# ARTICLES

# PROMOTIONAL PRICE-CUTTING AND SECTION 2(a) OF THE ROBINSON-PATMAN ACT*

DANIEL J. GIFFORD†

## I. INTRODUCTION

Section 2(a) of the Robinson-Patman Act[1] forbids discrimination "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly . . . or to injure, destroy, or prevent competition with any person who . . . grants such discrimination . . . ." In the quoted provisions, the Act attempts to prohibit price discrimination which is likely to lessen (or to destroy) competition between the discriminator and its rivals. Section 2(a) is the successor of the original

---

* This article is a revised version of a portion of a dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of the Science of Law from the Faculty of Law, Columbia University.

† Professor of Law, State University of New York at Buffalo School of Law. A.B., 1953, Holy Cross College; LL.B., 1958, Harvard University.

1. This article is concerned, almost exclusively, with sections 2(a) and 2(b) of the Robinson-Patman Act. The full text of section 2(a) provides:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: *Provided*, That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: *Provided, however*, That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or classes of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: *And provided further*, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: *And provided further*, That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

15 U.S.C. § 13(a) (1970). Section 2(b) provides:

section 2 of the Clayton Act[2] which was directed primarily at preserving independent local firms from the attacks of larger rivals operating in several markets. In the perceptions of the time, significant numbers of multimarket sellers were viewed as lowering local prices to artificially low levels in order to drive out their single-market rivals. The Act was designed to protect these local firms from such "unfair" competition and to reestablish properly competitive conditions around these local sellers.

The present article is concerned with "promotional price-cutting"—price-cutting designed to expand the sales base which the seller can reasonably expect to command in a market over a substantial period of time.[3] The Robinson-Patman dimensions of promotional price-cutting are important because the most effective way for a seller to increase its sales is through price reductions, and when a geographically dispersed seller lowers price in one out of several markets in which it is operating, it is engaged in price discrimination.[4] The legality of that discrimination under the Act depends upon an evaluation of the discriminator's behavior for its anticompetitive tendencies. The case law construing and applying the anticompetitive mandate of the Robinson-Patman Act is not noted for its

---

> Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: *Provided, however*: That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

15 U.S.C. § 13(b) (1970).

2. Section 2 of the Clayton Act provided:

> [I]t shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly to discriminate in price between different purchasers of commodities, which commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or any other place under the jurisdiction of the United States, where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce: *Provided*, That nothing herein contained shall prevent discrimination in price between purchasers of commodities on account of differences in the grade, quality, or quantity of the commodity sold, or that makes only due allowance for difference in the cost of selling or transportation, or discrimination in price in the same or different communities made in good faith to meet competition: *And provided further*, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade.

Ch. 323, § 2, 38 Stat. 730 (1914).

3. "Promotional price-cutting," as the term is employed in this article, means price-cutting which is designed to bring about a long-term increase in a seller's sales volume. It therefore excludes predatory price-cutting which is designed primarily to injure a rival firm. It also excludes temporary price reductions designed to clear stocks of discontinued items and temporary "sales," which are designed to meet a more elastic segment of a seller's demand, but which are not intended to produce effects on the seller's sales volume for more than that temporary period. *See* Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 713 (1975) [hereinafter cited as Areeda & Turner].

4. FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 549 (1960).

clarity, for its consistency or, indeed, for its fidelity to the Act's stated objective of preserving competition.[5] Yet neither is that case law without an expressed core of understandable primary concerns.

The Robinson-Patman Act case law has looked with suspicion upon "below cost" pricing,[6] "radical price cuts,"[7] pricing which gives rise to drastic declines in market-price structures[8] and low pricing which is followed by the exit of rivals from the marketplace.[9] This article will seek to provide a route for harmonizing this case law with the Act's proper concern for the maintenance of a competitive-market structure[10] and with the general concern of all of the antitrust laws for the growth of efficiency in production and distribution methods.[11] Moreover, it will provide a needed conceptual linkage between the Act's concern for preserving a competitive market structure and the economic efficiency imperative which is almost necessarily embodied in a competitive economic system.[12] Additionally, a note of vitality has been injected into the causation requirement latent in the Act by connecting the primary-line[13] cases, which have emphasized that causation element, with two considerations which are not frequently connected directly with the case law treatment of causation: (1) the soundness, from an economic policy point of view, of presuming the lawfulness of above-average-total-cost pricing; and (2) an explicit recognition of the flexibility inherent in causal attributions.

## II. THE INFLUENCE OF THE CLASSIC PREDATOR MODEL ON THE ROBINSON-PATMAN ACT AND ITS ADMINISTRATION

### A. *The Model's Relation to Congressional Concerns*

The evil which Congress sought to eliminate by enacting the original section 2 of the Clayton Act was described with some particularity in the House and Senate Reports.[14] As described in those Reports, multimarket firms would sell their products in selected local markets at below-cost

5. *See* Automatic Canteen Co. v. FTC, 346 U.S. 61, 65 (1953); *Eine Kleine Juristische Schlummergeschichte*, 79 HARV. L. REV. 921 (1966). *See also* M. ADELMAN, A&P: A STUDY IN PRICE-COST BEHAVIOR AND PUBLIC POLICY 150-81 (1959).

6. *See* notes 30-33 *infra*.

7. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 702 n.14 (1967); Continental Baking Co. v. Old Homestead Bread Co., 476 F.2d 97, 104 (10th Cir. 1973) [hereinafter cited as Old Homestead Bread Co.]; National Dairy Prods. Co., 71 F.T.C. 1333, 1427 (1967), *modified and enforced*, 412 F.2d 605 (7th Cir. 1969) [hereinafter National Dairy].

8. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 703 (1967).

9. *E.g.*, Old Homestead Bread Co., *supra* note 7, at 104.

10. *See, e.g.*, Dean Milk Co., 68 F.T.C. 710, 750 (1965), *aff'd in part and rev'd in part*, 395 F.2d 696 (7th Cir. 1969) [hereinafter cited as Dean Milk Co.].

11. *See* text accompanying notes 53-54 and 248 *infra*.

12. A competitive economic system operates over time to eliminate inefficient producers and thereby to promote efficiency.

13. "Primary-line" cases are those involving a tendency to injure competition in the market in which the discriminator and its rivals are competing.

14. *See* H.R. REP. No. 627, 63d Cong., 2d Sess. 8-9 (1914); S. REP. No. 698, 63d Cong., 2d Sess. 2-4 (1914).

prices or at prices which earned less than normal profits. These firms were then said to subsidize their lost profits or their losses from monopoly profits which they earned in other markets. When their artificially-low prices had succeeded in driving out the local rivals from a particular local market, then prices in those markets would be raised to monopoly levels. This model of geographic price discrimination has remained alive and, indeed, permeates much of the Robinson-Patman case law.

The conduct described by the model is almost universally characterized as "predatory," a term which describes uneconomic pricing employed by a firm to drive rivals from the marketplace,[15] and in its current usage, to force them to sell out on favorable terms, or, at least, to discipline[16] them for failing to conform to the wishes of the price-cutting firm.[17] Although even today the concept of "predatory" behavior is not without its ambiguities,[18] a key element in predatory pricing lies in its "uneconomic" level, in the sense that predatory pricing falls below the level of shortrun profit-maximization. A second (apparently essential) element in the definition of predatory pricing is the motive or design of the price cutter to injure or to destroy its rivals.[19] Predatory pricing is generally viewed as inherently antisocial behavior. It does not conform to the norms of the competitive market, and indeed, is consciously designed to lessen or to destroy competition.

If section 2(a)'s prohibitions reached only predatory pricing, it would not present obstacles to geographically dispersed firms which seek to gain entry to a particular market or to expand their sales base in that market. These objectives are, in themselves, nonpredatory. Section 2(a) however, applies to nonpredatory,[20] as well as predatory pricing, forbidding both

15. Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST LAW & ECON. REV. 105 (1971); Areeda & Turner, *supra* note 3, at 697-700.

16. Disciplining a rival means punishing that rival for undercutting by subjecting it to such low-price competition that it loses significant profits or even incurs losses. *See, e.g.*, Lloyd A. Fry Roofing Co. v. FTC, 371 F.2d 277, 281 (7th Cir. 1966).

17. *See* Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST LAW & ECON. REV. 105, 106 (1971); Koller, *On the Definition of Predatory Pricing*, 20 ANTITRUST BULL. 329, 331-32 (1975); Yamey, *Predatory Price Cutting: Notes and Comments*, 15 J. LAW & ECON. 129, 133 (1972) [hereinafter cited as Yamey]. Cases of price-cutting for purposes of disciplining rivals are excluded from the definition of "predatory" price-cutting employed in Areeda & Turner, *supra* note 3, at 712 n.35.

18. Professors Areeda and Turner define predatory price-cutting primarily with respect to the relation of a seller's prices to its marginal or variable costs. Areeda & Turner, *supra* note 3, at 698, 711, 712, 716, 719. A quite different view is taken by Yamey, *supra* note 17, at 133.

19. Subjective intent is an element in most understandings of "predatory" behavior. *See, e.g.*, Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST LAW & ECON. REV. 105, 107 (1971); Yamey, *supra* note 17, at 134. The Commission, however, has sometimes approached the matter of predatory intent from an objective foreseeability perspective. *See* National Dairy, *supra* note 7, 71 F.T.C. at 1427. *Compare National Dairy with* Dean Milk Co., *supra* note 10, 68 F.T.C. at 807-08 (Elman, dissenting). Areeda and Turner appear to reject a subjective element in their definition of predatory behavior. Areeda & Turner, *supra* note 3, at 699, 712 n.35.

20. *See, e.g.*, National Dairy, *supra* note 7, 412 F.2d at 612-13, 618; Balian Ice Cream Co. v. Arden Farms Co., 231 F.2d 356, 369 (9th Cir. 1955), *cert. denied*, 350 U.S. 991 (1956); H.J.

whenever such discrininatory pricing is deemed to produce an anticompetitive potential. Generally, a showing that a price cutter has been activated by predatory intent is taken as a sufficient showing that the price cuts are likely to lessen competition. Hence, if those price cuts are discriminatory, a violation of the Act has occurred.[21] When predatory motivation is not shown, however, further inquiry into anticompetitive impact must be pursued. Yet even in the nonpredatory primary-line cases, the classic predatory model lurks in the background and influences the attitudes of the Federal Trade Commission and the courts toward the assessment of primary-line injury.

### B. *The Elements of the Predatory Model*

The predatory model has been a source of significant confusion throughout the history of the original section 2 and its successor. In the model several elements are joined together which are not always joined in actual events. First, the goal of the discriminator is the elimination of the competitive constraint imposed by local-market rivals.[22] The point of driving these rivals from the market place is to enable the discriminator to raise local prices to supracompetitive levels. Second, a notion of unfairness permeates the description of the discriminator's behavior. It is pictured as subjecting its local rivals not just to the normal rigors of a "fair" kind of competition in which it would attempt to sell its goods at shortrun, profit-maximizing prices.[23] Rather, it is pictured as subjecting its rivals to suboptimal prices—prices below the shortrun, profit-maximizing level—which it is enabled to do only because the lost profits or even the actual losses it incurs in the local market are recouped or subsidized from monopoly profits which it earns in other markets. Since the local rivals' operations are confined to a single market, they cannot recoup the lost profits or losses which they incur in competing with the discriminator.[24] A competitive struggle for survival in which one firm can subsidize its local operations from extramarket revenues, while its rivals cannot, is seen as unfair.[25] Third, there is a causal factor inhering in the model. The harm to

Heinz Co. v. Beech-Nut Life Savers, Inc., 181 F. Supp. 452, 465 (S.D.N.Y. 1960); Dean Milk Co., *supra* note 10, 68 F.T.C. at 744-51; Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 265 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966). *Cf.* Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 702-03 (1967); Beatrice Foods Co., 76 F.T.C. 719, 799 (1969), *aff'd sub nom.*, Kroger Co. v. FTC, 438 F.2d 1372 (6th Cir.), *cert. denied*, 404 U.S. 871 (1971).

21. Lloyd A. Fry Roofing Co., 371 F.2d 277, 281-82 (7th Cir. 1966); National Dairy, *supra* note 7, 71 F.T.C. at 1427. *See* Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 702 (1967); Anheuser-Busch, Inc. v. FTC, 289 F.2d 835, 843 (7th Cir. 1961). *Cf.* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 552 (1960).

22. *See* H. R. REP. No. 627, 63d Cong., 2d Sess. 8 (1914); Dean Milk Co., *supra* note 10, 68 F.T.C. at 798 (Elman, dissenting).

23. *See* authorities cited in note 22 *supra*.

24. *See* Gifford, *Price Discrimination and Labelling*, 25 BUFFALO L. REV. 395, 407-08 (1976).

25. The House Report on the original section 2 stated that the section was "intended to prevent unfair discriminations." The classic predator model was then used to illustrate the

the local firms is produced by the discriminator's low prices, which are sustainable only because of the profits it is earning from its monopoly prices in other markets. Thus, in the model, the discrimination—which is constituted by the high and low prices in different markets—is both the cause of the conditions which injure the local rivals and the means by which those injurious conditions are sustained.[26] Finally, there is implicit in the description of the classic predator an assumption that the victims of price discrimination are likely to be small, locally owned and locally run enterprises, while the offending firm, perhaps because it operates in several markets, is likely to be large and powerful.[27]

It is important to add, however, that the same legislators who described the predator in these reports, and a majority of those who acted upon the recommendations of those reports, evidenced a concern for business efficiency when they explicitly permitted discrimination which reflected cost differences in selling or transportation.[28] This concern for efficiency was articulated further in the 1936 amendment to section 2.[29] Indeed, the general understanding of the classic predator model is one in which local firms are forced into a contest which turns on subsidizing abilities and not on superior efficiency. The suggestion of that model, therefore, is that the struggle ought to turn on efficiency.

### *C. The Confusion Caused by the Model in the Evaluation of "Below Cost" Pricing*

The potential for confusion which the classic predator model is capable of engendering is evidenced in the way the courts and the Commission have treated the matter of "below cost" discriminatory pricing. Not infrequently, the fact that a firm engaging in geographic price discrimination is selling "below cost" in a given locality is taken by the

types of "unfair discriminations" at which the section was aimed. H.R. REP. No. 627, 63d Cong., 2d Sess. 8 (1914). *Cf.*, Amalgamated Sugar Co., 54 F.T.C. 943, 945 (1958).

26. *See* H.R. REP. No. 627, 63d Cong., 2d Sess. 8-9 (1914). *See also* Borden Co. v. FTC, 381 F.2d 175, 180 (5th Cir. 1967); Tri-Valley Packing Ass'n v. FTC, 329 F.2d 694, 703-04 (9th Cir. 1964); Shore Gas & Oil Co. v. Humble Oil & Refining Co., 224 F. Supp. 922, 925-27 (D.N.J. 1963); Dean Milk Co., *supra* note 10, 68 F.T.C. at 799-800, 810 (Elman, dissenting).

27. The House Report on the original section 2 referred to geographic price discrimination as "a most common practice of great and powerful combinations . . . notably the Standard Oil Co., and the American Tobacco Co., and others of less notoriety, but of great influence . . . ." It also asserted that the practice was carried on also by "certain smaller concerns which seek to secure a monopoly . . . by aping the methods of great corporations . . . ." H.R. REP. No. 627, 63d Cong., 2d Sess. 8 (1914).

28. 38 Stat. 730 (1914).

29. In the Robinson-Patman amendment to the Clayton Act the cost-justification proviso is expanded to include differences in manufacturing expenses as well as differences in selling and delivering expenses. 15 U.S.C. Sec. 13(a) (1970). *See also* H.R. REP. No. 2287, 74th Cong., 2d Sess. 9 (1936), where it is stated that the amendment "leaves trade and industry free from any restriction or impediment to the adoption and use of more economic processes of manufacture, methods of sale, and modes of delivery, wheresoever they may be employed in streams of production or distribution . . . ."

courts or by the Commission as evidence of predatory conduct.[30] The below-cost price is seen as a replication of the loss-incurring prices of the predator in the model. While a number of commentators have pointed out the ambiguity of a "below cost" characterization in pricing,[31] that characterization continues to appear in the cases.[32] Moreover, in a number of cases, the Commission has condemned geographically discriminatory "below cost" pricing as anticompetitive without resting that condemnation on a finding of predatory intent.[33]

Pricing which is "below cost" can be below average total cost, below average variable cost, or below marginal cost.[34] For reasons which are developed below,[35] pricing which is below marginal cost probably ought to raise an inference of predatory intent and, accordingly, ought to be condemned as inherently anticompetitive. A general rule about pricing below average variable cost is less easily developed.[36] And pricing below

30. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 697, 702 n.14 (1967); Old Homestead Bread Co., *supra* note 7, 476 F.2d at 104; Porto Rican Am. Tobacco Co. v. American Tobacco Co., 30 F.2d 234, 236, 237 (2d Cir. 1929); National Dairy, *supra* note 7, 71 F.T.C. at 1427-28. *See also* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 552 (1960); Forster Mfg. Co., 335 F.2d 47, 53 (1st Cir. 1964), *cert. denied*, 380 U.S. 906 (1965); Ben Hur Coal Co. v. Wells, 242 F.2d 481, 486 (10th Cir. 1957); United States v. New York Great A&P Tea Co., 173 F.2d 79, 87 (7th Cir. 1949); E.B. Muller & Co. v. FTC, 142 F.2d 511, 516-17 (6th Cir. 1944).

31. Areeda & Turner, *supra* note 3, at 700; Yamey, *supra* note 17, at 134. *Cf.* Koller, *On the Definition of Predatory Pricing*, 20 ANTITRUST BULL. 329, 332 (1975); Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST LAW & ECON. REV. 105, 106 n.3 (1971).

32. *See* note 30 *supra*.

33. Dean Milk Co., *supra* note 10, 68 F.T.C. at 771, 774, 775; Borden Co., 64 F.T.C. 534, 568, 570 (1964), *rev'd* 339 F.2d 953 (7th Cir. 1964). *Cf.* Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 253, 263, 264, 265, 266 n.29 (1965), (predatory intent found although not relied upon; prices at or below the cost of rivals).

34. The term "total cost" refers to the entire amount expended on output. "Average total cost" is the total amount expended on output divided by the number of units of output. "Variable costs" are those costs which vary with output. "Average variable cost" is the total of all variable costs divided by the number of units of output. "Fixed costs" are those costs which do not vary with output. "Average fixed cost" is the total of all fixed costs divided by the number of units of output. Average fixed cost plus average variable cost equals average total cost. "Marginal cost" is the incremental cost of the last unit produced.

35. *See* text accompanying notes 73-74 *infra*.

36. Since a firm's marginal cost curve passes through the minimum point of its average variable cost curve, marginal cost will be below average variable cost at smaller outputs and above average variable cost at higher outputs. As Areeda and Turner point out, presuming the unlawfulness of prices which are below average variable cost—although above or equal to marginal cost—would be consistent with presuming the unlawfulness of uneconomic pricing, because a firm would be better off closed than operating at a below-average-variable-cost price level. Areeda & Turner, *supra* note 3, at 717. Those authors also suggest that while below-marginal-cost prices are suspect, they should be tolerated so long as they are above average variable cost. The bases for the latter suggestion are that average variable cost data are more readily obtainable than marginal cost data and that below marginal-cost prices which exceed average variable cost will not pose a major threat to efficient rivals. Areeda & Turner, *supra* note 3, at 718.

Several problems inhere in this latter suggestion. When a firm prices below its shortrun profit-maximizing level, it is necessarily seeking a goal other than short-run profits. Thus, it seems proper to require such a firm to explain what its goal is in those circumstances. Yet, because the price of a firm in a competitive market would equal its marginal cost, marginal-cost pricing by a firm in a non-purely competitive market might be viewed as a replication of average total cost clearly cannot be accurately equated with predatory behavior. Indeed, pricing at levels below average total cost in one or more (but less than all) markets in which a firm is selling may maximize the profits of a prospering firm. It is, in some circumstances, the behavior which is required for shortrun profit-maximizing.[37]

Since below-average-total-cost pricing is sometimes profit-maximizing behavior for a multimarket firm, it cannot, by itself, raise an inference of predatory intent. Yet the local rivals subjected to below-average-total-cost pricing may be subjected to a severe challenge. Prices at a below-average-total-cost level cannot be maintained for the long run by single-product, single-market firms. Local firms subjected to such pricing may be perceived as being subjected to the same kind of "unfairness" to which the classic predator subjected its local rivals.[38] The sensitivity of the Commission and the courts to the "below cost" aspect of discriminatory pricing, at

competitive-market pricing. However, a firm in a competitive market prices at a profit-maximizing level and, accordingly, has no ulterior motive for its pricing behavior. When those prices are below average total cost, equally efficient firms are encouraged to exit and discouraged from entering. In a competitive market, prices equal to marginal cost but below average total cost are a symptom of industry capacity in excess of the longrun equilibrium level. Entry in such circumstances should be deterred and some existing capacity ought not to be renewed. (Longrun equilibrium occurs when the efficiency and capacity of the industry is such that, given existing demand, no producer has an incentive to enter or to leave the market or to increase or to decrease the size of his plant.)

A monopolist or oligopolist which prices at marginal cost has an ulterior motive which the competitor firm lacks. However, a rule which would permit a firm to price at marginal cost regardless of its motive would embody certain safeguards against the achievement of predatory goals. If marginal cost were rising, a firm would be limited as to the volume it could attain at any given price level, since, at higher sales volumes, price which equalled marginal cost would rise. It would not, therefore, be able to supply the whole market at marginal-cost prices except at the price level indicated by the intersection of its marginal-cost curve with the industry demand curve. And if that level were below average total cost, entry would not seem desirable.

But if a firm's prices which are below marginal cost are presumed lawful unless they fall below average variable cost, a firm might set price below marginal cost without the volume constraint which the former rule would impose. If marginal cost were rising gradually, a firm which initially set price at a (nonoptimum) marginal cost level might expand output substantially at that level, even though its marginal cost continued to rise above it. Areeda and Turner appear to suggest that the anticompetitive potential here is not strong because equally efficient rivals could meet prices which are not below the firm's average variable costs. Entry, however, would be discouraged and exit encouraged so long as prospects in the market were for returns below average total cost. In these circumstances, the discouragement of entry and encouragement of exit can be justified neither on the grounds that the pricing which creates these effects conforms to shortrun-profit-maximization goals nor on the grounds that entry would be a socially wasteful use of resources.

