Classic Papers on Predatory Pricing

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Perhaps no area of antitrust law provokes as much controversy as predatory pricing, the theory that a firm violates the antitrust laws by setting its price too low. Under the standard definition, predatory pricing involves a strategy of cutting price below the level at which a competitor can survive in the market and then raising price to the monopoly level in a later stage known as recoupment period). Predation is harmful to consumers if the higher prices during the recoupment period more than offset the gains from lower prices they received during the period of predatory pricing.

The controversy created by laws penalizing the practice is easy to see. At first glance, penalizing price-cutting is inconsistent with the goals of competition law, since the obvious result is higher prices, which are harmful to consumers. On the other hand, firms that see themselves as the victims of predatory pricing argue that consumers are harmed in the long run because consumers are denied the benefits of competition during the recoupment period.

At present, U.S. law and EC law have reached different positions, with EC law taking a more restrictive approach towards predation. Indeed, the U.S. Supreme Court's decision in *Brooke Group*[1] is widely thought to have put an end to successful predatory pricing cases in the United States. In contrast, the European Court of Justice's judgment in *AKZO v. Commission* reasoned that dominant firms only price below cost in order to eliminate competitors and fur-

1 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

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ther a monopolistic position.[2] Demonstrating recoupment is not required, at least for dominant firms, under EC case law and as a result predation cases remain alive and well in the European Community.

Perhaps in the long run, the impact of predatory pricing law is ambiguous. Laws that restrict predatory pricing are equivalent to enacting price floors. Price floors, however, do not put an end to competition. The firms subject to a price floor can compete with respect to quality rather than price. In a perfectly competitive setting, quality competition should continue until economic profits are driven to zero. This would suggest that in the absence of entry barriers, competition will continue to reduce the number of firms with monopoly power both in the United States and in the European Community. However, in the United States, we will, under this view, see lower prices and relatively lower quality in comparison to the European Community.

This issue publishes two pieces suggesting alternative views of the social desirability of taking a strong approach towards the regulation of predatory pricing. The first is B. S. Yamey's, "Predatory Price Cutting: Notes and Comments" (1972).[3] Although Yamey's paper describes itself modestly as "notes and comments", it introduces an important strand in the theory of predatory pricing. Yamey suggests that instances of pinpointed predation, limited to the specific submarket and time period in which a rival enters, could be a form of successful predation. After describing this version of predation, primarily as an exception to the then-developing view of predation as an unprofitable and rarely used strategy, he offers several examples from the industrial organization literature: fighting ships, fighting brands, and punitive freight-rate bases. Yamey's argument has been insufficient to alter the general skepticism toward predation claims reflected in the literature, and today, that skepticism has become embodied in the law—especially U.S. antitrust law. Now that we have entered a period in which the law on predation is unreceptive to plaintiffs' claims, Yamey's analysis of pinpointed predation continues to serve as an important reminder of the existence of valid predation claims.

The second classic reprinted here is Phillip Areeda and Donald Turner's "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act" (1975).[4] This is one of those rare pieces of scholarship that has had an unambiguous impact on the law. The article used the basic cost curves diagram from introductory economics to identify regions of price-quantity space in which price cuts

2 Case C-62/86, AKZO Chemie BV v. Commission, 1991 E.C.R. I-3359.

3 Reprinted from B.S. Yamey, *Predatory Price Cutting: Notes and Comments*, 15 J.L. & Econ 129–42 (1972).

4 Reprinted from P. Areeda & D. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697–733 (1975).

presumptively should be deemed predatory or non-predatory. The article's recommendation that price must exceed some appropriate measure of cost (Areeda and Turner recommended average variable cost as a proxy for marginal cost) is now a prerequisite for any Sherman Act predatory pricing claim under the U.S. Supreme Court's *Brooke Group* decision. In addition, without explicitly using the error-cost framework introduced by Easterbrook in "The Limits of Antitrust" (1984) (reprinted in volume one, issue one of this journal),[5] Areeda and Turner used arguments that translate quite readily into a comparison of the costs of false positive and false negatives under alternative price-cost comparison tests.

Whether one agrees with the approach of U.S. law or that of EC law, both classics continue to provide valuable insights on the predation problem.

5 F. Easterbrook, *The Limits of Antitrust*, 68 TEX. L. REV. 1 (1982) (*reprinted in* 1 COMPETITION POL'Y INT'L 179–215 (2005)).