presented “credible opinions” and that a reasonable trier of fact could come out either way on the price-cost issue. If the case is not settled, therefore, it is quite possible that Northwest will be found to have priced above an appropriate measure of cost. If so, the case would present an especially plausible example of above-cost predation. The Sixth Circuit held that a trier of fact could reasonably find that "Northwest recouped any losses from its predatory pricing quickly after Spirit left these routes" and that consumers were likely to be harmed "for the foreseeable future."

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95 Id. at 922–23, 935.
96 Id. at 923–24.
97 Id. at 924, 935–36.
98 Indeed, the district court granted summary judgment for Northwest on the below-cost issue. Id. at 925.
99 Id. at 945.
100 Id. at 958.
101 Like the parties’ experts, the majority and Judge Moore focused on variable costs as the most appropriate cost measure. See id. at 939–45, 956–58. While the majority noted that Northwest could be found liable for pricing below average total cost, see id. at 951–52, it seems unlikely, given the state of the case law, see supra note 59, that Northwest would lose if it were ultimately found to have covered its variable costs.
102 Id. at 950.
103 Id. at 951 ("leisure travelers to Boston and Philadelphia . . . suffered not only a reduction in the supply of flights to these cities, but, to travel these
In these four cases, in short, defendants aggressively lowered their selling prices or raised their buying prices, harmed smaller rivals, and quite possibly reduced consumer or supplier welfare, yet they did not, or plausibly did not, fail to cover an appropriate measure of their costs. Under *Brooke Group* and *Weyerhaeuser*, therefore, these plausible instances of predation either were or could be beyond the reach of current law. There is reason, then, to consider replacing the *Brooke Group/Weyerhaeuser* standard with a more flexible standard, a standard that would cover above-cost routes, had to pay an almost seven-fold price increase. With the 'very high' barriers to entry, the consumers for this route likely would not have any viable alternatives to Northwest Airlines for the foreseeable future”). The court concluded that barriers were very high because “the record reveals that Northwest controlled sixty-four of the seventy-eight gates at the Detroit airport under long-term leases.” *Id.* at 947. In contrast, “Spirit had to pay $100,000 to access a gate as well as 25% higher landing fees than airlines with long-term leases.” *Id.* In addition, the court relied on scholarship indicating that the dominant carrier at a hub may be able to limit an entrant’s access to airport space. See *id.* (citing Note, *Compatibility and Interconnection Pricing in the Airline Industry: A Proposal for Reform*, 114 YALE L.J. 405, 424 (2004) (“an airline’s dominant presence at its hub may allow it to exert veto power over any plans to expand the airport’s capacity”) and Note, *The Antitrust Implications of Airport Lease Restrictions*, 104 HARV. L. REV. 548, 567 (1990) (“[w]hen an airline controls a substantial percentage of enplanements at an airport, it wields significant power over its competitors’ access to airport space”)).

The defendants did escape liability in two of the cases (*Weyerhaeuser* and *American Airlines*). In a third (*Northwest Airlines*), the plaintiff prevailed on summary judgment, but as Judge Moore’s concurring opinion made clear, the defendant may ultimately win on the cost issue if the case is not settled. Only in *Reid Brothers* did the plaintiff obtain a final judgment, but that case was decided before *Brooke Group* and *Weyerhaeuser*.

There may have been other plausible instances of above-cost predation in the airline industry. A recent empirical study identified seven markets in the 1990s in which a major airline’s pricing response to entry was “consistent with the evidence that the Supreme Court requires to determine predatory pricing practices.” Dixit et al., *supra* note 56, at 19. Although the study was unable to examine any airline’s costs, it found pricing behavior that was consistent with recoupment: “in the seven markets in which a discount airline entered and then subsequently exited, the dominant airline cut its prices and then increased its prices over time to the same or higher levels than those before the entry of the discounter.” *Id.*
predation but would also limit the chilling effect of antitrust litigation on desirable price competition. This standard—the welfare/economic sense standard—is described and evaluated in part IV.

IV. THE WELFARE/ECONOMIC SENSE STANDARD

Section IV.A describes the welfare/economic sense standard in more detail. Section IV.B shows that the economic sense defense presented here is likely to be workable in predation cases and that the combination of this defense with a welfare test may produce a better balance of false negatives and false positives than existing law.

