Competition Snuffed Out: How Predatory Pricing Harms Competition, Consumers, and Innovation

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market and Standard Oil was no longer forced to compete, it would raise the prices back up with businesses and communities left paying the inflated costs.

The Supreme Court condemned Standard Oil's predatory pricing as a violation of the Antitrust Laws. In the years that followed, Congress recognized the threat posed by predatory pricing and enacted laws prohibiting a range of unfair pricing tactics. In 1914, Congress enacted the Clayton Act, which strengthened the earlier Sherman Act and included provisions prohibiting price discrimination. In 1936, the Robinson-Patman Act explicitly outlawed selling "goods at an unreasonably low prices for the purpose of destroying competition or eliminating a competitor," in addition to outlying other forms of price discrimination.

In the decades that followed, these laws and precedent were used to check predatory pricing abuses across the economy. Around mid-century, some economists began questioning the viability of predatory pricing as an anti-competitive tactic. The thinking was that predation was too high risk a gamble. Any firm attempting predation would guarantee itself major losses without any similar guarantee that it could make up those losses through raising prices later.

Even if the firm succeeded in driving rivals out of the market through bleeding losses, the strategy would only be profitable if the firm could sustain those higher prices and nothing would stop the competitors from returning and eating into those profits once the predator firm raised prices again. This thinking

How should predation and predatory pricing doctrine account for these new commercial realities, especially when mechanisms for recoupment may look very different than they did decades ago? We've convened a terrific set of market participants today to help us wade through these tricky issues, including people who have a othe-ground view of what predation could look like in the year 2024. Thank you so much again to everybody for joining us, and I will now turn it over to our panelists92 26 13 g 0 G

its third-party sellers. In 2023, third-party sellers on Amazon's marketplace paid Amazon about $170 billion in fees. Analysts believe that this revenue stream is highly profitable, that the cost Amazon incurs

Lyft are now in most US metros in a stable duopoly where Lyft has about a third of the market, and Uber has about two-thirds of the market. Next slide.

How did Uber afford all these subsidies? Well, the short answer is that it lost a lot of money. These are net losses from Uber's financial statements. Note that those numbers in the column on the left are in the billions. Uber, which is a very asset-lite business, it didn't have a sophisticated technology that it was trying to build, it still managed to lose billions of dollars in 2016, 2017, 2018, if you correct the financial statements to smooth out their operations, 2019 and 2020. This money was going to predatory pricing. This money was going to subsidize the rides. Next slide.

Now, of course, as other speakers have talked about, predatory pricing has two stages. There's the predation stage, where prices are really low, and then there is the recruitment stage where prices are really high. We are now in the recruitment stage for Uber. Uber prices have risen considerably in the post-pandemic world, and the few remaining taxes in New York City have also raised their fares now that they're not quite facing the same competition that they once faced from Uber. Next slide. The most important point in our paper is that regardless of whether Uber actually recoups, Uber's venture capitalists have made out like bandits. Benchmark, which was the VC firmTf 1 0 0 1 72.023(fe)10(w34 540.)10

available to consumers has shrunk by nearly 15%. So there's a lot fewer pharmacy choices for consumers just over the last few years.

There was a time when it was the big mass merchandiser chains that were using predatory pricing to drive competition out of the marketplace. But modern

investors, or has another source of revenue, or is simply larger or multi-product or conglomerate, when you have a company like that that has a way to engage in a predatory pricing strategy, you're tipping the market in favor of those companies. Not based on this is not competition on the merits, right? It's not the best-winning, but simply the largest or the ones that are backed by these sources of funds. And in the long run, that's very bad for consumers.

Tamar Katz:

Bill, let's go to you next.

William J. McGee:

Sure. Well, I think the context that needs to be understood with predatory pricing in the airline industry is that, as I mentioned, we are in a more concentrated industry than we've ever had. We're down to just 11 carriers now. But what that means for the average passenger, when we were at American Economic Liberties Project, we were very vocal in opposing the Spirit-JetBlue merger earlier this year. I spoke to many people who said to me, "I never fly spirit. I really don't care if Spirit merges or it goes bankrupt. I have no desire to fly them." And what I said repeatedly was, "You should, because if you fly on a route, even if you're flying with American Delta, United, the largest carriers, a route that is served by Spirit, you

William J. McGee:

Yes, absolutely. When I was at the trial in Boston for the first week with the JetBlue-Spirit case with the DOJ, JetBlue was trying to make the case that, "Well, we're small. Look at the national market share." The line that the CEO kept choosing was, "We're not Coke and Pepsi, meaning that JetBlue and Spirit

minimization of false positives, not wanting to chill, salutary price competition. There is a deep skepticism that predation can actually work in practice. There's a famous quotation that predatory pricing schemes are rarely tried and even more rarely successful. This comment in Brooke Group goes back to an earlier case in which there was a claimed consensus among commentators at that, so that is a claimed consensus among, let's say academics that predation can't happen.

