

Washington University Law Review

Volume 73
Issue 2 *Limited Liability Companies*

January 1995

Recouping the Losses of Brooke Group

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Recommended Citation

David J. Kates, *Recouping the Losses of Brooke Group*, 73 WASH. U. L. Q. 609 (1995).
Available at: https://openscholarship.wustl.edu/law_lawreview/vol73/iss2/8

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NOTES

RECOUPING THE LOSSES OF *BROOKE GROUP*

Competition . . . brings out the only . . . arrangement of social production which is possible [Otherwise] what guarantee [do] we have that the necessary quantity and not more of each product will be produced, that we shall not go hungry in regard to corn and meat while we are choked in beet sugar and drowned in potato spirit, that we shall not lack trousers to cover our nakedness while buttons flood us in the millions.

-Friedrich Engels¹

I. INTRODUCTION

Imagine an industry dominated by six large firms.² All six firms make an enormous profit, because their market control allows them to charge excessively high prices. One of these firms, Firm A, has a steadily falling market share. In an attempt to regain its market share and increase its profitability, Firm A reduces the price of its product by thirty percent. This strategy yields instant success, quadrupling Firm A's market share.

As a result of Firm A's success, the other five firms suffer an unwelcome loss of sales and profits. In order to teach Firm A a lesson and to eventually return the price of its product to extravagant levels, Firm B cuts the price of its product below its cost of production.³ Consequently, Firm A loses most of its newly found and rightfully earned business to Firm B and society now produces too much of the product. Thus, consumer welfare decreases.⁴

1. WILLIAM J. BAUMOL & ALAN S. BLINDER, *ECONOMICS: PRINCIPLES AND POLICY* 556 (4th ed. 1988) (quoting Friedrich Engels).

2. The following hypothetical is based on *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 113 S. Ct. 2578 (1993). See *infra* notes 131-65 and accompanying text. The *Brooke Group* decision created the problem which this Note will address, namely the addition of a recoupment requirement in actions alleging predatory pricing under the antitrust laws.

3. At this point, a definition of "cost of production" will not be considered. For such a discussion, see *infra* notes 60-77, 117-21 and accompanying text.

4. At first glance, a statement that consumer welfare decreases when firms lower the price of their products seems preposterous. For a discussion of the economic argument explaining how consumers lose a portion of their net wealth from this type of price decrease, see *infra* notes 176-85 and accompanying text.

Because Firm A began this story in financial trouble, it can only match Firm B's below-cost pricing for a short time without going out of business. Firm B, with its larger market share and stronger financial position, can afford to maintain below-cost prices for a longer period. This disparity leaves Firm A with two choices: return its prices to the supracompetitive levels existing before the price cut or sue Firm B in federal court for practicing predatory pricing in violation of federal antitrust laws.⁵ Firm A chooses to sue, but the United States Supreme Court denies the validity of their claim. Instead, the Court adds a new recoupment requirement⁶ to predatory pricing claims and further states that firms in an oligopoly setting can almost never recoup losses brought about by below-cost pricing. Thus, Firm A loses its antitrust lawsuit and the scope of market protection available in the future from the antitrust laws is lessened significantly.

Left without any legal remedy, Firm A then succumbs to the pressure and raises its prices. Over the course of the next few years, the now-disciplined oligopoly raises prices in lock-step twice a year. Who ends up the big loser? The consumer.

The Supreme Court caused such a perverse result in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*⁷—the facts of which are loosely reflected in the above hypothetical⁸—when it added a recoupment requirement to predatory pricing claims.⁹ As Judge Stevens points out in his dissent,¹⁰ the *Brooke Group* facts illustrate one serious drawback to imposing a recoupment requirement: firms can now use below-cost pricing to discipline industry participants and maintain an oligopoly.

This Note addresses other negative implications of the *Brooke Group* decision. Part II begins with a history of the applicable antitrust laws. Part III describes the oligopoly problem facing the United States. Part IV outlines the law regarding predatory pricing as it stood prior to the *Brooke Group* holding. Part V then discusses the Court's new recoupment rule and its reasons for adopting such a rule. Finally, after an evaluation of the

5. Specifically, Firm A would claim that Firm B engaged in predatory pricing in violation of § 2 of the Sherman Act, 15 U.S.C. § 2 (1988 & Supp. V 1993), or primary line discrimination in violation of the Robinson-Patman Act, 15 U.S.C. § 13a (1988). See discussion *infra* notes 101-31 and accompanying text.

6. See *infra* notes 156-61 and accompanying text.

7. 113 S. Ct. 2578 (1993).

8. The hypothetical is not exactly true to the *Brooke Group* facts but it preserves the essence of the case presented to the Court. See *supra* notes 131-51 and accompanying text.

9. *Brooke Group*, 113 S. Ct. at 2588-89.

10. *Id.* at 2598.

recoupment approach, this Note concludes that the Supreme Court should remove the recoupment requirement. In the absence of such a ruling, the lower courts should not enforce the requirement strictly in future antitrust litigation.

II. ANTITRUST LAW: ECONOMIC AND NONECONOMIC PERSPECTIVES

Scholars continually debate the purpose of the antitrust laws.¹¹ Some argue that Congress was mainly concerned with achieving noneconomic goals, such as the protection of small businesses and consumers.¹² Others conclude that the antitrust laws were intended solely to facilitate economic efficiency.¹³ From either of these two perspectives, the Court's recoupment requirement in *Brooke Group* seems inappropriate.¹⁴

A. *The Noneconomic Camp*

On one side of the spectrum, commentators put forth a wide variety of noneconomic goals for federal antitrust regulation. Examples include dispersing economic and political power, deconcentrating markets and protecting small businesses.¹⁵ The noneconomic camp acknowledges, however, that courts also should consider economic goals in antitrust cases.¹⁶ Although these economic and noneconomic goals often conflict and lead to inconsistent results,¹⁷ scholars in the noneconomic camp do

11. HERBERT HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAWS* § 2.4, at 50 (1985); see also Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 67 (1982) (stating that "[c]onsiderable dispute over the goals of antitrust has surfaced in scholarly commentary on the subject").

12. See, e.g., Louis B. Schwartz, *"Justice" and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076 (1979); see also *infra* notes 15-41 and accompanying text. In this Note, I will refer to this group of scholars as the noneconomic camp.

13. See, e.g., Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979); Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966). In this Note, I will refer to this group of scholars as the economic camp.

A third group of scholars asserts that the goal of antitrust laws was to put an end to "unfair" wealth transfers from consumers to monopolists. Lande, *supra* note 11, at 68. Because most of the debate involves economic versus noneconomic goals, this Note will include wealth transfers in the general noneconomic category.

14. See *infra* notes 166-93 and accompanying text.

15. Herbert Hovenkamp, *Distributive Justice and the Antitrust Laws*, 51 GEO. WASH. L. REV. 1, 1 (1982).

16. HOVENKAMP, *supra* note 11, § 2.1, at 42 (stating that "[e]conomic theory enables the multi-valued policy maker to estimate the relative costs of protecting certain noneconomic values and helps her determine whether society should be willing to pay the price").

17. *Id.*

not think that these inconsistencies justify eliminating noneconomic goals. They argue instead that the responsibility lies with the courts to balance successfully the competing economic and noneconomic antitrust policies considered by Congress.¹⁸

Proponents of the noneconomic perspective advance several pieces of evidence that arguably establish congressional intent to use antitrust laws to pursue noneconomic goals. First, these commentators point to the historical setting prior to the passage of the Sherman Act.¹⁹ During this period, trusts and firms were engaged in a drive to accumulate market power that was triggered by the overcapacity problems of the industrial revolution.²⁰ These trusts and firms accumulated vast market power²¹ and used this power to prevent consumers from purchasing competitively priced goods and to eliminate competing sellers.²² When Congress passed the Sherman Act, the public opposed the trusts because of their negative impact on free competition and, particularly, on small businesses. Accordingly, protection of small businesses and free competition became a central goal of the Sherman Act.²³

Scholars in the noneconomic camp also point to the Sherman Act's legislative history to bolster their assertion that the Act was intended to protect competitors as well as competition.²⁴ Statements by congressmen²⁵ and the plain language of the Sherman Act support the position that

18. *Id.* For example, Hovenkamp stated that "[a]ntitrust could reasonably be expected to balance a policy of low consumer prices against a policy of protecting small businesses from larger competitors, and choose different policies to win in different cases." *Id.* § 2.1, at 42; see also *id.* § 2.4, at 50-53.

Other areas of the law successfully balance competing policies. For example, many constitutional decisions weigh opposing policies. See generally LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 815 (1978).