A. Elements of the standard

Under the welfare/economic sense standard, a plaintiff could not establish a claim of predatory bidding or predatory pricing without showing that the defendant's conduct was likely to reduce the welfare of suppliers or consumers.\(^5\) While the plaintiff would not need to show that the defendant failed to cover its costs, the defendant could escape liability by establishing that its conduct was expected to be profitable regardless of whether it produced anticompetitive gains.

1. PLAINTIFF'S BURDEN: HARM TO WELFARE

The plaintiff would have to demonstrate that the defendant's conduct was likely to cause a net adverse effect on the welfare of suppliers or consumers. In a predatory bidding case, the plaintiff would have to show harm to suppliers; in a predatory pricing case, it would have to establish harm to consumers.\(^6\)

To demonstrate probable harm to suppliers in a predatory bidding case, the plaintiff would have to establish four propositions.\(^7\) First, the defendant's conduct likely raised the price that one or more rivals paid for a critical input. Second, this price increase likely

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\(^5\) In an attempted monopolization case, the plaintiff would have to show only a dangerous probability of harm to welfare.

\(^6\) For the reasons why supplier welfare is the appropriate goal in a predatory bidding case and consumer welfare is the appropriate goal in a predatory pricing case, see Kirkwood & Lande, supra note 11.

\(^7\) The plaintiff's proof would be analogous in a predatory pricing case.
reduced the rivals' ability or incentive to compete, by driving them from the market, by depriving them of funds needed for promotion or investment, or by otherwise limiting the pressure they would likely put on the defendant. Third, the defendant was therefore able to acquire or maintain monopsony power that it would not otherwise have had and thus could depress the price of the input below, or further below, the competitive level. Fourth, the defendant likely could exercise this monopsony power long enough to recoup its earlier profit sacrifice and reduce the welfare of the input suppliers.108

Proof of the fourth proposition would require the plaintiff to demonstrate that the input market was protected by barriers to entry of sufficient height to permit recoupment and an adverse effect on welfare.109 These barriers could be structural or behavioral. They could consist of features of market structure like product differentiation and scale economies that would prevent or delay entry.110 The plaintiff could also establish that the defendant’s predatory conduct would itself deter future entry. If the plaintiff attempted to show such a behavioral barrier, it would have to demonstrate that the defendant’s

108 As presently formulated, the welfare/economic sense standard would require a predatory bidding plaintiff to establish both recoupment and harm to supplier welfare. This dual requirement might not be necessary, since in most cases proving recoupment would be sufficient to show harm to welfare. See infra section IV.B.1; Kirkwood, supra note 3, at 661 n.110 (noting that in a predatory pricing case, every dollar gained by the seller is a dollar lost by consumers). Nevertheless, in order to reduce the risk of false positives, this article suggests that a plaintiff be required to demonstrate harm to welfare in cases in which proof of recoupment is insufficient to establish such harm.

Since the plaintiff must prove recoupment and the defendant is entitled to an economic sense defense, litigation under the proposed approach would focus on why the defendant’s strategy was expected to be profitable. The plaintiff would assert that the strategy would not have been profitable but for its anticompetitive effects, while the defendant would contend that the strategy was likely to be profitable simply because of its procompetitive effects.

109 If some competitors remained in the market after the period of aggressive pricing, the plaintiff would also have to establish barriers to expansion.

aggressive bidding for inputs likely created a reputation for predation that would forestall new entry.\footnote{See Bolton, Brodley & Riordan, supra note 6, at 2300–11 (discussing reputation effect predation and the requirements for establishing it).}

In order to establish the second proposition—reduction in rivals' ability or incentive to compete—the plaintiff would have to show that the defendant’s conduct constituted a credible predatory strategy. Otherwise, the rival would assume that the defendant’s aggressive bidding was likely to be abandoned, and the rival would not withdraw from the market, refrain from further investment in the market, or otherwise curb its competitive activities.\footnote{For descriptions of credible predatory strategies and their requirements, see id. and Bolton, Brodley & Riordan, supra note 48, passim & Appendix ("Elements of Proof of Predatory Strategies"). Reputation effect predation, mentioned in the previous paragraph, is only one type of credible predatory strategy. Other types, which might not be sufficient by themselves to deter future entry (and thus might be insufficient to establish the fourth proposition), include financial market predation, test market predation, and cost signaling, See id.}

