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A Sheep in Wolf's Clothing: Predatory Pricing, Platform Antitrust, and the Risk of False Positives

By Sergei Zaslavsky & Tyler Helms[1]

The doctrine of predatory pricing has followed the vicissitudes of antitrust enforcement over the decades: from the plaintiff-friendly postwar period, to the more defendant-friendly "law and economics" era that started in the 1970s, to current calls for pro-enforcement reform. As the pendulum swings, it is important to remain alert to the problem of overcorrection. Whether the mood of the moment is pro-plaintiff or pro-defendant, we should remain cognizant of considerations pointing in the opposite direction to make sure the pendulum does not swing too far. Predatory pricing is an apt example: while reformers clamor for a loosening of the standard, any consideration of reform should consider that there is a category of important procompetitive conduct that is at risk of condemnation (or being chilled) even under the current (supposedly overly lax) standard.

I. As the Pendulum Swings: A Brief History of Predatory Doctrine

Predatory pricing refers to a strategy of using below-cost pricing to drive out competitors and attain a monopoly position, then raising price to reap monopoly rents once market dominance is secure. Standard Oil famously employed this predatory pricing strategy in the early twentieth century,[2] drawing the ire of lawmakers and courts alike and culminating in prohibition of the practice and, ultimately, breaking up of the massive oil giant.[3] Antitrust enforcement against predatory pricing thrived for decades, with plaintiffs successfully bringing predatory pricing claims in a variety of industries.[4] Plaintiffs only had to show that the defendant had "a large size advantage," was pricing below average total cost, and intended to (and did) exclude or injure competitors with the low pricing.[5] Plaintiffs did not have to worry about the difficulties of showing pricing below average variable costs or proving the likelihood that defendant would recoup foregone profits by charging high prices after securing a monopoly.

But in the 1970s and 1980s, the pendulum started swinging in the direction of reduced enforcement, following the controversial 1967 decision in *Utah Pie Co. v. Continental Baking Co.*[6] In this case, the Supreme Court found that a frozen pie manufacturer engaged in predatory pricing by selling its pies at a loss in Salt Lake City in an effort to more effectively compete with a quasi-dominant incumbent firm that had a cost advantage for distributing in the area. Outraged by what they saw as judicial interference with effective competition and consumer-friendly discounting, a group of scholars began to criticize the doctrine as chilling procompetitive conduct. They argued that the strategy of dropping one's price below cost in the hopes of making up the losses with future monopoly profits—the practice predatory pricing laws sought to proscribe—was irrational and unlikely

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[2] *See, e.g.*, IDA M. TARBELL, A HISTORY OF THE STANDARD OIL COMPANY 6–7 (1904).

[3] *See, e.g.*, *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1, 42–43 (1911) (listing the various offenses Standard Oil committed, which spanned "fifty-seven pages of the printed record"); Christopher R. Leslie, *Revisiting the Revisionist History of Standard Oil*, 85 S. CAL. L. REV. 573, 573 (2012).

[4] *See, e.g.*, *Nat'l Dairy Prod. Corp. v. Fed. Trade Comm'n*, 412 F.2d 605 (7th Cir. 1969) (fruit jams, jellies, and preserves), *E.B. Muller & Co. et al. v. Fed. Trade Comm'n*, 142 F.2d 511 (6th Cir. 1944) (granulated chicory), *Moore v. Mead's Fine Bread Co.*, 348 U.S. 115 (1954) (baked goods), *Porto Rican Am. Tobacco Co. of Porto Rico v. Am. Tobacco Co*., 30 F.2d 234 (2d Cir. 1929) (tobacco).

[5] *See* Joseph F. Brodley & George A. Hay, *Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards*, 66 CORNELL L. REV. 738, 765–66; *see also E.B. Muller & Co*, 142 F.2d at 514, 517 (holding that occupying "the greater part" of the market where prices "resulted in loss" with "deliberate intent to destroy" a competitor constituted predatory pricing), *Porto Rican Am. Tobacco Co.*, 30 F.2d at 236–37 (affirming violation where a firm with "an annual income of four times" that of a particular competitor sold product at a loss "designedly . . . to cause loss to . . . a weaker competitor").

[6] 386 U.S. 685.

to occur in practice. After all, there is no guarantee that below-cost pricing would drive competitors out of the market and even less assurance that a successful exclusion of competition in one instance would allow the incumbent to recover its lost profits before another competitor entered.[7] This theory, initially limited to academia, eventually found its way to the judiciary, influencing a line of cases that ultimately culminated in the Supreme Court's 1993 *Brooke Group v. Brown and Williamson Tobacco* decision, which established the current standard for predatory pricing.[8] The Supreme Court held that not only must the plaintiff show that the defendant set prices below an appropriate measure of cost (generally average variable cost or marginal cost), but also a likelihood of subsequent recoupment of lost profits.[9] The demanding *Brooke Group* standard reflected the view that predatory pricing was unlikely to occur[10] and that going after low pricing created a high risk of chilling the very price competition that antitrust laws seek to encourage.[11]

