Antitrust Law Blog

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A Step Back to Square One? California Court of Appeal Elevates UPA Protection of Competitors Over Protection of Competition in Newspaper Ad Dispute

On August 11, 2010, the California Court of Appeal for the First District upheld a jury verdict in favor of plaintiff Bay Guardian Company against defendants New Times Media LLC and San Francisco Weekly, finding that a claim of unfair competition based on below-cost sales of advertising did not require proof of the defendant's ability to recoup losses by subsequent monopoly pricing. *See Bay Guardian Company v. New Times Media LLC*, 2010 WL 3156631 (Cal.App.1 Dist, Aug. 11, 2010).

One of the longest reigning and still simmering disputes under American antitrust law has been the proper judicial analysis of "predatory pricing." Is the principle aim of antitrust to protect "small traders and worthy men"? *See United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 323 (1897). Or is it to benefit consumers through the prevention of artificial restrictions on market prices and output? Over time, it has become generally well accepted that the principle aim of both federal and California antitrust law is the latter – maximization of consumer welfare. *See, e.g.*, William F. Baxter, *Placing The Burger Court in Historical Perspective*, 47 ANTITRUST L.J. 803, 816 (1978); Robert H. Bork, THE ANTITRUST PARADOX 51 (1978) ("the only legitimate goal of American antitrust law is the maximization of consumer welfare"); Don T. Hibner, Jr. & Andrea B. Hasagawa, *The Silver Anniversary of an Antitrust Sea-Change. Continental T.V. and Brunswick at Twenty-Five*, 11 COMPETITION at 32, n.44.

Among the advances in analysis in the predatory pricing arena has been the development of what is generally known as the "structural filter school". By this analysis, cost-based rules are applied only if the market's structural features are such that the challenged pricing behavior is likely to injure consumer welfare. If the only result of below-cost pricing is correspondingly lower prices to consumers, such pricing behavior cannot injure competition. It is only when the price cutter is able to chasten or eliminate competition sufficient to allow it to recoup the price of its predation through monopoly pricing in the period following the exclusion that competition and consumer welfare are harmed. Otherwise, the only result is a continuous stream of rent transfers to consumers. By definition, this cannot injure competition. It is the essence of competition itself. This is generally now referred to as the "recoupment test." *See, e.g., Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) and *Brooke Group Ltd., v. Brown & Williamson Corp.*, 509 U.S. 209 (1993).

In *Bay Guardian*, the Court of Appeal for the First District has now rebuffed a structural recoupment test in a below cost pricing claim under the California Unfair Practices Act ("UPA"). This decision is arguably at odds with the California Supreme Court's decision in *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Company*, 20 Cal.4th 163 (1999) as well as the Second and Third District Courts of Appeal. *Compare Western Union Financial Services, Inc. v. First Data Corporation*, 20 Cal.App.4th 1530 (2d Dist. 1993) and *Turnbull & Turnball v. ARA Transportation, Inc.*, 219 Cal.App.3d 811 (3d Dist. 1990).

How did this happen? For openers, by seizing upon one phrase of the Unfair Practices Act, and disregarding, or at least failing to consider, the declaration of legislative purpose of the first section of the chapter which contains the UPA. *Compare* California Business and Professions Code sections 17001 and 17043. The court held that the "single purpose" to be considered is whether *competitors* have been injured, and not whether *competition* has been destroyed. The decision fails to appreciate that "the purpose of injuring competitors" or "destroying competition" should be read in the conjunctive, as each is a logical construct of the other. Absent an effect on competition that will transfer consumer welfare rents from consumers to producers, there can be no "injury" to competition. The demise of a competitor, where consumer rents continue to accrue and flow to consumers, negates the very concept of "antitrust injury." A better construction of Section 17043 would be to read it as " . . . for the purpose of injuring competitors or [in other words] destroying competition."

The UPA has long been criticized by economists and commentators for the use of a "cost" standard for below cost pricing that is at odds with federal law. Pursuant to Business and Professions Code Sections 17026 and 17029, "cost" has been generally defined as "fully allocated costs", including overhead, as opposed to the average cost of producing and selling the item under consideration. *Compare Amarel v. Connell*, 202 Cal.App.3d 137 (1988) and *Western Union, supra*, 20 Cal.App.4th 1530. Commentators have long recognized that developments under the UPA, at least in isolation, may run counter to the consumer welfare objectives of the Cartwright Act. Accordingly, the UPA needs substantial revision, or at least a more-enlightened judicial understanding of the dichotomy between protecting potentially inefficient competitors, and preserving the "vigorous" competition that benefits consumers. *See Statements of Professor Carl Shapiro and Don T. Hibner, Jr. before the California Senate Judiciary Committee*, 15 COMPETITION at 85 and 111 (2006) (Professor Shapiro, for example, recommends as a workable standard the concept of "average incremental cost", as there may be any number of procompetitive nuances to pricing below total average cost but above average incremental cost).