Establishing all the requirements of a welfare standard would impose a major burden on a plaintiff in a predatory bidding or predatory pricing case. The resulting litigation would typically be large, expensive, and time-consuming, necessitating extensive discovery and considerable expert testimony. This burden alone might be large enough to discourage all but a few attacks on legitimate bidding and pricing. The risk of false positives, in other words, might be reduced to acceptable levels simply by using a rigorous welfare standard. A welfare standard is comparable to the full rule of reason used in Sherman Act section 1 cases, and plaintiffs have had great difficulty winning full rule of reason cases.\footnote{See Robert Pitofsky, In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing, 71 GEO. L.J. 1487, 1489 (1983) ("it is very difficult for a plaintiff (either the government or a private party) to win a rule of reason case"). See also id. ("rule of reason cases often take years to litigate and are extremely expensive"); HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 105 (2005) (litigating a rule of reason case is "one of the most costly procedures in antitrust practice").}
Today, however, the desire to avoid false positives and create clear, workable rules for business is so great that this is probably not an acceptable approach. In four recent predation cases, the Supreme Court has imposed demanding standards on plaintiffs and resolved each case for the defendants in order to avoid false positives.114 And the business community has emphasized that it needs clear, workable rules in order to make real-time pricing decisions,115 a need that Justice Breyer has repeatedly recognized.116 If antitrust law is ever going to reach above-cost predation, therefore, it is probably necessary to supplement a welfare standard with a practicable safe harbor for


115 See, e.g., Brief for Amici Curiae Business Roundtable, supra note 44, at 17:

Routine pricing decisions are made by ordinary business people—not by industrial organization economists. These individuals cannot consult economists and lawyers every time a bid for materials is due, a contract is up for renewal, or another of the varied and routine pricing decisions must be made. Pricing decisions are often time sensitive and require the exercise of business acumen and insight; they should not require the participation of economists or lawyers.

116 See Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2736 (2007) (Breyer, J., dissenting) (endorsing the per se rule against minimum resale price maintenance in part because "it creates an easily administered and enforceable bright line . . . that businesses as well as lawyers have long understood"); Credit Suisse Securities (USA) LLC v. Billing, 127 S. Ct. 2383, 2397 (2007) (majority opinion by Breyer, J.) (holding that the securities laws preclude the application of the antitrust laws to the challenged conduct in part because of "the difficulty of drawing a complex, sinuous line separating securities-permitted from securities-forbidden conduct"); Town of Concord v. Boston Edison Co., 915 F.2d 17, 25 (1st Cir. 1990) (Breyer, C.J.) (antitrust rules "must be clear enough for lawyers to explain them to clients"). Justice Breyer has also asserted that without clear, workable rules, antitrust courts are likely to make significant mistakes. See Leegin, 127 S. Ct. at 2730 (Breyer, J. dissenting) ("One cannot fairly expect judges and juries in [full rule of reason] cases to apply complex economic criteria without making a considerable number of mistakes, which themselves may impose serious costs"); Credit Suisse, 127 S. Ct. at 2396 ("these factors suggest that antitrust courts are likely to make unusually serious mistakes"). See also William E. Kovacic, The Intellectual DNA of Modern U.S. Competition Law for
The economic sense defense is intended to fill that role. In the version suggested here, it should be as workable as the below-cost test.

2. AFFIRMATIVE DEFENSE: ECONOMIC SENSE  Under the welfare/economic sense standard, a defendant could escape liability either by rebutting any element of the plaintiff's prima facie case or by showing that its conduct made economic sense without regard to its anticompetitive gains. The second option—the economic sense defense—would protect the defendant even if its conduct was harmful to welfare. Like the price-cost test, therefore, the economic sense defense would provide a safe harbor for defendants. In order to satisfy that defense in a predatory bidding case, the defendant would have to establish that bidding up the market price of an input would have been profitable even in the absence of any increase in the defendant's profit margins due to the creation, enlargement, or preservation of monopsony power.

