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Predatory Pricing and Consumer Harm

In "The Perverse Effects of Predatory Pricing Law" (Winter 2005–2006), Daniel Crane argues that giving standing to predatory pricing cases will cause more harm than good, even if successful predation exists. He gives two reasons. First, such cases, whether successful or not, can have a chilling effect on pricing. Second, juries are liable to find predation where none exists. Finally, predation suits can be used to promote tacit collusion.

There are two problems with these assertions. First, Crane provides almost no evidence or at best speculative evidence. Second, he ignores consumer harm from even unsuccessful predation. When prices are below marginal costs, it is generally thought that consumers gain. This reasoning has been behind much of the support for making predation cases difficult to win. Nevertheless, this is naïve. It is based on partial equilibrium considerations in which only the market at hand is analyzed. The proper perspective, from a welfare standpoint, is general equilibrium. This shows that when prices are distorted, consumers lose in the long run even though predation is unsuccessful and prices of the particular product fall in the short run. There is an inefficient waste of resources in the short run that will adversely affect other markets in the short or long run. The net economic welfare effects must be negative in a competitive world. Whether the goal of antitrust laws is economic efficiency or benefits to consumers, the general equilibrium welfare context shows that prices lower than marginal costs create inefficiency and harm to consumers.

Crane notes that threat of a predatory lawsuit can chill legitimate competition. This is presumably true about the threat of any lawsuit that aims at a company's business practice. The lesson here would probably be to abolish antitrust. Whether or not this is a good idea is not yet proven.

That juries are unable to correctly determine whether or not predation exists seems unimportant given the *Brooke Group* standard, which has eliminated all, or almost all, successful predatory cases. The jury's job is reduced to finding whether or not the plaintiff met the requirements of *Brooke Group*. Further, it is unclear that juries' decisions are wrong.

The fact is that the proper status of predation law can only be determined from empirical study. My own empirical studies find, contrary to Crane, a strong case against eliminating standing to bring predation cases. (See "An Empirical and Theoretical Comparison of Alternative Predation Rules," by Richard Zerbe and Donald Cooper, *Texas Law Review*, Vol. 61, No. 4; "Does Predatory Pricing Exist?" by Richard Zerbe and Tom Mumford, *Antitrust Bulletin*, Winter 1996; "Monopsony and The Ross Simmons Case: A Comment on Salop and Kirkwood," by Richard Zerbe, *The Antitrust Journal*, Vol. 72, No. 2.)

I have also observed many instances, mainly in the nineteenth and twentieth century grain trade, in which the threat of predation has been used to maintain cartels. I suspect it has also been so used since that time. (See "The Origin and Effect of Grain Trade Regulations in the Late Nineteenth Century," by Richard Zerbe, *Journal of Agriculture History*, Vol. 56, No. 1.)

It is not difficult to find an absence of predatory lawsuits and of successful suits that apparently led to higher prices, to turn Crane's statement on its head. I must conclude that the argument for denying or making standing more difficult to obtain remains at least unproven, even by American standards of efficiency.

Crane may be incorrect to say that the earlier Courts did not take into account the effect of predation law on consumers. Robert Lande's work suggests antitrust laws were meant to give consumers a right to competitive prices, not to prices below the competitive level, and a right to small businesses (only) not to have to compete against firms selling below the competitive level. (See "Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged," by Robert Land, *Hastings Law Journal*, Vol. 34.) The preservation of competitive small businesses was part of the rationale for our antitrust laws.

This rationale might reflect consumer

preferences. In France for example, the predation laws are used to protect small businesses so as to help maintain local culture. The American counter-argument is that it is best to have lower prices and let consumers choose whether or not they want to maintain the culture of small businesses. The flaw in this argument is that there is a collective action problem. Consumers will shop where prices are lower because each consumer's contribution to the demise of small businesses is small. Such consumers might, however, collectively vote for the sort of French restrictions aimed at maintaining small businesses.

Intellectual analysis is a poor substitute for experience, which is properly the life of the law. Crane's position should not be accepted without the experience to justify it, and that experience does not yet exist. This is particularly true of the recent increased interest in predator bidding about which little empirical information is available. (I have been involved as an expert witness recently in a predatory bidding case.)

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Reply to Zerbe

In his letter, Richard Zerbe overstates my arguments. I do not argue that all private rights of action for predatory pricing, much less actions by the government, should be abolished. My principal concern is with claims by competitors, who prefer to keep prices above competitive levels and hence have interests antagonistic to those of consumers—the intended beneficiaries of antitrust law. Compared to the hundreds of private antitrust lawsuits by allegedly injured competitors, there are very few class action lawsuits by consumers alleging that they were injured by predatory prices that drove out the defendant's competitors and then enabled the defendant to charge prices above competitive levels. If predation were frequent and successful, one would expect to see many such claims.