In recent years, with the influence of the Chicago School increasingly questioned and neo-Brandesian antitrust on the rise, the pendulum may be swinging back toward a more plaintiff-friendly standard. Commentators are now questioning whether the *Brooke Group* standard sets the bar too high. Critics have complained that "recoupment is difficult for plaintiffs to prove in the short term" and "[s]ince the recoupment requirement was introduced, successful predatory pricing cases have plummeted."[12] Reformers have voiced particular concern about predatory pricing by digital platforms, claiming that "winner-take-all dynamics incentivize the pursuit of growth over profits" and cross-subsidization between multiple lines of business offers additional opportunities for predatory pricing.[13] These critics have called for a reformation of the standard, largely focused on removing the recoupment requirement, placing the burden on the defendant to rebut a presumption that its conduct is anticompetitive once the plaintiff establishes below-cost pricing.[14]

II. A Sheep in Wolf's Clothing: Procompetitive Platform Business Strategies That May Resemble Predatory Pricing

While many reformers claim that the rise of digital platforms warrants stricter predatory pricing enforcement and a more plaintiff-friendly standard, it is important to not overlook considerations pointing in the opposite direction: even under the current standard, there is risk that procompetitive platform business strategies will be incorrectly flagged as predatory pricing.

Entrants in platform markets face the "chicken-and-egg problem."[15] The platform intermediates between two or more groups of customers on different sides of the platform, and the value of the platform to one side depends on the presence of customers on the other side.[16] If one group is absent from the platform, the other

[7] *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF, 149–55 (1978).

[8] 509 U.S. 209 (1993).

[9] *Id.* at 222–28. The legal standard for likelihood of recoupment depends on the statue underlying the claim: "reasonable prospect" under the Clayton Act and "dangerous probability" under the Sherman Act. *Id.* at 224.

[10] *Id.* at 227–28 ("However unlikely predatory pricing by multiple firms may be when they conspire, it is even less likely when, as here, there is no express coordination.").

[11] *Id.* at 226–27 ("[M]istaken inferences . . . are especially costly, because they chill the very conduct that antitrust laws are designed to protect. It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high.") (internal quotation marks omitted). *See also* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 35-36 (1984) (arguing that complaints "concern[ing] lower pricing," particularly "predatory practices suits brought by firms that have not left the market" should generally be dismissed).

[12] H.R. REP. NO. 117-8, pt. 1, at 335–36 (2022).

[13] *Id.*; *see also* Lina Khan, *Amazon's Antitrust Paradox*, 126 YALE L. REV. 564, 756–68 (2017) (analyzing Amazon's conduct with respect to below-cost pricing of e-books).

[14] AMY KLOBUCHAR, ANTITRUST: TAKING ON MONOPOLY POWER FROM THE GILDED AGE TO THE DIGITAL AGE, 296–98 (2021); H.R. REP. NO. 117-8, pt. 1, at 335–36 (2022); S. 225, 117th Cong. § 9 (2021) (proposed legislation specifically excluding both below cost pricing and recoupment as a requirement for a violation).

[15] *See, e.g.*, Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, 1 J. EUR. ECON. ASS'N 990, 990 (2003).

[16] Erik Hovenkamp, *Platform Antitrust*, 44 J. CORP. L. 713, 714–15, 720 (2019).

groups have no incentive to use it, and vice versa. If a credit card company cannot convince merchants to accept its card, it will have little success attracting cardholders; and conversely, a credit card company with no cardholders will have difficulty convincing merchants to invest the time and money to update its payment systems to start accepting the card. A ride-hailing app will have a tough time attracting drivers if it has no passengers, and an equally hard time attracting passengers if it has no drivers. It is difficult to attract customers on Side 1 without having a large customer base on Side 2, but to build a large customer base on Side 2, it is often necessary to have customers on Side 1. Hence the chicken-and-egg dilemma.

One way an entrant can solve this chicken-and-egg quandary is by temporarily subsidizing one or both sides of the platform: offering very favorable terms of trade to attract users who may need enticement to join the platform because there are not yet very many participants on the other side of the platform. In the example above, if passengers receive a discounted price, they may be willing to use a ride-hailing service even if the paucity of drivers increases wait times; and drivers receiving a special bonus may be willing to participate even if it takes a long time to find a passenger. These discounts and bonuses may result in a net platform price[17] that is below cost, but this below-cost pricing represents a procompetitive effort to seed the platform (attract enough users to one or both sides to kickstart network effects and set the platform on a path to growth) rather than an anticompetitive effort to drive out competitors.