Dominant Firm Conduct: The Chicago/Harvard Double Helix, 2007 Col. Bus. L. Rev. 1, 14 (Breyer is one of the chief exponents of the Harvard school, whose main contribution to modern U.S. antitrust doctrine consists of its "cautions about the administrability of legal rules and the capacity of the institutions entrusted with implementing them").


While the economic sense test is usually advanced as a standard of liability, see, e.g., Werden, supra note 43, it has a number of advantages as a defense. Among them, the burden of establishing it is placed on the party with the most relevant information.

If the defendant's bidding also increased its downstream market power, any gains from that source would also be excluded in determining whether the bidding made economic sense. For comparable formulations of the test as a liability standard, see Werden, supra note 43, at 414 (the no economic sense test "asks whether challenged conduct would have been expected to be profitable apart from any gains that conduct may produce through eliminating competition"); Melamed, supra note 43, at 389:

In particular, under this test, conduct is anticompetitive if, but only if, it makes no business sense or is unprofitable for the defendant but for the
The logic of the economic sense defense is straightforward. It simply asks the defendant to provide an explanation for its conduct that is both procompetitive and adequate to account for it. That is, it asks the defendant to explain why its conduct was likely to benefit suppliers or consumers and why those benefits, by themselves, would result in an increase the defendant’s profits. In providing such an explanation, therefore, the defendant must disregard any anticompetitive effects the conduct might have had—specifically, any impact the conduct might have had on the firm’s pricing power, upstream or downstream. In a predatory bidding case, for example, the economic sense defense would require the defendant to answer the following questions:

- How would your strategy benefit your suppliers or customers?
- Would the gains that come from benefiting suppliers or customers cover your higher input costs?
- Or would those costs be covered only if your behavior enabled you to disadvantage competitors, gain greater pricing power over the suppliers of the input (or consumers of your output), and enlarge your price-cost margins?\(^{120}\)

The economic sense defense would be much easier for a firm to apply than a pure welfare test. The economic sense defense focuses on the profitability of the firm’s conduct, an ordinary business issue, not its impact on welfare, a more difficult issue that businesses do not normally address. For example, to determine whether an aggressive bidding strategy is likely to have an adverse effect on supplier welfare, the firm would have to assess the existence and height of barriers to entry and mobility. As many commentators have noted,

\(\text{exclusion of rivals and resulting supracompetitive recoupment. . . . The test . . . asks whether the conduct is profitable to the defendant in light of its (incremental) costs and (incremental) benefits. . . . Benefits do not include the ability to charge higher prices, or a downward shift in the variable cost curve, as a result of the exclusion of rivals.}\)

\(^{120}\) These questions outline the simple logic of the economic sense defense. To establish the defense in litigation, the defendant would have to provide a financial analysis of its strategy showing that it was expected to be profitable without regard to whether it created monopsony power or market power.
those issues are often hard to resolve, especially if they have to be resolved quickly. In contrast, business executives can evaluate the profitability of their actions—and explain them to judges and juries—much more readily.

To be sure, the profitability calculation required by the economic sense defense is different from the profitability calculation firms ordinarily perform. Instead of evaluating the total profitability of a strategy, taking into account all its gains and costs, as a firm normally does, the business must determine whether the procompetitive aspects of the strategy were likely to be profitable. As explained below, however, this calculation would not usually be problematic. The defendant would simply have to identify a procompetitive aspect of its strategy and show how that aspect, by itself, would have increased its profits. If the strategy were truly procompetitive (i.e., if it benefited suppliers or consumers), it would normally increase the defendant’s output and market share, upstream or downstream. Under the economic sense test, the defendant must disregard any effect this increase in market share might have on its pricing power. That is, while the output expansion might eliminate one or more competitors, the firm must assume away any increase in its margins due to the creation or enlargement of monopsony or monopoly power. Instead, the defendant must show that its profits were likely to increase because it had lowered its costs by improving its efficiency, raised its prices by offering greater product quality, or lowered its prices when a price reduction would be profitable in the short run.

121 See Kirkwood & Zerbe, supra note 110. See also Brief for Amici Curiae Business Roundtable, supra note 44, at 17 (noting that business people “cannot consult economists . . . every time . . . routine pricing decisions must be made”).