In other words, to make sense of the principal goal of antitrust law, whether under the federal regime or under California antitrust law, it is irrational and bad public policy to disincentivize sellers from engaging in aggressive competition that will lower cost to consumers and thus promote consumer welfare. Courts are ill-equipped to decide how much of a price reduction should be allowed to protect a small and perhaps inefficient competitor, or how much to "award" to consumers. Unless competition will be injured in a second phase by the imposition of monopoly pricing, consumers cannot be injured, and can only benefit. This, in fact, is the single plain meaning of *Cel-Tech*, 20 Cal. 4th 163, at 186. The same is true in *Western Union*, where the Second District Court of Appeal recognized that in a two firm market, sales below average total cost by a smaller emerging firm could not injure competition.

In the case at bar, the Bay Guardian and the SF Weekly are weekly "alternative" newspapers that compete in the San Francisco Bay areas for advertisers. The plaintiff alleged that the SF Weekly began a campaign of selling below cost advertising to lure advertisers away from the plaintiff, causing plaintiff to lose revenue. Plaintiff sued under the UPA. At the conclusion of a jury trial, the jury found that the defendant had sold advertising space at a price below cost for the purpose of harming the plaintiff as a competitor. It awarded $16 million in trebled damages.

Defendants appealed, arguing that the trial court erred by failing to recognize that a defendant's ability to recoup losses following from below cost pricing is an essential element of a claim under Section 17043 of the UPA. Specifically, defendants argued that the court erred by excluding defense evidence on recoupment, and refusing the defendants' proffered jury instruction on the element of recoupment and its relationship in a predatory pricing case. Lastly, the defendants claimed that the trial court erred by giving a defective instruction on the intent or purpose to harm a competitor.

As is common in predatory pricing cases, much of plaintiff's evidence was of "war stories" garnered from defendant's documents. A number of courts have recognized that the "hot document" or testimony that captures exclusionary comments by a defendant in describing what it will do to the competition, in graphic "Rambo" style hyperbole, is generally considered to be inherently unreliable and ultimately meaningless. *See Morgan v. Ponder*, 892 F. 2d 1355 (8th Cir. 1989); Don T. Hibner, Jr. and Suzanne B. Drennon, *What Lawyers Should Know About Markets, The Good, The Bad and The Ugly*, THE FEDERAL LAWYER (2002) (collecting cases analyzing "Rambo"-statements.) In a nutshell, and in keeping with the logic and rationale of a recoupment element to address injury to competition, there is nothing inherently wrong with a defendant wishing to "annihilate" its competition, so long as consumer welfare gains are realized in the process. As recognized by the California Supreme Court, the purpose of antitrust is to protect *competition*, not *competitors*. *See, e.g., Aguilar v. Atlantic Richfield Corp.*, 25 Cal. 4th 826 (2001); *Cel-Tech, supra*, at 189-90.

However, the First District Court of Appeal, in construing Section 17043, cleverly noted that it did not use the term "recoupment." The court then stated that established case law had not yet specified that the ability to recoup losses, in order to charge supra-competitive prices, was an element of a predatory pricing offense. Thus, the court rejected the *Brooke Group* analysis. The court noted that federal law did not have an intent requirement, while a claim under the UPA did. It noted that federal law "looks to the ultimate monopolistic impact and threatened harm produced by the pricing scheme," while under section 17043, "the very gravamen of the offense is the purpose underlying the anticompetitive act." The court found that there need not be an actual or threatened harm to competition. Thus, the court has taken us a step back and its decision has caused the congruity of California and federal antitrust law, at least in the San Francisco Bay area, to regress. The result may well be more filings under California law, and "show trials" based upon hyperbolic statements gleamed from, as Judge Easterbrook has phrased it, a "warehouse of documents". *See, e.g., A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396 (7th Cir. 1989). Clearly, an intention to injure a competitor does not, without more, equate to an injury to competition. As recognized by Judge Easterbrook, a desire to injure one's competitors is the very essence of competition, and that which makes the engine function. The court has thus disregarded an essential, "false positive" filter in separating the "Rambo-speak" from a legitimate injury to the competitive process.

Authored by:

Don T. Hibner, Jr.
(213) 617-4115
DHibner@sheppardmullin.com

and

John S. Whittaker
(415) 774-2938
JWhittaker@sheppardmullin.com