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SUPREME COURT HOLDS THAT PREDATORY PRICING STANDARDS APPLY TO PREDATORY BIDDING CLAIMS

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In 1993, the Supreme Court held in *Brooke Group v. Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993), that selling at a low price cannot be an act of monopolization—cannot constitute predatory pricing—unless the price is below an appropriate measure of cost and the evidence shows that there is a dangerous probability that the firm engaged in predation can recoup its investment in below-cost pricing. Earlier this week, in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, No. 05-381 (U.S. February 20, 2007) ("Slip Op."), the Supreme Court unanimously reaffirmed the *Brooke Group* rule and held that it also applied to claims of "overbidding"–buying "too many" inputs or paying "too much" for them. Applying the *Brooke Group* rule in the overbidding context, the Court held that overbidding is not unlawful unless it results in the defendant selling its output below cost with the possibility of recouping its investment in overbidding. The decision, by Justice Thomas, emphasizes the need for courts to be "wary of allowing recovery for above-cost price cutting because allowing such claims could, perversely, chill legitimate price cutting, which directly benefits consumers." Slip Op. at 5-6.

Weyerhaeuser is the latest in a recent string of unanimous Supreme Court decisions that favored antitrust defendants.[1]

LEGAL CONTEXT

In *Brooke Group*, the Supreme Court held that a predatory pricing claim required the plaintiff to show that 1) the prices complained of are below an appropriate measure of costs, and 2) that the predatory scheme would probably result in an increase of prices above the competitive level sufficient for the

1 The unity seen in the Court's recent antitrust decisions is striking. Five recent decisions—*Weyerhaeuser* as well as *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281 (2006) (no presumption of market power from a patent); *Texaco Inc. v. Dagher*, 126 S. Ct. 1276 (2006) (antitrust standards for joint ventures); *F. Hoffman-LaRoche Ltd. v. Empagran S.A.*, 524 U.S. 155 (2004) (ability of foreign plaintiffs to sue under US antitrust law), and *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (antitrust standards for unilateral refusals to deal), were all handed down by a unanimous court. *Volvo Trucks North America Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006) (application of the Robinson-Patman Act to bidding), was decided by a 7-2 majority.

alleged predator to earn excess profits sufficient to recoup losses sustained as a result of its below-cost pricing. *Brooke Group*, 509 U.S. at 225. In that case, the Court explained that the first prong of the test was a necessary screen—that any competitive advantage derived from low, but above-cost, pricing reflected either a more efficient cost structure and therefore competition on the merits or conduct "beyond the practical ability of a judicial tribunal to control without creating intolerable risks of chilling legitimate price cutting." *Id.* at 224. The second prong was necessary to show harm to consumers. The Court explained that absent a showing that the end result of a predatory scheme would be a period of high prices sufficiently long that the predator could recoup all losses from its below-cost pricing—including the time value of the money invested in it — there was no competitive harm. *See Id.* at 225. Absent this prospect of recoupment, the consumer benefit from low prices offsets any consumer harm from high prices and any harm to competitors sustained in the process "is of no moment to the antitrust laws." *Id.*

The Court in *Brooke Group* starkly set out prerequisites to recovery that the Court, itself, acknowledged were "not easy to establish." *Id.* at 226. In subsequent decisions, however, some lower courts seemed to narrow the applicability of the *Brooke Group* standard. In the *Weyerhaeuser* case itself, the district court and the Ninth Circuit court of appeals rejected application of the *Brooke Group* test where the defendant was alleged to have engaged in predatory buying in an input market rather than predatory pricing in an output market, noting that "predatory bidding is less likely than predatory pricing to result in a benefit to consumers or the stimulation of competition." *Weyerhaeuser*, 411 F.3d at 1038.

Perhaps more significantly, in *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003), the Third Circuit's *en banc* decision questioned whether the *Brooke Group* test was even applicable to monopolization claims. *Brooke Group* was decided under the Robinson-Patman Act, not § 2 of the Sherman Act, and the tobacco industry in which plaintiff and defendant in *Brooke Group* operated was alleged to be dominated by a small number of companies—an oligopoly, not a monopoly. *Brooke Group*, 509 U.S. at 214-16. After briefly summarizing the somewhat vague standards that had governed § 2 cases in the years prior to *Brooke Group*, the *LePage's* court concluded that the *Brooke Group* opinion could not be read to set out a general rule that all discounting practices resulting in above-cost pricing were *per se* legal. The court further explained that *Brooke Group* would not apply, in any event, in a monopolization case where "there is no market constraint on a monopolist's behavior" unlike the oligopolistic industry at issue in *Brooke Group*. *See LePage's*, 324 F.3d at 147-152. A few other courts have followed *LePage's*, rejecting application of *Brooke Group* to the discounting practices of alleged monopolists. *See Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917, 952 (6th Cir. 2006); *McKenzie-Williamette Hospital v. Peacehealth*, No. Civ.02-6032, 2004 WL 3168282, *4 (D. Or. 2004).