37. A firm will maximize profits (or minimize losses) by selling in those markets in which the excess of revenues over the marginal costs incurred in selling is greatest. Under this criterion, a firm already operating in one market will decide whether to offer its goods in other markets without taking into account fixed cost components of total costs. Accordingly, such a firm may find that it can increase its profits by selling in a market where the best price obtainable does not cover the sum of the incremental costs of selling there plus a pro rata allocation of fixed costs to those sales. *See* note 48 *infra*.

38. *Cf.* Amalgamated Sugar Co., 54 F.T.C. 943, 945 (1958), where the Commission expressed concern that a multimarket seller's local price reductions were "extremely harmful" to "one-unit processors" which sold extensively in the affected local market.

least in some instances, relates to their perceptions of such pricing as posing an "unfair" challenge to local rivals.[39] This sensitivity may also partially explain the reluctance of the Commission and the courts to be more precise about the kind of "below cost" pricing which they have condemned. A price below average total cost is literally "below cost," and pricing which is below the average total cost of rival firms carries a longrun survival challenge to those firms.[40]

Although the classic predator model—at least in its modern versions —may indeed continue to be useful for describing the more blatant examples of discriminatory pricing behavior, it needs to be supplemented with alternative models which describe more subtle aspects of some kinds of nonpredatory pricing. This article attempts to develop one such alternative model. In the model most of the ambiguities which have surrounded the concept of "cost" are clarified, many problems inhering in various forms of "below cost" pricing are identified, and solutions to those problems are proposed.

## III. THE FOCUS AND SCOPE OF THE ROBINSON-PATMAN ACT

The analytical model developed in this article will respect the better strands in the case law's approach to the preservation of "competition" in the marketplace, and the concerns which have been expressed in the case law about "below cost" pricing[41] and its impact upon "competition." Before proceeding further in developing the model, however, clarity will be served by initially focusing upon three elements that enter into determinations of Robinson-Patman legality. These are: (1) the Act's apparent incorporation of a market-structure test for the evaluation of the lawfulness of discrimination; (2) the significance of "strains" upon the survival capacities of a discriminator's rivals which are imposed by the discriminator's pricing; and (3) the causation element contained in the Act. These three elements are all connected with the concept of "competition" as it is employed in the Act and the case law interpreting the Act. These

39. *See* text accompanying notes 81-88 *infra*.

40. Pricing which is below the minimum point of a firm's average total cost curve (calculated to include a normal profit component) would, in a perfectly homogeneous market, encourage the exit of equally efficient firms and discourage the entry of such firms. These effects increase the further price falls below minimum average total cost. These effects are recognized by Areeda and Turner who nonetheless opt for a rule conclusively presuming the lawfulness of above-average-variable-cost pricing. Areeda & Turner, *supra* note 3, at 709, 711, 718, 719. *See* note 36, *supra*. For his analysis of predatory pricing, Koller employs average total cost which is defined to exclude a normal profit component. Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST LAW & ECON. REV. 105, 106 n.3 (1971); Koller, *On the Definition of Predatory Pricing*, 20 ANTITRUST BULL. 329, 332 (1975).

41. The focus upon below-cost, promotional pricing is derived from the cases, which have not always indicated a consciousness of the various meanings of "cost." The article attempts to provide a framework within which the existing case law can evolve in a more economically sophisticated direction. It seeks to accomplish this goal by isolating these aspects of the case law which have been based on sound intuition, and by suggesting where future development should take account of the variety of different "cost" conceptions.

elements, as will be seen, are also relevant to an analysis of the lawfulness, under the Robinson-Patman Act, of various types of "below cost" pricing.

### *A. The Act's Incorporation of a Market-Structure Test*

Section 2(a) does not refer to below-cost prices; it condemns discrimination which has a tendency to lessen competition.[42] Robinson-Patman legality thus turns on the question of the potential market impact of the discriminatory pricing behavior. Predatory discriminatory pricing and all other discriminatory pricing which will tend to move the market structure in a less competitive direction is condemned, regardless of its above-or below-cost aspect. Professor Yamey[43] has insisted that pricing can be predatory even though it is not below the predator's unit costs, because it is the impact on the predator's rivals which is crucial to the success of predatory behavior. If the rivals can be deprived of the profits they need to stay in business, or if they can be subjected to losses which they cannot sustain, then it does not matter whether the predator's pricing that imposed these injuries upon them was above or below its own unit costs. And this article will show[44] that certain types of capital investment will tend to push unit costs above the level of some prices which have a procompetitive impact. In short, the relation of a seller's price to its unit costs does not bear an invariable relation to the market impact of those prices.

### *B. The Relation Between Market-Structure Impact and Strains Imposed Upon the Survival Capacities of Existing Firms*

If price discrimination produces an anticompetitive impact in the market in which the discriminator is operating, it will do so by lessening the number of rivals with which the seller must compete.[45] This decline in the number of discriminator's rivals will occur for either of two reasons. Some rivals may be forced out of business because of losses imposed upon them by the discriminatorily low prices with which they must compete.[46] Other rivals may choose to divert their efforts into other markets whose relative profitability has increased as a result of the discriminator's low pricing in the market which they are leaving.[47]

42. The Act specifically states that discrimination is forbidden "where the effect of such discrimination may be substantially to lessen competition . . . ." 15 U.S.C. § 13(a) (1970).

43. Yamey, *supra* note 17, at 134.

44. *See* text at notes 99-107 & 153-96 *infra*.

45. *See* Dean Milk Co., *supra* note 10, 68 F.T.C. at 750; Borden Co., 64 F.T.C. 534, 569 (1964). *Cf.* Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 263 (1965); Forster Mfg. Co., 62 F.T.C. 852, 904-05 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964).

46. Dean Milk Co., *supra* note 10, 68 F.T.C. at 750; Forster Mfg. Co., 62 F.T.C. 852, 904-05 (1963), *vacated and remanded*, 325 F.2d 47 (1st Cir. 1964). *Cf.* Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 702-03 (1967).

47. A profit-maximizing firm will sell in the several markets in which it is operating at price-volume levels in which net marginal profits in each market are equal. *See* J. ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 181 (1933). Rivals which divert their operations into other, more profitable, markets will remain a competitive force in the original market,

The legality of price discrimination under the Robinson-Patman Act, therefore depends upon the likely impact of the discriminatory prices upon the market structure. In turn, the market-structure impact depends, in part, upon the extent to which local firms are able and willing to withstand a period of discriminatorily low pricing, and the extent to which nonlocal firms operating in the local market find it in their interest to stay in that market. No firm will continue in a market which it can foresee will be unprofitable.[48] To the extent that local or nonlocal rivals of a discriminator choose to continue in that market, it is either because they believe that they can compete and earn profits despite the discriminatorily low prices of the discriminator, or because they believe that those low prices are only a temporary phenomenon and that the longer-range forecast is a relatively bright one. In the latter case their survival capacities are tested. The relevant inquiry is whether these firms can survive subjection to discriminatorily low prices for the period in which those prices are likely to remain in effect.[49]

A proper approach, from a Robinson-Patman perspective, to discriminatory pricing is initially a market-oriented one. First, the discriminatorily low prices should be examined for possible procompetitive effects. This inquiry would examine the purpose of the low prices and, in the process, the time frame in which those prices are intended to continue. Second, an examination should be made of the likely effects of those prices upon the survival, in the local market, of the discriminator's rivals. Here the assessment would take into account the impact of the prices on the rivals' profit margins, their volume and unit costs, and their cash flows, as well as taking into consideration the time period during which the rival firms would probably be subjected to the discriminatory pricing.

An examination of entry pricing provides an illustration of this type of analysis. Entry is normally to be encouraged, because an additional firm is added to a local market. In terms of a somewhat oversimplified "numbers" approach to "competition,"[50] the intensity of competition in a market would normally be said to increase or to decrease as the number of firms in the market increases or decreases. If a period of undercutting is necessary for an entrant to achieve a volume level high enough to sustain permanent entry and thereby to increase the number of sellers in the market, that pricing would appear, on the surface, to be procompetitive. It

---

however, unless they leave that market completely, in which case they may encounter substantial barriers to reentry.

48. *See, e.g.*, J. HENDERSON & R. QUANDT, MICROECONOMIC THEORY 97 (1958). *Cf.* W. VICKREY, MICROSTATICS 194-95 (1964).

49. *See* notes 36 and 40 *supra*.

50. The "numbers" approach measures the intensity of competition solely by counting the number of competing firms. A sophisticated model of competitive relationships which is based upon numbers of firms, but which also makes adjustments for the relative sizes of the rival firms is found in Bishop, *Elasticities, Cross-Elasticities, and Market Relationships*, 42 AM. ECON. REV. 779, 786 (1952).

would appear procompetitive despite the fact that the entrant maintained higher prices elsewhere and that its low entry prices were therefore discriminatory. And it would appear procompetitive even though its low and discriminatory entry prices were "below cost" due to its incurrence of heavy fixed costs.[51]

However, to the extent that the entrant's low prices squeezed or eliminated the profit margins of some or all of the firms already operating in that market, their continuance in that market is made more difficult. If the prices of the entrant are so low as to force some existing firms in that market to operate at a loss, then it would be apparent that an indefinite continuance of those entry prices would force those firms from that market. But entry pricing which is designed to overcome buyer inertia, and thus to persuade buyers to try a new product, is only temporary. Accordingly, an assessment of the impact of this form of entry pricing upon the existing firms requires an inquiry into the projected length of that pricing and the resources and cash flows of the affected firms.[52] To the extent that the undercutting prices are jeopardizing the survival of some of the existing firms, they are threatening to alter the structure of that market in an apparently less competitive direction. But the point is that the proper Robinson-Patman approach is a risk-balancing one. If the entrant is pricing in such a way as to indicate a relatively high probability of successful entry and a relatively low risk of eliminating any of the existing firms, then, on balance, the entrant's discriminatory—and even below-cost—"entry" pricing appears in context to be procompetitive.

Before leaving the subject of the "strains" which discriminatory (and especially below-cost) pricing may place on the survival capacities of the discriminator's rivals, explicit reference ought to be made to the continual testing of survival capacities which is an essential aspect of a competitive market.[53] In a competitive market, firms are tested for efficiency and the less efficient firms are weeded out over the course of time. The concern of the Robinson-Patman Act with discriminatory pricing which tests the survival capacities of rival firms should therefore complement the efficiency-testing of the market. A concern with the efficiency-testing aspects of the market would tend to harmonize the Robinson-Patman Act with the goals of the other antitrust laws. And a consistent antitrust approach demands that the goals of all of the antitrust laws be harmonized as much as

51. *See* text following note 111 *infra*.

52. Cash flows are important because they may determine whether a firm subjected to a temporary period of competition at below-average-cost levels will be able to meet its payments to creditors. Thus, for example, a firm with limited funds which must meet monthly rent payments may be forced out of business when monthly receipts fail to supply funds sufficient to meet those payments. By contrast, a firm which owns its own plant may be able to weather a period of pricing below its own average total costs; its temporary failure to cover its depreciation expense does not place it in default with a creditor.

53. *See* J. Bain, Price Theory 156 (1952). *Cf.* C. Kaysen & D. Turner, Antitrust Policy, An Economic and Legal Analysis 11-13 (1959).

possible.[54] To the extent that the Robinson-Patman Act prevents the elimination of firms from the market for reasons other than their relative inefficiency, it aids in subjecting all firms to that efficiency testing which is an essential part of a competitive economic system.

### *C. The Connection Between the Discrimination and the Impact on Market Structure*

The Robinson-Patman Act does not forbid all pricing which produces anticompetitive tendencies in the marketplace; it only forbids discriminatory pricing which produces those tendencies.[55] The classic predator model, which is closely associated with the Act's approach to primary-line impact,[56] illustrated a causal link between the discrimination as such and the injury to competition. The discriminator's rivals were driven from local markets by the discriminator's low prices, but the discriminator was apparently able to sustain its low prices in those local markets because it recouped its losses or lost profits through the profits which it earned in other markets where it maintained higher prices.[57] Thus, both the high and low prices which constituted the discrimination, were essential parts of the predator's behavior. The low prices caused the harm to its local rivals, and the high prices sustained its ability to maintain the low prices.[58]

It is apparent that a firm may be able to sustain a period of low prices which may jeopardize the continued existence of some of its rivals for reasons other than its discriminatory pricing. Its greater relative efficiency may enable it to earn profits at price levels which fall below the unit costs of its rivals.[59] It may be able to sustain a period of below-cost pricing because it is, in effect, subsidizing its low prices from revenues which it is earning on sales of different products.[60] It may be able to sustain below-cost pricing because of its accumulated wealth.[61] In each of these cases the firm's low prices may have the same impact on the local market. If those low prices seriously jeopardize the continued existence of a substantial number of firms, they may move the market structure in a less competitive direction.

---

54. *See* Automatic Canteen Co. v. FTC, 346 U.S. 61, 74 (1953). *Cf.* Areeda & Turner, *supra* note 3, at 727.

55. *See, e.g.*, Commissioner Elman, dissenting, in Dean Milk Co., *supra* note 10, 68 F.T.C. at 808-09. *Cf.* Forster Mfg. Co. v. FTC, 335 F.2d 47, 53 (1st Cir. 1964). Nondiscriminatory pricing which produces anticompetitive tendencies in market structure might violate section 5 of the Federal Trade Commission Act. The extent to which such pricing would violate section 2 of the Sherman Act is unclear. *See* Cooper, *Attempts and Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two*, 72 MICH. L. REV. 373, 435-40 (1974). *Cf.* Areeda & Turner, *supra* note 3, at 727.

56. For a definition of the term "primary line cases" see note 13 *supra*.

57. H.R. REP. No. 627, 63d Cong., 2d Sess. 8-9 (1914).

58. *See* cases cited in note 26 *supra*.

59. *See, e.g.*, Report of the Attorney General's National Committee to Study the Antitrust Laws 323 (1955).

60. *See* Commissioner Elman's dissent in Dean Milk Co., 68 F.T.C. 710, 808-09 (1965).

61. *Cf.* Commissioner Elman, dissenting, in National Dairy, *supra* note 7, 71 F.T.C. at 1454.

But this kind of anticompetitive impact does not fall under the ban of the Robinson-Patman Act.[62] The Act condemns only anticompetitive pricing which is part of a discriminatory pricing scheme.

Moreover, even when discriminatory pricing exists, the Act may not apply unless the discriminatorily low prices are supported in some way by higher prices. There must be a causal connection between the firm's ability to maintain its low prices in one market and the higher prices it charges in other markets.[63] The factors relevant to drawing an inference of this causal connection are discussed in Part C of Section IV.[64]

## IV. BELOW-COST PRICING

This section will explore the relevance of "below cost"[65] pricing to Robinson-Patman legality by isolating several ways in which "below cost" pricing relates to the Robinson-Patman Act's concern with preserving competition in the marketplace. This examination is a necessary preliminary to the development of the analytical model for examining below-cost pricing which begins in Section V.

The "below cost" aspect of a seller's prices has been thought to be relevant to an assessment of their legality under the Robinson-Patman Act in any one of three ways: (1) below-cost pricing may be indicative of pricing which is not immediately profit-maximizing and is therefore directed towards achieving longer-term goals, one or more of which may be inconsistent with the preservation of at least the present degree of competition in the local marketplace; (2) below-cost pricing which is not justified by immediate profit-maximizing considerations may be thought to be placing an "unfair" burden on rival firms; and (3) below-cost pricing is relevant to the question of Robinson-Patman causation.

### A. *Below-Cost Pricing as an Indicator of Nonimmediate Goals*

Pricing which is not immediately profit-maximizing (or loss-minimizing) is probably directed toward the achievement of longer-term goals. The seller's longer-term goals might be: (I) to achieve a less vigorously competitive marketplace in which the seller could extract supracompetitive profits;[66] (2) to seek increased buyer acceptance of its product by encouraging buyers to acquaint themselves with the product's virtues through temporary price reductions;[67] or (3) to attempt to attain the

62. *See* Forster Mfg. Co., 62 F.T.C. 852, 893 & n.13 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964), *cert. denied*, 380 U.S. 906 (1965); *see also* note 55 *supra*.

63. *See* text accompanying notes 26 *supra* and 89-98 *infra*. *See also* note 55 *supra*.

64. *See* text accompanying notes 89-98 *infra*.

65. The descriptive term "below cost" is ambiguous because of the various meanings attached to the term "cost." *See* text accompanying note 31 *supra*.

66. *See, e.g.*, H.R. REP. No. 627, 63d Cong., 2d Sess. 8 (1914).

67. *See* Cooper. *supra* note 55, at 437; Areeda & Turner, *supra* note 3, at 713; Beatrice Foods Co., 67 F.T.C. 473, 723 (1965), *modified and aff'd*, 1967 Trade Cas. ¶ 72,124 (9th Cir. 1967); National Dairy, *supra* note 7, 71 F.T.C. at 1444 (Elman, dissenting).

volume which will enable it to lower its unit costs.[68] The goal described in (1) is a predatory one and cannot be employed as a justification for discriminatory pricing.[69] Standards for evaluating pricing designed to further goals (2) and (3) are developed in Sections VI and VII of this article.[70]

This approach of inquiring about the goal of a seller which is pricing at a level below that of immediate profit maximization is a valid one. But it requires, for its application, that pricing which is below immediate profit-maximizing levels be identifiable. The question, therefore, is whether and the extent to which pricing which is below those levels can be identified by the fact that it is also "below cost" in one of the various meanings of "cost." Pricing which is below a seller's current supply cost is not immediately profit-maximizing. It is possible, however, that it has other than a predatory motive for such pricing. It may desire to acquaint buyers with its product, and it believes that a price below its own supply costs is necessary to overcome strong buyer inertia. This reason, while not consistent with immediate profit-maximizing, is arguably consistent with profit-maximizing in the short run.[71] The tests for evaluating the validity of this purported justification are developed in Parts VI and VII.[72] However, it should be recognized that pricing which is below supply cost seems to have only limited bases for defense. Selling each unit for less than the seller paid for the unit appears inconsistent with shortrun goals and normally indicates that the seller is pursuing a predatory goal. Thus, the burden of proving that below-supply cost pricing is not intended to achieve a predatory goal should be placed on the discriminator. Prices which are above a discriminating seller's supply costs but below its marginal costs are similarly suspect, because at such prices the seller is increasing its losses with each additional sale.[73] In such circumstances, its behavior appears

68. Adelman, *The A&P Case: A Study in Applied Economic Theory*, 63 Q.J. ECON. 238 (1949); Cooper, *supra* note 55, at 437. *See also* Areeda & Turner, *supra* note 3, at 715. *Compare* Old Homestead Bread Co., *supra* note 7, at 101, *with* United Fruit Co., 82 F.T.C. 53, 151-52 (1973), *aff'd in part and rev'd in part*, 499 F.2d 395 (5th Cir. 1974). *See also* Ben Hur Coal Co. v. Wells, 242 F.2d 481, 484, 485 (10th Cir. 1957).

69. Although the goal described in (1), without more, is a predatory one, additional factors can complicate the case. Suppose, for example, that the seller is seeking a sales base expansion which would both give it additional market power and lower unit costs. In addition, suppose that the seller's market power would be exercised to give it supracompetitive profits, but at a price level lower than that which had previously prevailed. The relevance of such behavior to the Robinson-Patman Act is discussed in the text accompanying notes 153-96 *infra*.

70. *See* text accompanying notes 137-96 *infra*.

71. The distinction between immediate profit-maximizing and profit-maximizing in a shortrun period is discussed at note 77 *infra*.

72. *See* text accompanying notes 137-96 *infra*.

73. A seller seeking to maximize its shortrun profits is more likely to engage in below cost pricing which is above rather than below marginal cost. Below-cost pricing which exceeds marginal cost will, at least, decrease the seller's net loss with each additional sale. While it is possible that below-marginal-cost pricing may, in some instances, be designed to increase shortrun profits—as when it is used as a promotional device to encourage buyers to acquaint

superficially to be contrary to its shortrun interest and raises an inference that it is designed to achieve a longrun, predatory goal. In cases in which it is established that a discriminator is selling at below-marginal-cost prices, the discriminator should also bear the burden of showing that the prices were not designed to achieve a predatory goal.[74]

Pricing which is above marginal cost but below average total cost may or may not be predatory.[75] A number of cases, however, have drawn adverse inferences from a discriminator's undercutting existing firms with a below-average-total-cost price.[76] There are times when a firm in a purely competitive market will price at a level below its average total costs—for example, when market price has fallen to a level below the firm's total costs. It is, therefore, generally incorrect to equate below-average-total-

themselves with the product—those instances are unusual ones. In light of below-marginal-cost-pricing's potential for creating anticompetitive effects, sellers employing such pricing should bear the burden of establishing their procompetitive purpose when their prices are challenged under section 2(a). Areeda and Turner would conclusively presume the illegality of below-marginal-cost pricing by a monopolist, except when such pricing exceeds average variable cost. Areeda & Turner, *supra* note 3, at 713, 718.

74. *See* note 73 *supra*.

75. Pricing which is below average cost but equal to marginal cost can be expected from a firm seeking shortrun loss minimization in a competitive market during a period in which the number of firms exceeds that required for longrun equilibrium. While a firm which is pricing above shortrun marginal cost would seem to possess some power over price, it might find that pricing at a level below its average cost, but above its marginal cost would minimize its losses during a period in which more sellers were active in the market than longrun equilibrium would support. Sueh pricing might also be employed in promotional campaigns designed to acquaint new buyers with the seller's product. Below average cost pricing for promotional purposes is less suspect than below marginal-cost pricing, because the latter increases the seller's aggregate losses as the selling campaign succeeds. *See* notes 36 and 73 *supra*. Pricing which is below average cost but above marginal cost can be consistent with shortrun profit maximization for a prospering firm so long as it is confined to less than all of a seller's markets. *See* J. ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 183 (1933) (analysis showing profits when average cost is below aggregate average revenue but not necessarily below average revenue for each market). *See also* M. ADELMAN, A&P: A STUDY IN PRICE-COST BEHAVIOR AND PUBLIC POLICY 143-47 (1959); Gifford, *Price Discrimination and Labelling*, 25 BUFFALO L. REV. 395, 405-08 (1976). Koller would exclude from the definition of predatory prices all prices above average total cost and would rely upon subjective intent to determine which below-average-total-cost prices are not predatory. *See* Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST LAW & ECON. REV. 105, 106-07 (1971); Koller, *On the Definition of Predatory Pricing*, 20 ANTITRUST BULL. 329, 332 (1975). Yamey would even consider some above cost prices to be predatory, depending upon the seller's intent. Yamey, *supra* note 17, at 134. Areeda and Turner would primarily employ the criterion of whether price exceeds marginal cost to differentiate predatory from nonpredatory pricing. Areeda & Turner, *supra* note 3, at 697-700.

76. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 697, 698, 701, 702 n.14 (1967); Old Homestead Bread Co., *supra* note 7, at 104; National Dairy, *supra* note 7, 412 F.2d at 611; United States v. New York Great A&P Tea Co., 173 F.2d 79, 87 (7th Cir. 1949); Porto Rican Am. Tobacco Co. v. American Tobacco Co., 30 F.2d 234, 236, 237 (2d Cir.), *cert. denied*, 279 U.S. 858 (1929); Dean Milk Co., *supra* note 10, 68 F.T.C. at 771, 774, 775; Borden Co., 64 F.T.C. 534, 566-68 (1964), 339 F.2d 953 (7th Cir. 1964); Forster Mfg. Co., 62 F.T.C. 852, 893 n.13, 905 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964), *cert. denied*, 380 U.S. 906 (1965). *See also* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 552 (1960); Ben Hur Coal Co. v. Wells, 242 F.2d 481, 486 (10th Cir. 1957); E.B. Muller & Co. v. FTC, 142 F.2d 511, 516-17 (6th Cir. 1944).

cost prices with anticompetitive behavior. Yet it would be doing an injustice to the courts and the Commission to dismiss their approach out-of-hand. Their errors ought to be identified and rejected, but the extent to which they correctly intuited uneconomic pricing ought to be explored.

The courts and the Commission have sometimes drawn adverse inferences from a discriminator's undercutting a prevailing price at levels below the discriminator's average-total-costs. These tribunals apparently thought that the prior profitable operations of the existing firms indicated that the price cutter could have sold its goods in the local market at a price which would have earned it a profit. Or they may have thought that its below-cost undercutting could not be justified on immediate profit-maximizing grounds. In brief, those tribunals probably thought that if it was possible to sell in a local market at a profit, selling there at a loss suggested an ulterior motive—a desire to achieve a goal other than immediate profit maximization. From there, these tribunals jumped to the conclusion that the longer-term goal sought was a less competitive marketplace. The strand of truth in these cases lies in their discernment that conduct which is inexplicable on immediate goals is probably activated by a longer-range goal. Their errors, however, were of two kinds. Their first error was their apparent unawareness that pricing which could not be explained in terms of immediate profit-maximizing might nonetheless be explained by profit-maximizing in a shortrun period.[77] Their second—not altogether unrelated—error was their inability to see any longer-range goal other than an anticompetitive restructuring of the marketplace.[78]

This article will not challenge the proposition that the below-average-total-cost aspect of pricing may, in some limited and identifiable circumstances, indicate that a seller is pursuing a goal other than immediate profit maximization or loss minimization. Nor will it develop universally applicable criteria for assessing when pricing which is above marginal cost may be predatory. It will, however, attempt to clarify reasons why pricing which is below-average-total cost may be explainable in terms of shortrun profit maximization.[79] It will also attempt to assess the lawfulness of

77. The distinction in the text is between immediate profit-maximizing and profit-maximizing in a period which—while occurring within the shortrun—nevertheless possesses some temporal extension. An entry situation might serve as an example. An entering firm might price below the level indicated by the intersection of its present marginal revenue curve in the new market and its marginal cost curve in order to entice reluctant buyers to acquaint themselves with its product. If successful, that pricing technique might raise demand for its product in the new market and thereby increase total profits from that market, as measured over a period of several months, over the profits which would have been earned if the pricing had been at the optimum point on a static demand curve.

78. Present profit sacrifices may be made in order to increase future demand within a shortrun period, and thereby increase profits. *See* note 77 *supra*. Present profit sacrifices might also be made in order to attain the volume necessary to lower unit costs. *See* text accompanying notes 99-136 *infra*.

79. *See* text accompanying notes 99-196 *infra*. *See also* note 77 *supra* and accompanying text.

below-average-total-cost pricing which is designed to achieve a longer-term goal.[80]

### B. *Below-Cost Pricing as Placing an Unfair Burden on Rivals*

The assumption which underlies the fairness approach to an evaluation of below-cost pricing is that normative standards are derived from the competitive-market model.[81] Firms in a competitive market will price in accordance with shortrun profit-maximization or loss-minimization criteria. Under an approach which draws behavior standards from a competitive market model, such pricing would be deemed "fair" as would the burdens such pricing would impose on rival firms. Thus even when shortrun profit-maximizing prices jeopardized the survival of some rivals and, in so doing, threatened to increase the level of local market concentration, the behavior which brought about that result would not be deemed objectionable under a pure fairness approach. Moreover, because the increased level of concentration in the local market would be caused by a process consistent with the operation of a competitive market, this consequence would also be found tolerable. But non-shortrun profit-maximizing or loss-minimizing pricing is considered deviant behavior.[82] Under the fairness approach, therefore, the burdens or strains to which rival firms are exposed by such pricing are deemed unfair. When such pricing threatens to reduce significantly the number of sellers in the local market, neither the pricing nor the change in market structure produced by this deviant pricing can be justified by normative standards derived from the competitive-market model. Under the fairness approach, therefore, such pricing, when discriminatory, ought to fall within the scope of the Act's prohibition.[83]

However, a question arises as to the extent to which various kinds of below-cost pricing can be equated with—or are indicative of—non-shortrun profit-maximizing or non-shortrun loss-minimizing behavior. Certain types of pricing are not likely to be profit-maximizing or loss-minimizing in the short run. Such prices would include prices below a seller's supply costs and prices below a seller's marginal costs. Prices which are merely below average total cost may or may not be loss-

80. The longer-term goals referred to in the text include goals which are attainable in conjunction with market-structure changes and which may, therefore, occur within a technically longrun period.

81. *See* Commissioner Elman's dissent in National Dairy, *supra* note 7, 71 F.T.C. at 1443-44 & n.1. *Cf.* C. KAYSEN & D. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS 8 (1959); W. VICKREY, MICROSTATICS 221 (1964).

82. *Cf.* Areeda & Turner, *supra* note 3, at 703.

83. The perspective is from the standpoint of "fairness," and "fairness" is defined by a set of norms drawn from the competitive-market model. When non-shortrun-profit-maximizing discriminatory pricing produces the prohibited results, it has done so by casting an "unfair" burden on its rivals. The "fairness" perspective permeates the 1914 House Committee Report and former Commissioner Elman's view of anticompetitive discriminatory pricing. *See* H.R. REP. NO. 627, 63d Cong., 2d Sess. 8-9 (1914); Dean Milk Co., *supra* note 10, 68 F.T.C. at 799, 803, 808 (Elman, dissenting).

minimizing. If they are loss-minimizing, then the strains which such pricing places upon rivals are justified by competitive-market norms and are part of the process by which the market eliminates capacity which is in excess of what will be required in longrun equilibrium.

But below-average-cost prices which are not loss-minimizing may subject rival firms to strains which are not justified by competitive-market norms and which are not part of a market readjustment expected from a competitive process. Indeed, the strains engendered by below-average-total-cost prices which are below minimum average total cost[84] will—if carried on indefinitely—tend to drive out of the market equally efficient rival firms. From a fairness perspective—in which fairness is equated with competitive-market norms—such pricing should be condemned. A condemnation of below-average-total-cost pricing which is not loss-minimizing is also consistent with the tenets of the Robinson-Patman Act in two situations: when such pricing is likely to cause a large enough reduction in the number of firms to increase significantly the degree of consciously recognized interdependence in pricing by the remaining firms; or when such pricing is likely to eliminate firms from the market which are more efficient than, or as efficient as, the price cutter.[85]

The "fairness" perspective raises a further problem, however, by identifying non-shortrun profit-maximizing and non-shortrun loss-minimizing pricing as unfair. A prospering multimarket seller could sometimes find that its shortrun profits would be maximized if it prices below average cost in one or more (but less than all) of the markets in which it sells, and maintains those prices indefinitely.[86] Local firms confined to a single market, however, could not maintain prices below their own average costs indefinitely. So described, the local prices of the multimarket seller appear superficially to burden the local firms unfairly. Indeed, the Com-

84. Prices which are above the minimum point of a firm's average cost curve—even if below average cost at the actual point of production—can potentially be met by equally efficient firms unless the market demand is small in relation to the scale economies available to a single firm. In a case in which a single firm experiences an average cost curve which continuously declines to the point at which it intersects with the industry demand curve, socially efficient production would be accomplished by concentrating all production in that firm.

85. The tendency to lessen competition to which section 2(a) refers could be taken to mean an increase in the degree of oligopolistic interdependence, and might be taken to include a forced exit of firms whose efficiences would, or might have, guaranteed their survival in a struggle carried on according to competitive-market norms.

86. The case posed is one in which a firm is selling in several markets at varying prices, each of which is profit-maximizing in the market in which it applies. Thus, if selling and transportation costs are ignored, a firm would price in each market at the level indicated by the intersection of its marginal revenue curve for that market and its marginal costs. *See, e.g.*, J. ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 181 (1933). In such a way it is maximizing its shortrun profits. It is also possible that in one or more of those markets, its selling price is below its average cost. Although a single-market firm could not continue to operate for a longrun period at a price level which was continuously below its average total cost, a multimarket seller, in the situation described, could do so and would thereby continuously maximize its profits.

mission has given numerous indications that it considers the maintenance of below-average-cost prices by a multimarket discriminator to unfairly burden local firms. But at this point the standard of "fairness" is no longer being derived from profit-maximizing behavior expectations, since—as noted above—a multimarket seller could find that its profits are maximized by prolonged below-cost pricing in one market. It would be attractive, therefore, for purposes of evaluating the conduct of a multimarket seller, to adopt a view of "fair" market behavior which diverges from profit-maximizing behavior. Such a modification of the fairness perspective would be based in part upon the judgment that all markets ought to make proportionate contributions to a seller's fixed costs.

The model developed in the present article approaches price discrimination from a perspective other than that of "fairness." As the article proceeds, it will nonetheless attempt to identify the major times when below-average-cost pricing is explainable in terms of shortrun profit maximization. Moreover, the article will suggest that a proportionality test be applied to assess the impact of below-average-total-cost pricing.[87] A proportionality approach is not identical to an approach which would separately assess the "fairness" of each instance of below-average-total-cost pricing, but the results of the two approaches may largely coincide. The end-result test developed in Sections VII and VIII may depart substantially from the demands of a fairness approach, however.[88]

### C. *Below-Cost Pricing and Robinson-Patman Act Causation*

The below-cost aspect of pricing is perhaps more relevant to the Robinson-Patman causation question than to its potential impact on market structure.[89] As long as a seller's current local-market prices are not producing an anticompetitive impact on the local market, the causation question need not be addressed. When its local market prices are producing such an impact, however, the question of whether the Robinson-Patman Act applies to that pricing arises. As noted above,[90] the Act will not apply, even to pricing which is producing an anticompetitive impact, unless that pricing is also discriminatory. But the Act requires more than discriminatory pricing accompanied by an anticompetitive effect; it requires that the discrimination itself produce the anticompetitive effect. In other words, it requires that the low prices which are threatening to produce anticompeti-

87. *See* text accompanying notes 141-42 *infra*. *Cf.* text accompanying notes 119-25 *infra*.

88. *See* text accompanying notes 153-223 *infra*.

89. Prices below a seller's supply cost, below its marginal cost, or below its variable cost should raise an inference of illegality for reasons previously discussed. Prices below a seller's minimum average total cost may exert a longrun effect on market structure to the extent that those prices are below the average total costs of actual or potential rivals. But the line separating prices which are above from those which are below average total cost may be important to an assessment of Robinson-Patman causation, regardless of whether those prices are below the average total costs of actual or potential rivals.

90. *See* text accompanying note 55 *supra*.

tive alterations in the market structure be supported by the high prices which the firm is charging for the same product in other markets.[91] This question of support arises when a firm is pricing at a level below its own average total cost. Such prices can be maintained for a time, but they cannot be maintained indefinitely in all markets in which the firm is operating.

The significance of below-average-total-cost prices, therefore, lies in their relation to the causation question. If anticompetitive effects are produced by discriminatory pricing which is at a below-cost level, the source of the discriminating firm's ability to sustain such pricing must be discovered. Since below-cost prices do not generate sufficient revenues to be self-supporting, they must be supported from other sources. Some sources of sustenance fail to satisfy the Robinson-Patman Act's causation requirement. The Robinson-Patman Act's prohibition is a limited one. Below-cost pricing which is producing anticompetitive effects, but which is sustained by accumulated wealth, debt or earnings from the sales of different products is not forbidden by the Act, because the anticompetitive effects produced by that below-cost pricing are not connected to the price discrimination.[92] If, however, these loss-incurring prices of the firm in question are sustained by offsetting earnings from other—higher-priced—sales of the same grade and quality products, then the Robinson-Patman Act's causation requirement appears to have been met.

This latter form of causal statement, however, is not extremely helpful in assessing actual cases of discrimination because it does not yet contain criteria for determining when loss-incurring prices should be deemed "sustained" by offsetting earnings from higher-priced sales of the same kind of products. Many times a firm will find itself selling goods below cost for a short period and will be able to cover its average costs out of revenues generated before or after the temporary period of below-cost selling because of its accumulated wealth or because of revenues which it earns from the sale of unlike products.[93] In all of these cases the firm may be selling like products at a higher price in other markets and so be discriminating, but the revenues generated by the discriminatorily high prices may be unnecessary to the firm's ability to maintain its low and below-cost prices.

As the literature on proximate cause illustrates,[94] the attribution of causal connections between events is a matter which possesses a degree of inherent flexibility. The flexibility lies in the process by which some necessary, or unnecessary but supporting, conditions are selected as properly "causal" factors. In approaching Robinson-Patman causation,

91. *See* cases cited in note 26 *supra*.
92. *See* Commissioner Elman's dissent in Dean Milk Co., *supra* note 10, 68 F.T.C. at 808-09.
93. *Cf.* Commissioner Elman's dissent, in National Dairy, *supra* note 7, 71 F.T.C. at 1454.
94. *See* note 97 *infra*.

therefore, explicit recognition should be given to policy considerations in selecting factors as causal ones. If a discriminatory, below-cost price cutter is not easily differentiable from its rivals in terms of financial strength or other sources of income—or if the kind of pricing behavior in which it is engaging is behavior in which the rivals could engage as well[95]—then no causal connection ought to be drawn connecting the price cutter's low prices with its high ones. The point of this suggestion is to provide some scope for the rough and tumble of the marketplace. The law should not intervene in routine and expected jockeying for customers. Price cutting which is not extraordinary in terms of its depth or length of time and which its rivals could themselves routinely sustain ought not, therefore, to be suspect.

However, if the period in which a price cutter offers below-cost prices in a local market is long enough, or the price cuts deeply enough, or both, so as to threaten the abilities of the rivals to replicate the price cuts, then the financial position of the pricecutter appears to be significantly different from its rivals. In this case a closer examination of that pricing may be called for, and a search should be made for the source of the price cutter's ability to maintain below-average-total-cost prices.[96] Such a search will often disclose various sources of financial support, not all of which will be earnings from discriminatorily high prices. In such cases, therefore, there will be no "but for" causal connection[97] between the discrimination and the anticompetitive effects of the low prices; the earnings from the higher prices will contribute to the discriminator's ability to sustain the low prices, but they will not be necessary to that ability. The cases under discussion, then, are categorized by two considerations: (1) all, or substantial parts, of the price cutter's losses are offset by earnings from sales of the same type of commodity in other markets; (2) the price cutter's ability to bear the losses in question is assured in any event (and without the earnings described in (1)) by (a) the price cutter's accumulated wealth, or by (b) the price cutter's receipts from the sales of unlike commodities. In these cases the earnings from sales of like commodities contribute to the price cutter's financial

95. Areeda and Turner state that "predation cannot be successful, and therefore is unlikely to occur, when the predator's rivals possess resources comparable to his own." Areeda & Turner, *supra* note 3, at 698. Strictly, the success of predation turns upon two factors: (1) the marginal net profitability to each of the predator's rivals of diverting operations into other markets after adjustments are made for entry costs and for sunk investment in the market affected by the predatory prices; and (2) the barriers which other firms would confront in attempting to enter the market affected by the predatory prices.

96. The search must be made in order to discover whether the below-cost prices are being sustained by revenues generated by a discriminatory pricing structure and hence fall within the potential scope of section 2(a), or whether they are being financed solely by other means and hence fall outside the scope of section 2(a).

97. The revenue generated by the high prices is thus not a necessary condition of the seller's ability to sustain itself during a period of below-cost prices, but it may be an "additional cause" which contributes to its ability to sustain itself. *Cf.* H.L.A. HART & A. HONORÉ, CAUSATION IN THE LAW, 116-17, 216-25 (1959).

strength. To the extent that the firm's financial strength from elements (a) and (b) exceeds the financial strengths of its several rivals from similar sources, the firm's below-cost pricing cannot be replicated by those rivals and is, under our hypothesis, jeopardizing both their survival and the present degree of competition in the marketplace. Although the firm could, by virtue of elements (a) and (b), engage in local below-cost pricing, that firm's discriminatorily higher prices in other markets contribute to its financial strength and thus contribute to its ability to sustain its below-cost pricing. In such circumstances, the connection between the price discrimination and the firm's ability to engage in this loss-incurring pricing ought not to be ignored.[98]

## V. THE INTERACTION OF BELOW-COST SELLING AND SALES VOLUME

In Section IV the relevance to Robinson-Patman lawfulness of "below cost" discriminatorily low pricing was explored. In this section the inquiry into below-cost pricing will be carried further. Here the connection between below-cost pricing and sales volume will be examined. In the process, several relationships between price and average cost will be identified. The identification of these relationships will assist in the later process of evaluating, for Robinson-Patman Act purposes, several kinds of below-cost pricing.

Twenty-eight years ago Professor Adelman[99] defended the Great Atlantic & Pacific Tea Company's pricing practices, which had been condemned by the courts as violative of the Sherman Act.[100] The court proceedings had characterized as improper A & P's below-cost pricing in certain markets in which it operated.[101] The official interpretation of this practice was that the below-cost operations were being "subsidized" by A & P's profit-making operations in other markets.[102] Adelman's defense of A & P's below-cost pricing asserted that the below-cost aspect was only temporary. Present low prices were below cost only because volume was initially small. Those low prices were designed to create a higher volume of sales. Once the higher volumes were attained, economies of scale would ensure that unit costs would fall below those prices.[103]

98. *Id.*

99. Adelman, *The A&P Case: A Study in Applied Economic Theory*, 63 Q.J. ECON. 238 (1949).

100. *See* United States v. New York Great A&P Tea Co., 67 F. Supp. 626 (E.D. Ill. 1946), *aff'd*, 173 F.2d 79 (7th Cir. 1949).

101. *See* United States v. New York Great A&P Tea Co., 67 F. Supp. at 639-43, 664-71 (E.D. Ill. 1946).

102. The court believed that retail losses in particular geographic areas were subsidized by earnings from other areas and especially from nonretail earnings. *See id.* at 641. A&P's wholesale earnings (from its ACCO subsidiary) were the court's principal basis for finding that an illegal subsidy tainted A&P's retail operations. *Id.* at 663, 678.

103. *See* Adelman, *The A&P Case: A Study in Applied Economic Theory*, 63 Q.J. ECON. 238, 240 (1949). *See also* United States v. New York Great A&P Tea Co., 67 F. Supp. at 671;

The A & P operations, which Adelman was defending, were retail selling operations by a chain store organization which was partially vertically integrated.[104] The particular operations defended by Adelman, therefore, were different from many promotional pricing cases which involve producers whose goods reach ultimate consumers only through independent dealers. Yet Adelman's analysis is sufficiently broad in its scope to reach firms selling at other than retail levels. This section will use an elaboration of the Adelman analysis to evaluate Robinson-Patman Act approaches to below-cost selling by a firm attempting to expand its sales volume in a particular market. Adelman's firm, which engages in below-cost selling in order to create the volume necessary to bring its costs down to a level below its (declining) unit costs, may be either a firm already operating in the local market, as he visualized, or it may be a firm attempting entry into that market. In either event, the firm's below-cost selling is indicative of an attempt on its part to expand its sales in that market from its present volume, in the case of the preexisting firm, or from nothing, in the case of the new entrant. Part A of this section will develop three ways in which certain kinds of price cutting can be conceptualized. With these concepts as a basis, the relation between below-cost selling and a firm's attempts to increase its sales volume will be analyzed in the context of the Robinson-Patman Act.

### A. *Three Factors Relevant to an Analysis of Price-Cutting and Price-Cost Relationships*

To describe the three ways of conceptualizing price cutting, it is convenient to examine the case of a new entrant to the field. The matters raised in this examination are also relevant to an understanding of the pricing behavior of an existing firm attempting to expand in the manner described by Adelman.[105]

#### 1. START-UP COSTS: FACTOR 1

A new entrant might incur certain "starting up" costs, such as the acquisition of a plant, the formation of a production and sales force, and the institution of an advertising campaign extolling the virtues of its products. To the extent that the incurrence of these expenditures would be necessary to bring about a satisfactorily high level of sales in the local market, it

Old Homestead Bread Co., *supra* note 7, at 104; United Fruit Co., 82 F.T.C. 53, 151-54 (1973). *Cf.* Cooper, *Attempts and Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two*, 72 MICH. L. REV. 375, 437 (1974).

104. A firm is fully vertically integrated when it has united all of the functions in the production-distribution chain. A&P was partially vertically integrated because it had united wholesale and retail operations and some manufacturing operations. *See* M. ADELMAN, A&P: A STUDY IN PRICE-COST BEHAVIOR AND PUBLIC POLICY 248-96, 338-40 (1959).

105. *See* text accompanying notes 126-36 *infra*.

would be likely that, for an initial period, sales revenues from that market would fall below the firm's expenditures in that market. Even when the start-up costs are properly distributed on the firm's books over several accounting periods, it would be likely that for a time sales revenues would be less than the firm's costs attributable to these initial periods. This is, of course, another way of stating that the firm's prices during these initial periods will be below unit costs. This reason for unit cost exceeding price will, in subsequent discussion, be referred to as factor 1.