Zerbe faults me for providing no evidence that allowing firms to sue their competitors for pricing too low chills vigorous price competition. I plead guilty to having little hard-and-fast evidence of chilling, because evidence of that kind is very difficult to procure. There is abundant evidence of frivolous predatory pricing litigation, but that does not necessarily translate into a generally chilling effect on price competition. Last year, I conducted a survey of in-house lawyers, and a few responded that predatory pricing lawsuit threats by their competitors had deterred their companies from pricing aggressively. But the response rate and absolute numbers of respondents were small and there could have been a response bias, so I do not put too much weight on this survey.

In my *Cornell Law Review* article "The Paradox of Predatory Pricing," published last year (Vol. 91, No. 1), I discuss some other ways of trying to assess the chilling effect. But I doubt that the presence, or absence, of such an effect can be proven empirically rather than theoretically or anecdotally. It is likely, though, that there is such a chilling effect. A firm deciding on whether to cut its prices in the face of threats by a litigious rival would be irresponsible not to take into account the possibility of a treble damages judgment, unilateral fee-shifting in favor of the plain-

tiff, and its own very expensive costs of defending against a suit.

Zerbe makes a further point, which I also discuss in my *Cornell* article, that prices below marginal cost are inefficient even if they do not result in the exclusion of competitors. This is true, but any firm that prices below marginal cost for non-exclusionary reasons is making a mistake that hurts the firm itself. Such mistakes will quickly be corrected by the firm without any intervention of the law. Is there a pervasive pattern of firms stupidly pricing below marginal cost for non-exclusionary reasons and needing the threat of treble damages to understand that their behavior is hurting them? I doubt it.

Zerbe then asserts that Supreme Court precedent has eliminated all or most successful predatory pricing cases. Two reactions: First, if that is true, why are scores of such cases still filed? If they are unlikely to be successful on the merits, the best explanation is that there are strategic benefits to competitors from filing predation claims, such as inducing the defendant to increase its prices above competitive levels. Second, it is not true that predation cases never make it to the jury. Even since I wrote my article for *Regulation*, the Sixth Circuit held that Spirit Airlines' predatory pricing claim against Northwest Airlines should go to a jury. In my *Cornell* article, I discuss some other recent predation cases that have been successful.

Zerbe believes that "it is unclear that juries' decisions in predation cases are wrong." My response depends in part on the meaning of "wrong." If Zerbe means that juries may sometimes reach the right result in predation cases, that is true. Liability determinations are binary, so even the flip of a coin would yield the "right" result 50 percent of the time (assuming that cases that make it to trial are equally likely to be "right" or "wrong"). But if Zerbe means that juries can be expected to understand predation law and apply it correctly, I strongly disagree. The example I gave in the article—the *Brooke Group* jurors who had no understanding of the applicable legal test even though they were willing to find Brown & Williamson liable because it had impure thoughts—is hardly surprising. How is the average juror supposed to apply complex ideas of industrial organization and regulatory policy when many federal judges do not even understand them?

Zerbe also argues that the consequence of my argument would be the abolition of antitrust law. This is a vast overstatement. Strategic manipulation of antitrust is primarily a concern in cases involving exclusionary conduct, not collaborative conduct like price fixing or bid rigging. And predatory pricing is more susceptible to strategic abuse than most exclusionary conduct claims because it focuses on conduct (price cutting) that is almost always beneficial to consumers and harmful to competitors.

Finally, there is a bizarre turn in Zerbe's argument. After arguing at length about how predatory pricing harms consumers, Zerbe states, "The preservation of small businesses was part of the rationale for our antitrust laws." He is undoubtedly right as a factual matter that some of the congressmen who voted for the Sherman Act in 1890, many of the congressmen who voted for the Clayton Act in 1914, and most of the congressmen who voted for the Robinson-Patman Act in 1936 were more concerned about protecting small, inefficient businesses than about protecting consumers. In my view, that is a vice, not a virtue, of U.S. antitrust law.

Having defended my views, let me close by extending an olive branch. I agree with Zerbe's paraphrase of Justice Holmes's famous aphorism that the "life of the law has not been logic, it has been experience." Both Zerbe and I still have much to learn about how predation, and predation law, actually works in the United States today. I welcome empirical scholarship on predation, just as I welcome empirical scholarship on predation lawsuits and their sometimes unfortunate effects.

—Daniel A. Crane
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