122 See, e.g., Werden, supra note 43, at 421 (in applying the no economic sense test, a firm must exclude “the profit gains resulting from creating or maintaining monopolistic price-cost margins”).

123 See infra note 127 and accompanying text (explaining why and when a price reduction that is profitable in the short run would be entitled to the economic sense defense). In promotional pricing cases, a price reduction that is not profitable in the short run may still be eligible for the defense. See infra note 128.
When a strategy is likely to lower costs, the economic sense defense is particularly easy to apply. Suppose that the dominant purchaser of an input invests in new equipment that expands its capacity and lowers the quantity of labor and electric power required to produce each unit of output. Suppose further that because of this reduction in marginal costs, the firm calculates that its profit-maximizing output is now larger than before, even though it must lower its selling price and bid up the price of the input in order to reach this higher output. Finally, suppose that in making this calculation, the firm ignores any impact this strategy might have on its monopsony power, assuming instead that it would continue to pay this higher input price. Under these circumstances, the firm would be entitled to an economic sense defense, and the calculations required to establish this defense would be straightforward.124

Similarly, a dominant firm could establish the economic sense defense by showing that it bid up input prices in order to expand output and recapture economies of scale it had lost because of new entry. Suppose that the plaintiff enters the defendant’s market and takes a significant amount of business from the defendant, depriving it of economies of scale and raising the average variable costs of

124 This example mirrors Weyerhaeuser’s defense. Weyerhaeuser contended that it bid up sawlog prices not to drive out rivals and create monopsony power, but to exploit an investment in more efficient log-processing equipment. At oral argument, both Justice Scalia and counsel for Weyerhaeuser explained how such a strategy would make economic sense:

JUSTICE SCALIA: If you have a firm that has developed a new . . . technique for processing the logs, and it can process them cheaper and faster, and sell them for a lower price but in greater volume, and thereby make even more profit, that firm would be willing to pay more for those logs, even though it would sell them for less than competitors might sell them.

MR. PINCUS: That’s exactly right, Justice Scalia, and that’s what the record reflects here, that Weyerhaeuser invested in its lumber mills and created a process that got more value out of a log. . . . Weyerhaeuser invested [in] new processes that had less waste, produced more output as Justice Scalia suggested, and therefore it was able to sell . . . that output at a lower price and still make a profit, because it was getting more output [per] log and therefore could pay more for the log.

Transcript of Oral Argument, supra note 25, at 10-11.
running its plant. Suppose further that the defendant calculates it
would be profitable to increase its output and regain those economies
of scale, even though it would have to lower its output price and bid
up the price of a key input in order to do so. Finally, suppose that
this strategy would be profitable even if does not result in any
eventual decline in the price of the input or any rise in the price of its
output. The defendant assumes, in other words, that even if the
strategy were to drive out the plaintiff, the defendant could not
exercise any monopsony power or monopoly power. If the defendant
could establish these facts, its aggressive bidding strategy would
make economic sense, and the calculations required would again be
elementary.

Thus, when a dominant firm has a cost-saving explanation for
expanding its output and raising its payments for inputs, the
economic sense defense would not be difficult to apply. And even
when the challenged behavior would not generate cost savings, the
version of the economic sense defense recommended here is likely to
be workable, as the next section shows.

B. Comparison of the welfare/economic sense
and price-cost/recoupment standards

The welfare/economic sense standard may well be a method of
controlling predatory bidding and predatory pricing that is superior
to the below-cost/recoupment standard. While the answer cannot be

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125 That is, the reduction in variable costs from operating at a larger scale
would offset the higher input price and lower selling price.

126 Cf. Melamed, supra note 43, at 393 (the profit sacrifice test “provides
simple, effective, and meaningful guidance to firms so that they will know
how to avoid antitrust liability without steering clear of procompetitive
conduct”). While Professor Salop raises numerous objections to a profit
sacrifice test, see Salop, supra note 43, this article does not recommend a pure
profit sacrifice test, which would require defendants to demonstrate that their
behavior entailed no profit sacrifice whatsoever, i.e., that it maximized their
profits without regard to its anticompetitive effects. Instead, I propose a
simpler defense, under which defendants need only show that their behavior
was likely to increase profits regardless of whether it achieved any
anticompetitive gains. This defense should be substantially easier to
administer.
determined with certainty without more empirical evidence, the welfare/economic sense standard is unlikely to be less workable than the Weyerhaeuser/Brooke Group standard and may well produce a better mix of false positives and false negatives.