### 2. TEMPORARY PROMOTIONAL PRICE CUTTING: FACTOR 2

The new entrant might find it necessary or desirable to undercut the prevailing market price in the local market which it is entering in an attempt to achieve a wide acceptance of its product among buyers in that market.[106] This undercutting would exacerbate the relationships between its selling prices and its unit costs during the early periods of its entry. Price would be below unit cost, not only because of the incurrence of start-up costs, but also because selling price had been reduced to a temporary "promotional" level in order to encourage buyer acceptance. The extent to which price, during an initial "promotion" period, is reduced below the "normal" or longrun level which the firm plans to establish in the new market will, in the subsequent discussion, be referred to as factor 2.

### 3. PERMANENT PRICE CUTTING: FACTOR 3

Suppose that a new entrant was attempting to reach a price-volume-cost relationship in the new market which would permit it permanently to undercut the prices presently prevailing in the local market. In such a case its low, undercutting prices would not be raised after an initial promotion period. Such a firm may be attempting to achieve an efficiency level which exceeds that of the existing firms operating in the local market. Its prices, accordingly, may be designed to stimulate a substantial sales volume which will permit the firm to operate at an optimum level on a cost curve with a low point below that of its rivals.[107] The extent to which a firm is attempting to achieve a favorable unit cost position in a new market by seeking volume sales through permanent undercutting of the prevailing prices in that market will be referred to as factor 3. Factor 3 pricing was the behavior with which Adelman was concerned in his defense of the A & P pricing practices.

106. *See, e.g.*, the discussion of temporary price-cutting in order to achieve buyer acceptance in Commissioner Elman's dissent, in National Dairy, *supra* note 7, 71 F.T.C. at 1452, 1454.

107. *Cf.* Old Homestead Bread Co., *supra* note 7, at 101; United Fruit Co., 82 F.T.C. 53, 151-52 (1973), *aff'd in part and rev'd in part sub nom.*, Harbor Banana Distrib., Inc. v. FTC, 499 F.2d 395 (5th Cir. 1974); Ben Hur Coal Co. v. Wells, 242 F.2d 481, 484-85 (10th Cir. 1957).

### *B. The Relationship Between Below-Cost Pricing and the Robinson-Patman Act*

#### 1. NEW ENTRANT PRICING

*a. The interrelation of the three factors*

Any new entrant is likely to be selling at below-cost prices for a time. The reason may be fully explicable in terms of factor 1. Below-cost prices which also involve factor-2 temporary price reductions may present a misleading relation to unit costs. The below-cost aspect of these prices may be due solely, or largely, to factor 1. That is, the temporary reductions (below the firm's planned longrun prices) may be to a level which is only temporarily below-cost due to the extraordinarily high factor-1 costs which the entrant experiences in the initial stages of entry. Indeed, this might sometimes be shown by comparing the entrant's prices with the unit costs of established firms employing comparable production and distribution methods. The latter might be able to undercut the prevailing market price level by the same amount without selling below cost. An entrant's prices may therefore be below cost only because of factor-1 start-up costs are added to the factor-2 promotional price cuts.

The significance of a temporary (factor-2) component of a price reduction is, however, a somewhat complex matter. Factor 2 has been defined as the difference between a firm's planned longrun prices and its prices during an initial period, because it is this difference which constitutes the temporary challenge to existing rival firms. It is this difference which may challenge their staying power[108] in a way which is not related to their production and distribution efficiencies. If the entrant's planned longrun prices will be at the level of prices presently prevailing among its major rivals in the new market, then its own temporary price reductions are reductions from a prevailing market price and ought to be judged no more harshly than would equivalent temporary "promotional" reductions by one of those rival firms. No reason is apparent why harm to rival firms would be greater. From a Robinson-Patman perspective, the challenge to rival firms from one firm's temporary price reduction is directed solely to

108. "Staying power" refers to the willingness and ability of a firm to weather a temporary period of low-price competition. When a seller drops its price to a below-average-total-cost level, it is forcing equally efficient rivals to price at levels which they cannot maintain indefinitely. These rivals would leave the market if they did not expect that price would eventually rise to a level which would allow normal returns on investment. But even though such firms did expect prices eventually to rise, they must, during the interim, meet the claims of their creditors as they become due and obtain financing for capital replacement. Their ability and willingness to meet these claims, then, is their staying power.

It will be observed that factor-3 pricing places an entirely different challenge upon existing firms. The challenge of factor-3 pricing is to attain longrun efficiency. Access to financing to meet the claims of creditors during a period of temporary imbalance between revenues and outlays will not, in itself, suffice to meet the factor-3 challenge.

their abilities to survive this temporary inroad upon the existing price structure. This type of challenge to survival is not the kind which is decided on the basis of relative efficiencies, and to which all firms in a competitive market must expose themselves. However, the challenge is limited in time,[109] and, at worst, tests the firms' abilities to meet their obligations during that time. The fact that the entrant's temporary reduction occurs in a context in which its own new capital expenditures produce temporarily high unit costs does not increase the impact of the reduction on the rival firms.

Sometimes an inference of predatory intent is drawn from below-cost pricing.[110] Below-average-cost pricing, however, is not necessarily predatory. Indeed, at times shortrun profit-maximization goals may impel a prospering firm to price below cost in some of the markets in which it is selling.[111] Moreover in the entry circumstances being discussed, below-cost pricing caused by factor 1, in the absence of factors 2 and 3, does not create any inference of predatory behavior. The presence of factor 1 alone does not entail any undercutting of the prevailing market price and, therefore, does not pose a challenge to existing firms. This analysis also suggests that below-cost pricing by an entrant caused by a combination of factor-1 effects and factor-2 behavior should be evaluated solely in terms of the factor-2 behavior, because the factor-1 effects have no impact on the prevailing market price and thus do not pose a challenge to existing firms. To the extent that factor-2 behavior by an existing firm does not give rise to any predatory inferences, equivalent behavior by an entrant should be viewed similarly, even though factor-1 effects are present.

But suppose the entrant's planned longrun prices are below those presently prevailing in the market. According to my definitions, the factor-2 component of its entering prices measures the amount by which those prices fall below its planned long-term prices in the market, and factor 3 measures the amount by which its planned long-term prices fall below prevailing market prices.[112] The extent to which the entrant's prices fall below current market prices thus is measured by the sum of factors 2 and 3.

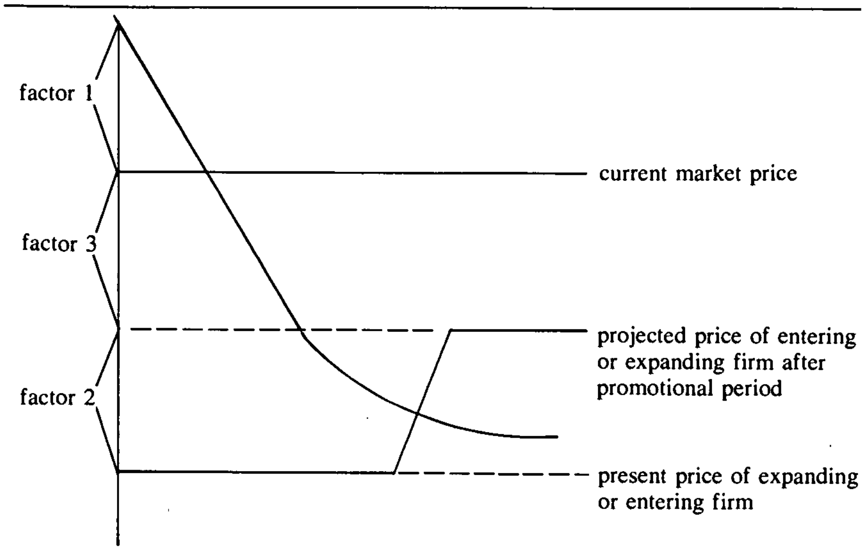
---

109. *Cf.* American Oil Co. v. F.T.C., 325 F.2d 101, 106 (7th Cir. 1963).

110. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 696 n.12, 702 n.14 (1967); Moore v. Mead's Fine Bread Co., 348 U.S. 115, 120 (1954). *Cf.* Lloyd A. Fry Roofing Co. v. F.T.C., 371 F.2d 277, 281-82 (7th Cir. 1966); National Dairy *supra* note 7, 71 F.T.C. at 1427.

111. *See* note 75 *supra*.

112. This article attempts to reconceptualize some of the underlying concepts in certain types of promotional price-cutting. Factors 1 and 3 could be stated in terms of changes in position on the average cost curves applicable to the firm's operations. The present vocabulary has been chosen in order to form a nexus among analyses in terms of cost curves, analyses in terms of business strategies, and many of the case law discussions which have shown a sensitivity to the relation between price and cost. The attempt is only an initial one. Hopefully, its deficiencies will be remedied in future years by myself and others. Diagrammatically, factors 1, 2, and 3 would appear as follows:




Factors 1, 2, and 3 can be related to the established concepts of total fixed cost, average fixed cost, total variable cost, average variable cost, total cost, average total cost, and marginal cost. Factor 2 is a measure of the amount by which the firm's projected long-term prices are temporarily undercut. It is not, therefore, directly related to the firm's cost structure. Factors 1 and 3 can be more directly related to the established cost terminology, although they are designed to highlight and to summarize aspects of pricing behavior that require a more elaborate description in the established terminology.

Factors 1 and 3 reflect variations in average total cost which are related to volume. Factor 1 does this directly. It measures the excess of average total cost over prevailing market price. This excess results from a firm incurring new fixed costs (investment or overhead) which are designed to support a sales volume that has not yet been attained. When volume expands to the projected level, average total cost will have been reduced to a level below the presently prevailing price level and the factor-1 effect will have disappeared. Factor 1 thus represents the imbalance of average total costs and price which results from a temporary allocation of fixed cost over a smaller number of units than the firm's projected volume. Factor 3 also reflects an interaction between average total cost and price, but a more complex one. Factor 3 represents the difference between the firm's projected longrun prices and prices presently prevailing in the marketplace. Factor-3 pricing occurs when a firm seeks additional volume through price undercutting which will reduce its average total costs to a level which will justify the permanent continuation of those prices. Factor-3 pricing is thus related primarily to scale economies which not only will reduce a firm's average costs, but which will justify the firm's long-term price at the lower (undercutting) level. Since at any given time the determinants of a firm's price level are its marginal cost and marginal revenue, in the circumstances posited, marginal cost at the firm's levels of output must be reduced. It would be expected that shortrun marginal costs often would be reduced as a result of capital investment or the incurrence of other fixed costs which would have the effect of increasing the efficiency of labor or other variable costs. Factor-3 pricing, therefore, would be expected to result primarily from capital-intensive technology. The concept of factor-3 pricing thus is one which embodies the interaction of (1) scale economies (involving higher fixed costs) and reduced marginal costs with, (2) marginal revenue, and hence produces (3) a lower optimum price level.

It would normally be expected that in a situation of constant marginal costs the temporary price-cutting referred to as factor-2 behavior would not be so great as to involve the incurrence of out-of-pocket losses. That is, factor-2 pricing might drop to a level below average total cost, but it rarely would be expected to fall to levels below marginal cost. The basis for this expectation is that above-marginal-cost pricing decreases the firm's total loss as the pricing successfully increases the firm's sales volume, whereas below-marginal-

It has previously been asserted that, in the absence of factor-3 behavior, a factor-2 price reduction by a new entrant (even when accompanied by a factor-1 unit-cost effect) has no more potentiality for harm than an equivalent temporary reduction by an existing firm. And it has also been suggested that such a reduction ought not to give rise to an inference of predatory intent or to a finding of competitive harm unless equivalent conduct by an existing firm, unaffected by factor-1 effects, would give rise to such an inference. The case is more complicated, however, when a factor-2 price reduction is joined with a factor-3 price reduction.

Factor-3 pricing presents an efficiency challenge to existing firms which is designed to be permanent. For this reason, a price reduction composed of factor-2 and factor-3 components should be evaluated in the light of the permanent factor-3 challenge first. To the extent that the factor-3 behavior passes muster, the factor-2 behavioral component would then be evaluated. Since the factor-2 behavior here constitutes a reduction from permanently reduced prices, it represents, at most, a challenge to the staying power of those rival firms which are able to meet the factor-3 challenge. Put another way, a factor-2 increment added to a factor-3 price reduction ought to be no more harmful than a temporary (factor-2) reduction employed after the long-term (factor-3) pricing has gone into effect. The difficulty with this approach, however, is that factor-3 pricing may present a formidable challenge to existing firms. Even if, on balance, some form of factor-3 pricing is recognized as legitimate, the simultaneous addition of a factor-2 challenge to existing market firms may, in some circumstances, increase the strain[113] upon some of them to the breaking point. Thus, the simultaneous factor-2 and factor-3 challenge may force firms from the marketplace which would not have been excluded had the factor-2 challenges taken place after a period of transition in which the market accommodated itself to the factor-3 pricing. The combination of factor-2 and factor-3 pricing may therefore lead to a Robinson-Patman Act violation even though the factor-3 pricing alone would be legitimate.[114]

cost pricing increases the firm's losses as volume increases. In a situation of constant marginal costs, average variable cost would approach marginal cost, so that pricing which exceeded marginal cost would also exceed average variable cost. In general, therefore, factors 1, 2, and 3 can be seen as variously related to a firm's fixed costs. Factors 1 and 3 symbolize, in the different ways above described, the failure of a firm to cover its capital costs. In a situation of constant marginal costs factor 2 is also related to fixed costs, in that the extent of a factor-2 cut will not normally exceed preexisting profit margin plus allocated fixed cost.

113. The strain is upon the firms' survival and it consists of the permanent factor-3 challenge, which is a challenge to the firms' abilities to improve their operational efficiencies. Meeting this challenge will entail not only rapid access to capital for plant renewal (and a concomitant imbalance between revenues and costs) but also effective employment of managerial skills. When a factor-2 challenge is simultaneously added to the factor-3 challenge, an affected firm must, in addition, acquire additional capital which will enable the firm to cover the additional operating deficit it will temporarily incur during the period of exposure to the temporary factor-2 prices.

114. This circumstance offers an opportunity to refine the end-result test developed later in the article. *See* note 177 *infra*.

*b. The Robinson-Patman Act implications of entry pricing*

An entrant which desires to act with some assurance that its offering prices will successfully open up a market share for itself might decide to price sufficiently low to discourage existing sellers from meeting its offering prices. In an imperfectly competitive marketplace, prices which are close to or equal to the marginal costs of the existing firms would discourage responses. Responses would be even more strongly discouraged if the entrant's prices are below the marginal costs of these firms.[115] It would not be unlikely, however, that an entrant which prices below the marginal costs of existing rivals would also be pricing below its own marginal costs.[116] The Commission has found an inference of predatory intent from below-marginal-cost pricing and from pricing which is consciously done so low as to discourage rivals from responding to it.[117] Yet, as will be observed later,[118] it has also given lip service to the proposition that discriminatory pricing and even below-cost discriminatory pricing may be tolerable for a limited period to enable a new firm to break into a market. What needs to be developed is a means of distinguishing between below-cost pricing which is procompetitive and that which is anticompetitive. And that distinction, perhaps, ought partially to turn on a determination of the extent of the discriminatory undercutting—and its duration—which is necessary to enable a new firm to enter the market.[119]

These are the kinds of problems which the Commission is beginning

115. *Cf.* Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 253 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966).

116. In National Dairy, *supra* note 7, 71 F.T.C. at 1426-27, the Commission inferred a predatory intent from prices which were so low as to discourage rivals from responding to them. In that case prices were apparently below marginal cost on vacuum-packed (and hence storable) fruit spreads, which were offered in unlimited amounts. As a result, some chain stores apparently purchased supplies for months in advance, significantly foreclosing rival suppliers from selling in that market for an extended time period. The question thus raised was whether the respondent was attempting to drive regional rivals from the marketplace permanently. A promotion which was designed to obtain buyer acceptance would probably not have offered a storable product at below-marginal-cost prices without a limit on purchases.

A proper way of evaluating the respondent's behavior, therefore, would be to place the burden on the respondent to justify its promotion in terms of legitimate and nonpredatory business goals. Judged on an objective basis, there seems to have been a disparity between the respondent's asserted goal of obtaining chain-store acceptance for its product and the size, unlimited order size, and impact of its price cut. It should be noted, however, that a focus solely upon whether a price cut would discourage responses in kind from rivals is misplaced, since a price cut would lose its promotional appeal if it were immediately duplicated by the entrant's rivals. A local price cut by a multimarket seller to the level of the costs of local rivals was found to give rise to an inference of probable anticompetitive impact under the circumstances found in Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 253 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966).

117. *See, e.g.*, National Dairy, *supra* note 7, 71 F.T.C. at 1426-27.

118. *See* text accompanying notes 225-26 *infra*; Dean Milk Co., *supra* note 10, 68 F.T.C. at 775 n.147; National Dairy *supra* note 7, 71 F.T.C. at 1440-41.

119. This resembles the examiner's approach in National Dairy, *supra* note 7, 71 F.T.C. at 1404. *See* note 142 *infra*.

to address,[120] but which it has not yet addressed in sufficient detail. Thus, for example, even the cases concerned with a claimed entry justification for discriminatory promotional pricing are largely silent on the question of entry size. It may be obvious that entry must be large enough to be economically viable, but it is not obvious how entry justifications for promotional pricing should be handled when entry is larger than needed to be viable. In relating pricing justifications to entry, analytical factors, such as the extent of the advertising budget and the time period in which this budget will be expended, should be explored. What is needed from the Commission is, first, an analysis of the differences in entry behavior which takes account of the variations in entry sizes and strategies. Second, since entry is being evaluated for its procompetitive influence, the size of the entry must be evaluated for any appreciable procompetitive influence which it may exert upon the behavior of existing firms.[121]

In evaluating the economic soundness of entry, a firm must consider that its operations in a new marketing area will involve the incurrence of recurring fixed charges which will have no relation to the amount of its sales. The advertising which is sometimes necessary to promote sales in a territory in which the product is unknown would constitute a fixed charge whose recovery in the new territory would be necessary.[122] District sales offices and minimal transportation facilities would impose recurring fixed charges on such operations. In the circumstances described, it is important for the firm to acquire rapidly a volume large enough to generate receipts to cover or partially to cover those fixed charges, especially the recurring ones. If it will take too long for a firm to reach a volume which is sufficient to cover fixed charges, entry may not be economically sound.[123]

At this point, an entrant must choose between two types of loss operations. The assumption here is that due to the factor-1 effect the new entrant will have to sell at some price which is below its unit costs. Should

120. *See* text accompanying notes 224-37 *infra*.

121. That is, an "entry" of significant size should be permitted. It will be observed, however, that in some circumstances a firm with a smaller share of the market will tend to exert a more vigorous competitive impact on the marketplace than will a firm with a larger share of the market. Thus the smaller firm is likely to experience a greater elasticity of demand for its products than a larger firm in conditions in which a price reduction of a given amount will tend to attract to the price cutter a given absolute volume increase. Moreover, the smaller firm will perceive that its price reduction, in some circumstances, will be less of a threat to its rivals than an equivalent reduction by a larger firm, and that those rivals, accordingly, will be less likely to respond with equivalent reductions of their own.

122. *See* note 225 *infra* and accompanying text.

123. In National Dairy, *supra* note 7, 71 F.T.C. at 1426, the Commission chided the respondent's Kraft Foods Division for not being content to expand its volume slowly in the new markets by pricing competitively with the other firms in those markets. But rapid expansion may be in order for the new entrant which requires a certain volume for its market activities to begin supporting themselves. One difficulty with a normal promotional explanation for National Dairy's behavior, however, is that the extent to which rival products were displaced vastly exceeded the Corporation's asserted goal of a permanently increased market share in the target areas.

it bear initially heavier losses by pricing below market price in order rapidly to attain the volume necessary to be self-supporting in the new market? Or should it bear a lesser loss on fixed charges for the longer period which it will take for operations at market prices to expand sufficiently to support the fixed charges?[124] Or should it follow some combination of these two approaches? The economic answer is that the entrant should take that route which will achieve the desired objective at the least total cost. The economics are determined by tbe rate at which entry can be achieved, the amount of uncovered fixed charges, and the ratio between the fixed-charge deficit and the expansion of sales volume. But the firm's actual answer may be influenced in part also by legal considerations. Under the second alternative, the entrant will be pricing below unit cost, but will nonetheless be meeting market prices. Under the first alternative it will be pricing below both unit costs and the existing market price. If such pricing is also discriminatory, the entrant will face a greater likelihood of being charged by the Commission with a Robinson-Patman Act violation under the first alternative than under the second.[125]

To these thoughts must be added the further caution that an entering firm may face a choice about the fixed charges it will incur. The size of its offices and staffs for its new sales, marketing, distribution, and other activities depend upon the volume for which it is striving in the new market. Since the size of the firm's fixed charges can be varied, the measurement and evaluation of discriminatory price undercutting and its duration in terms of what is necessary to cover fixed charges is, at best, imprecise. Such an evaluation, therefore, can only provide a general approach—a direction of inquiry—which may help dialogue in some cases to take a more rational, more understandable course.

### 2. THE CASE OF A FIRM ALREADY ESTABLISHED IN THE MARKET

Adelman discussed the case of an established firm which is attempting to reduce its unit costs by increasing its sales volume.[126] An established

124. Theoretically, the entrant has the additional option of setting price below the marginal cost of production and distribution. At that price the entrant would increase the probabilities that its prices would not be met by existing market rivals and that its volume would expand rapidly. According to the Federal Trade Commission, this was the route pursued by the respondent in National Dairy, *supra* note 7, 71 F.T.C. at 1426. However, this route would be extremely costly, since the entrant would be incurring operating losses with each additional unit it sells, and thus as it expands its volume, its losses would grow continually larger. At prices above marginal cost, increasing volume will tend to reduce total losses.

125. The Commission has given some indication that it objects to below-cost pricing for a long period, even when utilized by a new entrant. Dean Milk Co., *supra* note 10, 68 F.T.C. at 775 n.147. The depth of the undercutting and the extent to which such undercutting upsets the prevailing price structure are factors to which the Commission and the courts are sensitive. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 703 (1967); National Dairy, *supra* note 7, 71 F.T.C. at 1425-28. An entrant therefore increases the risk of incurring official action against it, the further its price cuts fall below the preexisting market price.