Now, a quick preview of my own take before moving back to the case. This kind of skepticism that we see in Brooke Group I think is unwarranted given the economic theory that was available even at the time of Brooke Group, and certainly has been established since. I think we'll talk more about that in the course of our panel. The two elements of the test are in a lot of tension that is below cost pricing itself is pretty strong evidence that the firm thought it could recoup. And so, where the recoupment test turns out to be decisive in real-world cases, there's a strong risk of a false negative that is of exonerating conduct that is actually really troubling.

I favor seeing these two steps of the test as factors in an overall analysis rather than sharply distinct inquiries in the way that the Brooke Group court seemed to suggest of if we moreover observe strong evidence of profit sacrifice, that seems quite powerful as an economic matter and hence a fruitful place for law to take cognizance of. So, coming back to the case for a minute, a few sort of less...

PART 2 OF 4 ENDS [01:08:04]

Scott Hemphill:

...the case for a minute. A few sort of less obvious aspects of the case that I think bear emphasis. First, the elements of this famous test, price-cost comparison, and prospect of recoupment weren't really contested in the Brook Group case itself. So, as part of some research a few years ago, I took a look at the Blackmun papers, the papers of Justice Blackmun, who was part of the court when Brook Group was decided. And it seems pretty clear that the court was kind of lulled to sleep by the fact that the counsel for each side of the case, Phil Arida, and Bob Bork respectively appeared to agree on the major elements of the test. And so the court just went along with that. So, I think our current predicament is to some degree kind of a result of sleepwalking on the part of the court. Second, most of the opinion is much of the opinion is dicta.

The case itself was quite narrow, not even about a monopolist, but rather about Robinson-Patman Act oligopoly, and an oligopoly recoupment was thought at least by that court to be less likely. It says it really doesn't tell us much about predation by a monopolist. The Blackmun papers further revealed that the court thought that this was a pretty narrow fact-bound case about a specific strategy employed by cigarette manufacturers. They didn't understand it as a case that would decide predation more generally so far as appears, at least from the Blackmun papers. And then finally, it was a pretty narrow, and fact bound focus. The court of appeals below had ruled for the defendants despite the plaintiffs winning at trial, mind you, on the ground that an oligopoly recoupment that is recoupment by multiple rivals was so implausible that it must fail as a matter of law. And at conference, that private discussion among the justices after oral argument, a majority of the court, including Justice Kennedy, was planning to reverse the court of appeals as having gone too far. Ultimately, Justice Kennedy switched his vote, and the result was an extremely deep dive into the details of a particular predation fact pattern. This was necessary given the court's ultimate disposition, which was to reject the verdict of a jury in the district court, and to conclude that the evidence that the jury considered was insufficient for any reasonable jury to find in favor of plaintiffs. But as a result, the expressed skepticism that we see in the case about predation ought to be understood in connection with the narrow theory placed at issue. Now, coming to kind of what is to be done, I think there are a few potential points of flexibility in Brooke Group. I don't count

myself a fan of the opinion, particularly, I'm trying to make the best of a bad situation. So, three brief things here. So, first on the recoupment prong of the test, we need to recognize that monopoly is different from oligopoly.

And so if a district court is evaluating a particular fact pattern, Brook Group's skepticism ought to be confined to oligopoly recoupment. Recoupment by a monopolist should not be met with the same skepticism. And we see in the American Airlines predation case from a few years ago that we may talk about later some comments consistent with recognizing that monopoly is different from oligopoly. Second, where recoupment is supported by some modern theory, modern economic theory of recoupment, for example, earning a reputation for predation, we ought to have some flexibility to ignore, or downplay the music, the negative music of the Brook Group opinion. And then third, when it comes to the price cost test, we often talk about average variable cost as a starting point, but the Supreme Court was not wedded to any particular measure of cost, and so we ought to recognize that

It is difficult for investors to distinguish unsuccessful entrants who just happened to be unsuccessful because their product was not good enough, because their cost structure was not competitive from those that were victims of a predatory campaign. So, what if those investors require some proof of success from the entrants, say they have to generate a certain level of cash flow within a certain amount of time for their credit lines to be extended. Then if you are the incumbent in this industry, you know that you just have to predate up to that threshold, so to speak, up to that cliff across which the entrant will fall if she does not manage to attract enough new financing, if she does not meet that hurdle that investors need to see to be convinced that this is a promising entrant, a promising competing product. So, in those situations, which I think are very realistic, it is perfectly rational, and perfectly profitable for an incumbent to stage a predatory campaign.