1. WORKABILITY The welfare/economic sense standard would not be substantially less administrable than the below-cost/recoupment standard for two reasons. First, the welfare component of the welfare/economic sense standard is nearly identical to the recoupment component of the below-cost/recoupment standard. Second, the economic sense defense suggested here is unlikely to be more difficult to administer than the below-cost test since it is based on straightforward profitability calculations that a profit-maximizing firm would make in the ordinary course of business.

The welfare component of the welfare/economic sense standard is essentially the same as the recoupment component of the price-cost/recoupment standard. As noted earlier, the welfare test would include a recoupment element, and in the typical case proof of recoupment would also establish harm to welfare. If the defendant recouped the initial profit sacrifice it made in bidding up input prices by later depressing them below the competitive level for a significant period of time, the defendant would normally have caused a net reduction in the welfare of suppliers. They would have lost more from the lower input prices than they gained from the earlier higher prices. While it is conceivable that the defendant’s costs varied between the two periods, and the defendant recouped its profit sacrifice before suppliers were harmed overall, that would be unusual. In the ordinary case, establishing recoupment would also demonstrate harm to welfare, and the two standards would be equally administrable.

The other elements of the two standards are not identical. While the below-cost test and the economic sense defense are similar—both focus on the profitability of the defendant’s conduct—they ask different questions. In a predatory bidding case, the below-cost test asks whether the defendant incurred losses during the period it bid up input prices. More precisely, it asks whether the defendant’s revenues covered an appropriate measure of its costs. In contrast, the economic sense defense asks whether the defendant’s conduct was profitable
without regard to its anticompetitive gains. That is, the defense asks whether the *procompetitive effects* of the defendant's conduct were sufficient to make it profitable. In essence, the below-cost test compares the defendant's revenues to its costs, while the economic sense defense compares the revenues from the procompetitive effects of the defendant's conduct to its costs. As a result, the economic sense defense entails an extra step—separating the procompetitive effects of the defendant's conduct from its anticompetitive effects. This extra step, however, is unlikely to make the economic sense defense more difficult to apply in a predatory bidding or predatory pricing case, since in these types of cases it should not be problematic to identify the procompetitive features of a strategy.

Consider, for example, the two illustrations of the economic sense defense set forth in the prior section. In both, the defendant would realize cost savings by expanding output, and in both, these cost savings would exceed the higher input prices (and lower selling prices) the firm must incur to expand output. Where a strategy would lower costs and expand output, these features would constitute its procompetitive dimensions. And if these features alone would make the strategy profitable, the defendant would be entitled to the economic sense defense.

Now consider a more difficult case, in which the defendant would not realize any cost savings from expanding output. Suppose, for example, that the plaintiff has entered the defendant's market and taken a significant amount of its business, depressing output prices and raising input prices in the process. And suppose that the defendant is considering whether it can respond to this entry by increasing output and regaining some of its market share, even though that would not yield any cost savings. Under the economic sense defense, the defendant could do so if the procompetitive aspects of the strategy were profitable by themselves. In this case, the procompetitive features of the strategy would be the expansion of output and the resulting higher input prices and lower output prices, which would benefit suppliers and consumers. And these procompetitive effects would be profitable by themselves if they were profitable without regard to any increase in the defendant's pricing power from the subsequent elimination or suppression of the
plaintiff. If that were true, the strategy would have to be profitable in the short run, since the defendant would make no greater profits later from the demise or decline of the plaintiff. In this situation, in short, the defendant could satisfy the economic sense defense by showing that expanding output would increase its profits in the short run.\(^1\)

Even in this case, therefore, the economic sense defense would not be more difficult to apply than the below-cost test, since both would require a determination of the short-run profitability of the defendant's actions. While the below-cost test would ask whether the defendant's actions incurred losses in the short run, the economic sense defense would ask whether they increased profits in the short run. Since a profit-maximizing firm would, in the ordinary course of business, determine the expected profitability of its actions in the short as well as the long run, both tests would be equally administrable. The advantage of the welfare/economic sense standard is that it may well reach the right answer more often.\(^2\)