19. 15 U.S.C. §§ 1-2 (1988 & Supp. V 1993).

20. See Thomas K. McCraw, *Rethinking the Trust Question*, in *REGULATION IN PERSPECTIVE: HISTORICAL ESSAYS* 1, 1 (Thomas K. McCraw ed., 1981).

21. Lande, *supra* note 11, at 105. Lande stated that:

Congress passed the Sherman Act to further a number of goals. Its main concern was with firms acquiring or possessing enough market power to raise prices artificially and to restrict output. Congress' primary aim was to enable consumers to purchase products at competitive prices All purchasers, whether consumers or businesses, were given the right to purchase competitively priced goods. All sellers were given the right to face rivals selling at competitive prices.

Id.

22. *Id.*; see also BAUMOL & BLINDER, *supra* note 1, at 701.

23. Lande, *supra* note 11, at 105; see also Hovenkamp, *supra* note 15, at 16.

24. Schwartz, *supra* note 12, at 1076-77.

25. For example, during debates on the Sherman Act, Senator Sherman stated that "[i]t is the right of every man to work, labor and produce in any lawful vocation and to transport his production on

Congress desired to achieve more than mere economic efficiency.²⁶

The antitrust statutes passed after the Sherman Act further manifest a congressional intent that antitrust law achieve goals other than economic efficiency.²⁷ In its subsequent enactments, Congress displayed a desire to protect small businesses from larger competitors.²⁸ For example, the Robinson-Patman Act²⁹ was designed principally to afford market protection to small businesses.³⁰ Congress drafted this legislation in response to concerns that large chain stores were bribing their customers with low prices to destroy smaller competitors.³¹

In addition to citing federal laws, scholars of the noneconomic camp explain that the concept of economic efficiency had not yet developed

equal terms and conditions and under like circumstances. This is industrial liberty and lies at the foundation of the equality of all rights and privileges." 21 CONG. REC. 2457 (1890).

26. For example, a conspiracy to put one competitor out of business violates the Sherman Act regardless of any showing of significant economic impact. Schwartz, *supra* note 12, at 1078.

27. Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1060-61 (1979). The ambiguous wording of the Sherman Act, in particular terms such as "restraint of trade" and "monopolize," necessitates further inquiry into subsequent antitrust statutes to find Congress' specific intent. *Id.*

28. HOVENKAMP, *supra* note 11, § 2.4, at 50-51.

29. 15 U.S.C. § 13a (1988). The Robinson-Patman Act states in relevant part:

It shall be unlawful for any person engaged in commerce . . . to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality, and quantity; to sell, or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor in such part of the United States; or, to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor . . . or, to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.

Id.

30. HOVENKAMP, *supra* note 11, § 2-4. In addition, consider the following quotation by Congressman Patman when he introduced the bill: "[I]t is one of the first duties of Government to protect the weak against the strong and prevent men from injuring one another." 80 CONG. REC. 3447 (1936). Congress was also interested in supporting small businesses when it enacted the Clayton and Federal Trade Commission Acts. Hovenkamp, *supra* note 15, at 19.

31. Hugh C. Hansen, *Robinson-Patman Law: A Review and Analysis*, 51 FORDHAM L. REV. 1113, 1123 (1983). Critics of Robinson-Patman have called the Act the "Typhoid Mary of Antitrust," "a grotesque manifestation of the scissors and paste pot method" and something "with which economic nonsense is associated." *Id.* at 1114. Nonetheless, the Act has survived amendment attempts and remains the law today. *Id.* at 1114 & n.7; see also EARL W. KINTNER, A ROBINSON-PATMAN PRIMER: A GUIDE TO THE LAW AGAINST PRICE DISCRIMINATION 344 (2d ed. 1979) (arguing that Congress created the Robinson-Patman Act to prevent large chain stores from driving local retailers out of business, despite the large chains' ability to offer temporarily lower prices).

when Congress passed the Sherman Act.³² In fact, allocative efficiency³³ did not emerge as an economic theory until twenty years later.³⁴ Thus, the primary purpose of antitrust law could not have been economic efficiency.³⁵

The Supreme Court's opinions often reflect agreement with the views of the noneconomic camp.³⁶ However, the Court's ultimate views on the goals of antitrust law remain unclear.³⁷ One case frequently cited—and cited incorrectly as defining the goals of antitrust law³⁸—is *Brown Shoe Co. v. United States*.³⁹ In *Brown Shoe*, the Court stated that “[i]t is competition, not competitors, which the [Sherman] Act protects. But we cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets.”⁴⁰ Courts have relied on parts of this quotation to support both a noneconomic and an economic

32. HOVENKAMP, *supra* note 11, § 2.4, at 50.

33. Economists define allocative efficiency in terms of the welfare of society as a whole. A society is allocatively efficient if it achieves the greatest possible social benefit from its available resources. ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 579-80 (1989) (referring to allocative efficiency as output efficiency); *see also* HOVENKAMP, *supra* note 11, § 2.2, at 46.

34. HOVENKAMP, *supra* note 11, § 2.4, at 50. Allocative efficiency developed in 1909 when Vilfredo Pareto formed his concept of Pareto optimality. *Id.* In fact, most of current economics did not come into being until after the 1930s. Lande, *supra* note 11, at 88 n.97.

Economists define Pareto optimality as follows: “a given assignment of resources is most efficient (‘Pareto Optimal’) if no alternative assignment will make at least one person better off without making at least one person worse off as well.” HOVENKAMP, *supra* note 11, § 2.2, at 46. Antitrust law uses a more serviceable translation. “A change is efficient . . . if the gainers from the change gain enough so that they can fully compensate all losers out of their gains—that is, if the total value placed on the gains exceeds the total value placed on the losses.” *Id.* Actual compensation of the losers out of the winners’ gains, however, is not necessary for efficiency to be achieved. *Id.* at 47.

35. HOVENKAMP, *supra* note 11, at 50.

36. *See* *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972); *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 213 (1959); *Associated Press v. United States*, 326 U.S. 1, 15 (1945); *Fashion Originators’ Guild v. Federal Trade Comm’n*, 312 U.S. 457, 465-66 (1941); *Charles A. Ramsey Co. v. Associated Bill Posters*, 260 U.S. 501, 512 (1922); *Eastern States Retail Lumber Dealers’ Ass’n v. United States*, 234 U.S. 600, 609-11 (1914).

37. *See, e.g.*, *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 231 n.3 (D.C. Cir. 1986) (Wald, J., concurring).

38. In fact, the Court in *Brooke Group* adopted just such a misinterpretation. *See infra* text accompanying notes 174-75.

39. 370 U.S. 294 (1962).

40. *Id.* at 344.

interpretation of the antitrust laws.⁴¹ If anything, it seems the Court believes that both economic and noneconomic goals merit consideration.

B. *The Economic Camp*

As indicated previously, another group of scholars believe that antitrust law should consider only economic goals.⁴² Proponents of this school of thought recognize the congressional intent to achieve noneconomic goals,⁴³ but they argue that courts can ignore this legislative intent because the Sherman Act reflects common law.⁴⁴ These scholars assert that Congress did not intend to solidify common law as it lived in 1890, but to allow the common law to change.⁴⁵ In practice, courts view the antitrust laws as merely an enactment of the common law⁴⁶ and often deviate from the law as it stood in the nineteenth century.⁴⁷ Thus, scholars of the economic camp argue that the antitrust laws empower courts to respond to the changing times.⁴⁸

Advocates of the economic camp further assert that shifting perspectives require application of the antitrust laws primarily for the purpose of increasing economic efficiency.⁴⁹ In order to achieve this increased efficiency, members of the economic camp propose that courts should

41. Examples of cases in which the Court relied on the theory that "it is competition, not competitors, which the [Sherman] Act protects" include: *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 338 (1990); *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 115 (1986); *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767 n.14 (1984); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977).

Examples of cases in which the Court relied on other statements in *Brown Shoe*—namely, "we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets . . ." *Brown Shoe*, 370 U.S. at 344—include: *United States v. Falstaff Brewing Co.* 410 U.S. 526, 542 (1973) (concurring opinion); *Ford Motor Co. v. United States*, 405 U.S. 562, 578 n.12 (1972); *Federal Trade Comm'n v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967); *United States v. Von's Grocery Co.*, 384 U.S. 270, 278 & n.14 (1966); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 360 n.37 (1963).

