Pricing Below Cost

In defense of its below cost pricing, Continental relies on a commentary by Areeda and Turner and certain court decisions that have adopted the view, that, if such pricing is above marginal or variable costs, pricing below fully allocated costs should not be presumed to be predatory (RBr. 35–36). In the context of this case, this proposition is not controlling. Such a view overlooks the fact that a large multiplant firm which prices products below fully allocated costs for an extended period of time in a local market either knows or should know that single plant firms in that local market may be irreparably injured or become so "conditioned" that they become "passive" competitors. This conditioning would be especially true in the wholesale bread business because no wholesaler can charge a higher wholesale price for white bread than the lowest wholesale price prevailing in the market for a comparable product without losing a substantial share of its white bread sales.

Continental contends that its pricing practices were reasonable responses to competitive conditions engendered by low retail prices established by captive bakers. It contends that the alternative to below cost pricing is withdrawal from the market (*See* R Reply Br. at 1). Continental's argument might be rephrased to mean that Continental should be free to engage in any conduct that will ensure to it a share of the market sufficient to permit Continental to operate at optimum efficiency. Approval of such a philosophy would negate the principal purpose of the antitrust laws, which is to prevent the restructuring of an industry to accommodate the most powerful member.

Continental also contends that the question of whether it sold its bread products below cost (whether below average variable cost or below fully allocated costs) should be determined on the basis of its costs of selling all products in its line to a particular grocery customer. In this respect, Continental points out that private label bread is sold with the expectation that the wholesale baker, by obtaining the next best position on the bread rack, will increase its sales of **[93]** advertised label bread. Continental suggests that it would never enter into a private label agreement unless it expected to make a profit on the total amount of business done with any customer.

The record shows that Continental does not control the "mix" of products purchased by the grocer. Many factors, including the retail price spread between private label and advertised label products, determine the relative quantities of each label sold. The grocer appears to negotiate private label prices separately and usually makes his decision to enter into a private label arrangement with the wholesale baker on the basis of the wholesale price of the most popular size loaf or loaves of white bread. Although Continental's contention as to measuring costs on the basis of an entire line might have some merit in a different industry setting, the peculiarities of the bread industry make such treatment inappropriate. The record shows that Continental continued selling private label to certain chain stores, although the amount of advertised label also sold could not possibly make the total sale profitable on a fully allocated cost basis.

Unreasonable Pricing Practices

In its recent *DuPont* decision, the Commission set forth criteria by which to measure whether a firm's competitive behavior is reasonable, notwithstanding the anticompetitive effects that might result from such behavior [Current Binder] 3 CCH Trade Reg. Rep. ¶ 21770 (1980) [96 F.T.C. 653]. Aside from the fact that Continental's pricing practices were illegal under Section 2(a) of the Robinson-Patman Act, its practices do not appear reasonable under the stated criteria. For example, below cost pricing cannot be considered to be an ordinary marketing practice and it is certainly not profitably or economically rational in itself. Such practices do not result in improved product performance and it is doubtful whether such below cost pricing would be effective in gaining and in holding market share for a firm which did not have substantial economic resources. In the market setting where the barriers of entry into wholesale baking are high, the anticompetitiveness of the challenged practices are exclusionary and disciplinary. In this respect, the effects of the practices are not reversible. In my opinion, Continental's behavior was not "reasonable" within the framework of a "rule of reason" test.

Price Leadership

Continental points out that it has no power to raise its prices without regard to its competitors' pricing, and that the absence of such power demonstrates that it has no monopoly power, and, in the circumstances of the bread industry, cannot obtain such power.

Although it cannot raise prices unilaterally, Continental is considered to be the price leader in many **[94]** marketing areas, in that, historically, the other wholesalers will usually follow Continental's lead in raising prices. It is not clear whether such leadership is the result of prolonged periods of low wholesale bread pricing, and the necessity to regain profitability, or an automatic response to Continental's moves in order to forestall any disciplinary action.

In my opinion, such price leadership demonstrates Continental's pricing power. In my opinion, Continental's predatory conduct is clearly "intended" to maintain or acquire such pricing power. The price leadership theme appears often in Continental's internal documents and appears to be the principal motivating force behind Continental's conduct challenged in this proceeding.

Alleged Threats

Complaint counsel contend that respondents' predatory intent is demonstrated by certain other actions taken by Continental's personnel against its wholesale baker competitors. For example, in the TCTA (Minneapolis), Continental's officials allegedly made threatening statements to Zinsmaster and Creamy Crust (CCPF 9–82; CC Mem. 97). In the Los Angeles marketing area, certain threats were allegedly made to the Gordons (CCPF 11–58; CC Mem. 122). These accounts are not supported by sufficient non-hearsay evidence to be considered as part of the pricing transactions that are challenged as predatory in nature. However, such events do indicate that some of Continental's wholesale baker competitors were apprehensive about Continental's possible actions in their marketing areas.

Market Strategy

One of complaint counsel's main contentions is that respondents have adopted a strategy of delaying wholesale price increases in order to hasten the exit of their weaker wholesale baker competitors. Complaint counsel cite this "hold-the-line-on-prices" strategy as the indicia of respondents' predatory intent.

Respondents claim that they never adopted such a strategy. They contend that the McKinsey report merely suggested a further study into the feasibility of such a strategy and they deny that Continental's officials ever discussed such a strategy.

The record shows that the effects of such a strategy were discussed among ITT, Continental and McKinsey personnel during the meetings that were part of the study conducted by McKinsey during 1971 (*See* CX 28S, T). Denial of this by respondents belies the management sophistication which is respondents' principal asset. Moreover, there can be no doubt that such pricing would be injurious to Continental's wholesale baker competitors. The record also shows that Continental did maintain low discriminatory, below cost prices on certain **[95]** products, usually on private label products, over relatively long periods of time in certain marketing areas.

It appears, however, that respondents adopted market strategies responsive to each individual market situation. Although their pricing moves were designed to take advantage of the weaknesses of their wholesale baker competitors, it cannot be concluded on this record that such decisions were part of some over-all "hold-the-line-on-prices" strategy. Nevertheless, the fact that respondents were aware of the result of their below cost pricing supplies the "predatory intent" necessary in an attempt to monopolize case.

Market Shares

Finally, Continental argues that in, the circumstances of the bread industry, there is no possibility that it could be successful in obtaining a monopoly in any local market. They point out that the evidence pertaining to the six geographic areas which were the subject of detailed analysis in this case demonstrate that it has not been able to obtain a leading share of any market, much less a monopolist's share in any of those markets.

In my opinion, Continental's actual success or failure of obtaining very high shares of the wholesale baking business in any of these six markets is not important. There is no doubt that Continental has improved substantially its position in the wholesale white bread market in several areas, namely, Denver, Los Angeles, Northern California, and Cleveland. In the latter three, Continental, for all intents and purposes, shares the entire wholesale produced white bread market with one of its multiplant wholesale baker competitors. In Los Angeles and Cleveland, it shares the wholesale baked bread market with Interstate and in Northern California it shares the market with Campbell-Taggart.

High concentration of market shares of the wholesale baked white bread market in a local area does not appear to be procompetitive in the bread industry. Wholesale bakers with established consumer franchises are able to sell advertised white bread at higher prices than other identical products. Maintaining such consumer franchise through advertising creates substantial barriers to entry into the wholesale white bread market because of the limited shelf space available. It is entirely possible that several wholesale bakers with a highly concentrated share of the white bread market can, through observance of price leadership and through control of the source of private label bread available to grocers, obtain higher prices for their white bread products, increase their sales of more profitable advertised label and variety breads, and thus make higher profits. It appears that Continental's strategy in certain markets in which they share the market about equally with another multistate wholesale baker was to emphasize sales of advertised label bread following the events challenged by **[96]** complaint counsel and the withdrawal of some of its smaller wholesale baker competitors from the market. The Northern and Southern California and Denver markets reflect Continental's reemphasis on the higher priced advertised label bread.

Moreover, Continental has been a defendant in private treble damage actions in each of these six markets and it may well be that as a result respondents' conduct since 1974 has been less aggressive in these areas. It should also be pointed out that respondents' production capacity available to service a particular market is limited. Although a multiplant firm such as Continental is more flexible because it can make certain interplant shipments, it does not appear that Continental has the production capacity to take more than a 50% share of any of the six market areas. In fact, with the exception of Pittsburgh and Washington, D.C., Continental's market share of any major wholesale white bread market does not appear to be more than 50% (*See* CX 4(131); *see also* CCPF 6–232).

In my opinion, Continental engaged in practices which contravened the general prohibition against attempting to monopolize. Such conduct violates Section 5 of the Federal Trade Commission Act.

If respondents are not prohibited from engaging in such predatory practices as selling below cost and discriminatory pricing and if the market power or potential market power they have obtained in certain markets is not controlled or reduced, the wholesale baking industry may continue to become more concentrated and less competitive.

ITT's Responsibility for Continental's Behavior

Respondent ITT is fully responsible for Continental's conduct which is the subject of this proceeding and which took place after the merger of ITT and Continental in 1968. It is not disputed that ITT had knowledge of, participated in and ratified Continental's management decisions and policies designed to assure that Continental would contribute its share to ITT's profits (*See* 626, 634–35 Woodward; 885–896 Stolle; CXs 113A, 25A-C; *see* CX 20). ITT benefited directly from Continental's business practices, and it should be named in any order issued in this proceeding. *See P.F. Collier & Son Corp.* v. *Federal Trade Commission,* 427 F.2d 261 (6th Cir. 1970), *cert. denied,* 400 U.S. 926.

Conclusions of Law

1. The Federal Trade Commission has jurisdiction over the subject matter of each of the counts of the complaint in this proceeding.

2. The Federal Trade Commission has jurisdiction of respondents. [97]

3. Respondent International Telephone & Telegraph Corp. is engaged in interstate commerce as "commerce" is defined in the Federal Trade Commission Act.

4. Respondent ITT Continental Baking Company, Inc., is engaged in the sale and shipment of bread in interstate commerce as "commerce" is defined in the Federal Trade Commission Act.

5. The baking, sale and distribution of white pan bread and bread

type rolls by wholesale bakers is an appropriate relevant product market in which to evaluate the conduct of respondent ITT Continental Baking Company, Inc.

6. The respondents' acts and practices as hereinabove found, hindered, lessened, eliminated, injured, destroyed or foreclosed actual and potential competition in wholesale baking and increased the probability that respondents will attain monopoly power in the wholesale baking industry in local geographic markets.

7. The respondents' acts and practices, as hereinabove found, are in violation of Section 5 of the Federal Trade Commission Act, as amended, and of Section 2(a) of the Clayton Act, as amended.

8. The proceeding is in the public interest.

Remedy

In the order filed with their proposed findings, complaint counsel seek provisions that: (1) would require the divestiture by respondents of five bakeries (Beverly Hills, Sacramento, Minneapolis, Akron, and Salt Lake City, Utah); (2) would require compulsory trademark licensing of respondents' trade names to these new wholesale bakers; (3) would prevent respondents from impairing the viability of the bakeries to be divested; (4) would reinstate the moratorium on acquisitions which expired in 1973; (5) would prohibit sales of bread products below cost; (6) would prohibit price discriminations in the sale of bread products; and (7) would require respondents to maintain certain records pertaining to its costs (*See* CC Mem. 174–181; CCPF 5–60–5–66).