126. The example contemplates economies of scale which produce a declining average cost curve when the firm significantly increases its volume beyond its present level of

firm pursuing this goal might, as Adelman suggested, reduce price to a level which is designed to attract the needed increase in sales volume. Using the terminology just developed, its undercutting, as well as the below-cost aspect of its sales, would be explicable in terms of factor 3.

But it seems likely that an attempt to secure a more favorable unit cost by means of volume increases would entail investment in new plant which is designed to be more efficient at the new, higher-volume level of operations the firm is seeking to attain, and, perhaps would also involve a writing-off of some of its less efficient, existing plant. In addition, the firm might incur other fixed expenses, such as a bigger payroll for the larger work and sales force, and more substantial overhead on its new, larger plant. Furthermore, it is likely that its expansion effort will be accompanied by a heavy advertising campaign. All of these new fixed costs incurred by the firm are likely to have the effect of raising unit costs at its current level of operations. The prices charged by Adelman's existing firm undertaking to expand its sales are, therefore likely to be exceeded by its costs, not only because of factor 3 to which Adelman has called attention, but because of factor 1 as well. The factor-1 effect will generally tend to accompany factor-3 pricing behavior.

Moreover, the firm in its expansion effort may attempt to take advantage of inertia or stickiness affecting consumer buying habits.[127] Thus it may pursue a strategy of attracting consumers with low prices and of later raising prices, perhaps in gradual stages, relying on the tendency of many consumers to stick with products which satisfy them. Accordingly, it may seek its volume increase not only through "permanent" price reductions, but also through low prices which it intends later to raise to levels which are more satisfactory to it for the long term. Factor-2 pricing thus may accompany factor-3 pricing.

The preceding discussion indicated that the prices and the price-cost relations of Adelman's established firm which is seeking a lower unit-cost position through volume expansion are likely to be explicable in terms of factors 1, 2, and 3. In general, the factor-1 effect appears less for an existing firm than for a new entrant. Since an existing firm already has a capital base in the market, some of which may contain slack usable in its

---

operation. Instances of significant economies of scale (either at current levels of production or at projected future levels) are not difficult to find in the case law. *See, e.g.*, United States v. New York Great A&P Tea Co., 67 F. Supp. 626, 671 (E.D. Ill. 1946), 173 F.2d 79 (7th Cir. 1949); Old Homestead Bread Co., 476 F.2d 97, 104 (10th Cir.), *cert. denied*, 414 U.S. 975 (1973); United Fruit Co., 82 F.T.C. 53, 151-54 (1973), *aff'd in part and rev'd in part sub nom.*, Harbor Banana Distrib., Inc. v. FTC, 499 F.2d 395 (5th Cir. 1974); Standard Oil Co. v. FTC, 340 U.S. 231, 249-50 (1951); Forster Mfg. Co., 62 F.T.C. 852, 902 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964); C.E. Niehoff & Co., 51 F.T.C. 1114, 1126 (1955), *modified and aff'd*, 241 F.2d 37 (7th Cir. 1957), *order reinstated and aff'd sub nom.*, Moog Industries, Inc. v. FTC, 355 U.S. 411 (1958). *Cf.* Atlas Bldg. Prods. Co. v. Diamond Block & Gravel Co., 269 F.2d 950 (10th Cir. 1959), *cert. denied*, 363 U.S. 843 (1960).

127. *See* text following note 148 *infra*.

expansion effort, the unit costs of expansion can be lowered by employing that slack as well as by increasing the firm's capital base. In addition, the existing firm's previously attained sales base in the market in which the expansion attempt is being made would act, under some methods of accounting, to reduce the per-unit burden of new capital costs allocable to its sales in that market.[128] By contrast, an entrant has no preexisting capital base in the new market. Its investment, accordingly, embraces all of the capital necessary to its new operation. Moreover, that capital investment would have to be allocated among an entirely new sales volume—a sales volume which (as distinguished from the case of an existing firm) does not rest upon and include a previously attained base.

The impact of the factor-2 effect on rival firms depends upon the drawing power of the price-cutting firm, and, more precisely, upon its drawing power against each of its rivals. That drawing power is obviously increased, the deeper the prevailing prices are undercut.[129] To the extent that anything more can be said in the abstract, it seems likely that the general impact of factor-2 pricing on the market as a whole will be greater as the existing sales base of the price cutter is larger.[130] In other words, all other things being equal, factor-2 conduct by an established firm occupying a significant share of the market is likely to have a greater impact on the market as a whole than would equivalent factor-2 conduct by a new entrant,

128. In National Dairy, *supra* note 7, the Commission seems to have viewed the National Dairy Products Corporation's Kraft Foods Division as attempting to enter the Washington, D.C. market. However its entry attempt was actually directed at the chain-store segment of that market. It had already been a supplier to nonchain-stores in the Washington area. Accordingly, any factor-1 effects which accompanied its attempt to enter the chain-store segment of that market may (as reflected on its own books) have been mitigated by allocating them over all of its Washington-area sales. *See Current Assets and Current Liabilities*, Accounting Research Bulletin No. 43, ch. 3A, 3 CCH ACCOUNTING, § 2031.05 (1974). In Armour & Co. v. United States, 402 F.2d 712, 715 (7th Cir. 1968), the court considered the lawfulness, under § 202(a), (b) of the Packers and Stockyards Act, 7 U.S.C. § 192(a), (b) (1970), of a promotional pricing operation of Armour & Co. in which Armour offered retail purchasers of its two-pound bacon packages a price rebate. In addressing the question of whether the bacon was sold below cost, the court asserted that it was "questionable" whether the $143,000 which the rebate program cost Armour "should be charged to thick-sliced bacon costs during the five weeks the plan was in existence, as the Department urges." Rather, the court noted that Armour argued "quite persuasively that the coupon plan was meant to improve the sale of all Armour Star products throughout the year and therefore cannot be charged to the five-week production cost of thick-sliced bacon." Indeed, in its own internal accounting, "all Armour Western Area meat products were assessed for the cost of the program even though the coupon refunds concerned only 2-lb. packages of thick-sliced bacon."

129. The sensitivity of the Commission and the courts to price undercutting seems to increase when the undercutting becomes deeper and when that undercutting significantly alters preexisting market shares. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 703 (1967); National Dairy, *supra* note 7, 71 F.T.C. at 1426. *Cf.* Anheuser-Busch, Inc., 54 F.T.C. 277, 300 (1957), *rev'd*, 265 F.2d 677 (7th Cir. 1959), *rev'd*, 363 U.S. 536 (1960), *order vacated*, 289 F.2d 835 (7th Cir. 1961).

130. When a seller lowers its own price below the prevailing market level, the larger the seller's sale base is relative to all sales in the market, the more likely it is that the seller's price reduction will force the prices of other sellers downward as well. *Cf.* Bishop, *Elasticities, Cross-Elasticities, and Market Relationships*, 42 AM. ECON. REV. 779, 786 (1952).

because the established firm's price reductions are immediately applied to its existing sales base, in addition to the new sales engendered by the price reduction. The only constraint placed upon the established firm is its capacity to supply the newly created demand.[131] However, an entrant may still have quite an effect on the market, since—as illustrated by a number of primary-line price discrimination cases litigated during the 1960's[132]—initial market impact can be enlarged as price cuts are deepened. Factor-2 conduct, in any event, is more tolerable in the case of a new entrant, since it is connected with a type of activity which increases the number of firms in the market,[133] and therefore generally ought to be considered procompetitive.

Generally similar remarks can probably be made about factor-3 price cutting. Here, however, it is relevant to note that factor-3 undercutting is limited by the firm's projection of an optimum price-volume-cost relationship.[134] In a pure factor-2 case the relevant considerations are two: the per-unit profit sacrifice; and the time period required for this sacrifice to generate the firm's volume goal.[135] The additional consideration in a factor-3 case is the interrelation of these two items with the firm's projected declining unit costs. Both factor-2 and factor-3 behavior can properly be described as "investments" in expected future profitable operations.[136]

131. *See, e.g.*, W. VICKREY, MICROSTATICS 311-21 (1964).

132. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967); National Dairy, *supra* note 7, 71 F.T.C. at 1426; Dean Milk Co., *supra* note 10, at 767.

133. *Cf.* United States v. Falstaff Brewing Corp., 410 U.S. 526, 537-38 (1973), where the suggestion is made that in applying § 7 of the Clayton Act a radical distinction might be made between conduct which enlarges the number of vigorous sellers in the market and conduct which does not.

134. Since a firm would not be expected to lower its long-term price below the level at which it can maximize its profits for the long run, the firm's long-term price would be determined by the interaction of its costs with demand. A firm would, accordingly, reduce its long-term prices only to the extent necessary to achieve such an optimum volume.

135. There is no close relation between factor 2 and the firm's costs as there is between factor-3 pricing and the firm's unit costs. Of course factor-2 pricing for volume-expansion purposes is rationally undertaken only when the firm's (marginal) costs are not rising so rapidly that the longer-term volume for which the firm is striving will prove unprofitable.

136. For example, in a pure factor-2 case, a firm is engaging in temporary price-cutting in an effort to increase its market share. Factor-2 pricing might be conceived as the costs (in terms of profit sacrificed per unit) necessary to overcome those frictions of the marketplace which preclude the firm from expanding its sales at the prevailing market price. It also might be conceived as an "investment" which the firm incurs in order to expand its share of the market in a relatively permanent manner. Assuming (1) constant marginal costs, (2) a market price unaffected by the price reductions of the firm seeking to expand, and (3) a volume of sales constantly increasing because of the price reduction, the prevailing market price could be represented as "p," the quantity sold at any one instant of time as "q," the factor-2 price as "p'," the per unit profit sacrifice as "p-p'," the total profit sacrifice at any one instant as "q(p-p')," and the total profit sacrifice or "investment" as "$\sum_{i=1}^{n} q_i(p-p')$" as the firm's sales (and hence, q) increase over n periods. This representation, of course, overstates the "sacrifice" or "investment," because the firm could not sell the quantity it wishes at the prevailing market price, as is demonstrated by the firm's recourse to factor-2 pricing.

Since factor-3 pricing involves a permanent price reduction to a level which is expected ultimately to prove profitable, the "investment" there should be regarded with reference to

Thus, the present sacrifice which the firm willingly endures bears a mathematical relation to the expected future increased profits (and, accordingly, to the expected level of future prices and costs). But in the factor-3 case, unlike the factor-2 case, the projected level of future unit costs indicates the lowest level to which the firm can permanently reduce price.

## VI. TEMPORARY PRICE REDUCTIONS BELOW A FIRM'S PROJECTED LONG-TERM LEVELS: FACTOR-2 PRICING

In Section V, three ways of conceptualizing certain forms of price cutting were described. In addition, the impact of factor I upon the determination of unit cost was explored. In this section, factor-2 pricing will be examined. It will be suggested that the lawfulness of temporary price cutting should be assessed, in each instance, under a criterion which looks to the potential impact of such pricing upon the number of firms in the market and the intensity with which they can be expected to compete with each other. This approach to evaluating temporary price cutting is largely—although not completely—compatible with the assumptions upon which the Commission and the courts are presently operating. It is not completely compatible with current official approaches because neither the Commission nor the courts accords sufficient weight to the desirability of encouraging competitive behavior in their enforcement of the Robinson-Patman Act. The approach to evaluating temporary price cutting described here will also be complemented by the test of price discrimination in factor-3 cases which will be developed in Section VII. Both approaches focus upon the social benefits expected from competition rather than exclusively focusing upon the number of firms operating in the marketplace.

### A. *Factor-2 Pricing by a New Entrant*

Earlier, it was suggested that temporary "entry" pricing designed to overcome buyer inertia ought to be evaluated by balancing the probabilities that the entry would add a new firm to the local market against the probabilities that the entry pricing would diminish the competitive structure of the local market by driving out a significant number of firms.[137] But

that expected long-term price position. Thus the investment would consist in the temporary incurrence of actual losses during the period required to bring cost and price into a normal relationship. If the factor-3 price is represented by "k" and the firm's unit costs by "f (q)," then the "investment" (here conceived as actual losses) involved in factor-3 pricing might be represented as "$\sum_{i=1}^{n} q_i (f[q_i]-k)$" as the firm's sales (and hence, $q_i$) increase over n periods.

The reader will, of course, observe that the sacrifice or investment is symbolized differently in the case of factor-3 pricing from the case of factor-2 pricing. In the latter case, the emphasis was upon a sacrifice or investment of lost profits. In the case of factor-3 pricing, lost profits have been ignored for simplicity in presentation and the sacrifice has been symbolized solely in terms of losses. It would not be incorrect to include lost profits in the factor-3 case as well.

137. *See* text accompanying notes 52-53 *supra*.

there are more imponderables than a mere balance of these probabilities would indicate. Healthy firms are normally expected to be capable of withstanding a temporary period of below-cost or even uneconomic pricing.[138] Firms which fail to survive a limited period of "entry" pricing may have had a limited life expectancy anyway. Changing technologies (which increase scale economies) may doom small enterprises;[139] and the contribution to the demise of some of these enterprises made by an entrant's below-cost or uneconomic pricing may be appropriately overlooked in such circumstances. Moreover, the general encouragement of entry behavior may justify toleration of specific instances of entry behavior which bring about the entry of one firm even though two or more preexisting firms are unable to withstand the strain of the market undercutting which facilitated that entry.[140] The application of a general policy to encourage entry should be most justified when the departing firms are less efficient than the entrant; but the application of such a policy should sometimes even be justified when the departing firms are somewhat more efficient than the entrant. If an entrant shows unusual competitive vigor in the sense, for example, that it is likely to price more competitively during the post-entry period than had the departing firms, and if the loss of existing firms does not leave a marketplace in which aggregate competitive behavior will be more inhibited than in the past, then the market seems, on balance, to have moved in a procompetitive direction.[141]

### B. *Proportionality in Factor-2 Pricing*

Suppose that an entrant miscalculates the depth of the undercutting, or the length of the undercutting period, which is necessary to achieve the sales volume level which will sustain permanent entry. Alternatively, suppose that an entrant consciously designs its entry undercutting to achieve substantially larger volume goals than are necessary to sustain entry. In such cases, existing firms will have been exposed to undercutting prices to a greater extent than was necessary to bring about the procompetitive effects of entry. Of course, since the kind of judgments involved here cannot be made precisely, there must be a substantial leeway for the toleration of differing judgments about necessary volume goals, the undercutting necessary to achieve those goals and the appropriate safety margins which may be incorporated within those judgments. Yet, after due allowance for such differing judgments is made, there will be cases in

138. *Cf.* American Oil Co. v. FTC, 325 F.2d 101, 106 (7th Cir. 1963).

139. *See, e.g.*, Beatrice Foods Co., 67 F.T.C. 473, 712-13 (1965), *modified and aff'd*, 1967 Trade Cas. (9th Cir. 1967).

140. This argument assumes that the number and vigor of firms remaining in the market are such as to maintain the same intensity of competition as had prevailed prior to the entry attempt. The Commission would more likely tolerate a smaller entrant's price-cutting to achieve entry, than similar conduct by a large multimarket seller. *Compare* Beatrice Foods, Co. 67 F.T.C. 473, 723-24 (1965), *with* Dean Milk Co., *supra* note 10, 68 F.T.C. at 750-51.

141. *Id.*

which the volume goals, or the depth or length of the undercutting, are vastly disproportionate to entry. In these cases it is appropriate to conclude that the burden on the existing firms was not justified by the procompetitive cffects of entry, because that entry could have been achieved with less below-cost pricing.[142]

### C. *Factor-2 Pricing by an Existing Firm*

Temporary price reductions—even if discriminatory—ought to be tolerated (and even encouraged) in the interests of promoting flexibility in the marketplace. Pricing rigidity is the opposite of competitive pricing behavior. It is only when price reductions undercut rivals by drastic amounts or are continued for unduly long periods, that further inquiry ought to be made into its potential effects. It should be presumed that normally healthy competitors are capable of withstanding temporary periods of low-price competition, including temporary exposure to uneconomic pricing by a rival.[143]

There are, of course, exceptions to any generalization. The exceptions ought to be in those industries where the combination of high volume, narrow profit margins and a single product line peculiarly expose normally healthy sellers to devastation when forced to compete with a rival offering unlimited supplies of goods at price levels below the seller's costs. In particular, retail gasoline dealers seem to be especially exposed to harm from such undercutting.[144] Their peculiar susceptibility seems to be due in large measure to the unusual nature of distribution in that industry where

---

142. *Cf.* the hearing officer's opinion in National Dairy, *supra* note 7, 71 F.T.C. at 1404. There the hearing officer suggested the case of a hypothetical nonpredatory entrant as a measuring rod to assess the properly incurred losses of the respondent. The suggestion is relevant, but raises the problem of whether "proper" entry losses (and the behavior which gives rise to those losses) can be discerned with sufficient precision to serve as a helpful guide to the resolution of a concrete case.

143. *Cf.* American Oil Co. v. FTC, 325 F.2d 101, 106 (7th Cir. 1963); Borden Co. v. FTC, 339 F.2d 953, 957 (7th Cir. 1964). It is only prolonged below-average-total-cost pricing which would encourage equally efficient firms to leave the market or would discourage equally efficient firms from entering. *See* note 108 *supra*. Therefore, non-shortrun-profit-maximizing prices which are equal to or above average cost should not pose a substantial anticompetitive threat. Even non-shortrun-profit-maximizing prices which fall below average total cost ought to pose no such threat so long as they are not maintained indefinitely. *Compare* International Air Indus., Inc. v. American Excelsior Co., 517 F.2d 714, 723-25 (5th Cir. 1975), *with* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 389 F. Supp. 1334, 1343 (N.D. Calif. 1975). *See also* the discussion of causation in the text accompanying notes 89-98 *supra* and 178-87 *infra*. In the text it is suggested that prices above average cost could not fulfill the Robinson-Patman causation requirement.

144. *See, e.g.*, Simpson v. Union Oil Co., 377 U.S. 13 (1964). *See* F. ALLVINE & J. PATTERSON, COMPETITION, LTD.: THE MARKETING OF GASOLINE 5 (1972), where dealer gross profit margins are said to be relatively high but where it is also indicated that net profit margins tend to be low. The authors suggest that the low net profit margins are the product of the maintenance by the major oil companies of an oversupply of service stations. In such circumstances existing demand must be divided among all of these stations. This, in turn, prevents many stations from reaching "efficient levels of manpower and facility utilization." *See also* FTC, PRELIMINARY STAFF REPORT ON THE PETROLEUM INDUSTRY 36 (1973).

high volume, low profit margins, a single product line, and each dealer's exclusive relations with a single supplier which is often both the dealer's landlord and the supplier of the undercutter, make the dealer's situation extremely precarious whenever the pricing conditions originally anticipated by the dealer when it opened its retail station break down. The Commission's sensitivity to the effects of discrimination (particularly to its secondary-line effects) in industries in which narrow profit margins prevail reflects a correct perception.[145] However, the Commission has been more articulate in expressing its concern over the negative effects of discriminatory pricing on narrow profit margins than it has been in expressing an expectation that normally healthy firms can bear a certain amount of low-price competition, including uneconomically low price competition. The Commission should therefore articulate standards by which it differentiates the relatively harmless instances of low and uneconomic pricing from their more problematic counterparts, not by formulating precise rules, but by explicating more elaborately than it has yet done the factors and the analytical framework through which it "structures" those decisions.[146]

Beyond the presumption that healthy rivals ought normally to be capable of withstanding a temporarily limited exposure to uneconomic pricing, it should be noted that temporary price reductions—even if locally discriminatory—may be justified by shortrun profit-maximization goals and thus should be seen as properly "competitive" behavior in four circumstances. First, temporary price reductions are justified when such reductions partake of the nature of periodic (e.g., annual or semi-annual) or random "sales." Such "sales" ought to be deemed to be part of competitive pricing behavior. They are methods by which sellers attempt to meet a segment of demand which is more selective and more price-conscious than the segment of demand to which they normally tend to respond during the remainder of the year. Second, temporary price reductions—even if discriminatory—may be justified by shortrun profit-maximization goals when they are part of a process of experimentation to test market demand. The classic competitive model assumes knowledge of market conditions by all sellers.[147] Attempts by sellers to ascertain demand, when viewed in the light of that model, ought to be seen as behavior which furthers competitive conditions. Third, temporary price reductions—even if discriminatory—may be justified by shortrun profit-maximization goals as responses to temporary changes in market demand.

145. *See* Forster Mfg. Co., 62 F.T.C. 852 (1963), *vacated and remanded*, 355 F.2d 47 (1st Cir. 1964). *See also* Gifford, *The Concept of "Competitive Advantage" in Assessing Secondary Line Injury under the Robinson-Patman Act*, 44 GEO. WASH. L. REV. 48, 62-65 (1975).

146. *See* K. DAVIS, DISCRETIONARY JUSTICE 97-141 (1969); Gifford, *Decisions, Decisional Referents, and Administrative Justice*, 37 LAW & CONTEMP. PROB. 3 (1972). "Structuring" is a term employed by Professor Davis to describe the process of relating decisions to prior decisions and other accepted decisional criteria within a coherent rational framework.

147. *See* D. DEWEY, THE THEORY OF IMPERFECT COMPETITION: A RADICAL RECONSTRUCTION 38 (1969). Dewey observes that perfect information is assumed in the models of every perfect market, competitive or otherwise.

Fourth, temporary price cutting by an existing firm may be justified by shortrun profit-maximization goals when the price cutting is designed to bring about a longer-term expansion of that firm's share of the market. If the local market demand is sufficiently inelastic,[148] a more-or-less permanent expansion of the existing firm's sales can occur only at the expense of its rivals. While a struggle among rivals for business is the essense of competition, and while both short- and long-term price changes are natural parts of such a struggle, the circumstance presently under consideration might be viewed as slightly different from a pure case of price competition. Here in order to attract buyers, one seller is making temporary price cuts to a level which may be uneconomic for it to continue indefinitely. In some cases it is temporarily cutting price to encourage potential buyers to try its product, a technique which was examined above in conjunction with entry behavior.[149] Once more buyers become acquainted with the seller's product, they will, it is hoped, treat it at least on a par with existing rival products. Future buyer choices, therefore, will be made on the basis of price and a more accurate assessment of quality: the inertia which has prevented the quality of the firm's product from becoming known will have been overcome. In other cases—principally involving consumer products—the seller is not only attempting to overcome buyer inertia as a barrier to selling its product, it may be relying to some degree upon buyer inertia to retain the newly attracted buyers after it later rescinds the price cuts. In the latter case judgments by the price cutter about the length and depth of the temporary price cuts are made in the light of judgments about later buyer inertia.