42. See *supra* note 13 and accompanying text.

43. Hovenkamp, *supra* note 15.

44. HOVENKAMP, *supra* note 11, § 2.4, at 50.

45. *Id.* Senator Sherman stated that the Sherman Act "sets out in the most specific language the rule of the common law which prevails in England and this country." 20 CONG. REC. 1167 (1889).

46. See *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 497-98 (1940).

47. HOVENKAMP, *supra* note 11, § 2.4, at 52.

48. *Id.* at 52-53.

49. 4 PHILLIP AREEDA & DONALD F. TURNER, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* ¶ 904 (1978).

increase consumer welfare through the teachings of price theory.⁵⁰ Price theory defines economic efficiency as “maximizing consumer economic welfare through efficiency in the use and allocation of scarce resources.”⁵¹ Scholars of the economic camp believe that price theory can identify those actions that increase efficiency and thus should be deemed lawful.⁵² According to this argument, exclusively striving to maximize consumer welfare yields several other benefits: it gives clear notice to competitors of what they can do to compete, it places responsibility for political decisions on Congress instead of the courts, it preserves the character of the legislative process, it results in court decisions based on economic principles, and it avoids capricious or anticonsumer judicial rulings.⁵³

Even if one disputes the benefits of exclusively pursuing the economic efficiency goal, advocates of the economic camp also find support for their position in the legislative history of the antitrust laws.⁵⁴ For example,

50. Posner, *supra* note 13, at 932. Basically, price theory assumes “that businessmen are rational profit maximizers, . . . that demand curves slope downward, that an increase in the price of a product will reduce the demand for its complement, [and] that resources gravitate to the areas where they will achieve the highest return, etc.” *Id.* at 928; see also ROBERT H. BORK, *THE ANTITRUST PARADOX* 116-17 (1978). For a more detailed discussion of price theory economics, sometimes also called consumer welfare economics, see *infra* notes 51-53, 59-77 and accompanying text.

51. 1 AREEDA & TURNER, *supra* note 49, ¶ 103, at 7. Economists define efficiency in the allocation of scarce resources, known as allocative efficiency or output efficiency, as the situation in which society “produce[s] goods in combinations that match people’s willingness to pay for them.” PINDYCK & RUBINFELD, *supra* note 33, at 579. Economists define efficiency in the use of scarce resources, known as productive efficiency, as the situation in which “the output of one good cannot be increased without decreasing the output of another good.” *Id.* at 575.

Commentators from the economic camp have stated that “[t]he whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency.” BORK, *supra* note 50, at 91. This Note criticizes that contention because the Court in *Brooke Group* changed the law in such a way as to injure allocative efficiency, a result the economic camp would admonish. See *infra* notes 176-85 and accompanying text.

Bork concluded that the word “competition,” in antitrust law, “must be understood as a term of art signifying any state of affairs in which consumer welfare cannot be increased by judicial decree.” BORK, *supra* note 50, at 51. In fact, the use of price theory is prevalent in the courts today. See Posner, *supra* note 13, at 932. For two pertinent examples, see *Matsushita Electronic Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) and *Spectrum Sports, Inc. v. McQuillan*, 113 S. Ct 884 (1993).

52. BORK, *supra* note 50, at 116 (“[P]rice theory enables us to identify . . . those activities whose primary effect is output restricting, leading to the inference that all other activity is either efficiency creating or neutral.”).

53. *Id.* at 81. Bork also concluded that an antitrust approach with multiple goals, including social goals, “can achieve none of these things.” *Id.*

54. Bork, *supra* note 13 (discussing specific legislative history and record of Sherman Act’s passage). Despite Bork’s and the economic camp’s views, most students of the Sherman Act’s history have determined that Congress had many goals in addition to economic efficiency. In fact, the “legislative history contains little discussion of efficiency as we understand it.” Hovenkamp, *supra* note

Senator Sherman's first draft of his bill made illegal agreements "designed, or which tend, to advance the cost to the consumer."⁵⁵ Additionally, Congress chose to allow monopolies that had gained their status due to superior efficiency to survive as legal entities.⁵⁶ Finally, proponents of the economic camp suggest that Congress, due to its limited view of its own powers in 1890, would not have attempted to pass laws of a social, noncommercial nature.⁵⁷ Thus, the economic camp argues, the legislative history of the antitrust laws illustrates the fact that Congress had, as its exclusive goal, the maximization of consumer welfare.⁵⁸

Assuming that the economic camp correctly states that economic efficiency is and should be the goal of antitrust law, one must understand the economic models involved.⁵⁹ Economists divide the concept of

15, at 17.

55. BORK, *supra* note 50, at 20.

56. Section 2 of the Sherman Act states: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a felony . . ." 15 U.S.C. § 2 (1988 & Supp. V 1993). Note that Congress chose not to make it a felony merely to possess a monopoly. BORK, *supra* note 50, at 62. As additional proof, Bork offered the following quotation from Senator Sherman: "[The courts] will distinguish between lawful combinations in aid of production and unlawful combination to prevent competition and in restraint of trade." *Id.* at 63.

57. BORK, *supra* note 50, at 62. Congress had a limited view of its constitutional powers in 1890, as its members generally believed "that the ends to be accomplished by an exercise of the commerce power must themselves be of a commercial nature and not attempts 'to regulate the good order of society.'" *Id.*

58. The legislative history of the Robinson-Patman Act poses the toughest challenge to the economic camp's reasoning. See *supra* notes 27-31 and accompanying text. The economic camp's response was best characterized by Robert Bork:

No doubt that many of the backers of the Robinson-Patman Act were moved by an NRA-style philosophy and intended to protect independent merchants against chains and new methods of distribution. But it is not at all clear that the congressmen who voted for the bill knew that they were sacrificing consumers for the benefit of small merchants. Indeed, . . . many congressmen thought the law would serve consumers by preserving small merchants . . . [T]he legislative history shows predominant concern for consumers, with protection of small competitors intended only when that was a means of protecting consumers . . .

BORK, *supra* note 50, at 63-64.

59. Using the following economic analysis, scholars in the Chicago school, referred to herein more generally as the economic camp, believe that:

[s]elling below cost in order to drive out a competitor is unprofitable even in the long run, except in the unlikely case in which the intended victim lacks equal access to capital to finance a price war. The predator loses money during the period of predation and, if he tries to recoup it later by raising his price, new entrants will be attracted, the price will be bid down to the competitive level, and the attempt at recoupment will fail. Most alleged instances of below-cost pricing must, therefore, be attributable to factors other than a desire to eliminate competition.

POSNER, *supra* note 13, at 927 (citations omitted). Assuming that attempts to price at a predatory level do not frequently occur if they occur at all, some in the Chicago school believe that a rule of law that

economic efficiency into two branches: allocative efficiency and productive efficiency.⁶⁰ Because the major “task” of antitrust law is to improve allocative efficiency,⁶¹ this discussion will focus on allocative efficiency. Allocative efficiency “refers to the placement of resources in the economy.”⁶² It requires the use of all of society’s resources such that no greater level of consumer welfare can be achieved through an alternative management of resources.⁶³

Under perfect competition,⁶⁴ an economy achieves allocative efficiency. An “equilibrium” state of resource allocation occurs when the demand curve and the supply curve intersect.⁶⁵ Because the demand curve⁶⁶ represents the marginal benefits to society and the supply curve⁶⁷ represents the marginal costs, their intersection represents a maximization of consumer welfare. Society reaches this equilibrium through the markets’ continual price adjustments.⁶⁸

The existence of a monopoly destroys this perfect allocation of resources.⁶⁹ A monopolist understands that his output decisions affect

outlaws those attempts will only rob consumers of the benefits of price decreases due to normal competition and superior efficiency. *See* BORK, *supra* note 50, at 149-55.

Others in the Chicago school do not agree with the above analysis. They agree that predatory pricing, while unlikely, still exists under certain conditions. For example, predatory pricing might occur in an industry with high barriers to entry or in which simply having a reputation as a predator would deter firms from entering the market. Therefore, even though predatory pricing may be unlikely, antitrust law should still prohibit such economically inefficient conduct. Benefits that consumers receive from other, legal competition can be protected through cautious prosecution of predatory pricing offenses. *See generally* Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

60. BORK, *supra* note 50, at 91. Economists define productive efficiency as “the effective coordination of the various means of production in each industry into such groupings as will produce the greatest result.” *Id.* (citations omitted); *see also* note 51.

61. BORK, *supra* note 50, at 91. Basically, allocative efficiency here refers to “the placement of resources in the economy, the question of whether resources are employed in tasks where consumers value their output most.” *Id.*; *see also supra* note 51.

62. *See supra* note 51.

63. *See supra* note 51.