Respondents contend that there is no record support for the proposed divestitures because the record in Docket 9000 does not detail the present competitive posture or financial condition of the five bakeries selected by complaint counsel for divestiture (R Reply Br. 68–72). Respondents argue that the proposed compulsory licensing makes no sense. They point out that Continental would be eliminated from any market in which it could not use its brand name (advertised label) because two bakers could not use the same brand name in any one market. Respondents also point out that the provision of the order that prohibits Continental from hiring personnel employed by the [98] bakeries selected for divestiture is unfair to the employees and would, in any event, eliminate Continental from the markets involved (R Reply Br. 70-71). Respondents also argue that the Commission does not have the authority to order divestiture in a case brought pursuant to Section 5 of the Federal Trade Commission Act which does not involve illegal acquisitions.

Respondents challenge complaint counsel's proposed ban on future acquisitions, noting that the record does not contain evidence of any illegal acquisition since the Commission, in 1973, refused to extend a 1962 order which prohibited such acquisitions.

Respondents argue that the provision of complaint counsel's order that prohibits Continental from selling any of its bread products below fully allocated costs is not only unprecedented but would put Continental out of business. For example, if a competitor established prices above its marginal costs but below Continental's fully allocated costs, the competitor would be able to take away Continental's business.

Respondents argue that the prohibition on price discrimination would eliminate their private and secondary label sales because such products would have to be priced at the same level as its advertised label. They also point out that the provision, as written, would not permit the use of the "meeting competition" or other statutory exceptions.

It is well settled that the Commission has wide discretion in its choice of a remedy adequate to cope with the unlawful practices in which respondents were found to be engaged. *Federal Trade Commission* v. *Ruberoid Co.,* 343 U.S. 470 (1952). That discretion will not be overturned by the reviewing courts unless the remedy has no reasonable relation to such practices. *Ruberoid Co.,* 343 U.S. at 473; *See Jacob Siegel Co.* v. *Federal Trade Commission,* 327 U.S. 608, 611–613 (1946).

In my opinion, the Commission has the authority to order divestiture to break up a monopoly or to restore competition that might have been lessened as a result of illegal conduct, even where no acquisition has been challenged. *See Federal Trade Commission* v. *Dean Foods Co.,* 384 U.S. 597, 606 n.4 (1966); *L.G. Balfour Co.* v. *Federal Trade Commission,* 422 F.2d 1, 23 (7th Cir. 1971); *International Boxing Club* v. *United States,* 358 U.S. 242 (1959). Otherwise, the Commission could not fulfil the Congressional mandate "to prevent . . . unfair methods of competition" in cases involving illegal monopolization or attempts to monopolize.

Notwithstanding the general rules concerning the Commission's discretion and authority in issuing orders, the provisions of any order must be realistic and the consequences of a respondent's compliance therewith must be compatible with the result the order is intended to accomplish. *See L. G.* **[99]** *Balfour* 442 F.2d at 23; *compare Colgate Palmolive Co.* v. *Federal Trade Commission,* 310 F.2d 89 (1st Cir. 1962) *with Federal Trade Commission* v. *Colgate Palmolive Co.,* 380 U.S. 374 (1965), *reversing Colgate Palmolive Co.* v. *Federal Trade Commission,* 326 F.2d 517 (1st Cir. 1963).

Respondents' objections to the divestiture provisions of the order raise serious questions as to whether the order will accomplish complaint counsel's purpose. As I understand complaint counsel's position, they intend to establish five independent single plant baking companies in order to restore effective competition in four local markets by reducing the level of concentration of market shares among wholesale bread bakers. In this respect, complaint counsel appear to envision that Continental will still be one of the wholesale baker competitors in each market; they point out that Continental will have at least one bakery in each market, *viz.;* DiCarlo in Southern California; San Francisco and Oakland in Northern California; Rochester in Southern Minnesota; Columbus and Dayton in Ohio; and Ogden in Utah.

I agree with complaint counsel that the viability of these new bakeries would depend on large part on each one having a strong consumer franchise. Compulsory licensing of Continental's established advertised brand name, Wonder, would accomplish this. But, on the basis of this record, respondents are correct in pointing out that grocers would not purchase the same brand product (Wonder) from two different wholesale bakers. And if Continental was successful in developing a consumer franchise for another brand, for example Home Pride, the newly created bakers could, under the provisions of the order, require Continental to grant them a license to use that brand name also.

It should be pointed out that the major wholesale baker competitors in four of the markets in which complaint counsel's newly created wholesale bakers will operate are multiplant corporations, Interstate in Los Angeles and Cleveland, American in Minneapolis, and Campbell-Taggart in Sacramento. The record indicates that Interstate and Campbell-Taggart also discriminated in price and sold bread products below their fully allocated costs. While it should not be presumed that any wholesaler will engage in illegal practices, the record facts do point out how vulnerable complaint counsel's newly created one-plant wholesale bakers will be to the competition of major multiplant competitors, who apparently will not be under conduct prohibitions such as those contained in the proposed order in this case. I am not certain that the newly created companies would be any more competitive than Inglis, Gordon, Prosser or Laub proved to be. In spite of the illegal practices in which respondents were found to be engaged Continental does provide competition that checks the market power of those other multiplant corporations with which Continental now shares a monopoly in these marketing areas. **[100]**

Although the legal and factual issues in this case turn on the importance of white pan bread to wholesale bakers, as well as to retail grocers and consumers, it is also clear that successful wholesale bakers sell a complete line of bread products, including variety breads and muffins. The record shows that during the relevant time periods during which the challenged practices took place, many of Continental's bakeries specialized in producing particular products. For example, the Minneapolis bakery produced mainly white bread and white bread buns and rolls, whereas the Rochester bakery produced mostly variety breads. The Akron bakery produced only white bread and was supplied with variety breads from other Continental bakeries in the Detroit region. Although the Beverly Hills bakery appears to have had the capability of producing both white pan bread and variety breads, it was supplied with buns and rolls and certain variety breads from the DiCarlo and the Salt Lake City bakeries. In my opinion, the viability of complaint counsel's newly created wholesale bakers must depend in large part on their capability of producing, or purchasing for resale at wholesale, a full line of bread products.

I agree with respondents that the record does not contain specific information about the current competitive posture or financial condition of the bakeries targeted for divestiture. One of complaint counsel's expert witnesses who recommended divestiture as a possible remedy in this case, agreed that the feasibility of any divestiture would depend upon a very extensive examination of the bakeries to be divested in terms of production, finance and economics (8083 Boyle). Although such a record difficiency could be remedied by reopening the record in this case, a greater problem exists. It can be anticipated that any divestiture that may be ordered by the Commission will not actually take place until the mid-1980's, because any such order will not have any force and effect until it becomes final, following Commission decision and court review. Moreover, during this period of time, respondents will not be subject to the ancillary prohibitions of the order relating to transferring personnel, holding separate the operation of the bakeries, and preserving the viability of the bakeries as such separate entities.

Although it is impossible to predict what changes in facts and circumstances may take place during this interim, it is highly unlikely that complaint counsel, by creating five new independent one-plant wholesale bakers, can accomplish their intended purpose of restoring the competition that was lessened by the exit of independent wholesalers from the various markets. I am also of the opinion that the targeting of individual plants for divestiture at this time is not appropriate. If ultimately, such a style of divestiture is deemed appropriate, the designation of the individual plants to be divested should be made on the basis of the competitive realities and financial conditions that exist at the time of the divestiture. **[101]**

During the hearings, complaint counsel's expert witnesses also proposed the divestiture of groups of Continental bakeries in geographic proximity to one another. They also recommended that ITT be required to divest Continental.

It is not clear why complaint counsel have abandoned these alternative forms of divestiture. In my opinion, the practices of selling below cost and discriminating in price over relatively long periods of time in selected marketing areas for the purpose of driving competitors out of the market or "conditioning" them to accept and follow Continental's price leadership was only possible due to respondents' vast economic resources with which they subsidized the losses incurred by their individual bakeries which were engaged in such practices. The only way to ensure that such economic power is not misused in the future is to eliminate the source of the power which appears to engender such anticompetitive practices. Complaint counsel appear to rely upon such a rationale regarding the proposal to have Continental divest its Salt Lake City plant.

The Administrative Law Judge recommends to the Commission that it consider ordering ITT's divestiture of Continental and the restructuring of Continental, with or without divestiture, into financially autonomous regional wholesale bakery units. This restructuring of Continental should overcome the problems inherent in situations where individual bakeries do not have the capability of producing a full line of bread products, a fact which makes the divestiture of individual plants impracticable. With the possible exception of some transshipments of products from the Braun bakery in Pittsburgh to the Youngstown and Akron bakeries, there does not appear to have been any serious product interdependence between Continental's regions.

Respondents' objections to the provision of the order banning future acquisitions are well taken. The record in this case does not support any finding that respondents have illegally acquired any bakery or bakery assets during the time periods involved or in the marketing areas which were the subject of this proceeding. In my opinion, such a ban bears no reasonable relationship to the illegal practices in which respondents were found to be engaged.

The paragraph contained in complaint counsel's order that prohibits price discriminations is directed to differences in price between competing customers. It would not appear to cover so-called territorial price discriminations as found to have been implemented in the Minneapolis and Rochester marketing areas. In this respect, the price discrimination prohibition does not appear to be directed at preventing direct subsidization of below cost prices in one marketing area through higher prices in a second marketing area.

Moreover, the proposed price discrimination paragraph could be interpreted, as respondents contend, to prohibit [102] outright any sale of private label or secondary label at any wholesale price lower than the wholesale price of the same size loaf of advertised label bread. The record in this case shows that such a price difference, although discriminatory, may not have an adverse effect on competition if the lower wholesale price for private label bread or secondary label bread is above Continental's competitors' average total costs of producing the same product, including a margin of profit, and where the resulting retail price spread between private label and advertised label bread is not extreme.

Complaint counsel take the position that their price discrimination provision in the proposed order "prohibits unlawful price discriminations." In my opinion, a separate paragraph covering private label and secondary label bread should be included in the order which adopts some of the statutory language relating to competitive effects. Such an all inclusive provision would clarify the ambiguities that appear in the version proposed by complaint counsel. In addition, a paragraph will be added prohibiting territorial price discriminations resulting in prices on advertised label bread that undercut the prevailing market price for advertised label bread and injure competition between competing wholesale bakers.

The "meeting competition" and other statutory exceptions or defenses are implicit in any price discrimination order, unless specific determination is made that certain conduct does not meet the requirements of the statute, such as selling below fully allocated costs.