Because buyers in the classic competitive model are fully mobile, the temporary price cutter's conduct here cannot be judged on the basis of that model. Indeed, the price cutter is consciously basing its behavior on the imperfections and frictions of the actual market. In evaluating pricing behavior which is geared to take advantage of market imperfections and frictions, it must be remembered that other firms also can overcome the effects of buyer inertia by lowering their prices. Unless the price cutter's factor-2 price-cutting threatens to move the market structure in a less competitive direction, and thus to reduce the chances that consumer inertia will be overcome by the price-cutting of the firm's rivals, it would not appear to constitute a violation of the Robinson-Patman Act.

148. Demand elasticity refers to the proportional change in quantities desired by buyers per unit of proportional change in price. Demand is said to be inelastic at a given price level when changes in price would bring about less than proportional changes in quantities desired by buyers. Consider a market in which all firms are in a heterogeneously competitive relation with each other. *See* R. TRIFFIN, MONOPOLISTIC COMPETITION AND GENERAL EQUILIBRIUM THEORY 103 (1940). A firm which seeks to expand its sales volume through price reductions in such a market will, if successful, necessarily take sales away from rivals unless aggregate demand by all buyers for the industry product is sufficiently elastic to absorb the firm's expanded sales as well as the increased sales by its rivals at reduced prices.

149. *See* text accompanying notes 50-52 *supra*.

### D. *The Relevance of Unit Costs to Factor-2 Pricing*

An evaluation of the lawfulness, under the Robinson-Patman Act, of the type of temporary price-cutting designed to achieve longer-term sales goals may be easily made in many cases. If a discriminating price cutter reduces its local price to any level which is above its unit costs, its conduct is not supported in any way by discrimination: there is no causal relation between the price discrimination and the "harm" inflicted upon local rivals by those prices.[150] If the price cutter offers its goods for this temporary period at a price below its unit costs, then it may be incurring a present "loss" in order to produce a future profit. The present loss is, in effect, an "investment" in a future return. Normally such conduct ought to be tolerated as part of the struggle of the marketplace. Yet, if the price cutter is incurring a loss during this reduced-price period, the basis for its ability to bear this loss is brought into question. It was suggested above[151] that if the price cutter is not easily differentiable from its rivals in terms of financial strength or other sources of income[152]—or if the kind of conduct in which it is engaging (such as periodic sales) is conduct in which the rivals could engage as well—then its low prices should be considered lawful.

However, if the price-cutting—either because of its depth or the length of time in which it is in force or both—cannot be easily duplicated by rivals, it may not be so easily dismissed as an example of expected and routine market rivalry. Yet merely to find the price-cutting to be more serious than routine rivalry does not move it to the level of a Robinson-Patman Act violation. But if the price-cutting is continued for a sufficiently

150. Under the theory propounded in Borden Co. v. F.T.C., 381 F.2d 175, 180 (5th Cir. 1967), and propounded by Commissioner Elman in Dean Milk Co., *supra* note 10, 68 F.T.C. at 799-800 (dissenting opinion), discriminatory pricing "causes" injury to rival firms when the discriminator's higher prices produce revenues which are necessary to support its lower prices. Such support might be inferred when revenues produced by the lower prices did not cover unit costs, since without such support the firm could not continue below-cost pricing indefinitely and still survive. Similar reasoning was embodied in significant portions of the legislative history of § 2 of the Clayton Act. *See* S. REP. NO. 698, 63rd Cong., 2d Sess. 3 (1914); H.R. REP. NO. 627, 63rd Cong., 2d Sess. 8-9 (1914). *Cf.* S. REP. NO. 1502, 74th Cong., 2d Sess. 4 (1936); H.R. REP. NO. 2287, 74th Cong., 2d Sess. 8 (1936); 80 CONG. REC. 6621, 6622, 7324 (1936). Commissioner Elman and others have stated this causal theory so broadly that below-normal profits produced by discriminatorily low prices would be deemed subsidized or supported by revenues produced by higher prices. *But cf.* note 209 *infra*. The analysis contained in the text does not accept this latter variation of the theory. *See* text accompanying note 209 *infra*.

151. *See* text accompanying notes 95-98 *supra*.

152. If the price cutter's rivals have comparable sources of income and wealth, they are able to engage in promotions or other forms of temporary price-cutting as well, including periods of temporary price-cutting which involve the incurrence of losses. Accordingly, it would seem that some room must be allowed for vigorous price competition to impose losses on business rivals when those losses result from behavior which—although not immediately profit-maximizing—is not predatorily motivated. This is especially true when the affected rivals are of comparable strength to the price cutter and able to bear associated losses as well. *See* H.J. Heinz Co. v. Beech-Nut Life Savers, Inc., 181 F. Supp. 452, 461-62, 464-65 (S.D.N.Y. 1960). *Cf.* Areeda & Turner, *supra* note 3, at 698.

long period or is at sufficiently deep levels it may jeopardize the existence of a sufficient number of rival firms to move the market structure in a less competitive direction. In this situation the price-cutting is tending to lessen competition in the marketplace and thus satisfies one requisite for a Robinson-Patman Act violation. Since the price-cutting is not—under the above assumption—sustainable from resources generally available to the price cutter's rivals, the lawfulness of that price-cutting turns upon a resolution of the causation question. Standards for assessing causation were suggested above in Part C of Section IV.

## VII. A MARKET STRUCTURE "END RESULT" TEST AND FACTOR-3 PRICING

In this section a market-structure test will be developed for assessing the lawfulness of price discrimination which may appear to vary from existing tests employed by the Commission and the courts, but which in reality incorporates and makes explicit the better strands found in the cases.[153] The market-structure test proposed here is an "end result" one. Discriminatory pricing will be deemed to lack an anticompetitive potential to the extent that such pricing, in context, appears likely to engender market conditions in which prices will tend to be lower than those generally prevailing prior to the discrimination in question.

This "end result" test is consistent with the market-structure approach described in Section VI. There factor-2 pricing was assessed from a perspective which asked: will the discriminatory prices tend to create a market structure conducive to oligopolistic pricing behavior? An affirmative answer to that question indicates that, if all other factors remain unchanged, prices would tend to be maintained at a higher level than they otherwise would have been, and the discriminatory pricing, under the test described in Section VI, should therefore be condemned. The focus in Section VI was upon market structure and upon the operation of market structure. In the consideration of factor-2 pricing, however, little attention was given to unit costs. In this section the scope of the market-structure approach is enlarged to embrace the interaction of price and unit cost. And the focus is upon factor-3 pricing where price and unit cost interact.

153. The market-structure focus is found in varying degrees of articulation in the cases. *See* Dean Milk Co., *supra* note 10, 68 F.T.C. at 750; Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 263 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966); Borden Co., 64 F.T.C. 534, 568-70 (1964), *rev'd*, 339 F.2d 953 (7th Cir. 1964); Forster Mfg. Co., 62 F.T.C. 852, 904-05 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964), *cert. denied*, 380 U.S. 906 (1965). An important element of the proposed test is the introduction of an efficiency element which modifies the ill-founded tendency of some of the cases to focus on the preservation of competition in a numbers sense. *Compare* Old Homestead Bread Co., *supra* note 7, *with* Beatrice Foods Co., 76 F.T.C. 719, 800 (1969), *aff'd sub nom.*, Kroger Co. v. FTC, 438 F.2d 1372 (6th Cir. 1971). But the efficiency strand in the proposed test is itself modified to insure that the consuming public receives the benefit of increased business efficiency. *But cf.* Areeda & Turner, *supra* note 3, where the authors embrace an efficiency test which would not always operate to bestow the benefit of efficiency on the consuming public. *See id.* at 710.

### *A. Factor-3 Pricing*

A seller pricing at a factor-3 level—whether it be an entrant or an established firm in the market—seeks, it will be recalled, the achievement of scale economies which will enable it permanently to price at a level below the presently prevailing market price.[154] The problematic aspects of factor-3 pricing consist of the impact of that pricing on small firms and on the market structure.[155] The factor-3 seller's own below-cost price-cutting may force the prices of rival firms down, so that those rivals feel the pinch of its lower prices in substantially reduced profits or even losses. If the price cutter's success in attaining the requisite volume depends upon its attracting business away from its rivals—as it would, for example, in a market in which demand for industry products was relatively inelastic[156] and in which the market was expanding at an insufficient rate—then the imitation of its cut by those rivals might frustrate its attempt to achieve the desired volume. This meeting of the price cutter's price reductions by those rivals may mean that no firm will initially achieve the necessary volume increase.[157] In such a circumstance, if many of the major sellers reinvest to acquire plant with a unit cost curve that declines over substantial increases in output, an economic equivalent of a war of attrition among those firms may result, and that war may continue until a sufficient number of sellers are driven from the marketplace to make it possible for the survivors to operate at a lower (more efficient) point on their unit cost curves.

For present purposes, however, it will prove more interesting to pursue an analysis of a less simplistic scenario in which the price cutters fall into several classes, some of which are financially stronger than others, and are thus more capable of acquiring the efficient high volume plant which is necessary for factor-3 pricing.[158] In this context, the original price reduction and its imitation by the stronger of the price cutter's rivals may mean that volume increases—and concomitant unit-cost decreases—will be

154. *See* text accompanying note 107 *supra*.
155. *See* text accompanying notes 162-77 *infra*.
156. *See* note 148 *supra*.
157. *See, e.g.*, Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582, 584 (1st Cir. 1960), *cert. denied*, 365 U.S. 833 (1961).
158. Some of the rivals may be independently contemplating volume expansion in order to reduce unit costs, and others may be stimulated into such a course by the example of the original price cutter or the economic pressures caused by the price cutter's behavior. But unless demand for the industry product is sufficiently elastic, there may not be room in the market for every existent seller to expand its sales volume. *Cf.* D. DEWEY, THE THEORY OF IMPERFECT COMPETITION: A RADICAL RECONSTRUCTION 32 n.4 (1969); Union Leader Corp. v. Newspapers of New England, Inc., 180 F. Supp. 125, 140 (D. Mass. 1959-60), *modified and aff'd*, 284 F.2d 582 (1st Cir. 1960), *cert. denied*, 365 U.S. 833 (1961). Rivals which are unable to expand their sales volume will be those which are unable to raise the required capital or to convert to an efficient plant before the market is filled by suppliers that have already converted their plants. *Cf.* Atlas Bldg. Prods. Co. v. Diamond Block & Gravel Co., 269 F.2d 950, 956 (10th Cir. 1959), where the contention was made that a producer was prevented from building an efficient plant which would have lowered its unit costs by the low-price competition of its rival.

successfully achieved by the original price cutter and the stronger of its rivals. The financially weaker rivals, the ones incapable of accommodating substantial volume increases, will be unable to achieve the higher-volume, lower-cost position. Some may withdraw from the market, and some may retire to smaller or more protected market situations where they can tradeoff convenience to their customers for higher prices. Indeed, this withdrawal is almost a necessary corollary to the attaining of scale economies by some firms in an inelastic marketplace.[159] In a situation of this type, it would be tempting for the Commission to assert that the initial below-cost pricing did produce anticompetitive tendencies. Some of the weaker firms did disappear, and their impact upon local competition did, accordingly, disappear. The below-cost pricing restructured the local market: the stronger competitors survived as lower-cost traders, while the weaker rivals retreated to protected enclaves or withdrew. Yet in the new market situation, costs and prices in the unprotected sector have been lowered.

To the extent that factor-3 pricing may tend to substitute smaller numbers of larger and more efficient sellers for more numerous smaller and less efficient sellers, the question will naturally arise as to whether this reduction in the number of sellers has lessened the degree to which the several sellers set their prices solely from an individually-oriented perspective and has increased the degree to which a sensed interdependency among the sellers influences their pricing decisions. Pricing decisions which are made by each firm in conscious awareness of the impact of its decisions upon the decisions of its rivals means that these firms are effectively collaborating in their decisions and are no longer actively competing in price.[160] In a market of relatively equal-sized firms, the degree to which the price-cutting decisions of one firm would significantly affect the sales of any given rivals would increase as the number of firms in the market diminished.[161]

If industry demand is sufficiently great relative to the number of high-volume sellers which the market can hold, then the change in the number of sellers may not significantly increase interdependency, and the market will remain a "competitive" one. If, however, the existing market can tolerate only a relatively small number of high-volume efficient sellers,[162] then pricing may tend to be made on a basis which takes the interdependency of each seller with its rivals into account. Before it can be

159. A demand which is small in relation to scale economies limits the number of optimally efficient firms which the market can accomodate. *See, e.g.*, Beatrice Foods Co., 67 F.T.C. 473, 712-13 (1965), *aff'd*, 1967 Trade Cas. 72124 (9th Cir. 1967). *See also id.*

160. *See, e.g.*, F. CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION 46-51 (8th ed. 1962). *Cf.* Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 660-73 (1962).

161. *See, e.g.*, Bishop, *Elasticities, Cross-Elasticities, and Market Relationships*, 42 AM. ECON. REV. 779, 788 (1952).

162. *See* note 158 *supra*.

concluded that this is a change for the worse—a change from a more competitive to a less competitive (or even to an "oligopolistic") market structure—consideration should be given to the way in which the oligopolists' or near oligopolists' increased degree of "power over price"[163] would in fact be used.

### *B. Power Over Price*

A monopolist's power over price is not a power to do business at any combination of price and volume, but rather a power to choose among the price-volume combinations given by the industry's demand curve. A firm selling in a purely competitive market is said to lack power over price because the market sets a going price independently from the action of any one seller. In such circumstances no firm can sell above market price. While it surely has "power" to sell below market, this power is not one which the seller would in fact exercise, since it would clearly be to its disadvantage to do so. In the case of a profit-maximizing monopolist, which has full knowledge of industry demand, there is only one price level which it is rational for it to set. It could sell above or below that optimum price level, but just as the competitive seller would forego the opportunity to decrease its returns by selling below market, the monopolist would also forego the opportunity to decrease its returns by selling above or below the profit-maximizing price. The monopolist, therefore, (as well as the competitive firm) has "power" over price which it is irrational to use; that is, its economic interests will impel it to set price at the profit-maximizing point on the industry demand curve.[164] A relevant question, then, when there exists the potential for change in the intensity of competition in a marketplace is whether this change is likely to be accompanied by a long-term rise or fall in the prevailing price level.

The point on the industry demand curve at which a profit-maximizing monopolist chooses to price is heavily influenced by two major factors.[165]

---

163. A seller in a market which is not purely competitive is said to have some degree of power over price because it can decide, within limits, the price at which it will sell.

164. Monopoly power, in other words, consists in the power to pick the point on the industry demand curve at which to sell. In theory, a rational profit-maximizing monopolist would attempt to price at the level at which it would achieve the optimum combination of price and volume, although in practice an actual monopolist would probably not price as high as its power permitted. The point discussed in the text is the possibility that cases will arise in which a shifting of cost curves could bring the optimum price for a monopolist below the price level which formerly prevailed in the market when it was competitively structured but composed of less efficient firms.

165. In one of the scenarios described in the text, demand for the industry product is relatively inelastic, but demand for the products of the expanding efficient firms is relatively elastic because they are able to attract customers away from the inefficient sellers. Because of the lower costs of the expanding firms, they will be impelled—even when acting in conscious interdependency—to maintain price at a level below that which had prevailed before the inefficient sellers were driven from the marketplace. In somewhat more technical terms, demand may be elastic for both the inefficient and efficient sellers at the preexisting price. But the interaction of cost and price which determines when a seller's profits will be increased or

One factor is the elasticity of demand. When industry demand is relatively elastic, at the preexisting price level, the monopolist will choose to produce for a larger demand at a lower price. The other major factor entering into such a monopolist's pricing decisions is its own cost structure. To the extent that its own marginal costs are falling, or rising only relatively gradually, it will be impelled to opt for a higher-volume, lower-price combination. A monopolist with a gradually rising marginal-cost curve and facing a highly elastic demand will thus be inclined to exercise its "power" to institute a low price rather than a high one. Indeed, in industries in which a highly elastic demand prevails, it would be expected that the transition from a "competitive" price structure—determined by the interaction of many inefficient sellers—to an oligopolistic, or even monopolistic, price structure—determined by the decisions of a few or even one highly efficient firm or firms—would produce a market price which is lower than the price prevailing prior to the transition. In such a case the efficiency objectives that are normally served by a system of free competiton will have been furthered by that transition.[166]

### C. *The Process of Transition*

In considering the price structure during the transition and post-transition periods it is useful to consider the hypothetical example of a new firm entering the market with a plant constructed to achieve scale economies superior to any existing firm, but at relatively high-volume levels of operation. In order to gain the requisite volume, it prices at a level which (1) attempts to undercut prevailing market prices and (2) initially is below its own unit costs, but which will exceed unit costs when volume has sufficiently increased. However, its conduct is replicated by at least some of the existing sellers in the local market. They begin to match the entrant's reduced prices and concomitantly expand or modify their production facilities to achieve the same cost economies at high levels of output. If demand in that market for the industry product is insufficiently elastic, the entrant and those preexisting sellers who are able to attain scale economies at high levels of operation ultimately will drive from the market some of the smaller and less efficient firms.

During the process of transition, the less-efficient sellers which cannot replicate the high-volume efficiencies of the new high-volume sellers may react in basically one of two ways. First, they may resist meeting the lower prices of the high-volume firms and settle for a substantial sales loss. This sales loss may result in the incurrence of an

decreased by a price change—which Vickrey refers to as pseudo-elasticity—will indicate to the inefficient sellers that price reductions from the preexisting price level will be disastrous and will indicate to the efficient sellers that permanent price reductions will increase their profits. *See* W. VICKREY, MICROSTATICS 308 (1964). *Cf.*, Gifford, *Assessing Secondary-Line Injury Under the Robinson-Patman Act: The Concept of "Competitive Advantage,"* 44 GEO. WASH. L. REV. 48, 74 n.101 (1975).

166. *See* United States v. ALCOA, 148 F.2d 416, 430 (2d Cir. 1945).

actual loss as decline in volume increases fixed charges allocable per unit, and as operating efficiencies are lost.[167] The incurrence of losses is particularly to be expected in the case of a firm dealing in a single product or product line.[168] A multiproduct firm faced with competition at a price level below its own costs on a particular product—and which refuses to meet that price—may not incur actual losses in its operations as a whole, but the sales losses may make the product significantly less attractive to it.[169] In such circumstances, it may decide to phase out the product; the market will in any event force a cutback on that part of its operations devoted to the production and sale of the product in question.

Second, some or all of these less efficient firms may attempt to meet the lower prices of the higher-volume, more efficient sellers. But if in order to do this they must sell below their own unit costs, they cannot continue to match these prices indefinitely.

Whichever route is taken by the smaller firms, ultimately some of them will have to retrench or to withdraw from the market. By hypothesis in the example, they cannot meet the low prices of the high-volume firms while covering their costs; the high-volume firms, however, are covering their costs at high-volume levels of output and sales. As the smaller and less efficient firms withdraw from the market, the supply of the industry product available for market will diminish. Market price, accordingly, can be expected to rise above the level of the transition period.

### D. *The Relationship of Price and Supply*

A price increase by the entrant shortly after the demise of a significant rival may be construed by a court as corroborative of the predatory nature of the entrant's initial below-cost pricing.[170] Perceiving the entrant's behavior through the lenses of Robinson-Patman tradition, the court may see it as having priced at "uneconomic levels" so that it can drive its effective rivals from the market, and then exercise its newly acquired power over price to extract monopoly profits from the now less competitive marketplace.[171] The entrant's final price increase may be seen as an objective indication that the entrant's behavior could not have been justified by Adelman's postulate of factor-3 pricing.

167. *See, e.g.*, Standard Oil Co. v. FTC, 340 U.S. 231, 249-50 (1951); Forster Mfg. Co., 62 FTC, 852, 902 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964); C.E. Niehoff & Co., 51 F.T.C. 1114, 1126 (1955), *modified and aff'd*, 241 F.2d 37 (7th Cir. 1957), *order reinstated and aff'd sub nom.*, Moog Industries, Inc. v. FTC, 355 U.S. 411 (1958).

168. Such a single-product firm is likely to sustain a greater injury than a multiproduct firm when both firms are beset by a falling market price on one of its products. The single-product firm is injured in its total business while the multiproduct firm is injured in only one segment of its business. Moreover, the single-product firm lacks the option possessed by the multiproduct firm to expand its sales efforts in unaffected product lines.

169. *Cf.* FTC v. Simplicity Pattern Co., 360 U.S. 55, 59, 63 (1959).

170. *See* Old Homestead Bread Co., *supra* note 7, at 104.

171. *Cf.* S. REP. NO. 698, 63rd Cong., 2d Sess. 3 (1914); H.R. REP. NO. 627, 63rd Cong., 2d Sess. 8-9 (1914).

Such "corroboration" is misleading, because it neglects to consider the impact of total available "supply" on the determination of market price. Whenever supply is reduced, a price rise can generally be expected. In the example, one or more high-volume, more efficient sellers set price at a low level in order to engender the volume which they need for efficient operations; in the process the number of sellers in the market will be decreased. If the decrease in the number of sellers does not significantly increase the abilities of the remaining sellers to act in a consciously interdependent manner, then the price increase is the phenomenon which would be expected in a competitive market when supply shrinks in the face of a stable demand. If the surviving sellers are more efficient than their smaller predecessors, then, even after capacity is readjusted by the exit of firms during the transition period, the final price, although above the prices of the transition period, should be below the prevailing prices of the inefficient producers of the pre-transition period. In such circumstances, the continuing absence of interdependent pricing indicates that competition has not lessened, and the lower price at the end of the transition period indicates that the benefits of competition have been passed on to consumers. However, even when the decrease in the number of sellers does significantly increase the sellers' abilities to act in a consciously interdependent manner, their interdependent prices may still be lower than the preexisting more competitively set ones if the efficiencies of the high-volume sellers are sufficiently great.

The increase of conscious interdependency among sellers should therefore be found unobjectionable when its rational exercise brings the expected long-term price level below that which previously prevailed, or could be expected to prevail, in the initially more "competitive" market structure. Accordingly, the initial price rise which accompanies the exit of some preexisting sellers is unobjectionable so long as the final increase does not bring prices up to the preexisting, more competitively set level of the pre-transition period.

