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The Antitrust-Busters With Gavels

Lower courts are trying an end-run around the Supreme Court's consumer-friendly rulings. Utah Pie, *anyone?*

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These days the goal of antitrust is to protect consumers, and the Supreme Court has a new opportunity to advance that goal. But protecting consumers wasn't always the rule. From the 1950s to the 1970s, U.S. courts commonly condemned price discounting as an antitrust violation. Companies were supposed to play nice by keeping their prices high rather than inconvenience their competitors with price wars—even if consumers might have benefited from lower prices.

This unfortunate trend of poorly reasoned court decisions reached the height of ridiculousness in 1967 with *Utah Pie Co. v. Continental Baking Co.*, when the Supreme Court found a frozen-pie company liable for entering a new market with low prices and thus reducing the incumbent's market share to half, from about two-thirds.

Beginning in the 1980s, the Supreme Court began to recognize that aggressive price-cutting is exactly the sort of behavior that antitrust law should encourage, because it helps consumers.

In a string of cases continuing into recent years, the justices made clear that any antitrust claim predicated on the argument that a firm excluded its rival through low prices would require proof that the defendant engaged in predatory, below-cost pricing. The intellectual embarrassment of antitrust jurisprudence of the earlier period has been repudiated by academics across the political spectrum. Economic analysis is now the uniform basis for antitrust analysis.

Undeterred, some lower courts have continued to recognize challenges to price discounting even when the prices are still above cost. The Supreme Court will shortly have an opportunity to review these decisions.

The latest victim of the lower courts' rebuff to the Supreme Court's precedents is Eaton Corp., a longtime producer of heavy-duty truck transmissions in North America. As demand for heavy-duty trucks declined dramatically in the late 1990s and early 2000s, Eaton responded by offering its customers rebates if they met minimum market-share targets in the preceding year. For example, if Volvo purchased 70%-78% of its transmission requirements from Eaton, the Swedish multinational would receive a year-end rebate.

In 2006, ZF Meritor, a joint venture competing with Eaton and backed by a leading European transmission manufacturer, brought a lawsuit alleging that Eaton's market-share rebates had contributed to Meritor's exclusion from the U.S. market. Meritor didn't argue that Eaton's rebates

resulted in below-cost pricing. Nonetheless, the U.S. district court in Delaware allowed the case to proceed to trial. In October 2009, the jury returned a verdict for Meritor.

On appeal, the U.S. Court of Appeals for the Third Circuit in Philadelphia affirmed the jury's liability determination—and even sent the case back for a possible retrial on the question of awarding damages. The appeals court found it unimportant that Meritor had failed to prove below-cost pricing, reasoning that the market-share rebates served as "penalties" on companies that didn't meet their market-share targets and hence coerced customers into semi-exclusive relations with Eaton.

The problem with the Third Circuit's penalty theory is that every financial reward to a loyal customer could, with the stroke of a lawyer's pen, be relabeled a threatened penalty on disloyal customers. Economic analysis, rather than lawyer's labels, should govern antitrust cases.

The Eaton case is part of a larger trend by plaintiffs and lower courts to evade the Supreme Court's price-discounting precedents by arguing that the discount in question had "anticompetitive effects" and therefore shouldn't require evidence of below-cost pricing. But to begin the analysis with the anticompetitive effect of a discount rather than with proof that it was below cost puts the cart before the horse. If a discount wasn't below cost, then an equally efficient competitor would be able to match it and remain in the market. The only rivals excluded by above-cost prices are less efficient ones. Protecting inefficient competitors at the expense of consumers stands antitrust law on its head.

In recent years, cases similar to Eaton's have been filed against manufacturers of medical devices, microprocessors, boat engines, sandpaper, cigarettes and condoms, among others. Airlines, hospitals and media companies have also been in the crossfire. If the Eaton precedent stands, many more cases will surely be filed. The result will be an American economy that is globally uncompetitive and inefficient, and consumers who will pay higher prices for all sorts of products—even pie.

The Supreme Court has an opportunity to review the Eaton decision and reaffirm that above-cost discounting cannot be the basis of an antitrust challenge. Let's not return to the antitrust policy of the 1960s.

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