The absolute ban on sales below Continental's fully allocated costs appears to be unreasonably harsh. Although respondents must expect some "fencing in," the order should not place them in an impossible business position. *See Federal Trade Commission* v. *National Lead Co.,* 352 U.S. 419, 431 (1957). The principal vice found in this case is the predatory use of sales below fully allocated costs to take business away from competing wholesale bakers in selected markets. In my opinion, sales below Continental's fully allocated costs should be permitted only in situations where competing wholesale bakers are actually selling below Continental's fully allocated costs and where Continental affords a price below fully allocated costs to retain the business of a specific customer.

For the above reasons, the provisions of the order relating to divestiture, compulsory licensing and future acquisitions will be deleted from complaint counsel's proposed order. The price discrimination and sales below cost provisions will be modified to conform with the views expressed in this section of the initial decision. **[103]**

ORDER

For purposes of this order, the term *respondents* refers to respondents International Telephone & Telegraph Corp. and ITT Continental Baking Company, Inc., and the successors, assigns, officers, directors, agents, representatives, employees, subsidiaries, and affiliates of either of them and the term *bread* refers to the products encompassed by the Bureau of Census' Standard Industrial Classification Codes 20511 and 20512 (1973), commonly known as bread and bread type rolls.

I

It is ordered, That respondents, directly or indirectly, in connection with the sale of bread in or affecting commerce, as "commerce" is defined in the amended Clayton Act, shall cease and desist from discriminating, directly or indirectly, in the price of advertised label bread between purchasers in the same line of commerce, by granting a price reduction from the established market price in any market where respondents are in competition with any other wholesale baker if the effect of the lower price may be to substantially injure competition between respondents and their competitors engaged in the wholesale baking business in the market in which the price reduction is granted unless it proportionally reduces its prices everywhere on the same advertised label bread products.

II

It is further ordered, That respondents, directly or **[104]** indirectly, in connection with the production, marketing and sale of bread in or affecting commerce, as "commerce" is defined in the amended Clayton Act, shall forthwith cease and desist from discriminating in the price of any advertised label bread product and the price of any private label or secondary label bread product of like grade and quality y selling to any purchaser at a higher price than the price charged ny other purchaser who, in fact, competes with the purchaser paying he higher price and where the effect of such discrimination may be bstantially to lessen competition between respondents and their mpetitors engaged in the wholesale baking business or between spondents' customers paying the higher price and respondents' cusners paying the lower price.

III

It is further ordered, That respondents, directly or indirectly, in connection with the production, marketing and sale of bread in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, shall forthwith cease and desist from selling any bread product below their fully allocated costs; *provided* that nothing herein contained shall prevent respondents from selling below their fully allocated costs in order to retain an established volume of business with specific customers and where competing wholesale bakers are actually selling identical products at the price at which respondents sell such products below their fully allocated costs. **[105]**

IV

It is further ordered, That respondents shall maintain, at all times, records of its cost of producing and distributing each bread product. Such records shall be kept up to date so that no such record is more than six months old. The costs of manufacturing, selling and distribution and overhead shall be reflected in such records, so that the fully allocated cost of each product can be ascertained. The fully allocated, incremental, average variable or marginal cost reflected in any such records shall be binding upon respondents in any enforcement proceeding involving violation of Paragraphs I, II and III of this Order. In the event the costs of any bread product is at issue in an enforcement proceeding involving violations of Paragraphs I, II and III of this Order and respondent cannot produce such a cost record of a product at issue, respondents may not object to the use of a cost record pertaining to an advertised label of the same grade and quality as a product at issue to show the costs of a product at issue. Such cost records shall be kept for ten years.

V

It is further ordered, That respondents shall, within sixty (60) days after the date of service of this Order submit in writing to the Federal Trade Commission a verified report **[106]** setting forth in detail the manner and form in which respondents intend to comply, are complying or have complied with this Order.

VI

It is further ordered, That respondents notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or of any other change in the corporation which may affect compliance obligations arising out of the Order.

OPINION OF THE COMMISSION

BY DOUGLAS, *Commissioner:*

Introduction

The complaint in this matter alleges that International Telephone and Telegraph Corporation, through its wholly owned subsidiary ITT Continental Baking Company, Inc. (hereinafter referred to as "Continental"), violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45 (by violating Section 2 of the Sherman Act, 15 U.S.C. 2), and Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act, 15 U.S.C. 13(a).[1] Count I of the complaint alleges that Continental engaged in the following practices, *inter alia:*

> (1) Sales of bread [at prices] below . . . cost or at predatory prices for substantial periods of time in various geographic markets; [2]
>
> (2) Subsidization of sales below cost or at predatory prices in various geographic markets by sales at higher prices in less competitive geographic markets;
>
> (3) Discriminations in price, directly or indirectly, between purchasers of bread of like grade and quality.[2]

Count I concludes by alleging that these practices represented an attempt by Continental

> to monopolize and injure competition in the wholesale baking industry in relevant geographic markets in violation of Section 5 of the Federal Trade Commission Act.

[1] The following abbreviations are used in this opinion:

ID	–	initial decision page number
IDF	–	initial decision finding number
Tr.	–	transcript of testimony page number
CX	–	complaint counsel's exhibit number
CAP	–	complaint counsel's appeal brief
CAB	–	complaint counsel's answering brief
CRB	–	complaint counsel's reply brief
CMF	–	complaint counsel's memorandum supporting proposed findings of fact and conclusions of law
CPF	–	complaint counsel's proposed finding of fact number
RX	–	respondent's exhibit number
RAP	–	respondent's appeal brief
RAB	–	respondent's answering brief
RRB	–	respondent's reply brief
RMF	–	respondent's memorandum supporting proposed findings of fact and conclusions of law
RPF	–	respondent's proposed findings of fact number

[2] For the purposes of the complaint, "bread" is defined to encompass "white pan bread and bread type rolls and related products."

Count II of the complaint alleges, *inter alia,* that Continental discriminated

> in price, directly or indirectly, between different purchasers of bread, by selling bread of like grade and quality to some of such purchasers at substantially higher prices than to other of such purchasers.

Count II concludes by alleging that these practices violated Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act.[3]

The Administrative Law Judge (ALJ) determined that Continental sold white bread products at predatory and discriminatory prices for significant periods of time in five relevant geographic markets: Cleveland, Denver, Northern California and Western Nevada, Southern California, and the Twin [3] Cities of Minneapolis and St. Paul.[4] The ALJ concluded that Continental had attempted to monopolize white bread product sales in each of those markets; should be held liable for primary-line price discrimination in each of those markets; and should be held liable for secondary-line price discrimination in the Cleveland and Northern California/Western Nevada markets.[5] The ALJ issued an order that would prohibit Continental (1) from discriminating in the sale of advertised label and private label bread products, where the effect of the discrimination might be to substantially injure or lessen competition among competing sellers, or to "substantially lessen competition" among competing buyers; and (2) from selling such products at prices below fully allocated costs, with certain exceptions.[6]

On appeal, Continental argues that it did not attempt to monopolize the relevant markets or engage in illegal price discrimination, and that the complaint in this matter should be dismissed. Complaint counsel argue that the findings and order of the ALJ should be sustained, and that in addition the Commission should (1) require Continental to divest its "plants, [4] equipment and other assets" located in Sacramento and Beverly Hills, California; Akron, Ohio; Minneapolis, Minnesota; and Salt Lake City, Utah; and (2) prohibit Continental, for ten years, from acquiring any bread manufacturing facility without first securing Commission approval.

The complaint raises important questions as to the extent to which the Commission should act to prevent firms from selling at allegedly

[3] The complaint contains a variety of other allegations, but the allegations described above represent the gravamen of the complaint and subsume all its other allegations.

[4] The ALJ concluded that Continental did not attempt to monopolize a sixth relevant geographic market in Seattle, Washington. Complaint counsel have not appealed that determination.

[5] Primary line discrimination cases under the Clayton Act address injury to competition among rival sellers, while secondary line discrimination cases address injury to competition among favored and disfavored buyers.

[6] The order would permit sales at prices below fully allocated cost in order to "retain an established volume of business with specific customers," where "competing wholesale bakers are actually selling identical products" at the same price.

predatory or discriminatory prices. As a general proposition, firms should be accorded the discretion to set prices at whatever levels they choose in response to competitive conditions, since permitting that flexibility is most likely to maximize consumer welfare. Section 2 of the Sherman Act and Section 2(a) of the Clayton Act are intended, *inter alia,* to prevent pricing conduct that injures competition and therefore reduces consumer welfare. However, as we noted in *General Foods,* overly broad efforts to apply these standards may sometimes chill "the rivalry that is the essence of dynamic competition" by discouraging aggressive price and non-price competition.[7] Therefore, the legal and economic standard for evaluating allegedly predatory or discriminatory conduct should carefully distinguish the structural conditions and behavioral patterns that are likely to improve competitive performance from those that are likely to injure competition. We have concluded that Continental's conduct did not violate either the Federal Trade Commission Act or the Clayton Act, and have therefore determined to dismiss the complaint in this matter in all respects. [6]

I. INDUSTRY CHARACTERISTICS

The International Telephone & Telegraph Corporation is a large corporation whose $10.2 billion in sales placed it ninth among domestic corporations in 1973. IDF 1. Continental, its wholly owned subsidiary, manufactures and distributes a wide variety of food products, including bread, cake, snacks such as potato chips, and frozen prepared foods. In 1972, Continental's total net sales amounted to $865 million. IDF 2. Continental has been the largest bread and snack cake baker in the United States since 1924; in 1970, its $375 million in sales of these products represented 12.4 percent of total industry sales nationwide.[8] In 1973 its bread sales amounted to approximately $445 million; by 1977, they had increased in nominal terms to $609 million.[9] Continental's largest competitors in wholesale baking include Campbell-Taggart, American Baking Company, Interstate Brands Corporation, Flowers Bakery, and Metz Baking Company. IDF 10. In addition, it confronts substantial competition from the large captive bakeries that many retail grocery chains operate to produce most of the bread they sell in their retail stores. *See* IDF 19.

Wholesale bakers typically produce white bread, hamburger buns, and hot dog rolls, as well as variety breads such as whole [7] wheat, rye, and pumpernickel breads. IDF 20. Economies of scale are impor-

7 *General Foods Corp.,* 3 Trade Reg. Rep. (CCH) ¶22,142 (April 6, 1984), at 22,973. [103 F.T.C. 204 (1984)]

8 IDF 4; *ITT Continental Baking Co.,* 84 F.T.C. 1349, 1395 and n.4 (1974).

9 IDF 3, 43. In constant 1973 dollars (as adjusted by the producer price index for total finished goods), Continental's bread sales actually declined to $429 million in 1977. *See Economic Report of the President* (February 1, 1984), 285.

tant in the baking industry; moreover, wholesale bakers must operate their bakeries at approximately eighty percent of maximum production capacity (encompassing two full production shifts and some overtime) in order to maximize production efficiency.[10] The costs of producing white bread are generally uniform among bakeries. However, chain store bakers enjoy a distributional cost advantage that is attributable to differences in delivery methods.[11]

Most wholesale bakers sell bread primarily to retail grocery stores; their other bread customers include restaurants, institutions, and hotels.[12] Continental and most other wholesale bakers market an "advertised label" line of bread products sold under a brand name that is usually owned and promoted by the wholesaler. Continental's principal advertised brand is "Wonder Bread," it accounts for most of its white bread sales. IDF 29. Continental and most other wholesalers also sell "private label" bread products—usually including the most popular white bread [8] loaf sizes, and hamburger and hot dog rolls—that are packaged for sale under the private labels of retail grocery store chains. IDF 30. Finally, some wholesalers sell "secondary label" bread to independent grocers that are too small to have their own private label programs.[13] Nearly all remaining bread that is sold in retail outlets is "captive label" bread; that is, it is produced by the retail grocery chain that sells it. In 1971, captive and private label bread accounted for thirty-six percent of total white bread sales in the United States; by 1977, that percentage had climbed to approximately fifty percent. IDF 32, 38. Most retail grocery stores, including chains with their own bakeries, will carry limited quantities of the advertised label breads of each of the wholesale bakers active in a given area. IDF 34.