### E. *Factor 1, 2, and 3 Related*

In the preceding discussion some parts of the price reductions of the expanding firms were "temporary," factor-2 reductions, since price was raised as potential supply decreased. A firm which, after the transition period, raises price to a level lower than that which previously prevailed in the local market has employed both factor-2 and factor-3 pricing. So long as there remains a factor-3 component, the firm's "final"[172] price is below

172. "Final" is obviously not used in the sense of unchangeable. Rather, the reference is to a price-level range which, given the firm's cost position and the expectations about long-term demand, appears to reflect the rational pricing options of the firm. The principal focus is a relative one: it examines the range of rational price-making to determine whether such pricing appears to be above or below the range which would have prevailed in the untransformed market structure.

that which previously prevailed in the marketplace, and from the perspective of the end result,[173] the public has received the benefits which competition is expected to produce. However, suppose that the expanding firms' price policies not only produce a significant reduction of the number of sellers in the market but that the price level which prevails (or is expected to prevail) after the transition in market structure has been completed is higher than the preexisting one.[174] In that case the expanding firms will have engaged solely in factor-2 pricing. Measured by the end-result (or expected[175] end-result) test described above, the public will have been subjected to burdens against which "competition" is normally expected to protect it. "Competition," so construed, has been lessened in the local market. In the circumstances described, it can be tentatively concluded that an expanding firm which engages solely in factor-2 pricing has engaged in conduct which has anticompetitive effects,[176] while an expanding firm which engages in factor-3 pricing—whether or not accompanied by factor-2 pricing as well—has engaged in conduct which should be deemed procompetitive for Robinson-Patman Act purposes.[177]

The next question is whether the local-market effects of the temporary price-cutting behavior just described are "caused" by discrimination.[178] To satisfy the causation requirement of the Robinson-Patman Act the seller's low prices must be supported in some way by the seller's higher prices in other markets. To the extent that a firm's prices during the

173. From the perspective of the end-result test, the crucial factors are the prevailing price level in the marketplace and the price levels which are expected to prevail for the foreseeable future. *See* text accompanying notes 153-66 *supra*.

174. *Cf.* Old Homestead Bread Co., *supra* note 7, at 104.

175. An end-result evaluation applied to test the legality of behavior under the Robinson-Patman Act would have to consider not only actual impact on the market, but the probable or likely impact. *Cf.* Corn Prods. Refining Co. v. FTC, 324 U.S. 726, 738, 742 (1945); FTC v. Morton Salt Co., 334 U.S. 37, 50,56-58 (1948).

176. The circumstances described involve a market transformation in which the degree of seller interdependence in pricing is increased. Since the tendency towards increased interdependency apparently is not offset by the operation of cost factors which would operate to pressure prices downward, the only relevant factor for assessing the impact of the pricing on an end-result test is its tendency to increase seller interdependency.

177. "Procompetitive" is a conclusion determined by application of the end-result test described above. *See* text following note 153 *supra*.

If at the end of the transition period the longrun prospects are for a price level lower than that of the pre-transition period, due to increased efficiencies in operations, the end-result test would consider the transition a "procompetitive" one. But suppose the combination of factor-2 with factor-3 pricing imposed such a strain on existing firms that the market was forced to a higher level of concentration than would have been necessary to produce the increase in production efficiency and concomitant lower prices. In such a case the depressing influence upon price brought about by increased efficiencies would be offset to some extent by a partially unnecessary increase in conscious interdependence among the surviving firms. Hence the long-term post-transition price would be lower than the pre-transition price, but somewhat higher than it might have been had more firms survived the transition. The factor-2 pricing which gave rise to the unnecessary increase in conscious interdependence ought, in the spirit of the end-result test, to be deemed anticompetitive. But this line may be too fine to warrant following in normal enforcement proceedings.

178. *See* text accompanying notes 89-98 *supra*.

transition period are at levels which would be above the firm's unit costs calculated with reference to the (realistic) sales-volume objectives which the firm's temporary low prices are designed to achieve, then at least wben the firm has reached its sales-volume objective its pricing behavior within the local market is self-supporting;[179] its local operations are not supported or subsidized by revenues earned elsewhere. At all times, prices have been at a potentially self-supporting level, the self-support being contingent only upon the ultimate achievement of the firm's sales-volume goal.[180] If, during the transition period, price remains below unit cost, even after the firm reaches its volume goal, then the firm's conduct at its volume goal is not self-supporting. Moreover, if during the immediate post-transition period, price is raised to a level as high or higher than that which prevailed during the pre-transition period and only at this later time covers unit cost, then the situation is such that the firm's local operations were in fact subsidized from other operations at all times during which its prices were below the pre-transition price level. Under the end-result test it was concluded that a firm whose behavior both tends to increase the level of market concentration and produces post-transition prices which are higher than the pre-transition prices has produced an anticompetitive impact on the market.[181] The further conclusion that the firm's local behavior was subsidized from its other revenues satisfies the Robinson-Patman Act's causation requirements. In the situation described, a Robinson-Patman Act violation bas now been established.

A consideration of the causation problem is also relevant in the situation in which it was tentatively concluded that the firm's local prices had produced a procompetitive impact on the local market.[182] In this situation the firm's local pricing is not self-supporting until the firm's volume goals have been attained. The firm's initial losses may be analogized to "investments" in the local market which the firm expects ultimately to pay off in significant profits from future local operations. Such an "investment"-oriented perspective suggests that the significant relationship is a chronological one, between the present time period in which the "investment" is made and a future time period in which that investment produces the expected profits.[183]

179. *Cf.* Old Homestead Bread Co., *supra* note 7, at 102, 104; United Fruit Co., 82 F.T.C. 53, 151 (1973).

180. The point here is to identify prices which are not even potentially self-supporting and thereby to establish a strong basis for inferring a supporting relationship between the low local prices and revenues earned from the firm's higher prices elsewhere.

181. *See* text accompanying notes 174-76 *supra*.

182. *See* text accompanying notes 172-73 *supra*.

183. This chronological relationship is contained in the classic model of the predatory geographic discriminator. The classic model, however, focuses primarily upon the simultaneous intermarket subsidy relationship. *See, e.g.*, S. REP. No. 698, 63rd Cong., 2d Sess. 3 (1914); H.R. REP. No. 627, 63rd Cong., 2d Sess. 8-9 (1914); Dean Milk Co., *supra* note 10, 68 F.T.C. at 808-09 (Elman, dissenting).

The investment analogy, however, also suggests consideration of the method in which the "investment" is "financed" in the present period. The firm's ability to make this investment—its ability to operate locally at a loss—depends upon the extent of its accumulated wealth and its revenues from other operations. If the firm is earning profits from selling the same product in other markets at the same time that it is incurring the local losses, it is a reasonable conclusion (although not always a necessary one)[184] that the local losses are being subsidized from those profits, in the sense that the profits contribute to the firm's ability to survive while incurring losses. Thus, it is not unreasonable to attribute a causal relationship between the expanding firm's price discrimination[185] and the local-market effects of its local price undercutting. But since, in these circumstances, the final long-term price level is lower than the pre-transition level, the market structure, on an end-result test, must be deemed more "competitive."[186] Accordingly, to the extent that the discrimination can be said to "cause" any local market effects,[187] it can here be said to "cause" a "procompetitive" change in the behavior of the local market. No Robinson-Patman violation should therefore be found.

The analysis of factor 1 follows the path of that applied to factors 2 and 3. Factor-1 losses are incurred because a firm has incurred fixed costs necessary to its efficient operation at a high-volume level, and they are measured by the excess of its unit costs over the prevailing market price.[188]

184. If the firm's accumulated wealth would enable it to survive without the revenues earned in other operations, then these revenues are not a necessary condition for the firm's survival. *Cf.* Commissioner Elman's dissent in Dean Milk Co., 68 F.T.C. 710, 808-09 (1965), *aff'd in part and rev'd in part*, 395 F.2d 696 (7th Cir. 1968). These extramarket revenues do, however, contribute to the total resource position of the firm, and in that sense can be viewed as a contributing cause of the firm's ability to survive loss operations conducted in a particular market.

185. The distinction here is between the effects of low prices and the effects of discrimination. The focus of the latter is upon the relation of the higher prices to the local-market effects of the lower prices. This relationship can be shown when the higher prices in some way support the lower prices. *See* Borden Co. v. FTC, 381 F.2d 175, 180 (5th Cir. 1967); Dean Milk Co., *supra* note 10, 68 F.T.C. at 808-10 (Elman, dissenting).

186. The argument in the text is that whether a market is more or less "competitive" for Robinson-Patman purposes should not be determined by rigidly applying a "numbers" test which simply counts the number of rivals active in the marketplace, but rather should be a conclusion dependent upon policy considerations implicit in the general understanding of the goals of marketplace competition. As applied here, this latter approach would find that "competition" for Robinson-Patman purposes has increased whenever a market structure has changed in a way which promises a greater likelihood of lower long-term prices. *See* text following note 153 and text accompanying note 177 *supra*.

187. *See* text accompanying notes 89-98 and 177 *supra*.

188. *See* text following note 105 *supra*. That part of the firm's unit losses which is attributable to the excess of unit costs over the prevailing market prices is defined as a factor-1 loss. Those parts of the firm's unit losses which are measured by the difference between the generally prevailing market price (or the market price which would have prevailed in the absence of that firm's price undercutting) and the firm's selling prices are defined to be either factor-2 or factor-3 losses. *See* text accompanying notes 105-07 *supra*. The argument is that factor-1 losses are consistent with pricing which is procompetitive to the extent that the pricing in question moves the market in a more "competitive" direction, either in an ecomomic sense or in an end-result sense.

If a price-cutting firm incurring factor-1 losses ultimately attains its high-volume goals, it may behave in any one of a number of ways. (1) It may raise price to the prevailing market level. (2) It may continue to price below the level of the preexisting market price because the attainment of its goals has not significantly increased the degree of consciously interdependent pricing among sellers in the marketplace.[189] This would be the case where the firm additionally implemented a policy of factor-3 pricing, and the market was large enough to accommodate a sufficient number of high-volume firms to remain competitive in the traditional "numbers" sense. (3) The firm may price at a level lower than the previously prevailing market price even though its expansion (and the concomitant expansion of some other firms) has increased the degree of seller interdependency. Such a result would occur where the efficiencies of the seller's high-volume plant were sufficiently great as to offset the tendency of increased seller interdependency to exert an upward pressure on the price level.[190] (4) The expanding firm (after it has attained its volume goals) may ultimately raise price to a level higher than that which previously prevailed in the marketplace.[191] Such a result might occur when the expansion of several firms created a more oligopolistic market structure, and when the efficiencies resulting from the expansion were not sufficiently great to offset the upward pressure upon price which such a market structure would engender.

Whether the firm follows route (1), (2), (3), or (4), depends upon the shape and placement of the industry demand curve and upon the relative efficiencies of high-volume operations. Whether result (1) is procompetitive, anticompetitive, or neutral depends upon the market structure after the period of discriminatory undercutting has terminated.[192] It has already been argued that results (2) and (3) are procompetitive ones, while result (4) is anticompetitive.[193] Since the firm's local operations initially appear

189. *See* text accompanying notes 161-62 *supra*.

190. An increased degree of seller interdependency will tend to raise prices above the level which they would have reached if marginal cost were equal to price. Yet in a situation in which the marginal cost curve itself has fallen, prices may decrease despite the increase in seller interdependency.

191. *Cf.* Old Homestead Bread Co., *supra* note 7, at 104.

192. In the situation in which the firm in question raised the price to the preexisting market level, the result should be considered neutral from a Robinson-Patman perspective, if market structure remains competitive in a numbers sense. The result should be considered anticompetitive if the numbers of firms in the local market have been reduced to a point where conscious interdependency in pricing is significantly increased. The result should be considered procompetitive if the price-cutting has been instrumental in increasing the number of firms in the market, especially if conscious interdependency in pricing is thereby weakened. It might also be possible to evaluate the situation as "procompetitive" (in the sense described in note 193 *infra*) when the price-cutting has helped to produce sales-volume increases which have made possible the erection of more efficient plants whose efficiencies—although not presently reflected in lower prices—are likely, perhaps because of growing demand, to be reflected in lower prices in the near future. *See* notes 177-86 *supra*.

193. *See* text accompanying notes 153-77 *supra*. The argument is based upon an approach which would import policy considcrations into the terms "procompetitive" and "anticom-

to be at below-cost levels, profits from the higher-priced operations elsewhere could reasonably be deemed to be subsidizing these loss operations under the theory set forth above.[194] It would not be unreasonable, then, to find that the price discrimination is a partial cause of the local-market effects of the expanding firm's low prices, and that when those effects are anticompetitive as they are in (4), the discrimination falls within the proscription of the Robinson-Patman Act.

### *F. Summary*

It will be observed that the approach which has thus far been taken looks for actual losses and lost profits. Actual losses and lost profits can be analogized as "investments" in future profits from local operations.[195] The investment analogy suggests consideration of the way in which the "investment" was "financed"—the way in which the firm was able to support the incurrence of this present investment. In the case of lost profits—profits lower than the firm might have earned during the present period in its local market operations—no difficulty arises in determining how the firm is able to incur the present reduction in its local profits. Its local operations are self-supporting, and some local profit is merely sacrificed during the present period in order to engender larger profits during a future period. In the case in which the firm is incurring actual losses from its local-market operations, however, its local operations are not self-supporting. If it is earning profits from higher-priced operations elsewhere, those profits are part of the total package of resources available to the firm, and hence contribute to the firm's ability to sustain actual losses in one part of its operations. It is therefore not unreasonable to conclude that the higher-priced operations, by helping to sustain the firm while it is carrying on loss operations in the local market, can be a contributing cause of the local-market effects of the firm's local loss operations.

It then remains to assess the effects of the firm's loss operations in the local market. It has, in effect, been argued[196] that if these operations do not increase significantly the degree of seller interdependency, then no anticompetitive impact has occurred. If these operations do increase significantly the degree of seller interdependency, then the competitive impact should depend upon whether increased operational efficiencies will be likely to offset the increased upward pressure on price which such increased seller interdependency usually engenders. In short, if the expected or resulting efficiencies would produce, for the long term, lower prices than prevailed prior to the discrimination, then the structural change should be deemed to be a "procompetitive" one.

---

petitive." Under this approach, the terms are conclusions and not descriptive economic terms.

194. *See* text accompanying notes 89-98 *supra*.

195. *See* text accompanying note 183 *supra*.

196. *See* text following note 161 *supra*.

## VIII. THE "END-RESULT" TEST: OBJECTIONS AND ELABORATIONS

### *A. Comparison With Traditional Approaches*

The A & P branch operations discussed by Adelman[197] were operating at a below-cost level in an effort to gain sales volume through low prices. When the volume was obtained, unit cost would fall and the stores would be operating at a profit. The stores were thus engaged in factor-3 pricing. The Government, however, charged that the stores' below-cost operations were being subsidized by profitable operations elsewhere, and tended to view the A & P operations through the lens of the classic predator model. The "end result" test suggested here would justify Adelman's A & P branch, not because it was not being subsidized during its initial operating period, but because the ultimate result of its operations appears to have been long-term lower prices.[198] An analysis which depends upon a predictive or actual impact upon market prices appears drastically different from most Robinson-Patman analyses which, in form, tend to focus exclusively upon market structure in terms of numbers of firms, but which tend to neglect other influences upon pricing policies.[199]

Moreover, an analysis which examines price-level impact brings to mind the early antitrust decisions which rejected arguments that the courts evaluate restraints by the reasonableness of the price level engendered by these restraints. In rejecting those arguments, the Court explained that it lacked criteria for assessing reasonableness of prices and that it would pose too great an administrative burden upon the courts to continually evaluate the reasonableness of price levels in the face of constantly changing economic circumstances.[200]

Neither of those two objections apply to the proposed analysis which merely takes into account the likely changes in the long-term price structure which would result from certain kinds of discrimination. Since the focal point of the price level inquiry is whether discrimination is likely to raise or to lower the long-term local-market price level, neither the Commission nor the courts need be concerned with the reasonableness of any specific price level, nor with criteria for assessing reasonableness.[201]

197. Adelman, *The A&P Case: A Study in Applied Economic Theory*, 63 Q.J. ECON. 238 (1949). *See* text accompanying notes 99-104 *supra*.

198. Under the analysis set forth in the text accompanying notes 183-87 *supra*, the branch could reasonably be deemed to be subsidized by other operations during its initial loss period of operations. Under the end-result test described in the text, however, the branch would be seen as a procompetitive force so long as its long-term tendency was toward prices lower than those previously prevailing in the market.

199. *See, e.g.*, Dean Milk Co., *supra* note 10, 68 F.T.C. at 750; Borden Co., 64 F.T.C. 534, 568 (1964), *rev'd*, 339 F.2d 953 (7th Cir. 1964); Yale & Towne Mfg. Co., 52 F.T.C. 1580, 1598, 1602 (1956). *Cf.* National Dairy, *supra* note 7, 71 F.T.C. at 1427-28; Forster Mfg. Co., 62 F.T.C. 852, 899-900, 904-07 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964).

200. United States v. Trenton Potteries Co., 273 U.S. 392, 396-98 (1927). *Cf.* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 213-14 (1940).

201. The criteria, rather, examine the tendencies of an altered market structure to move

Second, no continuous supervisory function is involved in assessing the likely permanent impact on local-market pricing resulting from the discrimination. The inquiry is the same one-time-only inquiry which the Commission and the courts presently pursue in connection with their assessment of the probable impact of discrimination upon market structure.[202] Indeed, the present suggestion is that the market-structure inquiry proceed in the manner in which it is presently being carried on, but that the inquiry be broadened to take into account the full implications of the prospective change in market structure. If seller efficiencies will more than offset the upward pressures upon price which a reduction in the number of sellers would be likely to engender, then that fact is a relevant aspect of a full examination of the structure of the firm and of the industry, and of the manner in which the two interact in the market.[203]

Finally, the focus upon selling price suggested here is not foreign to Robinson-Patman decisional approaches. Selling price is necessarily involved in cases concerned with price discrimination.[204] In addition, the courts have not infrequently attributed significance to the apparently long-term price level of a firm, either as evidencing the cessation of discrimination,[205] or as evidencing a misuse of its power over price.[206]

### B. *A Brief Comment on Subsidy Analysis*

One form of the traditional subsidy analysis tends to see the low prices of a discriminating firm as involving lost profits or losses which are subsidized by monopoly or quasi-monopoly profits earned elsewhere.[207] Ex-Federal Trade Commissioner Elman, for example, has asserted that the

long-term prices above or below the level which would be expected to prevail under the preexisting market structure.

202. Judgments by the Commission and the courts about impact or tendencies of discrimination upon market structure are made in one proceeding and are not generally followed up by that kind of supervision which would continuously readjust the decision or decree in the light of each change in market conditions. It is true that decrees are sometimes readjusted to take account of major changes in market conditions whose occurrences were unprovided for in the original decrees. Under the end-result test the Commission and the courts could similarly reopen a decree for adjustment in the light of major unforeseen contingencies without committing themselves to a continuous supervisory function.

203. The assumption here is that market analysis properly includes consideration of the interaction of industry and firm demand with firm costs.

204. Since price discrimination is merely a difference in selling prices, a tribunal considering an alleged violation of the Robinson-Patman Act must focus on selling prices at least to the extent of ascertaining whether selling prices differed. *Cf.* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 549 (1960). Although market structure is the prime focus of primary-line cases (*see* note 199 *supra*), some degree of attention to relative price levels and profit margins is not uncommon. *See, e.g.*, Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 263 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966); Forster Mfg. Co., 62 F.T.C. 852, 903-04 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964), *cert. denied*, 360 U.S. 906 (1965).

205. *E.g.* FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 540 (1960).

206. Old Homestead Co., *supra* note 7, at 104-05; Forster Mfg. Co., 62 F.T.C. 852, 899-900 (1963).

207. S. REP. No. 698, 63d Cong., 2d Sess. 3 (1914); H.R. REP. No. 627, 63d Cong., 2d Sess. 8-9 (1914).

requisite subsidy is likely to occur only if the discriminating firm is selling goods at higher prices in monopoly or quasi-monopoly markets, because only in such markets can the firm earn the extracompetitive profits necessary to support the firm's low prices.[208] He thus incorporates into his analysis of the subsidy relation an inquiry into the structure of the higher-priced markets in which the discriminator is selling. The inquiry is limited, however, to the number and market shares of the firms active in those markets.

In contrast, the approach offered here is one which admits the legitimacy of inferring subsidization of local-market, below-cost pricing from a firm's other operations, whether or not those other operations occur in monopolistic or oligopolistic settings and whether or not the firm earns extracompetitive profits in those other markets. Moreover, under this approach, a subsidy for lost profits (as opposed to actual losses) in local-market operations is less likely to be inferred than it is under some of the more traditional subsidy approaches.[209] The subsidy inference is less likely to be drawn because a sacrifice of some, but less than all, locally derived profits is consistent with self-sustaining operations.

The specific changes from the more traditional approach outlined here, then, are a depreciation of the importance of finding extralocal-market operations in quasi-monopoly settings, and a heightening of the importance of incorporating cost data into the assessment of firm and market structure in order to evaluate the consequences of market changes which occur as a result of discrimination. This assessment has as its focus an inquiry into the actual or likely longterm pricing which is foreshadowed by the discrimination.[210]

### C. *A Troublesome Case*

Suppose (1) that a local market is presently occupied by a number of firms possessing identical cost curves, (2) that each firm is operating at a

208. Dean Milk Co., *supra* note 10, 68 F.T.C. at 800 (Elman, dissenting).

209. Under traditional subsidy approaches, the loss of profits which would have been earned had the commodities in question been sold at a "fair" profit have been seen as requiring recoupment from the revenues earned from higher prices imposed elsewhere. *See, e.g.*, H.R. REP. No. 627, 63d Cong., 2d Sess. 8-9 (1914).

It should be noted, however, that Ex-Commissioner Elman, a strong proponent of a subsidy approach to section 2(a), has indicated that he would find it difficult to establish the existence of a subsidy relationship between operations in two markets unless operations in one market are carried on at prices below the level of "out-of-pocket costs." *See* Dean Milk Co., *supra* note 10, at 808.