\(^{127}\) For a similar analysis, see Melamed, *supra* note 43, at 392 (noting that a profit sacrifice or no economic sense test would protect conduct that increases profits and welfare in the period before any rivals are excluded). A focus on the short run is generally appropriate for predatory bidding cases, predatory pricing cases, and other cases that fit the traditional predation paradigm, in which there is a period of aggressive competition followed by a period of recoupment. In this paradigm, the anticompetitive effects occur only in the second stage. As a result, if the strategy is profitable in the short run, those profits can be attributed to the procompetitive effects of the strategy. In raising rivals cost cases, however, it would not be appropriate to look only at the short run in determining whether the economic sense defense is satisfied. In these cases, anticompetitive effects may occur in the short run. As a result, a short-run profit increase could not automatically be attributed to the procompetitive effects of the defendant's strategy. In some predation cases, moreover, it may be necessary to look beyond the short run. See *infra* note 128.

\(^{128}\) In the types of cases discussed in the text, the defendant could satisfy the economic sense defense by showing that its profits were likely to increase in the short run. In one type of predation case, the defendant may be able to establish the defense even if it cannot show a short-run profit increase. Suppose that the defendant introduces a new product and offers it initially at a very low (and allegedly predatory) price. Even if this price causes the defendant to incur short-run losses, it may be procompetitive if it induces consumers to try the new product and they find that they prefer it to the established products, even after the defendant raises price to recover its initial
2. BALANCE OF FALSE POSITIVES AND FALSE NEGATIVES

The welfare/economic sense standard may produce a better balance of false negatives and false positives than the price-cost/recoupment standard. In the first place, the welfare/economic sense standard is likely to generate fewer false negatives, since it would reach above-cost predation. If a dominant firm aggressively bids up input prices in order to exclude rivals and gain monopsony power—harming suppliers and possibly consumers as well—the welfare/economics sense standard would ban the behavior, even if the dominant firm covers its costs. As shown above, such behavior, like comparable above-cost predatory pricing, appears to be a significant problem.\textsuperscript{129}

The welfare/economic sense standard may produce some false negatives, since it is possible for conduct to satisfy the economic sense defense even though it reduces welfare.\textsuperscript{130} In general, however, the economic sense defense is more restrictive than the below-cost test. In the version proposed here, the economic sense defense would protect losses. In this case, therefore, the defendant would be entitled to the economic sense defense if it can show that its pricing strategy was likely to be profitable over the long run whether or not the plaintiff remained a viable competitor. In short, in a promotional pricing case, the economic sense defense may require an examination of long-run profitability. This broader time span should not render these cases unworkable, however, because introductory promotions are so common. As a result, it should be easy for courts to establish benchmarks that would enable businesses and litigants to quickly determine whether a particular promotion is likely to be regarded as procompetitive.

\textsuperscript{129} See \textit{supra} section III.

\textsuperscript{130} For instance, suppose that a dominant firm responds to entry with above-cost price cuts that are extended \textit{only} to the entrant's customers. Such price reductions are likely to increase the dominant's short-run profits, since the only customers who could take advantage of them are customers the dominant firm has already lost. These price cuts would also harm consumer welfare if they destroy the entrant and deter future entry. As a result, perfectly targeted price cuts could constitute a false negative under the proposed standard. So might similar, less perfect forms of price discrimination. Such behavior, however, is likely to be difficult to accomplish. To the extent the dominant firm cannot confine its price reductions to the entrant's customers (and new customers), it must cut prices to existing customers, making an increase in its short-run profits less likely.
aggressive bidding and pricing only if it increased the firm's profits without regard to its anticompetitive effects, whereas the below-cost test would protect it so long as the firm covered its average variable costs.\textsuperscript{131}

In addition, the welfare/economic sense standard is unlikely to produce significantly more false positives than the price-cost/recoupment standard. The welfare/economic sense standard combines a rigorous welfare test, a recoupment element, and a complete defense for behavior that makes economic sense apart from its anticompetitive gains. Together, these three elements would make it extremely difficult for a plaintiff to win a predatory bidding or predatory pricing suit when the underlying conduct is not predatory.

