Supreme Court Decides Predatory Bidding Case

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On February 20, the Supreme Court issued its decision in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.,* No. 05-381, addressing the antitrust analysis of predatory bidding (i.e., paying an above-market price to gain control of a necessary input to the detriment of other buyers) under Sherman Act Section 2. In an opinion by Justice Thomas, the Court unanimously concluded that the predatory pricing test of *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), also applies in the predatory bidding context. As a result, the Court reversed a treble damage judgment of $79 million for the plaintiffs. The practical effect of the decision is to make it very difficult for plaintiffs to prevail in predatory bidding cases. The decision also reflects the continuing strong influence of economic analysis in the Court's antitrust jurisprudence.

Ross-Simmons and Weyerhaeuser both operated hardwood lumber mills in the Pacific Northwest, and purchased red alder sawlogs as inputs for their mills. Although the mills had some long term contracts, an important source was an open bidding market. From 1998-2001, the price of these logs generally increased while the price of finished lumber generally decreased. When, as a result of this trend, Ross-Simmons went out of business in 2001, it brought an antitrust action against Weyerhaeuser, which was the largest sawmill operator in the area. Specifically, Ross-Simmons charged that Weyerhaeuser had employed a number of means to drive up its competitors' costs, including predatory overbidding for sawlogs, overbuying, entering exclusive deals with sawlog suppliers, and making misrepresentations to state officials in order to obtain sawlogs from state forests. It alleged that this conduct constituted monopolization or attempted monopolization of the Pacific Northwest input market for red alder sawlogs. The focus on appeal was the predatory bidding claims.

At the end of the jury trial, Weyerhaeuser argued unsuccessfully that the predatory pricing standard of *Brooke Group* should apply to the predatory bidding claims. Under that demanding standard, a plaintiff must prove, first, that the defendant priced below some measure of cost, and, second, that the defendant could "recoup" its "investment" in the predatory pricing scheme by later increasing the market price after driving its competitors from the market. The trial court refused to give the instructions based on *Brooke Group*. Although the trial court included a number of standard Section 2 instructions, on the critical issue it instructed that the jury could rule for Ross-Simmons if Weyerhaeuser paid a higher price "than necessary" for sawlogs in order to prevent competitors from buying at a "fair" price, or bought more logs "than it needed." This part of the instructions gave the jury the ability to find liability based on completely open-ended standards. The jury found for Ross-Simmons on both its monopolization and attempted monopolization claims, and awarded damages of approximately $26 million, which were then trebled.

On appeal, the Ninth Circuit affirmed. It reasoned that predatory bidding differed from predatory pricing in ways which precluded application of *Brooke Group*. In particular, the conduct of lowering prices—a necessary element of predatory pricing—provides a direct consumer benefit and is generally procompetitive. For that reason, the Supreme Court in *Brooke Group* had applied a high standard of proof so that the risk of antitrust liability would not deter procompetitive price-cutting. By contrast, the Ninth Circuit noted that bidding up the cost of inputs has no necessary effect on prices paid by consumers. Additionally, while an increase in prices for inputs may stimulate competition in the supply side of the market, this effect was unlikely here given the finite supply of alder sawlogs available.

Although the Supreme Court recognized that there are some differences between predatory pricing and predatory bidding, it found that the similarities justify the same high standard of proof. First, from a high-level economic perspective, the Court concluded that the practices are essentially mirror images of each other, with the monopolist gaining market power as a seller, and the monopsonist gaining market power as a buyer. The Court then turned to a review of the similarities and differences from the perspective of its opinion in *Brooke Group*.

The Court found that, like predatory pricing, predatory bidding was an unlikely competitive strategy. Both require significant expenditures in the current period on the chance that the investment will be recouped in the future. In the Court's view, a rational company will rarely find that strategy to be attractive. Moreover, as with charging low prices to consumers, making high bids to suppliers is often competitively legitimate or even procompetitive. The Court identified a number of legitimate reasons why a company might intentionally bid high. Bidding up input prices may simply be the result of a miscalculation, an effort to hedge against a future supply shortage, or a more efficient firm seeking to gain market share.