And as a final observation, let me also mention that we can tell a very simple story of sequential entry where it is really the scale of entry that determines the success of a predatory campaign. So, we can very simply think of a situation where the entrant has to enter sequentially into different products, or so these can be different markets that open one by one successively. So, in such a situation, if the

Last thing I want to address, what can be done? I've laid out many of the difficulties that someone faces, and when you're a private plaintiff, and largely represented by a contingent law firm who's putting up real money, millions of dollars for economic analysis, you want to have some expectation that you have a reasonable chance for success. I think if these cases are going to flourish, inevitably we're going to need to take into account the significant impact of what Chairman Kahn called targeted pricing, and what I may be more pejoratively referred to as price discrimination, which is the ability to use high prices in various segments of the market to fund targeted below cost pricing in another segment of the market. And my own view is, and had we reached summary judgment without resolution in the Uber

merits, when in fact they've just been outcompeted because of predatory pricing. The problem has been trying to find these examples in the wild, trying to see this happen in real life. As co-author, and I, Matt Wansley argued in this paper Venture Predation.

Next slide, please. We think you can find this example in Silicon Valley. So, let me just talk briefly. Matt talked about it earlier, but just to introduce this theory again. So, if you think about classic predation, you take a firm that is going to self-fund, or use bank funding for a price war. Its hope is to chase out the rival, or discipline the rival, and then raise prices above the competitive level. And it really is dedicated to making back all that money because it's on its own account. A venture predation is different, right? So, here the money comes from the venture capitalists. What the venture capitalists is hoping to do is to create a company with a huge amount of scale, and do it very quickly. So, it's going to fund a price war probably to a platform company, allow the platform company to solve the chicken, and egg problem, and get users on both sides of the platform, hoping that company scales very quickly. And then within the tenure timeframe of the venture fund, the venture capitalists are going to cash out either through an IPO, or through an acquisition. And probably some of the founders are going to cash out, too. Okay, next slide please. So, there are a couple differences that are really critical about venture predation as opposed to classic predation. So, the big one I think Matt talked about earlier is that, as opposed to a firm that's doing this on its own account, venture capitalists don't care about recoupment. They don't care if the company ultimately makes back all the money that was lost during the price war. All they care about is convincing the next investor at the IPO, or at the acquisition stage, that this company has enough scale that's going to be able to charge monopoly, or oligopoly prices, and make a good profit for the later investors.

Okay, next slide, please. The second difference that we think is key between venture predation, and classic predation goes to this asymmetric information setting that the post-Chicago School economists talked about. So, if you think about a public company. Now, a public company can try to hide predation through accounting measures. Eventually, probably people are going to ask questions. In a private company of a VC-backed startup, for instance, it's easier to hide predation, it's easier to take advantage of the asymmetric information. The venture capitalists often sit, or almost always sit on the board of the startup. They can work with the founders to get the strategy going. And it's very difficult for the rivals, say the taxicab companies with Uber to understand what's going on.

They might think rationally that Uber has some new efficiency, and that's why they're able to charge below what the taxicabs have been charging for years. But in fact, what's going on is this is venture-backed predation. Okay, next slide, please. Okay, so what are the costs of venture predation, or predation generally? And in the paper we talk about three states of the world with venture predation that we think we've seen. So, one would be successful recoupment. This is, let's say Uber is able to, with Lyft, raise their prices above the competitive level for long enough that they make back every last dollar they spent during the price...

PART 3 OF 4 ENDS [01:42:04]

Sam Weinstein:

... for long enough that they make back every last dollar they spent during the price war. This fits just within Brooke Group as a case law matter, it would be unlawful under Brooke Group if you could show it, but as Lew was saying, it'd be very difficult to show. The harm is obvious, super competitive prices paid by consumers. There are fewer firms to choose from, less product innovation.