The welfare/economic sense standard is also unlikely to chill significantly more procompetitive behavior than does the price-cost/recoupment standard. Profit-maximizing firms would ordinarily be able to determine whether their bidding or pricing strategies are entitled to the simplified version of the economic sense defense presented here. Moreover, the rigor of the welfare test and the breadth of this defense would give firms considerable assurance that their bidding and pricing are unlikely to be challenged except in the most extreme cases. In short, there is a sound basis for believing that a welfare/economic sense standard would be superior to a price-cost/recoupment standard in a predatory bidding or predatory pricing case.\textsuperscript{132}

V. CONCLUSION

Recent cases in the airline industry and the timber industry suggest that above-cost predation is a serious concern. These cases indicate that dominant firms can aggressively bid up input prices or

\textsuperscript{131} Or another appropriate measure of its costs. See supra note 59.

\textsuperscript{132} Although normally an advocate of the no economic sense test, Greg Werden supports a safe harbor for above-cost pricing because such conduct "is overwhelmingly likely to enhance consumer welfare, and the tools of antitrust are too blunt to make it worthwhile to attempt the identification of rare exceptions to that general rule." Werden, supra note 43, at 419. I suggest, in contrast, that above-cost predation is a significant problem and that a simplified version of the economic sense test, when combined with a rigorous welfare test and a recoupment requirement, would supply a reasonably precise instrument for identifying it.
aggressively lower output prices, drive out rivals, and then lower input prices or raise output prices to non-competitive levels—all without incurring losses. In theory, this behavior could be stopped by applying a balancing test of the sort articulated in Microsoft,\textsuperscript{133} since such a test would condemn behavior that reduces competition and the welfare of suppliers or consumers even if it does not violate a below-cost test. A balancing test, however, may not be clear enough to apply to above-cost bidding or pricing, and without a clear, workable standard, an attempt to ban the anticompetitive instances may deter too much desirable behavior.

This article suggests an alternative standard, a standard that combines the theoretical precision and reach of a balancing test with a defense that businesses and courts can use to separate illegal predation from legitimate price competition. This standard would impose a heavy burden on the plaintiff—it would have to demonstrate that the defendant’s conduct was not only profitable but harmful to suppliers or consumers. And the defense would be workable, since it would focus on a routine business issue—the profitability of a proposed strategy—and ask a question that businesses would normally have no difficulty answering: was the strategy likely to be profitable if it created value for your suppliers or customers but gave you no additional pricing power? In short, the burden of the welfare test and the workability of the economic sense defense would prevent the standard from chilling much procompetitive behavior or generating many false positives. At the same time, the standard is likely to reduce the number of false negatives since it would reach above-cost predation.

In sum, the welfare/economic sense standard may well be a superior method for controlling predatory bidding and predatory pricing than the below-cost/recoupment standard of Weyerhaeuser and Brooke Group.\textsuperscript{134}

\textsuperscript{133} United States v. Microsoft Corp., 253 F.3d 34, 58–59 (D.C. Cir. 2001).

\textsuperscript{134} While the welfare/economic sense standard would be appropriate whether the plaintiff was a competitor of the defendant or a consumer or supplier, suits by consumers or suppliers are less likely to be protectionist—and thus less likely to generate false positives—than suits by competitors. As a result, courts should be most willing to adopt the proposed standard in suits by customers or suppliers.
And although this article has not analyzed other forms of aggressive pricing like bundled discounts, the welfare/economic sense standard may be a better way of evaluating them as well.\footnote{Greg Werden suggests that the no economic sense test would not be “well suited to the bundled rebates at issue in LePage’s,” LePage’s v. 3M Co., 324 F.3d 141 (3d Cir. 2003) (en banc), since such rebates “implement a form of price discrimination, which can make them profitable even apart from any tendency to eliminate competition, and it may be infeasible to separate the profits due to price discrimination from the profits due to the elimination of competition.” Werden, supra note 43, at 421. Under the version of the economic sense defense recommended here, however, bundled rebates would be entitled to the defense if they increased the defendant’s profits in the short run, i.e., before rivals were eliminated or their ability to constrain the defendant’s pricing was reduced. Under this standard, it would not be necessary to “separate the profits due to price discrimination from the profits due to the elimination of competition,” since in the short run, there would be no profits from the elimination of competition.}