What happens if this procompetitive entry strategy is successful? The platform succeeds in sparking the virtuous cycle of network effects—as more participants join on Side 1, the platform becomes more attractive to customers on Side 2, and as more of those customers join on Side 2, the platform can attract even more Side 1 users, and so on. Eventually, the platform offers significant value to users on both sides and the promotional below-cost pricing is no longer necessary. The platform can then raise its price to an above-cost level. Its revenue increases (often dramatically)—not only is it charging a higher price, but the virtuous cycle of network effects can increase the platform output rapidly as growth on one side encouraged growth on the other side and *vice versa*. Its costs also increase, but frequently by a significantly smaller percentage than its revenue: platforms (especially in digital markets) are frequently characterized by high fixed costs and low marginal costs. If marginal costs are low, revenue growth outpaces cost growth when there is a rapid expansion of output, which results in the platform earning significant margins. Nothing anticompetitive took place, yet the platform priced below cost and then recouped losses by earning high margins—superficially appearing to meet the elements necessary to show predatory pricing.

The reader may object: predatory pricing is a monopolization offense—surely no one would think that a new entrant possesses monopoly power (or has a dangerous probability of acquiring it), obviating the risk of false positives. Not so fast. First, the entrant may be opening a new market rather than challenging an incumbent in an existing market—in that case, the entrant may have high market share in the nascent market even early in its lifecycle. Second, some courts may look to margins rather than share as evidence of monopoly power,[18] and as explained above, successful execution of a procompetitive entry strategy may well result in a platform earning significant margins. Third, courts may decide (rightly or wrongly) that if the entrant overtakes the

[17] The net price is the fee the platform earns for facilitating a transaction.

[18] *See, e.g.*, *Virginia Vermiculite, Ltd. v. W.R. Grace & Co.-Conn.*, 965 F. Supp. 802, 828 (W.D. Va. 1997) ("[A] market share of fifty percent (or somewhere below fifty percent) alone does not conclusively foreclose the possibility of monopoly power."); *Conwood Co. v. L.P. v. U.S. Tobacco Co.,* No. 5:98-CV-108, 2000 WL 33176054, at *3 (W.D. Ky. Aug. 10, 2000) (holding that high profit margins supported a finding of monopoly power), *State of Ill. ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 730 F. Supp. 826, 906 (C.D. Ill. 1990) (finding that the defendant's "financial performance evidences its monopoly power"), *Banana Distributors, Inc. v. United Fruit Co*., 162 F. Supp. 32, 39 (S.D.N.Y. 1958) ("Defendants' profit margin is another factor which may properly be considered . . . in determining whether the defendants had monopoly power."); *but see United States v. Eastman Kodak Co*., 63 F.3d 95, 109 (2d Cir. 1995) ("Certain deviations between marginal cost and price, such as those resulting from high fixed costs, are not evidence of market power.").

incumbent, the presence of network effects will make it difficult for rivals to constrain the successful entrant's power, even if other platforms continue to compete in the market.[19]

A recent case, *SC Innovations, Inc. v. Uber Technologies, Inc.*,[20] illustrates this concern. Plaintiff Sidecar launched a ride-hailing app in 2012; Uber started offering a service connecting passengers to drivers driving their personal vehicles a year later.[21] Sidecar alleged that Uber "offer[ed] above-market incentive payments to drivers, and . . . below-market fares to passengers" and "has lost billions of dollars in the process."[22] "According to Sidecar, Uber's strategy [was] premised on the goal of establishing a monopoly and reaping the reward of supracompetitive monopolist pricing in order to recoup early losses."[23] Uber argued that Lyft's strong market presence doomed Sidecar's claim: it is implausible that Uber had a monopoly and could recoup early losses by earning monopoly rents when a rival continued to command a significant share of the market. The court disagreed and denied Uber's motion to dismiss, reasoning that "in geographic markets where Lyft has a smaller market share than Uber . . . Lyft would be expected to offer a [*sic*] less efficient matches between drivers and passengers than Uber," and thus network effects may prevent Lyft from effectively constraining Uber.[24] Thus, even where the alleged below-cost pricing was used as a platform entry strategy and the platform did *not* drive out its chief rival, a court found that the plaintiff sufficiently stated a predatory pricing claim.

III. Conclusion

With the pendulum swinging toward policies favoring more enforcement, it is no surprise that there are calls to make predatory pricing standards more plaintiff friendly. But any potential reform should consider both the risk of false positives and false negatives. For predatory pricing enforcement involving multi-sided platforms, the risk of false positives is very real: procompetitive conduct that can help entrants jump-start their platforms may superficially resemble predatory pricing, even under the current standards that reformers say are too lax. Dismissing the risk of false positives can lead to chilling procompetitive conduct and less competition—a fact that is no less true for being out of fashion.

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[19] The fact that the entrant managed to overtake the incumbent *should* reassure courts that other companies should be able to credibly threaten to overtake the new market leader (and thereby impose a competitive constraint), but as the example from the ride-hailing industry in the subsequent paragraph shows, courts do not necessarily draw this inference in practice.

[20] No. 18-CV-07440-JCS, 2020 WL 2097611 (N.D. Cal. May 1, 2020).

[21] *Id*. at *2. Prior to 2013, Uber offered "a service for passengers to arrange for transportation in limousines driven by licensed chauffeurs." *Id*.

[22] *Id.* at *3.

[23] *Id*.

[24] *Id.* at *8.