The "quality, nutrition, palatability and physical features" of white bread are relatively similar from one brand to another.[14] The wholesale and retail prices of advertised label bread are typically higher than those of private, captive, controlled, and secondary label breads, largely because wholesale bakers have been able to create consumer franchises for their [9] advertised label bread products. IDF 35, 36. However, as the size of this price differential increases, advertised

[10] IDF 23; Shaus, Tr. 11204–05, 11223–24; *see* Jakacki, Tr. 10295, 10300–02.

[11] IDF 27. Retail chain stores use semitrailers, driven by hourly rate Teamsters, to deliver their bread to the "doors" of their retail outlets, for shelf placement by their own employees. By contrast, wholesale bakers generally use more highly paid "route salesmen"—Teamsters who earn a salary plus coommission—to distribute their bread products to retail grocery stores and restaurants, and place the bread on the shelves. IDF 25–27.

[12] IDF 24. For example, restaurants and institutional accounts represent approximately thirteen percent of Continental's total route sales. *Id.*

[13] IDF 31. A wholesaler may also sell bread to a given retailer under a label that the wholesaler controls, but to which the retailer is accorded exclusive license in a particular area. This bread is referred to as "controlled label" bread because the label is ultimately controlled by the wholesaler rather than by the retailer. *Id.*

[14] IDF 35. This does not mean, however, that all white bread should be considered to be identical. There are of course some quality, nutrition, palatability, and physical differences among brands.

label bread loses more and more sales to private, captive, controlled and secondary label breads. Conversely, as the size of the differential declines, these other types of labels lose more and more sales to advertised label breads. IDF 36.

The bread industry has undergone some very substantial changes over the last twenty years, and an earlier Commission case involving Continental produced some useful evidence as to competitive conditions during the time period at issue in this case. In 1962, the Commission issued a consent order against Continental that, *inter alia,* prohibited it from acquiring any interest in, or the assets of, any concern engaged in the production and sale of bread and bread-type rolls without Commission approval.[15] In 1968, International Telephone & Telegraph acquired Continental as a wholly-owned subsidiary.[16] On April 27, 1972 the Commission issued an order requiring Continental to show cause why the Commission should not extend the acquisition ban for an additional five years.[17] On November 26, 1974 —the same day it issued the complaint in this matter—the Commission reversed the decision of the [10] Administrative Law Judge to extend the ban on acquisitions without Commission approval and dismissed the order to show cause.[18]

The opinion of the Administrative Law Judge in the earlier case provides a useful overview of economic conditions in the bread baking industry between 1963 and 1973. The ALJ found that the number of plants and producers in the industry had declined substantially during that period, and suggested a number of explanations for the industry's problems:

> At least since the beginning of 1973, 90 percent of all wholesale bakeries have been operating at a loss. The president of Quality Bakers of America estimated that about 50 percent of his cooperative members are running in the red and that the industry is in a state of disaster. Wards went through a radical reorganization. Interstate was almost acquired by Beatrice Foods. Most wholesalers are closing plants. Many smaller bakers are going out of business.
>
> The wholesale bakers' problems have been caused, in large part, by the activities and growth of chain bakeries, costly labor contracts, technological improvements that have created overcapacity, improved highways permitting larger areas to be served by a single plant, high ingredient, selling and distribution costs, problems arising from Federal price controls in effect since Aug. 1971, and the decline in per capita consumption of bread. Of particular current impact is the tremendous [11] increase in the cost of flour following the shipment of flour to Russia in 1972 and the corresponding short

[15] *Continental Baking Co.,* 60 F.T.C. 1183, 1193–94 (1962) (consent order).

[16] *ITT Continental Baking Co.,* 84 F.T.C. 1349, 1393–94 (1974).

[17] *Id.* at 1394.

[18] *ITT Continental Baking Co.,* 84 F.T.C. 1349, 1400. Although it is not completely clear from the record, the Commission may have issued the complaint in this matter because it was not sure—as of 1974—"whether competition in the various local and regional markets in the country was increasing, decreasing, or holding steady . . ." and whether any such changes were attributable to merger activity "or to some other cause or causes . . ." *Id.* at 1394–95.

supply here coupled with the inability to recoup costs because of price controls. These factors are generally found, to varying extents, in all markets, whether or not ITT Continental is present.[19]

In its opinion dismissing the show cause order, the Commission confirmed the ALJ's assessment of the economic condition of the bread baking industry:

The number of bread producers has been declining sharply for many years . . . While a substantial number of these departing firms were acquired by the larger members of the industry in the pre-1964 period, a major factor here has clearly been a series of technological changes in the industry that have significantly increased the minimum efficient plant size. As more and more firms have sought to get their per-unit costs down to the minimum level by incorporating the newer and lower-cost technology in their plants, the productive capacity of the industry has sharply outstripped the growth in consumer demand. The result is that the industry has been suffering from chronic excess capacity for many years, a situation that of course further intensifies the competitive struggle [12] for volume.[20] The smaller firms, especially those with older plants and equipment, have thus found themselves operating not only high-cost facilities but operating them at less than full capacity. Not being able to match the lower costs and prices of their more technologically advanced rivals, many of these smaller firms have been forced to either close their doors or sell out to other firms in the industry.[21]

In short, during the 1963–1973 period, the bread baking industry confronted substantial and chronic excess capacity created largely by technological improvements; high ingredient, selling and distribution costs; Federal price controls that became effective in August, 1971; and a decline in *per capita* bread consumption. These conditions existed to varying degrees in all parts of the country, regardless of the presence or absence of Continental in any particular market. It is therefore not surprising that a number of firms left the industry during this period, and that a large number of other firms suffered losses; indeed, it would be surprising if a period of such widespread economic and technological change did not produce precisely those effects that are the gravamen of the complaint in this matter. [13]

The record evidence developed since the complaint was issued provides no reason to conclude that any of the economic conditions the Commission described in its 1974 opinion should be attributed to Continental's pricing behavior in any of the relevant geographic mar-

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[19] *Id.* at 1381 (Initial Decision) (citations omitted). The ALJ concluded that the acquisition restriction in the 1962 order should be extended until April 13, 1977. He based this conclusion principally upon the fact that "industrywide concentration" had increased *nationwide* since 1962, despite his determination that the relevant geographic markets were regional or local, and the absence of evidence that Continental's alleged acquisitions had increased concentration in any relevant regional or local market. *Id.* at 1387–90. The Commission reversed because of the absence of evidence of injury to competition in the relevant local bread markets. *Id.* at 1399.

[20] The Commission noted, for example, that in 1958 the industry was reportedly operating at only forty percent to sixty percent of capacity. *Id.* at 1396 n.12. The ALJ in this case concluded, by contrast, that there was "no chronic excess capacity in the bread baking industry during the relevant periods." ID at 19. However, the record evidence does not support that conclusion. *See* Metz, Tr. 10223; Jakacki, Tr. 10273–76; CX 1355; RX 1000; RX 1101.

[21] *ITT Continental Baking Co.*, 84 F.T.C. at 1396 and n.12.

kets. The Commission has therefore determined to dismiss the complaint in this matter in all respects. A more detailed discussion of the attempted monopolization and price discrimination allegations follows.

II. SECTION 2 OF THE SHERMAN ACT: ATTEMPTED MONOPOLIZATION

In its classic formulation of the offense of attempted monopolization, the Supreme Court determined:

> Where acts are not sufficient in themselves to produce a result which the law seeks to prevent—for instance, the monopoly—but require further acts in addition to the mere forces of nature to bring that result to pass, an intent to bring it to pass is necessary in order to produce a dangerous probability that it will happen.[22]

Somewhat more recently, the Commission has described the elements of the offense in the following fashion: [14]

> . . . [T]he attempt offense includes three principal elements: (1) specific intent to control prices or destroy competition, (2) exclusionary or anticompetitive conduct, and (3) a dangerous probability of success.[23]

This portion of the opinion discusses each of these elements in some detail.

A. *Specific Intent*

Proving the first element of the attempted monopolization offense requires establishing a specific intent to control prices or otherwise injure competition.[24] However, the Commission has [15] emphasized that the specific intent element depends importantly upon the nature of the conduct that a firm employs pursuant to that intent:

> As a general matter, it seems unwise to find that a firm has the requisite specific intent for anticipating the exclusionary consequences of successful competitive behavior

[22] *Swift & Co.* v. *United States*, 196 U.S. 375, 396 (1905).

[23] *E.I. Du Pont de Nemours & Co.*, 96 F.T.C. 653, 725 (1980); *accord, General Foods Corp., supra* note 7, ¶22,142 at 22,973; *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.*, 718 F.2d 1431, 1435 (6th Cir. 1983), *cert. denied*, 52 U.S.L.W. 3886 (U.S. June 12, 1984) (No. 83–1698); *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d 1014, 1027 (9th Cir. 1981), *cert. denied*, 103 S.Ct. 58 (1982); *United States* v. *Dairymen, Inc.*, 660 F.2d 192, 194 (6th Cir. 1981); *Northeastern Telephone Co.* v. *American Telephone & Telegraph Co.*, 651 F.2d 76, 85 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982); *Chillicothe Sand & Gravel* v. *Martin Marietta Corp.*, 615 F.2d 427, 430 (7th Cir. 1980); *California Computer Products, Inc.* v. *IBM Corp.*, 613 F.2d 727, 736 (9th Cir. 1979); *Pacific Engineering & Production Co.* v. *Kerr-McGee Corp.*, 551 F.2d 790, 791 (10th Cir. 1977); *Merit Motors, Inc.* v. *Chrysler Corp.*, 417 F.Supp. 263, 269–70 (D.D.C. 1976), *aff'd*, 569 F.2d 666 (D.C. Cir. 1977).