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All right, that was terrific. Thank you. So that concludes our presentations and now hopefully we can get all these folks to engage in a productive question and answer period. And I want to start off by noting that I sent some agreement among the panelists that Brooke Group's court's skepticism about whether predatory pricing occurs and is profitable was not warranted and that there is predatory pricing going on in markets that is not being enforced against. And Sam talked some about the cost of that predatory pricing that is not being subjected to enforcement. And I just wanted to ask the other panelists if there are costs that Sam did not mention to this unenforced predatory pricing. Scott, you want to start us off?

Scott Hemphill:

Yeah, sure. I'd be happy to jump in. And I should say for avoidance of doubt, we are definitely in a realm of under enforcement to the extent that the set of cases that are brought as basically zero. And given

Well, I'll jump in on this. I think they will be, and I think that the place where this will be helped is, the emergence of AI and algorithms I think will ultimately convince the courts that some of the rigid standards of Brooke Group cannot go forward in the same way, there has to be some ability to pursue these cases on the basis of the data and you simply can't. You've got to give flexibility. And I do, maybe I'm just an optimist, but I actually think the courts will recognize that for these cases to have any opportunity to succeed, there has to be flexibility in the analysis both on the recruitment side and on the price cost side. And I'm very hopeful that will happen.

Lina M. Khan:

And Scott, I think your article points the way to some of the ways that could happen. I'm curious whether you have seen any evidence in the courts that they are actually embracing some of your very wise insights.

you has a different standard and I would love for you to sort of give a sense of what that standard is and how successful it is and whether you think that would make sense as a standard in US cases as well.

Liliane Karlinger:

Yeah, I'm happy to speak about that a bit. So basically putting on my enforces hat, which I also have as a member of the Chief Economist team here at DG COMP, I can tell you about the legal standard that we havehere in Europe that differs from the US standard in two fundamental ways, and I think both of these give us here more leeway, more discretion to run predation cases. And that is why we have a non zero number of predation cases, not many, but at least a handful to point to.

So one key difference is the legal standard for the price cost test. So in Europe we have one test that is very similar to the one that you have in the US. So [inaudible 01:56:15] principle, if you will, that pricing below average variable cost is considered presumptively illegal in the EU, but it does not end there. So in the EU you can also run cases where prices are above ABC. There is a whole range of prices, even all the way up to average total cost that could potentially be considered unlawful, predatory if, and that's a big if of course, as an authority you can provide evidence of intent to exclude competitors. So that in practice means you need documentary evidence, some internal documents, deliberations of management showing beyond a simple email, an angry email, but really showing that there was a strategy behind this pricing that had as its goal the exclusion of an entrant.

So I think that second leg of the test or that second type of test that we have in Europe strikes a nice balance for those who are worried about false positives. Of course, as soon as you allow prices to go above ABC and still find an instance of predation, that gets you closer and closer to false positives because prices above ABC are compatible with a number of pro competitive strategies, so no doubt. So what really eliminates that risk again is the evidence on intent. Because if that pricing strategy was pro competitive, if it was a matter of what we just discussed, overcoming chicken and egg problems, promotional pricing at the beginning, a pro competitive reaction in one way or another to entry, this would be reflected in the strategy documents of the firm. Where instead it becomes clear that they were consciously sacrificing profit or consciously slashing prices with the sole objective of excluding a competitor, contemplating as an intended result of those actions the exclusion of a competitor that reduces the ambiguity as to what it is exactly that you're seeing in those prices.

So that's one leg. And the other, I think, main difference that we have in Europe is that we do not have to show recoupment. So this is simply not part of the required standard of evidence, which from my own experience in the [inaudible 01:59:12] case, and I'm happy to speak into that later if useful, is it's hugely helpful because it is just very difficult to argue successful recoupment, not necessarily because it doesn't happen, but because it may happen in a different way on a different market. It is just a lot more complex than what in the US case law judges seem to expect of just observing increasing prices on the very same market post exit or post end of the predatory campaign. So since recoupment is not articulated, spelled out in this straightforward way in most predation cases that I've seen, that requirement would not be met in a number of cases that instead were successfully brought in Europe.

signal that they were up to something. It's a sacrifice analysis which we're familiar with from other parts of antitrust.

And just coming back to some of Sam's work with respect to venture predation that I think sometimes we imagine what's needed for a recoupment test is that recoupment was more likely than not, and that just seems totally wrong to me when we think about these sort of long shot strategies.

So one way, I don't think this is necessarily... I don't know whether Sam would agree with the following or not, I'm not sure it's a point of major emphasis there, but you could imagine that let's say a one in 10 shot of a huge amount of recoupment over the course of decades is enough to justify a big expenditure in the moment, that is that recoupment and expected value, even if the probability of achieving that is pretty low to be ought to be enough and so that even if we have a recoupment requirement, we ought to understand that with that in mind, especially in environments where we know that the investors are taking a flyer on a low probability jackpot that the prospect of recoupment could be much dimmer as long as the magnitude is high enough.