64. For a discussion of the perfect competition model, *see* HOVENKAMP, *supra* note 11, § 1.1.

65. This “equilibrium” state denotes a condition where the marginal benefit received from use of a particular resource exactly equals the marginal cost of that resource, thus maximizing the available benefit. *See* BORK, *supra* note 50, at 98.

66. A demand curve represents the benefits that society places on each additional unit of a particular good. *Id.* at 97.

67. The supply curve represents the cost to society of each additional unit of production of a particular good. *Id.*

68. BORK, *supra* note 50, at 98.

69. *See generally* BAUMOL & BLINDER, *supra* note 1, at 604-06.

price.⁷⁰ As a result, the monopolist's marginal revenue curve will have a steeper slope than the demand curve.⁷¹ The intersection of the monopolist's marginal revenue curve with the marginal cost curve will be to the left of the equilibrium intersection of the demand curve and the marginal cost curve.⁷² Thus, the monopolist will maximize profits at an output level that is less than socially optimal.⁷³

This monopolist's price and output decisions are detrimental to consumer welfare, because social costs no longer equal social benefits.⁷⁴ The reduced output resulting from a monopoly means that resources are placed in an industry (or, alternatively, left idle) such that the benefit they yield for society is less than it would be if these resources were used in the monopolized industry.⁷⁵ Society achieves less wealth than it could have if the resources had been used in the monopolized industry.⁷⁶ This decrease in consumer welfare through the misallocation of resources is

70. *Id.* at 600-01. The reasoning behind this statement comes from the fact that the monopolist does not have the usual supply curve that all firms face in a perfectly competitive industry. "[A] monopolist is not at the mercy of the market; he does not have to take the market price as given and react to it. Instead, the monopolist has the power to . . . select the price-quantity combination on his demand curve that he prefers." *Id.* at 601. Thus, when a monopolist picks the quantity he wishes to sell, he determines the price. For an explanation of the concept of a firm in perfect competition as a "price-taker," one that cannot set the price based on the amount it produces, see *id.* at 559-61.

71. *Id.* at 602. A monopolist's marginal revenue curve is below its demand curve because:

[a] monopolist normally must charge the same price to all his customers. So, if he wants to raise his sales by one unit, he must lower his price somewhat to *all* his customers Thus, the *additional* revenue that he takes in when he increases sales by one unit (his *marginal revenue*) is the price he collects from his new customer *minus* the revenue he loses by cutting the price paid by all his old customers. This means that [marginal revenue] is necessarily *less* than price

Id.

72. BAUMOL & BLINDER, *supra* note 1, at 603-06. Marginal cost is defined as the addition to total cost resulting from increasing production by one unit. *Id.* at 601.

73. Economists call this an inefficient allocation of resources. The monopolist is assessing a greater price and producing less output than would a firm in a competitive industry. *Id.* at 605-06.

Despite the monopoly's evils, economists find some benefits to monopolies. For example, monopolists have a greater incentive to advertise and thereby increase demand, for the increase in demand will cause the monopolist to increase its output. Thus, the difference in the output between a monopoly and an industry in perfect competition may not be all that significant. Of course, a major difference in price will still exist, because the monopolist will charge much more for the same goods. *Id.* at 606-07.

Economists recognize other benefits of monopoly as well, namely that monopolies aid in innovation, that a single monopoly producing all the products in an industry may be the cheapest mode of production, and that monopolists internalize pollution costs while a perfect competitor, absent regulation, does not. *Id.* at 607-08.

74. BORK, *supra* note 50, at 101.

75. *Id.*

76. *Id.*

allocative inefficiency.⁷⁷

Economists assert that, due to the inefficiencies of monopolies, Congress should regulate giant firms.⁷⁸ Proponents of the economic camp argue that antitrust law should attempt to accomplish such regulation by stopping attempts to form monopolies only when such attempts are not in and of themselves efficient.⁷⁹ The economic camp identifies one of these types of inefficient attempts as “predation.”⁸⁰

One form of “predation” includes below-cost pricing.⁸¹ A firm that eliminates its competitors by selling at prices below its cost does not compete “on the merits.”⁸² Scholars of the economic camp, however, warn that some price reduction and the subsequent elimination of competitors is efficient.⁸³ For example, a firm might lower its prices due to superior efficiency that results in lower cost structures.⁸⁴ Antitrust law, according to the economic camp, must distinguish this situation from one in which below-cost predatory pricing exists.⁸⁵ If the law does not make this

77. *Id.* For a definition of allocative efficiency, see *supra* note 61 and accompanying text. Posner noted that there exists a second cost of monopoly, in addition to the misallocation of resources. This cost refers to the likelihood that:

an opportunity to obtain a lucrative transfer payment in the form of monopoly profits will attract real resources into efforts by sellers to monopolize The costs of the resources so used are costs of monopoly just as much as the costs resulting from the substitution of products that cost society more to produce than the monopolized product.

RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 11 (1976).

78. PINDYCK & RUBINFELD, *supra* note 33, at 355-56.

79. See BORK, *supra* note 50, at 98-101. Bork stated that not all monopolies should be deemed illegal because, at times, the monopoly’s increased productive efficiency can offset the losses to allocative efficiency. *Id.* at 98; see also *supra* note 73.

80. “Predation” is defined as:

a firm’s deliberate aggression against one or more rivals through the employment of business practices that would not be considered profit maximizing except for the expectation either that 1) rivals will be driven from the market, leaving the predator with a market share sufficient to command monopoly profits, or 2) rivals will be chastened sufficiently to abandon competitive behavior the predator finds inconvenient or threatening. Since these results are detrimental to consumer welfare, predation is not to be classed as superior efficiency.

BORK, *supra* note 50, at 144.

81. *Id.* at 149-55.

82. Areeda & Turner, *supra* note 59, at 697.

83. BORK, *supra* note 50, at 137.

84. *Id.*

85. *Id.* Such distinctions are not easy to make. Firms often decrease their prices in response to increased competition, a technological innovation, or superior efficiency. Without an insider’s view, a court can never truly determine whether one of these acceptable purposes actually motivated the price decrease or whether the firm decreased its price to eliminate a rival. *Id.* For Areeda and Turner’s solution to this problem, see *infra* notes 118-21 and accompanying text.

distinction, it inevitably will dampen some amount of productive behavior.⁸⁶

The above discussion outlines the two major viewpoints regarding the goals of antitrust law.⁸⁷ Before applying these goals to the predatory pricing case law and the new recoupment requirement, one must understand the "oligopoly problem."

III. THE OLIGOPOLY PROBLEM IN THE UNITED STATES

Most of the goods produced in the United States economy are sold in an oligopolistic market structure.⁸⁸ Under this structure, a small group of sellers can avoid competitive forces and achieve a higher-than-competitive price, just as a monopoly does,⁸⁹ by acting in concert. Moreover, sellers in an oligopoly can do so without actually entering into an agreement that would violate the Sherman Act.⁹⁰

The mechanism most frequently used by oligopolies to charge supracompetitive prices is "price leadership."⁹¹ Through price leadership, one oligopolist sets the price for a good. Other oligopolists, known as "price followers," then set the same price for their goods.⁹² Each oligopolist has an incentive to follow the "price leader": they know that undercutting the leader will reduce profit over time by triggering reciprocity by competitors.⁹³ Thus, oligopolies can, and do, maintain

86. See BORK, *supra* note 50, at 137.

87. The economic camp has made many other assertions about the economic nature of antitrust law's goals. Because the *Brooke Group* case, *supra* notes 1-9 and *infra* notes 131-65, focuses on below-cost pricing, those other assertions will not be considered in this Note. For a discussion of those assertions, see generally BORK, *supra* note 50.

88. BAUMOL & BLINDER, *supra* note 1, at 617. Economists define an oligopoly as "a market dominated by a few sellers at least several of which are large enough relative to the total market to be able to influence the market price." *Id.*

89. For an analysis of monopolies, see *supra* notes 69-80 and accompanying text.

90. ELEANOR M. FOX & LAWRENCE A. SULLIVAN, *CASES AND MATERIAL ON ANTITRUST 507* (1989).

91. PINDYCK & RUBINFELD, *supra* note 33, at 445. The main obstacle to achieving an effective oligopolistic market structure is that it is hard to get firms to agree on the proper price. "Price leadership" effectively gets around this problem. *Id.*

92. *Id.* The price that the leader charges will depend on many factors, one of which is the question of whether the price followers will restrain production or will instead produce more due to the higher price. For a general discussion on how price leaders set price, see *id.* at 445-46.