[24] *Times Picayune Publishing Co.* v. *United States*, 345 U.S. 594, 626 (1953) ("a specific intent to destroy competition or build monopoly"); *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.*, 718 F.2d at 1435 ("specific intent to monopolize"); *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1027 ("specific intent to control prices or destroy competition"); *Northeastern Telephone Co.* v. *American Telephone & Telegraph Co.*, 651 F.2d at 85 ("specific intent to monopolize"); *Chillicothe Sand & Gravel* v. *Martin Marietta Corp.*, 613 F.2d at 430 ("specific intent to control prices or destroy competition"); *United States* v. *Empire Gas Corp.*, 537 F.2d 296, 302 (8th Cir. 1976) ("an intent to control prices or to restrict competition unreasonably"), *cert. denied*, 429 U.S. 1122 (1977).

which leads or may lead to a monopoly, so long as that behavior is reasonable. To suggest otherwise would be to proscribe all acts in which firms conjure up some thoughts of achieving monopoly irrespective of the actual character of the means employed to gain that end.[25]

In short, although evidence of a specific intent to injure or destroy competition can be helpful in establishing liability for attempted monopolization, its utility depends crucially upon the nature of the conduct at issue. Any successful business strategy will injure competitors to some degree; it satisfies the specific intent requirement only if it contemplates doing so by means of anticompetitive conduct. As the Commission recently stated, the specific intent element

is not satisfied by ambitious and aggressive plans to compete, even with the goal of taking business from competitors or vanquishing a troublesome rival. The **[16]** antitrust laws provide no protection from such designs, where the means to effectuate them amount to no more than vigorous competition.[26]

B. *Anticompetitive Conduct*

Proving the second element of the attempted monopolization offense requires a thorough evaluation of the conduct that the firm involved employed. In *DuPont,* the Commission determined that essentially three criteria should be considered in conducting such an evaluation: (1) whether firms without substantial market power would find the conduct at issue to be profitable or economically rational; (2) whether the conduct improves product performance; and (3) whether industry conditions such as high entry barriers are likely to mitigate or accentuate any anticompetitive effects of the conduct.[27] When properly defined, predatory pricing satisfies these criteria, because it is highly unlikely that firms without substantial market power will find it either profitable or otherwise economically rational; it is highly unlikely to improve product performance; and whether it will prove to be successful is largely a function of a variety of structural industry characteristics. Of course, a determination that a given firm has sold at predatory prices for a significant period of time does not in and of itself establish liability under the Sherman Act or the Clayton Act. It satisfies the "specific intent" and **[17]** "anticompetitive conduct" components of the attempted monopolization offense, but does not, without more, satisfy the "dangerous probability of

[25] *E.I. Du Pont de Nemours & Co.,* 96 F.T.C. 653, 727 (1980); *accord, e.g., General Foods Corp., supra* note 7, ¶22,142 at 22,974; *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.,* 718 F.2d at 1435; *Williams Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.,* 668 F.2d at 1028, 1031 n.18; *Lektro-Vend Corp.* v. *Vendo Co.,* 660 F.2d 255, 273 (7th Cir. 1981); *Buffalo Courier Express, Inc.* v. *Buffalo Evening News, Inc.,* 601 F.2d 48, 54 (2d Cir. 1979); *Hayes* v. *Solomon,* 597 F.2d 958, 977 (5th Cir. 1979), *cert. denied,* 444 U.S. 1078 (1980).

[26] *General Foods Corp., supra* note 7, ¶22,142 at 22,974 (citations omitted).

[27] *E. I. Dupont,* 96 F.T.C. 653, 738–39 (1980).

success" requirement. It also satisfies the "predatory pricing" requirement for primary-line liability under Section 2(a) of the Clayton Act, but does not satisfy the jurisdictional requirements of that section.

The difficult question is of course how to define predatory pricing. It is crucially important to distinguish prices that are perfectly consistent with competitive behavior from prices that are not. Price is the "central nervous system" of the economy,"[28] and vigorous and healthy competition engenders economic efficiency which redounds to the benefit of consumers. By contrast, overly zealous efforts to prevent sales at prices below cost are likely to reduce competition and increase prices.[29] Therefore, we must carefully avoid adopting a predatory pricing rule that will deter legitimately competitive pricing conduct. The significant likelihood of injury to competition from erroneously prohibiting low prices should be contrasted with the low likelihood that an unrestrictive rule [18] will erroneously permit anticompetitive conduct, given the low likelihood that any predatory strategy will prove successful. As Phillip Areeda and Donald Turner have pointed out,

> proven cases of predatory pricing have been extremely rare. . . . That predatory pricing seems highly unlikely does not necessarily mean that there should be no antitrust rules against it. But it does suggest that extreme care be taken in formulating such rules, lest the threat of litigation . . . materially deter legitimate, competitive pricing.[30]

An ideal predatory pricing rule must therefore satisfy two criteria. First, it must distinguish predatory intent from competitive intent; that is, it must distinguish pricing behavior that is very likely intended to injure competition from pricing behavior that could very well be directed toward perfectly legitimate competitive objectives. Sales at prices below average variable cost—as properly defined—for a significant period of time may well satisfy this requirement. They are more likely intended to injure competition than to achieve legitimate competitive objectives because they do not cover any fixed costs of operation, and do not cover all of the variable costs of operation. The firm that sells at such prices consequently loses [19] more money by continuing to operate than by shutting down altogether. Sustained

[28] *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 224–26 n. 59 (1940).

[29] The National Recovery Administration's effort to enforce its code against "destructive price cutting" provides a good example of this latter phenomenon. An economist associated with the program and a contemporary Brookings Institution study separately concluded that extensive enforcement of the code tended to reduce competition, to raise prices, and, in some cases, to injure small competitors that could not capitalize upon their greater efficiency. *See* L. Lyon *et al., The National Recovery Administration: An Analysis And An Appraisal* 604–05, 620–21 (1935); C. Roos, *NRA Economic Planning* 249, 256–59, 275, 407–08, 416 (1937).

[30] P. Areeda and D. Turner, III *Antitrust Law* 152 (1978). At least two commentators have argued that predation is so rare that it should be completely ignored, in order to avoid deterring legitimate competitive pricing. R. Bork, *The Antitrust Paradox* 149–155 (1978); Easterbrook, *Predatory Strategies and Counterstrategies,* 48 U. Chi. L. Rev. 263 (1981).

sales at such prices can therefore be presumed to be intended to injure competition.[31]

An ideal predatory pricing rule must secondly distinguish pricing behavior that is likely to injure competition in the generality of cases from pricing behavior that is not. The antitrust laws focus upon preserving or enhancing consumer welfare by preserving or enhancing competition. One effect of healthy competition is to redirect production and sales from less efficient firms to more efficient rivals. Therefore, one logically ought to determine the pricing level that is likely to force equally efficient firms to shut down, with the effect of injuring competition.[32] A price that forces an equally efficient [20] firm to sell at a price below its own average variable costs for a significant period of time satisfies this criterion. Because sales at such prices do not even cover the variable costs of operation, an equally efficient firm will ordinarily shut down completely rather than continue to operate. Since its shutdown is induced not by competitive conditions but rather by anticompetitive conduct on the part of the predatory firm, it injures competition and therefore worsens consumer welfare.

The most appropriate predatory pricing rule will therefore satisfy two separate requirements: (1) a predatory *intent* requirement—sales at prices below average variable cost for a significant period of time; and (2) a predatory *conduct* requirement—sales at prices that are likely over a significant period of time to force equally efficient firms to shut down completely. Sales at prices below the average variable costs of an alleged predator for a significant period of time will presumptively satisfy both of these criteria. The Commission has therefore concluded that it should rely upon average variable cost to distinguish presumptively legitimate prices from presumptively predatory prices, in the following fashion:

(1) *Sales at prices that equal or exceed average variable cost should be strongly, often conclusively, presumed to be legal.* This presumption could possibly be rebutted in some circumstances [21] by a strong showing that sales at such prices were not, absent the effect of the alleged predation, consistent with profit maximization or loss minimi-

[31] This analysis of predatory intent focuses upon average variable cost rather than marginal cost to distinguish predatory from competitive objectives. *Compare, e.g.,* P. Areeda and D. Turner, III *Antitrust Law* 153 (1978). That is because a firm will produce at an output at which marginal cost equals price (average revenue) only under perfectly competitive conditions. Any firm with some degree of market power—that is, any firm that confronts a downward-sloping demand curve, and is therefore to some degree a price *maker* rather than a price *taker*—will seek to maximize profits or minimize losses by selling at the point at which (declining) marginal revenue equals marginal costs, rather than at the point at which (a constant) *price* equals marginal cost.

[32] Two firms are "equally efficient" if each firm minimizes its average total costs at the same level. Scherer, *Predatory Pricing and the Sherman Act: A Comment,* 89 Harv. L. Rev. 868, 872 n.10 (1976); *Transamerica Computer Co.* v. *IBM Corp.,* 481 F.Supp. 965, 991, 992 (N.D. Cal. 1979), *aff'd,* 698 F.2d 1377 (9th Cir. 1983), *cert. denied,* 104 S.Ct. 370 (1983); *see* R. Posner, *Antitrust Law: An Economic Perspective* 188–89. When this is the case, each firm can produce a given quantity of output with precisely the same quantity of resources.

zation.[33]

(2) *Sales at prices below average variable cost for a significant period of time should be rebuttably presumed to be anticompetitive.*[34] This presumption could be rebutted by showing, for example, that the sales at issue (1) were of products that were obsolete, perishable, or otherwise subject to rapid value deterioration; (2) were at introductory prices designed to induce trial; or (3) were [22] made to avoid losing goodwill, such as product loyalty, that it would be very costly to regain were the firm to shut down and then reopen later.[35]

(3) *Sales at prices that equal or exceed average total cost should be conclusively presumed to be legitimate.*[36] Sales at such prices cannot by definition exclude equally efficient firms. They may, of course, exclude less efficient firms, but that is often an effect of vigorous and healthy competition. [23]

Two important considerations should be addressed in conjunction with this standard. First, although it is difficult to precisely determine the duration of a "significant" time period, it should be sufficiently long to make it likely that sales at prices below average variable cost could in fact force equally efficient firms to exit. Discontinuous or episodic instances of sales at such prices are unlikely to satisfy this standard, because they may very well be nothing more

[33] *General Foods Corp., supra* note 7, ¶22,142 at 22,975–76 (citations omitted). Complaint counsel argue that this standard should not apply "when predatory pricing can be cross-subsidized currently from profits in the predator's more secure markets." CAB at 16. However, even if a firm earns greater profits in some markets than in others, sales at prices equal to or greater than average variable cost will not make sense as a predatory strategy because they will not force equally efficient firms from those markets, and subsequent recoupment of losses in those markets will therefore not be possible. Complaint counsel also suggest that the legitimacy of sales at prices below "full [unit] cost" should vary with the degree to which, and the sales volume and duration for which, such prices fall below full cost. CAB at 26–27. Apart from its conflict with the strong presumptive legitimacy of prices equal to or greater than average variable cost, the "rule of reason" standard complaint counsel propose would be very difficult to apply in practice, with very uncertain results, and we therefore decline to adopt it.

[34] *General Foods Corp., supra* note 7, ¶22,142 at 22,975–76 (citations omitted). The concept of "average variable costs" should probably encompass "reasonably anticipated" average variable costs, to protect sales made in anticipation that costs will fall. P. Areeda and D. Turner, III *Antitrust Law* 154, 174 (1978).