Lina M. Khan:

Well, Sam, we're almost out of time, but since your work was invoked by Scott, I want to give you a chance to have the last word.

Sam Weinstein:

Yeah, I just want to completely endorse everything he just said, which is to say one way you might criticize our theory is, well, why would the late stage investors ever take on this company if they look at the documents and say, "Well, they're not really making money." But it's just the reason that Scott said, they think, well, they have a lot of scale, so they're trying to hit a grand slam and they think there's a chance here with a company like Uber that we will hit that grand slam. So it's not irrational for the late stage investors to take the company off the VC's hands. So it's a great point and I completely agree with it.

Lina M. Khan:

Well, unfortunately, that does conclude our panel because we are out of time, but this has been such a terrific discussion and thank you so much to our panelists for sharing your thoughts and insights. I would now like to welcome Commissioner Bedoya to give some closing remarks. Commissioner Bedoya.

Tamar Katz:

predatory pricing, everyone except the predator loses. Today I want to do two things in brief. First, I want to challenge one idea at the heart of Brooke Group, or rather, I want to add my voice to the chorus of people challenging this idea, and that's the idea that predatory pricing is rare. That's the first thing I want to do. The second thing I want to do is highlight what I think is an underappreciated symptom of the recoupment that follows a predatory pricing strategy. We all know that the second prong of predatory pricing under Brooke Group is recruitment through super competitive prices. It's clear to me that often recruitment also manifests as infra-competitive wages, infra-competitive working conditions and infra-competitive product quality.

So taking a step back, since Brooke Group, scholars and economists have done a great job undercutting this idea that predatory pricing is irrational. So there's a whole lot of reasons why someone, a business might want to engage in the strategy. Maybe other firms won't know your pricing below costs. Maybe they'll assume you've just built a far cheaper and better mousetrap so they exit. Maybe all you need is to establish a reputation for being a predator, and that will help you push out your rivals without actually incurring the cost of pricing below costs. So there's any number of ways in which this can be "rational", at least from an economic sense.

But I think for far too long, people have assumed that predatory pricing is in fact rare when it very obviously it's not. And of the scholarship that was highlighted today, I'm especially grateful to Professor Weinstein and Professor Wansley for their article Venture Predation, which highlights how venture capital-backed startups very clearly appear to engage in predatory pricing. So with these massive VC war chests startups price their products and services well below cost. The VCs don't mind if they fail because all they need is just one or two of their bets to pay off. Rivals certainly don't know that startups are pricing below cost because privately held companies don't have the same obligations to disclose their financials as publicly traded companies and so those infracompetitive prices push their rivals out of the market. Once they've established that market share, founders and VCs can make highly profitable exits, not by actually recouping, but by convincing other investors who buy their shares that recoupment is in fact possible. And once the firm actually starts recouping the public and workers suffer.

I'll say that as I was reading Venture Predation, it reminded me of a different cycle that was outlined by author and friend of the FTC, Cory Doctorow, he calls it the let's just say, enblankification of the internet. And all of us have seen that cycle. It goes like this, a platform could be a rideshare platform, a social media site, an online marketplace starts out with low prices and high quality. It builds market share and locks consumers, workers and businesses into the platform. And then when it's time to recoup those losses, prices go up and quality goes through the floor. In 2024, I think people have a very hard time describing that cycle as rare. And while Doctorow's enblankification of the internet is not a one-to-one match to the requirements of the predatory pricing cycle, I think it's close enough that it is very, very hard to call predatory pricing rare. That's my first point on the rarity or rather the commonness of this strategy.

This is my second point, and it ties into something that came up in Professor Wansley and Weinstein's article. They highlight the fact that recruitment might not come in the form just of super competitive prices to consumers that would of course be recognized by the consumer welfare standards, it might also come in the form of infracompetitive wages and working conditions to the working people who supply the labor to the alleged predator. Specifically, they highlight the experiences of taxi drivers who might see that a rideshare company is paying better than a taxi company who might leave their jobs at taxi companies to go drive for that rideshare company, even purchasing vehicles to do that only to see their wages plummet when the rideshare company allegedly enters a recoupment phase.

Now here's the thing is that when I read this, this isn't some hypothetical set of allegations. These are the exact allegations being made right now today by rideshare drivers across the country. So just two