93. *Id.* at 443. Some commentators feel that the oligopoly theory outlined above "is little more than a guess about the ways in which firms might be able to behave in a market composed of a few sellers." See, e.g., BORK, *supra* note 50, at 92. Such commentators believe that the temptation to cheat on the oligopoly price structure would be too great and would lead to the breakdown of any potential oligopoly. The temptation to gain additional business with only a small price reduction will tend to

supracompetitive prices without an express agreement. When oligopolists achieve and maintain supracompetitive price levels, they create a decrease, in consumer welfare similar to that which results from a monopolist's pricing scheme.⁹⁴

Although oligopolies, and their accompanying consumer welfare losses, currently pervade the American business landscape,⁹⁵ attempts to stem the growth of oligopolies have achieved little success. Congress has considered legislation aimed at preventing mergers that might result in undue market concentration,⁹⁶ yet, markets continue to evolve into oligopolist structures through internal growth.⁹⁷ The current legal apparatus does not provide a mechanism for successful challenges to these market structures, and when would-be enforcers have attempted to make use of the antitrust laws,⁹⁸ their efforts have failed.⁹⁹ Thus, to date, there does not exist an effective method to deal with the prevalent oligopoly problem. *Brooke Group's* recoupment requirement further frustrates this effort.¹⁰⁰

IV. THE LAW OF PREDATORY PRICING BEFORE *BROOKE GROUP*

Congress has enacted several antitrust statutes¹⁰¹ intended to remedy

sever any tacit agreement within the oligopoly. *Id.* at 104. Therefore, these theorists argue that "[a]ntitrust should not interfere with any firm size created by internal growth The high probability is that any such interference will lead to a net loss in consumer welfare." *Id.* at 178. According to this model, government should simply allow oligopolies to destroy themselves.

Actual market performance indicates, however, that this argument may be flawed. Successful oligopolies exist throughout the United States economy. One need only look at the prices and profits in the ready-to-eat cereal industry to appreciate this fact. *See In re Kellogg Co.*, 99 F.T.C. 8 (1982).

94. *See supra* note 89 and accompanying text.

95. *See* text accompanying *supra* notes 69-80, 88.

96. *Id.* at 508 (citing LAWRENCE A. SULLIVAN, *ANTITRUST LAW* 128-29 (1977)).

97. FOX & SULLIVAN, *supra* note 90, at 508.

98. Generally, they have tried to use either the Sherman Act or the Federal Trade Commission Act. *Id.* at 507-08.

99. *See Kellogg*, 99 F.T.C. at 269. In *Kellogg*, the Federal Trade Commission (FTC) refused to take action against oligopolies in the ready-to-eat cereal industry for two reasons. First, the FTC refused to impose the high cost of restructuring on the industry without a clear showing of predatory behavior or conspiracy. *Id.* at 275 (Separate Opinion of Commissioner Clanton). Second, conduct remedies would either be "inherently undesirable" or would simply not work. *Id.* at 278 (Separate Opinion of Commissioner Clanton). Thus, the FTC did nothing to alleviate the oligopoly problem in this industry. *Id.* at 269.

100. *See infra* notes 186-93 and accompanying text. *See also* Justice Stevens' dissent in *Brooke Group*, 113 S. Ct. at 2598.

101. These include: the Sherman Act, 15 U.S.C. §§ 1-7 (1988) (originally enacted as Act of July 2, 1890, ch. 647, § 1, 26 Stat. 209); the Clayton Act, 15 U.S.C. §§ 12-27, 44 (1988) (originally enacted as Act of Oct. 15, 1914, ch. 323, § 1, 38 Stat. 730); and the Federal Trade Commission Act, 15 U.S.C. §§ 41-57a (1988) (originally enacted as Act of Sept. 26, 1914, ch. 311, § 1, 38 Stat. 717). Congress has

the problems of concentrated industry¹⁰² and to preserve competition.¹⁰³ For example, courts have construed both the Sherman Act¹⁰⁴ and the Robinson-Patman Act¹⁰⁵ to prohibit predatory pricing.

When a firm prices below its costs, it violates section 2 of the Sherman Act.¹⁰⁶ Section 2 outlaws, among other things, monopolization.¹⁰⁷ Proving illegal monopolization requires two elements: the existence of monopoly power¹⁰⁸ and the willful acquisition or maintenance of that power.¹⁰⁹ Courts define monopoly power as "the power to control prices or exclude competition."¹¹⁰ Market share serves as the prime indicator by which courts measure monopoly power.¹¹¹ Courts have held as little as a seventy-five percent market share sufficient to show the existence of monopoly power.¹¹² A sixty-percent market share, however, "probably" would not constitute monopoly power under section 2.¹¹³

In addition to monopoly power, courts require antitrust plaintiffs to show that the alleged monopolist obtained or maintains its monopoly through some specific act or conduct.¹¹⁴ Predatory pricing satisfies this conduct

also amended the antitrust laws several times. These amendments include: the Robinson-Patman Anti-Discrimination Act, 15 U.S.C. §13 (1988) (originally enacted as Act of June 19, 1936, ch. 592, § 1, 49 Stat. 1526); the Celler-Kefauver Anti-Merger Act, 15 U.S.C. §§ 18, 21 (1988 & Supp. IV 1992) (originally enacted as Act of Dec. 29, 1950, ch. 1184, 64 Stat. 1125); and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. §§ 1311-1314 (1988) (Pub. L. 94-435, Sept. 30, 1976, 90 Stat. 1383).

102. See *supra* notes 88-100 and accompanying text.

103. See *supra* notes 11-58 and accompanying text. Of course some scholars state that the preservation of competition for consumer welfare was the only goal of these laws. See *supra* Part II.

104. For relevant text, see *supra* note 56.

105. For relevant text, see *supra* note 29.

106. See *Transamerica Computer Co. v. IBM Corp.*, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983).

107. For relevant text, see *supra* note 56.

108. See *United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377 (1956).

109. See *United States v. Grinnell Corp.*, 384 U.S. 563 (1966); see also *United States v. Aluminum Co. of Am. (ALCOA)*, 91 F. Supp. 333 (S.D.N.Y. 1950).

110. *DuPont*, 351 U.S. at 391.

111. See *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

112. *Id.* at 343-46.

113. See *ALCOA*, 91 F. Supp. at 333 (quoting Judge Learned Hand in *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 424 (2d Cir. 1945)).

114. For examples of the type of conduct that satisfies this requirement, see *ALCOA*, 91 F. Supp. 333 (expanding capacity to meet all the demand which the company had created); *United States v. Griffith*, 334 U.S. 100 (1948) (using monopoly power in one geographic area to foreclose competition in other areas); *United Shoe*, 110 F. Supp. at 323-46 (using leases to deter customers from buying from a competitor).

requirement.¹¹⁵ The term predatory pricing refers to “the deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition.”¹¹⁶ Thus, proof of below-cost pricing is needed.

Early court decisions provided only vague definitions of “below cost.”¹¹⁷ Professors Phillip Areeda and Donald Turner subsequently devised an economic method to determine when a firm engages in predatory pricing.¹¹⁸ Areeda and Turner’s model concludes that a price at or above the firm’s average variable cost is nonpredatory per se.¹¹⁹ When a firm sells below its average variable cost, however, the intrinsic

115. See *Transamerica Computer Co. v. IBM Corp.*, 698 F.2d 1377 (9th Cir.), cert. denied, 464 U.S. 955 (1983).

116. 3 AREEDA & TURNER, *supra* note 49, ¶ 711b, at 151.

117. See, e.g., *National Dairy Prod. Corp. v. United States*, 350 F.2d 321, 327 (8th Cir. 1965), vacated and remanded on other grounds, 384 U.S. 883 (1966); *Forster Mfg. Co. v. FTC*, 335 F.2d 47, 53 (1st Cir. 1964), cert. denied, 380 U.S. 906 (1965); *E.B. Muller & Co. v. FTC*, 142 F.2d 511, 517 (6th Cir. 1944).