[35] *Buffalo Courier Express* v. *Buffalo Evening News*, 601 F.2d 48, 55 (2d Cir. 1979); *General Foods Corp., supra* note 7, ¶22,142 at 22,975; P. Areeda, *Antitrust Law Supplement* 121, 151, 157–58 (1982); *see* P. Areeda and D. Turner, III *Antitrust Law* 176–78 (1978).

Most courts have now concluded that sales at prices equal to or greater than average variable cost should be rebuttably presumed to be legitimate, and that sales at prices below average variable cost should be rebuttably presumed to be predatory. *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.*, 718 F.2d 1431, 1437 (6th Cir. 1983), *cert. denied*, 52 U.S.L.W. 3886 (U.S. June 12, 1984) (No. 83–1698); *Transamerica Computer Co.* v. *IBM Corp.*, 698 F.2d 1377, 1386 (9th Cir. 1983); *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d 1014, 1035–36 (9th Cir. 1981), *cert. denied*, 103 S.Ct. 58 (1982); *Superturf, Inc.* v. *Monsanto Co.*, 660 F.2d 1275, 1281 (8th Cir. 1981); *O. Hommel Co.* v. *Ferro Corp.*, 659 F.2d 340, 352–53 (3d Cir. 1981) (dictum); *Northeastern Tel. Co.* v. *AT&T Co.*, 651 F.2d 76, 88 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982); *International Air Industries, Inc.* v. *American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976); *see Chillicothe Sand & Gravel Co.* v. *Martin Marietta Corp.*, 615 F.2d 427, 432 (7th Cir. 1980); *Pacific Engineering & Prod. Co.* v. *Kerr-McGee Corp.*, 551 F.2d 790, 797 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977). For two good reviews of the relevant cases, *see* Calvani and Lynch, *Predatory Pricing Under the Robinson-Patman and Sherman Acts: An Introduction*, 51 Antitrust L.J. 375 (1982); Hurwitz and Kovacic, *Judicial Analysis of Predation: The Emerging Trends*, 35 Vand. L. Rev. 63 (1982).

[36] *Arthur S. Langenderfer, Inc.* v. *S.E. Johnson Co.*, 1984–1 Trade Cas. (CCH) ¶65,905 (6th Cir. 1984), at 67,865; *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 231, 235–36 (1st Cir. 1983); P. Areeda and D. Turner, III *Antitrust Law* 169–70 (1978).

than responses to fluctuating demand and in any event are unlikely to be sufficiently long-lived to exclude equally efficient firms. Second, the difficulty of identifying the costs that should be treated as variable in any given situation should not be underestimated. As the Commission pointed out in *General Foods Corp.*, it will often be difficult to allocate joint variable production, distribution, or promotional costs among different brands of a given product, among different products, or among different geographic areas.[37] Moreover, it will frequently be difficult to distinguish the investment or fixed cost component **[24]** of promotional expenses from the variable cost or current expense component. As the Commission has indicated:

> Promotional outlays or reduced prices that cause current accounting losses may represent an investment in long-lived information and goodwill that will pay off with enhanced future revenues. If so, the investment component should be amortized over the life cycle for which respondent expected it to endure.[38]

With these considerations in mind, we nevertheless believe that relying upon average variable cost represents the most economically sensible and predictable predation standard available.

In her concurring and dissenting opinion, Commissioner Bailey argues that the Commission should instead rely upon industrywide capacity utilization levels to determine whether average variable cost or average total cost should be used to distinguish competitive from predatory pricing. More particularly, she argues that prices that equal or exceed average variable cost may nevertheless be predatory if they fall below average total cost in a market characterized by a high level of capacity utilization. Under her approach, a plaintiff (or **[25]** complaint counsel) apparently could shift the burden of justifying sales at prices below average total cost to the defendant or respondent by establishing that the industry involved does not confront substantial excess capacity.

There are a number of difficulties with this approach that would make it less desirable as a predatory pricing standard. First, it might very well deter competitive pricing behavior, because there are a variety of legitimate competitive reasons for prices that fall below average total cost but equal or exceed average variable cost. In particular, prices within this range may represent a perfectly legitimate,

[37] *General Foods Corp., supra* note 7, ¶22,142 at 22,975; *accord,* P. Areeda, *Antitrust Law Supplement* 146 (1982).

[38] *General Foods Corp.,* ¶22,142 at 22,975. Professors Areeda and Turner have argued that all costs except capital costs, taxes unaffected by output, and depreciation should be rebuttably presumed to be variable. P. Areeda and D. Turner, III *Antitrust Law* 173 (1978); P. Areeda, *Antitrust Law Supplement* 147 (1982). Although that approach may be a useful starting point in some respects, we would like to emphasize that the investment or fixed cost component of promotional expenses should always be treated as a fixed cost. Of course, as the time period relevant to evaluating an allegedly predatory strategy lengthens more types of costs should be characterized as "variable." In the long run, all costs are variable; at that point, average variable cost and average total cost are therefore equivalent.

loss-minimizing response to excess capacity at the *firm* level. As the Ninth Circuit Court of Appeals indicated recently:

> Pricing below average total cost may be a legitimate means of minimizing losses, particularly when the firm is "temporarily" experiencing "excess capacity" in its productive facilities. . . . Prices below the average total cost of production, but above the average variable cost, may represent a legitimate means of minimizing losses during the period of inadequate demand. Such a price will be sufficient to recover the variable costs of production and at least some portion of the firm's fixed costs—those costs that would remain even if [26] the firm ceased production. To discontinue production under these circumstances would increase losses because even that portion of its total fixed costs would be lost.[39]

Moreover, sales at prices within this range are not likely to represent an effective predatory strategy. As long as prices equal or exceed average variable cost, they will not force an equally efficient firm with comparable variable costs to shut down. In fact, an equally efficient rival will ordinarily have a strong incentive to continue production, since prices at that level cover at least the variable costs of production and possibly some fixed costs as well.

Second, for a variety of reasons, measuring the imprecise construct "average total cost" is relatively more difficult than measuring average variable cost. The accounting measure of average total cost during any particular period will not necessarily reflect the long-term value of the underlying investment. Under conditions of competitive equilibrium, the discounted present value of revenue contributions above variable cost that a given investment will produce over its useful life ("quasi-rents") will equal its capital cost. However, the accounting value of revenue over cost may vary considerably over time, causing accounting "profits" in some years (when price [27] exceeds the accounting measure of average total cost) and accounting "losses" in others (when price falls below the accounting measure of average total cost). Moreover, average total costs, as measured by accounting data, include arbitrary measures of depreciation (since there is no "correct" depreciation schedule) and measures of capital cost which are both "embedded" (*i.e.*, reflecting past interest rates and historic costs of capital equipment) and incomplete (not including the opportunity cost of equity). Furthermore, where production takes place jointly with other products, allocating fixed costs among these products must be arbitrary, making the ultimate evaluation of average total costs similarly arbitrary.

Third, relying upon *industrywide* capacity utilization levels to de-

[39] *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d 1014, 1035 (9th Cir. 1981), *cert. denied*, 103 S.Ct. 58 (1982) (citations omitted). Of course, as the Court points out, sales at such prices over the long run "will not justify renewal of investment at the previous level." *Id.* at 1035. However, the rule we have adopted accounts for this phenomenon because all costs—including investment—are variable in the long run.

termine when the average total cost standard should be used would not be practicable or appropriate. The concept of "capacity" envisions a discontinuity in the production function which does not typically exist, or at best can be measured against rapidly rising marginal cost only with imprecision. As a consequence, any measure of capacity represents only a very imprecise surrogate for actual capacity. Moreover, predatory pricing requires an assessment of the intent of the alleged predator, and industrywide capacity utilization levels are not really relevant to that assessment. Indeed, in many industries, such as electrical power generation, efficiency mandates some continuous level of "excess" capacity in order to permit rapid responses—in the form of production levels substantially greater than normal—to seasonal or otherwise cyclical peaks in demand. **[28]**

The fact that an alleged predator may have recently increased its individual capacity is not likely to be any more helpful. There are, after all, a variety of legitimate competitive reasons for plant expansion, and if a given expansion reduces costs, concurrent or subsequent price reductions to reach optimal utilization levels may be a perfectly logical and competitive corollary.[40] Furthermore, if additions to capacity must be made in large "lumps" because of technological constraints, large expansions will increase fixed costs so that competitively efficient prices may at times fall below average total cost, even though industrywide capacity utilization levels may be high.

The final difficulty with Commissioner Bailey's approach is that it would reduce business certainty, because businesses would need to determine the level and significance of industrywide capacity utilization before deciding whether to follow the average variable cost or the average total cost standard. As a result, many businesses might simply decide to avoid selling at prices below average total cost altogether, regardless of competitive conditions. In conjunction with the other problems outlined above, this factor confirms the preferability of a **[29]** standard that focuses upon average variable cost alone, rather than upon capacity utilization levels and average total or fully allocated cost.[41]

The foregoing discussion explains how the Commission's predatory pricing standard fits into the attempted monopolization offense. However, the Commission has taken the position that in attempted monopolization cases, the dangerous probability of success element should be evaluated "before proceeding to the other two elements."[42] That

[40] *E.I. Dupont de Nemours & Co.,* 96 F.T.C. 653, 747–48 (1980).

[41] It would be particularly inappropriate to rely upon average total cost to distinguish competitive from predatory pricing in the baking industry because—as we have noted *supra*—the industry confronted chronic and substantial excess capacity in most if not all relevant geographic markets throughout the time period at issue in this case. *See* pp. 10–12, *supra.*

[42] *General Foods Corp., supra* note 7, ¶22,142 at 22,977; *E. I. Dupont de Nemours & Co.,* 96 F.T.C. 653, 725–26 (1980).

approach was particularly appropriate in *General Foods* because an accurate evaluation of the extensive price and cost information in that case would have required a very complex and time-consuming evaluation of a variety of relevant data. In the attempted monopolization part [30] of this case, the dangerous probability of success element can be evaluated fairly readily. We therefore proceed to discuss that element.[43]

C. *Dangerous Probability Of Success*

Proving the attempted monopolization offense finally requires establishing that the conduct at issue created a dangerous probability that the firm involved would acquire "the power to control price or exclude competition" in the relevant market(s).[44] This section discusses the legal and economic standards for making such a determination, and then applies them to the facts of this case.

1. Relevant Markets

The first step in evaluating the dangerous probability element is delineating the relevant product and geographic markets within which monopoly power may be acquired.[45] As the Supreme Court has indicated with respect to product market definition: [31]

> To establish monopolization or attempt to monopolize a part of trade or commerce under §2 of the Sherman Act, [one must] appraise . . . exclusionary power . . . in terms of the relevant market for the product involved. Without a definition of that market there is no way to measure [a firm's] ability to lessen or destroy competition.[46]

Most courts have taken the same position with respect to geographic

[43] As our discussion of the Clayton Act below indicates, a showing of predatory pricing is an essential element of a primary line price discrimination case, and the test for predatory pricing under the Sherman Act should apply in Clayton Act cases as well. An evaluation of the price and cost data that complaint counsel relied upon in their effort to establish liability *is* required to determine whether Continental violated the Clayton Act in all five of the relevant geographic markets.