210. Such long-term results are, in effect, the social ends which a competitive-market economy is intended to achieve. When, in peculiar circumstances, competition in a numbers sense does not promote the goals toward which a competitive-market economy generally tends, the courts have given various indications that the goals of efficiency and low prices are paramount to competition (in the numbers sense). *See* United States v. Terminal R.R. Ass'n, 224 U.S. 383, 398, 402-03 (1912); United States v. Aluminum Co. of America, 148 F.2d 416, 429-30 (2d Cir. 1945). *Cf.* Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582, 584 (1st Cir. 1960). *But cf.* Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962); United States v. ALCOA, *supra*, at 429.

point at which its unit-cost curve is falling,[211] (3) that each firm is maximizing its shortrun profits by operating at its present price and output, and (4) that substantial barriers prevent the entry of additional firms into that market. In this case operating efficiency will be improved if some of the firms leave the market. Existing demand divided among a smaller number of sellers would, by increasing the volume of each, enable each such seller to operate at a lower point on its average-cost curve. In a purely competitive marketplace experiencing productive capacity in excess of the longrun equilibrium level, the interplay of aggregate demand and supply would force prices downward to a level below the cost of some or all firms and maintain them at that below-cost level until a sufficient number of firms had been eliminated to permit price to rise eventually to the level of minimum industry average cost.[212]

In the case posited, the number of firms is too small to facilitate the impersonal operations of the market in this manner.[213] Accordingly, it is possible that price will continue to be maintained at an above-cost level while each of the firms experienced some unused capacity.[214] However, any one or group of firms could, by reducing price to a below-cost level, force the general price level down to a point where the financially weaker firms—but not the less efficient, since all firms are, by hypothesis, equally efficient—would be eventually eliminated from the market.[215] Such conduct might be a rational response to a situation characterized by excess capacity, low profits, inefficient use of plant and a market structure which holds the promise of future returns that would more than offset the losses incurred during a present period of below-cost selling.

211. The situation described is one of overcapacity. In a purely competitive market such a situation might arise, for example, when, after production capacity grew to meet long-term demand for the industry's product, substantial decreases in that demand occurred. The overcapacity situation described also resembles one which is found in the so-called "tangency" solution to the problem of imperfect competiton. See D. DEWEY, THE THEORY OF IMPERFECT COMPETITION: A RADICAL RECONSTRUCTION 24-41 (1969). *See also* E. CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION 106 (8th ed. 1962). In the imperfect-competition situation, however, the longrun equilibrium situation is one in which each firm's profit has been eliminated as a result of repeated entries of new firms sharing industry demand. With each entry, the demand curve faced by any one firm moves to the left, until eventually it is tangent (or close to tangent) to its unit-cost curve. In the case posited in the text, entry barriers prevent this occurrence.

212. P. SAMUELSON, ECONOMICS 448 (8th ed. 1970).

213. R. TRIFFIN, MONOPOLISTIC COMPETITION AND GENERAL EQUILIBRIUM THEORY 104-05 (1940). *See* E. CHAMBERLAIN, THE THEORY OF MONOPOLISTIC COMPETITION 48 (8th ed. 1962). *Cf.* Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 658, 660-63 (1962).

214. In the situation described, each firm would experience a demand curve which is falling to the right. In such circumstances, marginal revenue would intersect marginal cost while marginal cost is still below price. Hence, the costs to the firm of employing further capacity would be covered by the revenues generated by the sale of the units produced with that further capacity.

215. In a purely competitive market, it is expected that, in the situation described, market price would (through a process of competitive underbidding) gradually descend to a below-cost level which would eliminate the weaker firms.

In both the instant example and in Adelman's A & P branch example, price-cutting is undertaken to increase the economies of local operation. In the instant situation the price-cutting firm knows its price reductions will be replicated by its rivals[216] and, accordingly, seeks the higher volume of sales from a market restructured by the withdrawal of some of those rivals. Adelman's A & P branch may be seeking its volume goals from business new to the market. But it is more likely that its new business will be drawn from preexistent rivals, and it is not at all impossible that the diversion of trade to it will force some of those rivals out of business.[217] While the A & P branch, however, would implement efficiencies inhering in a cost curve apparently below that prevalent in the local market, in the instant situation the sellers have identical cost curves.[218] While the goal of production efficiency is attained, it is attained by weeding out some firms upon a criterion of financial strength.[219] Especially when that financial strength derives from extralocal-market revenues generated by discrimination, the market restructuring is not without its legally cloudy aspects.[220] If, however, the market restructuring will tend to produce an apparently long-term price level below that previously prevalent in that market, the end-result approach would find the price-cutting lawful.[221]

The end-result test does guard against the use of external revenues to restructure the local market for the purpose of raising local prices above the level which previously prevailed. This prohibition may in fact significantly limit the kinds of discriminatory behavior which it would be rational for a firm to employ. Discrimination designed to force prices upward by the use of market power acquired through the demise of local rivals or to maintain a prevailing price by disciplining local rivals would not be protected by the end-result test. Within the limits of such an end-result test, a firm would rationally employ discriminatorily below-cost pricing whenever the potential efficiencies in higher-volume local-market operations would operate to reduce long-term prices below the level prevailing prior to the discrimination, but not otherwise.

A problem may be perceived to arise here from the "financing" of the below-cost pricing. Factor-3 pricing will achieve its goals largely by diverting sales from smaller firms lacking the scale economies of the firm engaged in factor-3 pricing. Factor-3 pricing is an "investment" type of market behavior. Present losses are incurred in order to engender the

216. This is the case in oligopoly. *See, e.g.*, American Tobacco Co. v. United States, 328 U.S. 781, 804-10 (1946). *See* note 213 *supra*.

217. *Cf.* Old Homestead Bread Co., *supra* note 7, at 102 (10th Cir. 1973). *See* text accompanying note 170 *supra*.

218. *See* text accompanying note 211 *supra*.

219. *See* note 215 *supra*.

220. The history of the Robinson-Patman Act and its predecessor, the original § 2 of the Clayton Act, evidence a high degree of sensitivity towards extramarket revenues subsidizing local-market prices which are designed to force local rivals out of the market. *See, e.g.*, text accompanying notes 14 and 207 *supra*.

221. *See* text accompanying notes 163-66 *supra*.

volume which will, as one of its effects, recompense the firm for its initial losses. The longer the loss period extends, the more the firm employing the factor-3 prices requires external support to offset those losses. Revenues generated from sales of like commodities in other markets is one source of such support. If those sales are at higher prices, then receipts from those sales are a contributing cause of the firm's ability to engage in factor-3 pricing. Restated, the firm's discriminatory price structure supports its factor-3 pricing behavior and is a contributing cause of the local-market effects of the factor-3 pricing, including the impact of such pricing on small local rivals. Yet, if the factor-3 pricing appears likely to produce permanently lower prices in the local marketplace, the aggregate impact of the factor-3 pricing—judged on a criterion of efficiency and benefit to consumers—is procompetitive.[222] The discriminatory price structure, therefore, can properly be said to be a contributing cause[223] of this procompetitive result.

## IX. AN EVALUATION OF THE ROBINSON-PATMAN ACT LAW IN TERMS OF THE MARKET-STRUCTURE TEST

An evaluation of the courts' and the Commission's approach to below-cost pricing reveals that they have been moving towards an acceptance of the market-structure analysis developed in this article for factor-1 and factor-2 pricing.[224] The factor-1 reason for price falling below unit cost has received some recognition in the cases and the proportionality approach to factor-2 pricing tends to parallel Commission attitudes. However, the courts and the Commission have failed to evaluate factor-3 conduct in the light of the end-result test which seeks to implement the Robinson-Patman Act's efficiency mandate.

In two cases the Commission has indicated an increased sensitivity to the factor-1 effects of pricing by exhibiting a willingness to tolerate a temporary period of below-cost undercutting by a new entrant.[225] And the Commission has indicated that in assessing whether an entrant's prices are,

222. That is, it would be justified under the proffered "end-result" test. *See* text accompanying notes 153-66 *supra*.

223. *See* text accompanying notes 89-98 *supra*.

224. *See* note 30 *supra* and accompanying text.

225. National Dairy, *supra* note 7, at 1440; Dean Milk Co., *supra* note 10. In *Dean*, then-Chairman Dixon, writing for the Commission, commented:

> Respondents contend that their prices were below unit cost only because their volume of sales was low. Although a new entrant into a market may not be able to avoid prices which are below unit cost when it first begins selling, that situation is decidedly different from the present situation where respondents' below cost sales first occurred some five years after their entry into the market. In any event, we do not think that the Robinson-Patman Act permits a large, multi-market seller to undercut prevailing local prices by pricing its products below unit cost or at prices yielding only negligible profits for an extended period of time or after it has been in the local market for a number of years, if it maintains higher prices in other markets and recoups its losses or the absence of normal profits either from such markets or from superior cash reserves built up through activities in other markets, provided there is a reasonable possibility of statutory competitive injury. 68 F.T.C. at 775 n.147.

or are not, below cost, certain expenses—such as advertising expenses-[226]—would be disregarded. There is some room for development inplicit in these cases. If advertising expense is, in certain types of entry cases, to be disregarded, so should other types of capital expenditures. Surely, the factor-1 effect bears upon all fixed costs which must be made in sufficient amounts to support sales volume increases that have not yet taken place.

The recommendations in Section VI with respect to factor-2 pricing largely parallel current practice. In Section VI it was suggested that lawfulness ought to be assessed by examining the discriminatory pricing's potential for working a change in market structure. In this regard, the proportionality of a price cut—in terms of its depth and its duration—in relation to the seller's legitimate goals was offered as one means for singling out cases for further inquiry on potential market-structure impact. In this connection, proportionality could serve as a perspective from which to view those cases[227] which have found anticompetitive tendencies in temporary, but deep and prolonged, undercutting, and perhaps it could provide a basis for harmonizing them with a basic market-structure approach. Finally, it was suggested that discriminatory price-cutting to levels equal to, or above average cost appeared unable to support an inference of Robinson-Patman unlawfulness, because no causal connection could be shown between the discrimination and a threatened change in market structure.[228] Case law appears consistent with the main lines of these suggestions. The Commission and the courts at least say that they are applying a market-structure test.[229] And the causal approach tends to find persistent, if intermittent expression in judicial opinions.[230]

The matter of factor-3 pricing was before the Commission in an

---

Dixon here is differentiating advertising from other production and sales costs. He appears to be arguing that the presence of a profit computed without taking cognizance of advertising expenditures makes below-cost sales not quite fully below cost. Indeed, his reference to the treatment of advertising expenses as capital investment raises the question as to whether the impact of other capital cost components would be similarly muted in the Commission's determination of whether discriminatory sales were or were not "below cost." Is the Commission, for example, neglecting fixed-cost components in its determination of "cost"?

226. *See* note 225 *supra*.

227. Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 702-03 (1967); National Dairy, *supra* note 7, 71 F.T.C. at 1426-28.

228. *See* text accompanying notes 178-87 *supra*.

229. An unusually sophisticated court opinion employing such an approach is International Air Indus., Inc. v. American Excelsior Co., 517 F.2d 714, 720-26 (5th Cir. 1975), where the court follows the analysis suggested by Areeda & Turner, *supra* note 3. *See* Dean Milk Co., *supra* note 10, 395 F.2d at 711; Borden Co. v. FTC, 339 F.2d 953, 957 (7th Cir. 1964); William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 389 F. Supp. 1334, 1342-44 (N.D. Calif. 1975). *See also* Dean Milk Co., *supra* note 10, 68 F.T.C. at 750; Lloyd A. Fry Roofing Co., 68 F.T.C. 217, 263 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966); Borden Co., 64 F.T.C. 534, 568-70 (1964), *vacated*, 339 F.2d 953 (7th Cir. 1964); Forster Mfg. Co., 62 F.T.C. 852, 904-05 (1963), *vacated and remanded*, 335 F.2d 47 (1st Cir. 1964), *cert. denied*, 380 U.S. 906 (1965).

230. Dean Milk Co. v. FTC, *supra* note 10, 395 F.2d at 705, 711-12, 713-14; Borden Co. v. FTC, 381 F.2d 175, 180 (5th Cir. 1967); Shore Gas & Oil Co. v. Humble Oil & Refining Co., 224 F. Supp. 922, 926-28 (D.N.J. 1963).

attempt-to-monopolize context in *United Fruit Co.*,[231] where the Commission conferred some limited legitimacy upon that form of pricing behavior. In that case a fruit distributor—which had just built a new warehousing plant twice the capacity of its preexisting one[232]—reduced its prices to a level which was initially below its unit costs, but which would exceed unit costs when sufficient new volume had been attracted by the reduced prices.[233] The distributor seems to have operated at a loss for almost a year after the price reduction went into effect.[234] The Commission found no specific intent to monopolize by the distributor, largely on the ground that because of projected local population growth, the distributor's new plant was not "excessively large" and its decision to expand its plant, therefore, was "entirely reasonable."[235]

The Commission's acceptance of factor-3 pricing here was, of course, quite limited: the Commission merely held that no specific monopolistic intent was implied by the occurrence of that form of pricing under the circumstances. Yet the Commission was again recognizing—as it had twice earlier in Robinson-Patman contexts[236]—that expected sales volume increases would lower unit costs over a period of time and thereby convert "below cost" sales into profitable ones. The two earlier cases had dealt with entry situations and therefore, perhaps, only with the factor-1 effect. But in *United Fruit Co.*, the doubling of plant size, combined with the price reduction, provides a strong indication that the situation involved a factor-3 aspect as well.

The Commission's acceptance of factor-3 pricing was limited, however, by its observations that the plant size was reasonable under the circumstances of the projected growth in population.[237] The implication is that if the population had not been projected to grow, the new plant might have been "unreasonably" large, and the Commission would have found a specific intent to monopolize on that basis. There is thus some ground for believing that, although the Commission is becoming more sensitive to factor-1 explanations of below-cost pricing, the Commission has not yet accepted factor-3 pricing where a more efficient and higher-volume plant is constructed in a situation in which the operator of the new plant will, by expanding his own operations, significantly reduce the number of sellers in the marketplace. In short, the Commission has probably not yet reached the point where it is ready to accept the proffered "end-result" test. Its increasing sensitivity to the factor-1 effect, however, may yet dispose it to

231. United Fruit Co., 82 F.T.C. 53, 151-56 (1973), *aff'd in part and rev'd in part on other grounds sub nom.*, Harbor Banana Distributors, Inc. v. FTC, 499 F.2d 395 (5th Cir. 1974).

232. 82 F.T.C. at 155.

233. 82 F.T.C. at 151, 152.

234. 82 F.T.C. at 151. Most of its rivals incurred losses during that period as well. *Id.* at 153.

235. 82 F.T.C. at 156.

236. *See* note 225 *supra*.

237. 82 F.T.C. at 156. *See* text accompanying note 235 *supra*.

assess the factor-3 analysis carefully. Moreover, an assessment of its responsibilities to ensure the public the benefits of production and distribution efficiencies which competition should engender, as well as a growing awareness by the Commission of the role of a functionally competitive and efficient marketplace in holding down prices, may yet move it towards the end-result approach.

A case in which a court failed to use an end-result type test and in which the use of such a test would have clarified the court's analysis is *Continental Baking Co. v. Old Homestead Bread Co.*[238] In that case a bakery company constructed a new plant which was able to attain efficiencies unavailable to its rivals, but only at a substantially higher volume than that at which it was then operating. Indeed, it would have had to increase its preexisting sales by 50 percent in order to attain a level of profitable operations.[239] In order to increase its sales, the company marketed a private label product whose price was maintained at a level 1 cent below that of its regular brand and of rival brands.[240] As a result of this pricing behavior, the company's sales expanded rapidly with the result that one of its major rivals was forced out of business. Shortly thereafter, the company raised its prices.[241]

Against that background, the Tenth Circuit affirmed a jury verdict (and associated treble damage award) against the bakery for unlawful price discrimination. The court based its affirmance largely on the ground that a jury finding of predatory intent was warranted.[242] In this connection the court discussed the size of the company's plant, as well as the length, depth and below-cost aspects of its pricing. The court relied upon the United States Supreme Court opinion in *Utah Pie Co. v. Continental Baking Co.*,[243] for the proposition that predatory intent could be found from "'persistent unprofitable sales below cost and radical price cuts themselves discriminatory.'"[244] Moreover, the court noted that the bakery's new plant was "the largest in the Rocky Mountain area," and that, at its opening, the plant operated—unprofitably—at 50 percent of capacity.[245] With specific reference to the company's goal of production at 75 percent of capacity, the court said, "in view of the existing suppliers, the achievement of that goal would indicate that [the company's] operations were based on something more than 'fierce competitive instincts.'"[246]

238. *See* note 7 *supra*.
239. Old Homestead Bread Co., 476 F.2d at 104.
240. *Id.* at 102.
241. *Id.* at 104.
242. *Id.* at 104-05.
243. 386 U.S. 685, 702 n.14 (1967).
244. 476 F.2d at 104.
245. *Id.*. At its opening, the plant operated at 50% of capacity. The plant became profitable when it could be operated at 75% of capacity, or at a 50% increase over its initial operating level.
246. 476 F.2d at 104.

The unlawfulness of the company's pricing thus rested upon its predatory intent, which was inferred from the disproportionate size of the company's plant. Whether or not the plant was disproportionately large was judged by examining the existing demand and the existing suppliers in the local market. This approach bears a marked similarity to the approach used in *United Fruit Co.* where something close to an objective test for a reasonably sized plant—given the existing suppliers and projected increases in demand—was employed by the Commission to determine the presence or absence of specific monopolistic intent.

However, the partially objective test employed in *Continental Baking*[247] completely ignores the efficiency imperative contained in the Robinson-Patman and other antitrust acts.[248] Whether or not the public is better off with cheaper bread than was previously available is a question which the court did not consider. The rise in price after the demise of the local rival was seen by the court as a confirmation that the bakery was exercising newly acquired market power in the manner of the classic predator.[249] The Court did not inquire as to whether the initial price rise was a concomitant of the decreased supply which would necessarily follow the elimination of excess production capacity in any market structure, or whether the production capacity which was eliminated was "excess" at a longrun equilibrium (and socially efficient) level. Neither did the court inquire as to whether the final price level would be higher or lower than earlier price levels. The questions raised by the end-result test were therefore neither asked nor answered.

## X. CONCLUSION

This article has suggested a number of ways of thinking about the application of section 2(a) of the Robinson-Patman Act to the primary-line aspects of promotional price discrimination. For most of the history of section 2(a) and its predecessor, the original section 2 of the Clayton Act, the case law has been largely confused. One way of dealing with this mass of confusion is to ignore it and to offer a standard based solely upon

247. *See* National Dairy, *supra* note 7, 71 F.T.C. at 1419-21. In that case the Commission came close to employing an objective—reasonably foreseeable—analysis to conclude that the respondent was predatorily motivated. The consequences of the respondent's pricing, including the immediate displacement of its rivals from a substantial share of the targeted local markets, and particularly, the inability of its rivals to meet those prices, were foreseeable by the respondent. The respondent was therefore charged with intending those consequences.

248. *See* text accompanying notes 28-29 and 53-54 *supra*. *See, e.g.*, Blake & Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377, 394-98 (1965); Blake & Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422, 436-40 (1965). Even Judge Hand who was outspoken in suggesting that social factors be incorporated into the interpretation of the Sherman Act despite losses of efficiency, also suggested that an efficiency-created monopoly ought not to be held to violate the Sherman Act. *See* United States v. ALCOA, 148 F.2d 416, 427, 429-30 (2d Cir. 1945).

249. 476 F.2d at 104.

economic analysis as a guide for future decisions. This is essentially the path followed by Areeda and Turner in their recent article,[250] and it has already been adopted by the Fifth Circuit.[251]

In this article, however, a different route was taken—one which is more incremental. The approach taken hy this article was to respect the patterns of concern repeatedly expressed by the courts and the Commission, and to inquire into the validity of those concerns. Frequently, conceptual bridges were built from the sometimes confusing analytic patterns of existing case law to a more coherent and economically sound approach to primary-line price discrimination. Accordingly, the approach adopted in this article accepted the case law's concern with below-average-total-cost pricing, as superficially valid and examined that concern to determine the extent to which it has, in fact, a rational basis.

The end-result test developed in this article justifies market structure alterations which increase efficiency and confer the benefits of that efficiency on the public. That the antitrust laws in general—including the Robinson-Patman Act—are concerned with the promotion of efficiency and consumer benefit cannot be denied. That they contain as well strands concerned with the preservation of small enterprise as such—even at the expense of efficiency—has been asserted. Yet the conflict between efficiency and public benefit on one hand, and noneconomic goals on the other, has not been adequately explored. The end-result test proffered here is one which does embody legitimate antitrust values. A major, and indeed chronic, criticism of the Robinson-Patman Act is that it stifles competition and thereby imposes higher prices upon the public. If the Act were to prevent "competition" from performing its traditional function of replacing inefficiency with efficiency and passing on the benefits of increased efficiency to the public, then that criticism would be justified. Serious consideration of the end-result test by the Commission, the courts, and

250. *See* Areeda & Turner, *supra* note 3.

251. International Air Indus., Inc. v. American Excelsior Co., 517 F.2d 714, 724 (5th Cir. 1975). Here Dixon is apparently conceding that during a limited "entry period" a new entrant may price below (1) unit cost; (2) prevailing market prices; and (3) the seller's prices elsewhere.

In one part of the *National Dairy* case complaint counsel had urged that Kraft's below-cost pricing proved the predatory nature of its intent. Dixon, however, writing for the Commission, rejected this inference. He justified his conclusion by pointing to the fact that although the dairy company sustained net losses for each of these 3 years, it earned a substantial net profit before advertising in the last two of those years. He further pointed to testimony from a representative of the company's Kraft Food Division to the effect that the Division "traditionally regards advertising on a new product for the first three to five years as part of its capital investment." Dixon continued along this line of analysis by concluding:

> In any event, it does not appear to be unusual for a company introducing a new product to sustain a net loss. We are not convinced that the net losses sustained by respondent, particularly since it would have to employ extensive advertising in the primary marshmallow topping market, dominated by a competitor, in order to gain consumer acceptance, is sufficient to warrant a finding of predatory intent. 71 F.T.C. at 1441.

interested legal and economic scholars would at least bring public benefit again to the center of attention. Furthermore, the fundamental questions about the kinds of "competition" which the Robinson-Patman Act—and perhaps the other antitrust acts as well—should be taken to foster could be faced squarely.