118. See Areeda & Turner, *supra* note 59. To facilitate understanding of this approach, though, a few economic terms referring to alternative measures of cost need to be defined. First, “fixed costs” are “costs that do not vary with changes in output.” *Id.* at 700. These include costs such as an investment in a building or in machinery to make a product. “Variable costs” are those costs that will increase as the firm’s production expands. *Id.* Examples of variable costs include labor or fuel used to produce goods. “Average variable cost” is the aggregate of all variable costs divided by the total output. Finally, economists define “marginal cost” as “the increment to total cost that results from producing an additional increment of output.” *Id.*

119. *Id.* at 732-33. Areeda and Turner reached this result by first asking which of the various economic costs is relevant to the predatory pricing issue. *Id.* at 701. The authors looked at how firms maximize profits in order to answer their first question, because “a firm which seeks to [maximize profits] is normally responding to acceptable economic incentives and thus is not engaging in predatory behavior.” *Id.*

The profit-maximizing point for any firm is the point at which any decrease in production would decrease revenues more than it decreases costs or, conversely, where any increase in production would increase costs more than it would increase revenues. *Id.* This occurs when market price equals the marginal cost. *Id.* at 702. Thus, any firm charging its marginal cost acts as a normal competitor and is not engaged in predatory pricing. The relevant cost is, therefore, the marginal cost. *Id.* at 702-03. Areeda and Turner went on to conclude that pricing above marginal cost should be per se legal while pricing below marginal cost is per se predatory pricing. *Id.* at 712-13.

Areeda and Turner, however, did not ultimately use marginal cost as the dividing line between predatory and nonpredatory behavior. Instead, they chose average variable cost to serve as that dividing line. *Id.* at 716. They justified this choice because of the difficulty that administrators of the rule would have in ascertaining a firm’s marginal cost. *Id.* Courts may use average variable cost as a replacement because at most firm’s production points, the average variable cost will be equal to or greater than marginal cost. Thus, at worst, a test based on average variable cost will be more permissive than one based on marginal cost. In addition, one can more readily find a firm’s average variable costs from its accounting books. *Id.* at 717-18. For these reasons, Areeda and Turner chose average variable cost as the relevant dividing line between predatory and nonpredatory behavior.

conclusion is that the firm has engaged in predatory pricing.¹²⁰ Applying these guidelines, Areeda and Turner's test is intended to protect from liability those firms engaged in "legitimate, competitive pricing."¹²¹

Although the Supreme Court has declined to decide the issue,¹²² the federal circuit courts have generally accepted the use of average variable cost as the appropriate measure in determining below-cost pricing. However, the circuits have not fully adopted Areeda and Turner's per se rules. Instead, these courts have used average variable costs merely to establish a presumption in favor of one of the parties to a predatory pricing claim.¹²³

In *Transamerica Computer Co. v. IBM Corp.*,¹²⁴ the Ninth Circuit stated the general test for below-cost pricing as follows:

If the defendant's prices were . . . above average variable cost, the plaintiff bears the burden of showing the defendant's pricing was predatory. If, however, the plaintiff proves that the defendant's prices were below average variable cost, the plaintiff has established a prima facie case of predatory pricing and the burden shifts to the defendant to prove that the prices were justified without regard to any anticipated destructive effect they might have on competitors.¹²⁵

Thus, prior to the Supreme Court's *Brooke Group* decision, in order to prevail in a predatory pricing suit under section 2 of the Sherman Act, a plaintiff essentially needed to demonstrate that a defendant firm priced below its average variable cost.¹²⁶

120. Areeda & Turner, *supra* note 59, at 733. Thus, a monopolizing company "may not defend on the grounds that [its] price was 'promotional' or merely met an equally low price of a competitor." *Id.*

121. *See id.* at 699.

122. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 113 S. Ct. 2578, 2587 n.1 (1993).

123. *See, e.g., Transamerica Computer Co. v. IBM Corp.*, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983).

124. *Id.*

125. *Id.* at 1386. The court stated several reasons for adopting this test rather than an exact replica of the Areeda-Turner test. Among these reasons were the following: that prices above average variable cost might still be predatory, as in the case of limit pricing schemes; that courts should look at both the short-run and the long-run consequences of price cuts; that cost estimations are inherently uncertain; and that courts do not want to give monopolies a "free zone" in which to exploit their power. *Id.* at 1386-87.

126. Furthermore, the circuits are divided as to a plaintiff's burden when a defendant firm's prices are above its average total cost. Compare *Transamerica Computer*, 698 F.2d at 1386-88 with *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236 (1st Cir. 1983). The First Circuit deems this pricing policy to be per se legal, *Wright*, 724 F.2d at 236, under the rationale that prices above average total cost will infrequently be anticompetitive. *Id.* at 234-35. In *Transamerica*, on the other hand, the Ninth Circuit established a different approach to this situation. 698 F.2d at 1388. When a defendant

A plaintiff firm may also bring a predatory pricing claim under section 2(a) of the Clayton Act as amended by the Robinson-Patman Act.¹²⁷ Under the Robinson-Patman Act, courts refer to a below-cost pricing scheme designed to eliminate competition with one's own competitor as primary line discrimination.¹²⁸ Aside from this difference in terminology, proving a violation of the Robinson-Patman Act requires essentially the same elements as under the Sherman Act.¹²⁹ Thus, before *Brooke Group*, a plaintiff alleging predatory pricing under the Robinson-Patman Act was required to show only that the defendant priced below average variable cost.¹³⁰

V. THE BROOKE GROUP ADDITION: A RECOUPMENT ELEMENT

In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,¹³¹ the Supreme Court added a recoupment element to a predatory pricing

firm's prices are above its average total costs, the Ninth Circuit will require a plaintiff to prove by "clear and convincing evidence" that the defendant's pricing policy constitutes predatory behavior. *Id.*

Of course, factors other than average variable cost may influence a determination that predatory pricing has occurred, but the basic element in the cases cited herein is the requirement that a plaintiff show that a defendant has priced below the defendant's average variable cost. For views that disagree with the prevailing use of the average variable cost test, see Paul L. Joskow & Alvin K. Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213, 265-69 (1979); POSNER, *supra* note 77, at 191-93; William J. Baumol, *Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing*, 89 YALE L.J. 1, 9-11 (1979); Richard Schmalensee, *On the Use of Economic Models in Antitrust: The RealLemon Case*, 127 U. PA. L. REV. 994, 1018-19 (1979); F.M. Scherer, *Some Last Words on Predatory Pricing*, 89 HARV. L. REV. 901 (1976).

127. 15 U.S.C. § 13a (1988). For the specific language of the Robinson-Patman Act, see *supra* note 29.

128. *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). Secondary line injury consists of "discrimination which disadvantages a disfavored buyer in its competition with a favored buyer." FOX & SULLIVAN, *supra* note 90, at 209.

129. See, e.g., *Henry v. Chloride Inc.*, 809 F.2d 1334, 1335 (8th Cir. 1987); *D.E. Rogers Assocs., Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1439 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1041 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982); *Malcom v. Marathon Oil Co.*, 642 F.2d 845, 853 n.16 (5th Cir.), *cert. denied*, 454 U.S. 1125 (1981); *Pacific Eng'g & Prod. Co. of Nevada v. Kerr-McGee Corp.*, 551 F.2d 790, 798 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977).

Differences do exist, however, in how closely courts require a defendant to have come to harming competition. As the Supreme Court stated, "we interpret § 2 of the Sherman Act to condemn predatory pricing when it poses 'a dangerous probability of actual monopolization,' whereas the Robinson-Patman Act requires only that there be 'reasonable possibility' of substantial injury to competition before its protection are triggered." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 113 S. Ct. 2578, 2587 (1993).

130. See *supra* notes 117-25 and accompanying text.

131. 113 S. Ct. 2578 (1993).

claim.¹³² *Brooke Group* involved the highly concentrated American cigarette industry.¹³³ Along with four other cigarette producers, the plaintiff and defendant, commonly known as Liggett and Brown & Williamson, respectively, essentially control cigarette production in the United States.¹³⁴ This six-firm industry functions as a traditional oligopoly.¹³⁵ For example, over a period of several years, cigarette prices increased in “lock-step” twice a year regardless of any changes in production costs, and the *Brooke Group* Court found evidence that these prices surpassed those that would have been charged under competition.¹³⁶

By 1980, the cigarette market had changed significantly. Due to transformations in health habits, demand for cigarettes decreased.¹³⁷ This decrease in demand had a particularly harsh effect on the plaintiff, Liggett. Liggett’s market share had deteriorated from twenty percent to a mere two percent.¹³⁸

In order to boost its business, Liggett took the extreme measure of decreasing the price of its cigarettes.¹³⁹ Moreover, it did so in an unusual manner. In an apparent attempt to avoid the fury of the other oligopolists,¹⁴⁰ Liggett introduced a new line of generic cigarettes at a price almost thirty percent below the price of branded cigarettes.¹⁴¹ These generics were an instantaneous success, and Liggett’s market share grew to over four percent by early 1984.¹⁴²

The growth of Liggett’s market share came at the expense of the five other cigarette producers.¹⁴³ Thus, the other producers were compelled to respond.¹⁴⁴ The defendant, Brown & Williamson, took the most severe

132. *Id.* at 2588.