In *Brooke Group*, the Court had noted that a failed predatory pricing scheme (that is, one in which recoupment does not succeed) benefits consumers by lowering the price in the market. This is a variation of the point that lower prices benefit consumers, and that legal rules should not deter low prices except in very clear cases. In *Weyerhaeuser*, the Court said that the same could be, but is not necessarily, true of a failed predatory bidding scheme. It would only be true if the resulting acquisition of more inputs leads to the manufacture of more outputs and thus lowers prices in the downstream market. The Court did not discuss whether this possible positive effect was likely in *Weyerhaeuser*, but it probably was not. The Ninth Circuit noted that the supply market for sawlogs was highly inelastic, with the result that higher prices would not produce significantly greater supply at the manufacturing level. Also, the Ninth Circuit noted that the finished alder lumber sold by Weyerhaeuser competed in a much larger hardwood market, so that changes in the supply of alder logs might not change market prices anyway. Thus, both generally and as applied in this case, the argument based on this factor for using the *Brooke Group* standard was not as strong as in *Brooke Group* itself.

The Court also noted that successful predatory bidding "presents less of a direct threat of consumer harm than predatory pricing." Successful predatory bidding does not necessarily involve higher consumer prices, unlike predatory pricing where the predator recoups its losses by subsequently charging consumers supracompetitive prices. In contrast, the successful predatory bidder typically uses its subsequent monopsony power to increase profits by depressing input prices paid *to suppliers* without any necessary change in the price charged *to consumers*. The distinction is correct, but it is not obvious that it justifies applying a high standard of proof to predatory bidding claims. The Court's point seems to be that, even though the high standard of proof will allow some successful predatory bidders to avoid liability, that result is acceptable because the resulting monopsony will harm suppliers rather than consumers. The Court thus put a higher value on harm to consumers than on harm to suppliers, even though harm to suppliers through monopsony may cause a significant misallocation of resources the avoidance of which is one of the economic rationales for antitrust law. Although the point was not directly articulated, the Court thus seems to have adopted the theory that the main justification for antitrust law is to prevent harm to consumers. Because this is an issue hotly debated by antitrust scholars, the case could have important significance far beyond predatory bidding.

Based on the above analysis, the Court thus concluded that the standard in *Brooke Group* should apply to claims of predatory bidding. One might have thought that the Court would modify *Brooke Group* to focus on a comparison of the defendant's bids and the bids that one would expect in a competitive situation. Such an approach would focus on the input or buying side, but, with no discussion, the Court stated the first part of the test in terms of the defendant buyer's pricing in its *output* market instead: "only higher bidding that leads to *below-cost pricing in the relevant output market* will suffice as a basis for liability for predatory bidding." (Emphasis added.) The Court thus used the *Brooke Group* test literally for the different issue of predatory bidding. Of course, increasing the cost of the input will affect the profitability of the pricing in the output market, but the Court's test is likely to be met only where the input in question is a large part of the price of the output. If one assumes that prices in the output market are competitive, as they apparently were in *Weyerhaeuser*, the increased price of the product in question as the result of the alleged predatory bidding must at least be enough to eliminate all profit. This might be a reasonable test for the sawmill situation, where the cost of the sawlogs was about 75% of the total costs, but it is an unusual situation for one input to represent such a large percentage of total costs. There may be few real world examples of predatory bidding, but the Court offered no explanation for allowing predatory bidding to create monopsony power simply because the product in question is a relatively small part of the total costs of the defendant.

As in *Brooke Group*, the Court also required a plaintiff to prove that the defendant has "a dangerous probability of recouping the losses incurred in bidding up input prices *through the exercise of monopsony power*." (Emphasis added.) This statement of the test apparently means that one would not consider the possibility of recoupment through increases in price in the downstream market in those situations where the defendant has market power there too. The test is highly fact-intensive, requiring "a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market." Under this test, a plaintiff presumably would have to show that the sellers in the monopsonized market had no reasonable alternatives and therefore would have to accept a significant price reduction for a significant period of time. This part of the analysis would involve the same types of economic analysis of market definition and entry that is common in merger analysis and elsewhere in antitrust. In predatory pricing cases, it is often possible to eliminate claims quickly and efficiently because of the obvious impossibility of recoupment. Thus, the recoupment element is a valuable part of the test in that context, and it makes equal sense for predatory bidding.

The open-ended standard in the instruction used by the trial court in *Weyerhaeuser* was not an acceptable standard for evaluating claims of predatory bidding. It did not provide a basis for separating aggressive but legitimate bidding from bidding that had the potential effect of creating monopsony power. The Court was right to reject that standard. It is less clear that the standard created by the Court is the correct one. Regardless of the correctness of the decision, there is no question that the Court is firmly committed to trying to apply economic analysis in its antitrust decisions. The fact that the decision was unanimous is further proof that antitrust plaintiffs should be prepared to show that their cases can be justified under economic analysis.

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