[44] *General Foods Corp., supra* note 7, ¶22,142 at 22,976.

[45] In an analogous context, the Supreme Court has repeatedly indicated that "Determination of the relevant product and geographic markets is 'a necessary predicate' to deciding whether a merger contravenes the Clayton Act." *United States* v. *Marine Bancorporation,* 418 U.S. 602, 618 (1974), *quoting United States* v. *DuPont & Co.,* 353 U.S. 586, 593 (1957).

[46] *Walker Process Equipment, Inc.* v. *Food Machinery & Chemical Co.,* 382 U.S. 172, 177 (1965); *accord, Super Turf, Inc.* v. *Monsanto Co.,* 660 F.2d 1275, 1283 (8th Cir. 1981); *Spectrofuge Corp.* v. *Beckman Instruments, Inc.,* 575 F.2d 256, 276 (5th Cir. 1978); *United States* v. *Empire Gas Corp.,* 537 F.2d 296, 298–99 (8th Cir. 1976), *cert denied,* 429 U.S. 1122 (1977); *Coleman Motor Co.* v. *Chrysler Corp.,* 525 F.2d 1338, 1348–49 (3d Cir. 1975); *George R. Whitten, Jr., Inc.* v. *Paddock Pool Bldrs., Inc.,* 508 F.2d 547, 550 (1st Cir.), *cert. denied,* 421 U.S. 1004 (1974); *Mullis* v. *ARCO Petroleum Corp.,* 502 F.2d 290, 295 (7th Cir. 1974); *Merit Motors, Inc.* v. *Chrysler Corp.,* 417 F.Supp. at 269–70. Only the Ninth Circuit has suggested that market definition may not be a prerequisite to attempted monopolization liability, although its most recent decisions require a showing of a "specific intent to control prices or destroy competition with respect to a part of commerce" in order to establish attempted monopolization. *Compare Transamerica Computer Co.* v. *IBM Corp.,* 698 F.2d at 1382; *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.,* 668 F.2d at 1027 *with Greyhound Computer Corp.* v. *IBM,* 559 F.2d 488, 504 (9th Cir. 1977), *cert. denied,* 434 U.S. 1040 (1978); *Lessig* v. *Tidewater Oil Co.,* 327 F.2d 459, 474–75 (9th Cir. 1964), *cert. denied,* 377 U.S. 993 (1964).

market definition.[47] [32]

Reliable measures of supply and demand elasticities provide the most accurate estimates of relevant markets.[48] However, it is ordinarily quite difficult to measure cross-elasticities of supply and demand accurately.[49] Therefore, it is usually necessary to consider other factors that can serve as useful surrogates for cross-elasticity data. In the case of geographic market definition, these factors may include

> the extent of different price changes and patterns from region to region; the level of barriers to trade flow between regions (including high transportation costs relative to product value); the degree of product shipping from one region to another (*i.e.*, transshipment); and the perceptions of competition from distant firms on the part of industry members.[50]

In the case of product market definition, these factors may include

> whether the products and services have sufficiently distinctive uses and characteristics; whether industry firms routinely monitor each other's actions and calculate and adjust their own prices (at least in part) on the basis of other firms' prices; the extent to which consumers consider various categories of sellers . . . as substitutes; and whether a sizeable price [33] disparity between the different types of . . . sellers . . . persists over time for equivalent amounts of comparable goods and services.[51]

a. *Relevant Geographic Market*

The parties have agreed that the relevant geographic markets in this industry are localized, and the record evidence supports that conclusion. A given bakery can provide fresh bread for only a relatively small area—swept by a radius of one hundred to two hundred miles—and competitive conditions tend to differ from one area to another.[52] Therefore, the five areas in which Continental's conduct is

[47] *E.g., Super Turf, Inc.* v. *Monsanto Co., supra*, 660 F.2d at 1283; *Spectrofuge Corp.* v. *Beckman Instruments, Inc.*, 575 F.2d at 276; *United States* v. *Empire Gas Corp.*, 537 F.2d 296, 298–99 (8th Cir. 1976), *cert. denied*, 429 U.S. 1122 (1977); *Coleman Motor Co.* v. *Chrysler Corp.*, 525 F.2d 1338, 1348 (3d Cir. 1975); *George R. Whitten, Inc.* v. *Paddock Pool Builders, Inc.*, 508 F.2d 547, 550 (1st Cir. 1974), *cert. denied*, 421 U.S. 1004 (1974); *Mullis* v. *ARCO Petroleum Corp.*, 502 F.2d 290, 295 (7th Cir. 1974).

[48] *Grand Union Co.*, 3 Trade Reg. Rep. (CCH) ¶22,050 (July 18, 1983), at 22,702–03 [102 F.T.C. 812]; *accord, General Foods Corp., supra* note 7, ¶22,142 at 22,977–78; *Beatrice Foods Co.*, 101 F.T.C. 733, 829–30 (1983) (Douglas, Commissioner, and Miller, Chairman, concurring); *FTC Statement On Horizontal Mergers* (June 14, 1982), *reprinted in* 42 Antitrust & Trade Reg. Rep. Special Supplement (June 17, 1982) (hereinafter cited as *FTC Statement*), at (S–15)–(S–16).

[49] *Grand Union Co.*, ¶22,050 at 22,703.

[50] *Id.* at 22,703–04; *accord, FTC Statement, supra* note 48, at S–16; *Justice Department Merger Guidelines* (June 14, 1984), *reprinted in* 46 Antitrust & Trade Reg. Rep. Special Supplement (June 14, 1984) (hereinafter cited as *DOJ Guidelines*), at S–4.

[51] *Grand Union Co.*, ¶22,050 at 22,703; *accord, FTC Statement, supra* note 48, at S–15; *DOJ Guidelines, supra* note 50, at S–2. The Justice Department indicates that the test of the viability of a prospective market should be whether a hypothetical monopolist would find it profitable to impose a "small but significant and nontransitory" price increase, ordinarily to be approximated by a five percent price increase lasting one year. *DOJ Guidelines, supra*, at (S–2)–(S–3).

[52] IDF 28; *accord, ITT Continental Baking Co.*, 84 F.T.C. 1349, 1397 (1974). Continental agrees that the relevant geographic markets are local, but argues that the complaint only alleges a *nationwide* predatory campaign. However, paragraph 17 of the complaint alleges a plan "to achieve dominance . . . in all relevant geographic

(footnote cont'd)

at issue (the metropolitan areas of Denver, the Twin Cities of Minneapolis and St. Paul, Los Angeles-[34]Ventura (covering most of Southern California), and Cleveland, and the larger Northern California/Western Nevada area) should each be treated as a separate geographic market.[53]

b. *Relevant Product Market*

The Administrative Law Judge concluded that the "baking, sale and distribution of white pan bread and bread type rolls by wholesale bakers" should be treated as the relevant product market. ID at 97. However, the relevant product market should also include all white pan bread and bread type rolls produced by the captive bakeries of chain grocery stores. The record does not contain any direct evidence as to the cross-elasticities of demand and supply between white bread products produced by wholesale bakers and white bread products produced by captive bakers. However, on the demand side the record evidence does establish a high degree of competition between these two sources of white bread products.[54] The ALJ himself pointed out that "As the retail price of captive bread decreases, noncaptive chains demand lower wholesale prices for private label bread." ID at 9. [35] He also noted that "private, controlled, and secondary label breads [all of which are produced by wholesale bakers] are used by chain stores which do not have their own bakeries to compete at the retail level with the captives." IDF 36. A number of industry witnesses agreed that captive and wholesale bakers compete vigorously with one another and that their respective brands compete vigorously at the retail level,[55] and complaint counsel's own expert agreed that captives and wholesalers "compete with each other." Walsh, Tr. 8356; *but see* Tr. 8360. Furthermore, the ALJ indicated:

Most grocers including chains who have their own bakery will usually carry a limited quantity of the advertised labels of all the wholesale bakers selling in a particular marketing area in order to meet consumer demand.

markets;" paragraph 18 alleges an intent to "attain monopolies . . . in one or more relevant markets;" and paragraph 19(h) alleges that Continental's practices will "[i]ncrease the probability that respondents will attain a monopoly in the wholesale baking industry in each and all relevant geographic markets."

[53] The Northern California/Western Nevada market, consisting of California north of Bakersfield and south of Eureka, and the western Nevada communities of Reno, Carson City, and Lake Tahoe is considerably larger than a single metropolitan area. However, prices throughout the region appear to be relatively uniform, and the region encompasses the service areas of a number of wholesale bakers who ship products throughout the region. Continental's counsel stipulated the area as a relevant geographic market. CPF 12–14 through 12–21.

[54] The principal issue with respect to demand is whether a small change in the price of captive label white bread would induce a significant and like-signed change in the quantity of wholesale baker white bread that is demanded, and vice-versa. *FTC Statement, supra* note 48, at S–15; *Justice Department Merger Guidelines, supra,* note 50, at (S–2).

[55] Murray, Tr. 8858; Vander Giessen, Tr. 10954–57; Schaus, Tr. 11225–28; Metz, Tr. 10208–14; Nissen, Tr. 10138–39; Jakacki, Tr. 10271–73.

IDF 34. In short, captive and wholesaler bread products compete vigorously at both the wholesale and the retail level.

On the supply side, the principal issue is whether a small change in the price of wholesale baker white bread will induce a significant and opposite change in the quantity of white bread that captive bakers supply, and vice-versa.[56] That is clearly the case here. Captive bakers could readily divert production to retail grocers in response to an increase in wholesale baker [36] prices. Moreover, some retail chains could switch from purchasing white bread from wholesale bakers to producing it themselves, in their own captive bakeries.

When considered together, these factors all suggest that the relevant product market should include white bread products produced by both wholesale and captive bakers. That would be consistent with the 1984 *Justice Department Merger Guidelines,* which expressly conclude that captive production should be included in the relevant product market in merger cases when a "small but significant and nontransitory" price increase is likely to induce vertically integrated firms to increase production of the relevant product, either for outside sales or to increase their own downstream sales.[57] It would also be consistent with previous cases in which the Commission itself has recognized that wholesale and captive bakers compete with one another.[58]

2. Likelihood That Continental Would Acquire Monopoly Power

Having delineated the relevant product and geographic markets, the next step is to determine whether the conduct at issue created a dangerous probability that Continental would acquire monopoly power within those markets. A successful predatory strategy depends on the following scenario: once competition has been injured, the predator will be able to raise [37] prices to supracompetitive levels long enough to recoup losses incurred during the predatory period, and to earn greater overall profits than would have been possible from pursuing a competitive strategy.[59] A number of factors—including in particular the market power of the prospective predator, and the height of barriers to entry—affect the degree to which a given course of predatory action can be expected to result in successful monopolization.[60]

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[56] *FTC Statement, supra* note 48, at S–15; *DOJ Guidelines, supra* note 50, at S–3.