133. *Id.* at 2582-83.

134. *Id.* at 2582.

135. *See supra* notes 88-93 and accompanying text.

136. *Brooke Group*, 113 S. Ct. at 2583.

137. *Id.*

138. *Id.* The “effects of non-price competition” also had a negative impact on Liggett’s market share. *Id.*

139. *Id.*

140. For a description of how oligopolists often respond to a price cut in an oligopolistic industry setting, see *supra* notes 3-4 and accompanying text.

141. *Brooke Group*, 113 S. Ct. at 2583.

142. *Id.*

143. *Id.*

144. *Id.* This represents a classic oligopolistic response. *See supra* notes 3-4 and accompanying text.

action by introducing its own brand of generics.¹⁴⁵ Moreover, Brown & Williamson sold its generics at a price substantially below Liggett's.¹⁴⁶ Liggett then matched Brown & Williamson's prices and precipitated a price war.¹⁴⁷ Liggett alleged that, by the end of the price war, Brown & Williamson sold its generic cigarettes below cost.¹⁴⁸

At this point, Liggett had two choices: it could either sell its cigarettes at a loss and try to beat the financially stronger Brown & Williamson¹⁴⁹ or it could file an antitrust lawsuit.¹⁵⁰ Liggett chose to sue Brown & Williamson under the Robinson-Patman Act, alleging primary line price discrimination.¹⁵¹

The Supreme Court began its legal analysis of Liggett's claim by explaining that a primary line price discrimination action requires the same analysis as a predatory pricing action under section 2 of the Sherman Act.¹⁵² The Court then went on to state that, under both the Sherman Act and the Robinson-Patman Act, there are two prerequisites to recovery.¹⁵³ The first element reflects traditional predatory pricing precedent:¹⁵⁴ the plaintiff must show that the defendant set prices below an appropriate measure of costs.¹⁵⁵

The Court then went on to state a second, and new, element of the below-cost pricing test: the recoupment element. The Court held that a plaintiff must show that the defendant has "a reasonable prospect" or a

145. *Brooke Group*, 113 S. Ct. at 2584. Among the oligopolists in the industry, Brown & Williamson felt the most severe effects of Liggett's action because their customers were some of the most price-sensitive in the market. *Id.* at 2583. In fact, although Brown & Williamson's market share equalled only 11.4% of the market, 20% of Liggett's new generic cigarette customers used to smoke Brown & Williamson's brands. *Id.* Thus, of the remaining five producers, Brown & Williamson had the most incentive to respond in kind to Liggett's price cuts. *Id.*

146. *Brooke Group*, 113 S. Ct. at 2584. Brown & Williamson beat Liggett's prices by offering larger volume discounts. *Id.*

147. *Id.*

148. *Id.*

149. Because Liggett was in dire straits at the time, *see supra* note 137 and accompanying text, and Brown & Williamson had a stronger base due to its larger market share, *see supra* note 145 and accompanying text, Liggett could not sustain the losses for long and probably would have gone out of business.

150. *See supra* note 5 and accompanying text.

151. *See supra* notes 127-30 and accompanying text.

152. *Brooke Group*, 113 S. Ct. at 2587.

153. *Id.*

154. *See supra* notes 101-30 and accompanying text.

155. *Brooke Group*, 113 S. Ct. at 2587-88. As stated above, the Court refused to address the question of the appropriate measure of cost. *Id.* at 2587 n.1. Thus, the division among the circuit courts as to the appropriate standard remains unresolved. *See supra* notes 122-25 and accompanying text.

“dangerous probability”¹⁵⁶ of recouping its losses from the alleged below-cost pricing scheme. The Court based this recoupment element on two grounds. First, proof that a firm has the ability to recoup losses from below-cost pricing demonstrates that the firm also has achieved monopoly power over its industry.¹⁵⁷ If the predator cannot recoup its losses through monopoly pricing, the only result of below-cost pricing is a temporary decrease in the price of the particular good. This temporary price drop, the Court reasoned, would only enhance consumer welfare and thus benefit society.¹⁵⁸ The Court expressly downplayed the fact that below-cost pricing “encourage[s] some inefficient substitution toward the product being sold at less than its cost.”¹⁵⁹ Second, the Court justified the addition of a recoupment requirement on the basis that Congress had passed the antitrust laws for “the protection of *competition*, not *competitors*.”¹⁶⁰ Thus, the Court reasoned, the mere fact that below-cost pricing will inflict painful losses on its victim does not mandate the protections of the antitrust laws.¹⁶¹ Without the ability to recoup its losses, the alleged predatory firm has not injured competition and therefore has not violated the antitrust laws.

Having created the new recoupment requirement, the *Brooke Group* Court then held that the defendant’s actions did not meet the recoupment element for two reasons particular to an oligopolist market structure. First, in an oligopoly setting, it is unlikely that prices will remain high without express coordination among the industry participants.¹⁶² Second, producers operating under an oligopolist framework are forced to share any supracompetitive prices earned by virtue of their explicit or tacit collusion.¹⁶³ However, when a single firm, such as Brown & Williamson, incurs the losses necessary to carry out a below-cost pricing scheme, this firm must bear all the losses on its own. Thus, the *Brooke Group* Court estimated that a firm in Brown & Williamson’s position, in order to recoup its losses effectively in the tightly oligopolistic American cigarette market,

156. *Brooke Group*, 113 S. Ct. at 2588. The choice between these two standards depends on whether the case is brought under the Robinson-Patman Act or the Sherman Act. See *supra* Part IV. In *Brooke Group*, the plaintiff sued under the Robinson-Patman Act. 113 S. Ct. at 2578.

157. *Brooke Group*, 113 S. Ct. at 2588.

158. *Id.*

159. *Id.*

160. *Brooke Group*, 113 S. Ct. at 2588-89 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)) (emphasis in original).

161. *Brooke Group*, 113 S. Ct. at 2588.

162. *Id.* at 2590.

163. *Id.*

would have to earn nine dollars in supracompetitive profits for each dollar it chose to lose in its alleged predatory scheme.¹⁶⁴ Given the low probability of this scenario occurring, the Court concluded that Brown & Williamson could not have engaged in either primary line pricing or predatory pricing, despite having sold cigarettes at prices below its costs.¹⁶⁵ By so holding, the Court created a new element to a below-cost pricing antitrust claim.

VI. AN IMPROPER ADDITION

The problems resulting from the new recoupment element affect nearly all parts of society. Members of both the economic and noneconomic camps would disagree with the Court's improper addition.¹⁶⁶ The new requirement fails to limit, and even exacerbates, one of the greatest problems facing antitrust and the American economy today—oligopolies.¹⁶⁷ As a remedy, this Note calls for the elimination of the recoupment requirement or, in the alternative, its liberal interpretation by lower courts.

Initially, the *Brooke Group* decision is inconsistent with the views of the noneconomic camp. As stated above, scholars in the noneconomic camp believe that Congress passed the antitrust laws for important social reasons in addition to the goal of protecting economic efficiency.¹⁶⁸ One major social policy goal inherent in the antitrust laws is that of protecting small businesses from unfair competition.¹⁶⁹ In fact, Congress passed the Robinson-Patman Act¹⁷⁰ solely to protect small businesses.¹⁷¹

The recoupment requirement completely ignores this congressional intent. A large producer attempting to eliminate its smaller competitor with below-

164. *Id.*

165. *Id.* at 2598. Justice Stevens, in dissent, stated his belief that a violation of the antitrust laws did in fact occur in this case. In Stevens' view, the evidence showed that Brown & Williamson intended to harm Liggett and in fact did so. *Id.* at 2601 (Stevens, J., dissenting). Brown & Williamson desired to discipline Liggett and return the price to supracompetitive levels. *Id.* at 2603 (Stevens, J., dissenting). The evidence also showed that Brown & Williamson believed that their plan would work and that they would profit from it. *Id.* To Stevens, this behavior constituted a violation of the antitrust laws. *Id.* at 2604 (Stevens, J., dissenting).

166. *See supra* Part II.

167. *See supra* Part III.

168. *See supra* notes 15-18 and accompanying text.

169. *See supra* notes 15-41 and accompanying text.

170. 15 U.S.C. § 13a (1988). For the Robinson-Patman Act's language, see *supra* note 29. The plaintiff in *Brooke Group* sued under the Robinson-Patman Act. *See supra* note 151.