FACTS

Both the plaintiff, Ross Simmons Hardwood Lumber Co. Inc., and the defendant Weyerhaeuser operated sawmills, purchasing sawlogs and converting them to timber. After sustaining heavy losses and incurring several million dollars in debt during a period in which lumber prices were falling and prices for the raw logs were increasing, Ross-Simmons shut down its mill. Slip Op. at 2. Ross-Simmons filed a Sherman Act § 2 claim against its competitor, Weyerhaeuser, alleging that Weyerhaeuser had engaged in monopolization or attempted monopolization by paying excessive prices for sawlogs, buying the logs in excess of its needs, entering into exclusive contracts with sawlog suppliers, and obtaining sawlogs from state forests through

misrepresentations to state officials. *Weyerhaeuser v. Confederated Tribes of Siletz Indians of Oregon*, 411 F.3d 1030, 1034-35 (9th Cir. 2005). The case was tried to a jury, which found in favor of Ross-Simmons and awarded damages of over $26 million pre-trebling. *Id.*

Weyerhaeuser appealed, arguing that the Supreme Court's *Brooke Group* barred a predatory bidding theory where the prices it paid for logs were not so high that the finished lumber was sold at a loss and that the jury, therefore, had been improperly instructed on the law.

The Ninth Circuit, however, affirmed the entry of judgment against Weyerhaeuser. It first held that *Brooke Group* was limited to predatory pricing claims in output markets, not predatory bidding claims in input markets, sustaining a jury instruction that anticompetitive conduct could be found if "[d]efendant 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 fair prices." *Weyerhaeuser*, 411 F.3d at 1038-39. The Court of Appeals also found that Weyerhaeuser's 65% market share and the presence of high barriers to entry, combined with direct evidence of Weyerhaeuser's ability to affect prices in the sawlog market, supported a finding of monopoly power. *Id.* at 1042-1043.

THE *WEYERHAEUSER* DECISION

In *Weyerhaeuser*, the Court concluded that "[p]redatory pricing and predatory bidding claims are analytically similar." Slip Op. at 8. In both kinds of cases, the Court explained, the alleged predator must sustain losses for some period "on the chance that it will reap supracompetitive profits in the future." Slip Op. at 10.

The Court noted that–like the price discounting at issue in *Brooke Group*—overbidding often has a competitively benign explanation. For example, overbidding may arise from simple miscalculation, hedging behavior (*i.e.* overpurchasing in the belief that prices are likely to rise in the future), or the need to acquire a high volume of raw materials to support a capital expansion or build market share. *Id.* Moreover, in the case of both price discounting and overbidding, a failed attempt at predation can create benefits to consumers. *Id.* at 11. The Court further explained that the sort of high bidding at issue in Weyerhaeuser "is essential to competition and innovation" since it directly benefits existing sellers of inputs and encourages entry. *Id.* at 10-11.

Accordingly, the Court concluded that the *Brooke Group* rule applied in predatory bidding as well as predatory pricing cases. In a predatory bidding case, under *Weyerhaeuser*, a plaintiff must prove that the alleged predator paid prices sufficiently high that they lead "to below cost pricing in the relevant *output* market." Slip Op. at 12 (emphasis added). In addition, plaintiffs must, as in a predatory pricing case, show that "the defendant has a dangerous probability of recouping the losses incurred." *Id.* The Court applied its *Brooke Group* test notwithstanding the presence of a monopolization claim, *id.* at 4, and it expressly held that the *Brooke Group* test applies to both monopolization and Robinson-Patman Act claims. *Id.* at 4-5 n.1.

OPEN QUESTIONS

In *Weyerhaeuser*, the Court reaffirmed its *Brooke Group* test, specifically grounding its holding in the need to avoid creating incentives that suppress legitimate price-cutting behavior. The Court again noted the limits on the practical ability of courts to police above-cost price discounting. Because *Weyerhaeuser* was a monopolization case, the Court's decision undercuts important parts of the Third Circuit's decision in *LePage's*—a decision that called into question a wide variety of above-cost discounting practices. The precise scope of the *Weyerhaeuser/Brooke* Group requirement that a plaintiff "must prove that the prices complained of are below an appropriate measure of its rival's costs," however, remains to be seen. Challenges to the kind of loyalty discount and bundled pricing

packages at issue in *LePage* are not uncommon, and plaintiffs in these cases typically do not directly allege that the discounts are predatorily low. The *Weyerhaeuser* opinion gives no additional guidance on the ways courts should apply the *Brooke Group* standard in this context. Nor does the Court provide guidance on the "appropriate measure" of costs to be used in a predatory pricing or overbidding claim. The lower courts have endorsed various measures, including average variable cost, average total, and marginal cost.

CONCLUSION

Although some open questions remain about the scope of the *Weyerhaeuser/Brooke Group* rule, the Supreme Court's unanimous decision in *Weyerhaeuser* represents a clear victory for antitrust defendants. It clarifies that the high barrier to predatory pricing claims set out in *Brooke Group* applies even to claims against monopolists, and expands that rule to cover a monopolist's decisions about its input purchases, not just its sales of final goods. Of equal importance, the *Weyerhaeuser* decision, like the 2004 decision in *Trinko*, reflects the Court's concern that the antitrust laws not be used to chill procompetitive behavior. As such, it may signal the Court's openness to giving firms with high market shares more latitude to compete in ways that are good for consumers, even if they result in short-term harm to competitors.

If you would like more information about the Weyerhaeuser decision or its implications, please contact your Arnold & Porter attorney or:

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