171. *See supra* notes 29-31 and accompanying text. .

cost pricing inflicts injury on the small business simply by its anticompetitive behavior. The ability of the large competitor to recoup its losses does not affect the magnitude of injury to the small competitor, who has been driven out of business. Therefore, the recoupment requirement makes the intentional elimination of small businesses more possible by restricting protection against anticompetitive behavior until the unlikely point at which a plaintiff could prove the probability of recoupment.¹⁷²

That the Supreme Court misunderstood a major goal of the antitrust laws is also illustrated by their reliance on *Brown Shoe Co. v. United States*.¹⁷³ The Court quoted *Brown Shoe* for the proposition that the antitrust laws "protect competition and not competitors."¹⁷⁴ In reality, *Brown Shoe* does not stand for this proposition. The text in *Brown Shoe* immediately following the language quoted in *Brooke Group* evinces that Court's recognition that the antitrust laws also aim to protect small businesses.¹⁷⁵ Thus, the *Brooke Group* Court ignored and thwarted Congress' goal of protecting small business when it added a recoupment requirement to below-cost pricing claims.

Even those who believe that the goal of antitrust laws should be economic efficiency¹⁷⁶ have reason to oppose the *Brooke Group* decision. The Court made light of the effects that below-cost pricing has on

172. Predatory pricing can now occur at will because it does not seem likely that the Court will ever find that recoupment is possible. *Brooke Group* remains a prime example: the Court did not find recoupment even where the facts clearly showed a strong probability of recoupment following the abandonment of the existing below-cost pricing scheme. As Justice Stevens' dissent points out:

At the end of 1985, the list price of branded cigarettes was \$33.15 per carton, and the list price of black and whites, \$19.75 per carton. Over the next four years, the list price on both branded and black and white cigarettes increased twice a year, by identical amounts. The June 1989 increases brought the price of branded cigarettes to \$46.15 per carton, and the price of black and whites to \$33.75

. . . .

The expert economist employed by Liggett testified that the post-1985 price increases were unwarranted by increases in manufacturing or other costs, taxes, or promotional expenditures.

Brooke Group, 113 S. Ct. at 2601-02 (citations omitted).

173. 370 U.S. 294 (1962).

174. *Brooke Group*, 113 S. Ct. at 2588-89 (quoting *Brown Shoe*, 370 U.S. at 320) (emphasis in original).

175. See *supra* notes 39-41 and accompanying text. This is such an important point that the full quotation from the *Brown Shoe* opinion is worth repeating here. The Court stated: "It is competition and not competitors which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets." *Brown Shoe*, 370 U.S. at 344.

176. For a discussion of the economic camp's views, see *supra* notes 42-58 and accompanying text.

allocative efficiency.¹⁷⁷ However, when a firm prices below cost, consumers overpurchase.¹⁷⁸ Consequently, scarce resources are directed toward the predator's industry when society would otherwise put them to a more socially desirable use.¹⁷⁹ In this way, below-cost pricing destroys allocative efficiency.¹⁸⁰

Scholars in the economic camp argue that the laws prohibiting predatory pricing attempt to arrest the loss of the economic efficiency similar to that caused by monopolies.¹⁸¹ In the monopoly situation, however, the problem is reversed, resources are directed out of the monopolized industry though they could better be used there.¹⁸² As with below-cost pricing, this results in a misallocation of goods.¹⁸³ A reallocation of the goods through the workings of competitive market forces would, therefore, increase consumer welfare in both situations.¹⁸⁴ If the noneconomic camp is correct, the antitrust laws should attempt to stop the inefficient act of below-cost pricing regardless of whether it actually results in the creation of a monopoly.¹⁸⁵

Finally, the *Brooke Group* decision is problematic because it adds to the already pervasive oligopoly problem.¹⁸⁶ As noted by the dissent in *Brooke Group*, the cigarette industry was in fact an oligopoly.¹⁸⁷ The natural

177. *Brooke Group*, 113 S. Ct. at 2588.

178. See generally BAUMOL & BLINDER, *supra* note 1, at 634.

179. *Id.*

180. Some scholars argue that because predatory pricing rarely occurs, and because most price decreases are the result of advances in technology or the achievement of superior efficiency, we should not prosecute claims of below-cost pricing. BORK, *supra* note 50, at 154. Prosecuting below-cost pricing will too often turn beneficial price reductions into illegal acts due to mistaken judgments as to the intent behind a price reduction. *Id.* These mistakes, according to this group of scholars, will dampen the incentives to advance technology or achieve superior efficiency. *Id.*

However, these concerns, simply do not justify the outright elimination of protection from predatory pricing, nor do they support making a below-cost pricing claim extremely difficult to win. Predatory pricing does, upon occasion, exist. Areeda & Turner, *supra* note 59, at 697-99. Courts must therefore take care in deciding below-cost pricing claims to guard against the concerns raised by scholars such as Bork. *Id.* at 699. Yet, the predatory pricing laws prior to *Brooke Group* accomplished this goal. The laws did so by using the average variable cost method first advocated by Areeda and Turner. See *supra* notes 118-21 and accompanying text.

181. See *supra* notes 69-86 and accompanying text.

182. See *supra* text accompanying notes 75-77.

183. See generally PINDYCK & RUBINFELD, *supra* note 33, at 352.

184. See *supra* notes 69-80, 89 and accompanying text.

185. A below-cost pricer must achieve monopoly or oligopoly power in order to recoup its losses. Thus, requiring that a monopoly actually exist before a predatory pricing claim may successfully be maintained is simply another way of imposing a recoupment requirement.

186. See *supra* Part III.

187. *Brooke Group*, 113 S. Ct. at 2599 (Stevens, J., dissenting).

destruction of an oligopoly will occur only under the right conditions, when firms become willing to cheat on the system.¹⁸⁸ Liggett attempted to rebel against the cigarette oligopoly and may have destroyed the oligopoly pricing structure in that industry.¹⁸⁹ To Liggett's dismay, however, its attempt triggered Brown & Williamson's below-cost pricing scheme.¹⁹⁰ Brown & Williamson used the below-cost pricing tactic to force Liggett to get its prices back in line with the oligopoly's supracompetitive prices.¹⁹¹ Liggett had two choices at the time, or so it thought.¹⁹² It could either raise its prices and perpetuate the oligopoly or it could sue Brown & Williamson for an antitrust violation. Liggett attempted to make appropriate use of the antitrust laws, but the Court's new recoupment requirement defeated its efforts. The Court limited future plaintiffs' range of choices to one: perpetuating the oligopoly structure.¹⁹³ As a result, the Court's recoupment requirement gives oligopolists a method to maintain their oligopolies: below-cost pricing.

VII. CONCLUSION

In sum, *Brooke Group*, rather than being "a boon to consumers,"¹⁹⁴ is a bust to society. Small business owners lose the valuable protection of the antitrust laws' prohibitions against below-cost selling. Society loses a portion of its wealth due to the misallocation of resources. Moreover, oligopolists gain another tool in perpetuating their oligopolies, a major problem in the United States economy. Thus, the Supreme Court should abandon the recoupment requirement.

However, until the Court chooses to overrule *Brooke Group*, interim measures are needed to limit the harsh effects of this new requirement. Lower courts should take a liberal approach to enforcement of the recoupment requirement, to prevent producers from using it to maintain their oligopolies. Setting standards for establishing probable recoupment that can be easily met by plaintiffs could achieve this goal. For example, courts could readily find barriers to entry in the below-cost pricer's industry that will make proving the recoupment element more possible. Large initial

188. See *supra* note 91-93 and accompanying text.

189. See *supra* notes 139-45 and accompanying text.

190. See *supra* notes 144-47 and accompanying text.

191. See Justice Stevens' dissent in *Brooke Group*, 113 S. Ct. at 2603.

192. See *supra* notes 149-51 and accompanying text.

193. See text accompanying *supra* note 186.

194. *Brooke Group*, 113 S. Ct. at 2588.

capital outlays can almost always be found necessary to enter an industry, thus creating a barrier to entry. When barriers to entry exist, the possibility that losses from predatory pricing can be recouped is increased because the probability that new market entrants will replace the forced out competitor is decreased. If these barriers are high enough, then all the losses can be recouped.¹⁹⁵ Thus, a court would be justified in finding the recoupment requirement per se satisfied where large capital outlays are necessary for market entry. This interpretation would reduce or eliminate the harsh effects of the *Brooke Group* requirement.¹⁹⁶ Our need for competition¹⁹⁷ requires no less.

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195. *See supra* note 59.

196. *Id.*

197. *See supra* text accompanying note 1.