[57] *DOJ Guidelines, supra* note 50, at S–3.

[58] *Bakers of Washington, Inc.,* 64 F.T.C. 1079, 1124–25 (1964), *aff'd sub nom. Safeway Stores, Inc. et al. v. FTC,* 366 F.2d 795 (9th Cir. 1966), *cert. denied,* 386 U.S. 932 (1967); *See Flowers Industries, Inc.,* Docket No. 9148 (1980) (complaint). [102 F.T.C. 1700 (1983)]

[59] *E.g.,* Joskow and Klevorick, *A Framework For Analyzing Predatory Pricing Policy,* 89 Yale L. J. 213, 219–20 (1979).

[60] The terms "market power" and "monopoly power" are often treated as synonymous from an economic perspective. However, the term "market power" is used here to describe a whole continuum along which the power [illegible] beginning with the complete absence of market power at one end and ending with

Relevant determinants of the market power of a prospective predator in this regard include its absolute and relative market shares, and those of competing firms; "the strength and capacity of current competitors; the potential for entry; the historic intensity of competition; and the impact of the legal or natural environment."[61] A firm with a large absolute share of sales in a given market will, *ceteris paribus,* find it easier to execute a successful predatory strategy than a smaller firm. Most courts have determined that market share ranging from forty percent to [38] sixty percent prior to the commencement of a predatory strategy ordinarily must be established in order to prove the requisite dangerous probability of successful monopolization.[62]

However, as the Supreme Court has recognized, focusing exclusively upon absolute market share percentages can produce a distorted view of actual market power:

> Obviously no magic inheres in numbers; "the relevant effect of percentage command of a market varies with the setting in which that factor is placed." . . . obviously, if a producer controlling an even lesser share than [the 40% share the defendant in the case controlled] is ringed by numerous smaller satellites together accounting for [39] the rest, his mastery of the market is greater than were he facing fierce rivalry of other large sellers.[63]

In this case, the record evidence indicates that it is highly unlikely that Continental could have acquired monopoly power in any of the relevant markets. As noted above, absolute and relative market share data can provide important evidence on this issue. The record does contain some useful market share data for three of the five relevant geographic markets (Denver, the Twin Cities, and Northern California/Western Nevada), and some less useful market share data for a fourth geographic market (Cleveland). These data are summarized below: [40]

[61] *General Foods Corp., supra* note 7, ¶22,142 at 22,976.

[62] *E.g., Times-Picayune Publishing Co.* v. *United States,* 345 U.S. 594, 612–13 (1953) and n.33 (40%); *Nifty Foods Corp.* v. *Great Atlantic & Pacific Tea Co.,* 614 F.2d 832, 841 (2d Cir. 1980) (a share of 54.5% not sufficient when share fell to 33% within five years); *United States* v. *Empire Gas Co.,* 537 F.2d 296, 305 (8th Cir. 1976) (50% not necessarily sufficient, particularly in light of unreliability of data), *cert. denied,* 429 U.S. 1122 (1977); *Kearney & Trecker Corp.* v. *Giddings & Lewis, Inc.,* 452 F.2d 579, 598 (7th Cir. 1971) (33%), *cert. denied,* 405 U.S. 1066 (1972); *Lektro-Vend Corp.* v. *Vendo Co.,* 500 F.Supp. 332, 356 (N.D. Ill. 1980) (not even 50% market share in itself sufficient), *aff'd,* 660 F.2d 255 (7th Cir. 1981), *cert. denied,* 102 S.Ct. 1277 (1982); *Outboard Marine Corp.* v. *Pezetel,* 461 F.Supp. 384, 410 (D. Del. 1978) (35%); *W.L. Gore & Associates* v. *Carlisle Corp.,* 381 F.Supp. 680, 704 (D. Del. 1974) (40–60%), *aff'd in part and rev'd in part on other grounds,* 529 F.2d 614 (3d Cir. 1976); *Bowl America, Inc.* v. *Fair Lanes, Inc.,* 299 F.Supp. 1080, 1091, 1094–95 (D. Md. 1969) (in two markets: 15.5%; 33%); *Diamond International Corp.* v. *Walterhoefer,* 289 F.Supp. 550, 578 (D. Md. 1968) (share of 51% insufficient); *General Foods Corp., supra* note 7, ¶22,142 at 22,976; *E.I. du Pont de Nemours & Co.,* 96 F.T.C. 653, 725–26 n.16 (1980) (30% might in some circumstances be sufficient).

[63] *Times-Picayune Publishing Co.* v. *United States,* 345 U.S. 594, 612–13 and n.33 (1953), *quoting United States* v. *Columbia Steel Co.,* 334 U.S. 495, 528 (1948); *accord, American Tobacco Co.* v. *United States,* 328 U.S. 781, 796 (1946); *Pacific Coast Agricultural Export Association* v. *Sunkist Growers, Inc.,* 526 F.2d 1196, 1204–05 (9th Cir. 1975), *cert. denied,* 425 U.S. 959 (1976); *see United States* v. *Grinnel Corp.,* 384 U.S. 563, 571 (1966).

Sales of White Bread Products By Wholesale Bakers and Captive Bakers In Four Markets

Denver: 1963[64]

Firm	Share
1. King Soopers and Safeway Captive Bakeries	50.0%
2. Continental	17.5%
3. Old Homestead	14.5%
4. Campbell-Taggart	9.0%
5. Interstate	8.0%

Twin Cities: 1966[65]

Firm	Share
1. Red Owl and National Tea Captive Bakeries	30.0%
2. In-Store Bakeries of Other Firms	20.0%
3. American	15.0%
4. Continental	15.0%
5. Zinsmasters	10.0%
6. Pan O Gold	7.5%
7. Creamy Crust	2.5%

[41]

N. Cal./W. Nev.: 1972[66]

Firm	Share
1. Campbell-Taggart	34.0%
2. Continental	25.5%
3. American	21.3%
4. Safeway and Lucky	15.0%
5. Inglis	4.3%

Cleveland: 1971[67]

Firm	Share
1. Pick N Pay and Fisher Fazio	50.0%
2. Interstate	-
3. Ward	-
4. American	-
5. Continental	-

The foregoing data indicate that Continental accounted for less than twenty percent of total white bread sales in the Denver and Twin Cities markets, and considerably less than thirty [42] percent of total white bread sales in the Northern California/Western Nevada market, at the respective points in time at which it began its allegedly predatory campaigns in each of those markets.[68] Those shares are

[64] IDF 60, 61. The market share for the captive bakeries of Safeway and King Soopers is a minimum, since the ALJ indicated that "[i]n volume of white bread sales, the bakery operations of King Soopers and Safeway were larger than the combined volume of all the wholesale bakers." IDF 61 (citation omitted). Therefore, the wholesale baker market shares the ALJ cites must be reduced by at least fifty percent.

[65] IDF 111, 112. Since captive and in-store bakeries accounted for fifty percent of total white bread sales, the wholesale baker market shares the ALJ cites must be reduced by fifty percent.

[66] IDF 240, 242. These data are very approximate. The ALJ found that Safeway and Lucky together accounted for 17.8% of total white bread sales in the San Francisco/Oakland area and 11.7% of total white bread sales in the Sacramento area. IDF 242. Presumably, these figures are for their captive bakeries only, since wholesaler sales are listed separately. Since the first area is considerably larger than the second, 15% may be a roughly accurate estimate of Safeway's and Lucky's combined sales throughout the Northern California market. The share data for wholesalers that the ALJ cites should therefore be reduced by at least fifteen percent, and the chart reflects that correction. However, the wholesaler shares probably should be reduced even further to account for the captive bakery sales of Alpha Beta, another large retail chain. Unfortunately, the ALJ was apparently not able to secure market share data for Alpha Beta.

[67] IDF 296, 297. The ALJ indicates that among wholesalers, Continental was tied for third with American behind Interstate and Ward. IDF 296. Since the captive bakeries of Pick N Pay and Fischer Fazio alone accounted for fifty percent of total white bread sales to grocery stores and Kroger, A&P, and Lawsons also operated their own captive bakeries, Continental's share must not have been very large. Of course, it probably increased substantially when Continental became Pick N Pay's supplier of private label white bread. In 1980, when both wholesaler and captive bakers are included, Continental ranked second, still behind Interstate but ahead of Fisher-Fazio. IDF 342.

[68] By 1967, Continental had increased its share of total white bread sales in the Denver market to 25.6 percent at most. *See* IDF 88. This figure assumes that captive bakers still accounted for at least fifty percent of total white ... assumption seems reasonable, because wholesaler white bread dollar sales did not increase a

considerably below the forty percent absolute market share that the courts have generally concluded must be shown, *ceteris paribus,* before a dangerous probability of success can be established. That conclusion is strengthened when Continental's share levels are considered in relative terms. In the Denver and Twin Cities markets, Continental confronted very strong competition from substantially larger captive bakery operations, as well as strong competition from one or more wholesalers of comparable size in each market. In the Northern California/Western Nevada market, Continental confronted strong competition from a substantially larger wholesaler, a wholesaler of comparable size, and three large retail chains with significant captive bakeries.

The foregoing data also indicate that Continental accounted for a significantly smaller absolute share of sales in the Cleveland market (at least before Pick N Pay closed its captive bakery and began buying private label bread from Continental). As a consequence, it seems likely that Continental's absolute share of sales was considerably below the forty percent absolute market share that the courts have generally concluded must be [43] shown, *ceteris paribus,* before a dangerous probability of success can be established. Moreover, Continental confronted strong competition from two larger wholesalers and one wholesaler of comparable size.

The record apparently does not contain any evidence with which Continental's approximate share of total white bread sales in the Southern California market can be calculated. However, the ALJ did conclude that in 1974, after its allegedly predatory conduct had ended, Continental and Interstate each accounted for about forty percent of wholesaler white bread sales. IDF 225. These absolute shares would in all likelihood be reduced considerably if the white bread sales of captive bakeries—including those of Safeway, Ralph's, Von's, Lucky, Alpha Beta, Albertson's, and Certified, all large retail grocery chains —were included. *See* Vander Giessen, Tr. 10954; IDF 189. Moreover, it is important to remember that forty percent is the share of wholesale baker sales that Continental secured *after* its allegedly predatory conduct, and it is no larger than Interstate's share of sales; that hardly represents successful monopolization. Therefore, it is highly unlikely that Continental's actual share of total white bread sales, before or after its allegedly predatory conduct, satisfied the standard that most courts have endorsed.

As we noted earlier, other industry characteristics may help determine whether a given absolute and relative share of the relevant market creates a dangerous probability of monopolization. The absence of substantial entry barriers, [44] *ceteris paribus,* is particularly likely to eliminate that probability. Barriers to entry must be substantial for a predatory strategy to succeed. Otherwise, when the predator attempts to raise prices to supracompetitive levels after the predation period, new firms will enter and/or terminated firms will reenter and force the predator to lower its prices to competitive levels.[69] The Commission has defined entry barriers as "substantial non-recurring outlays" that raise the entry costs of potential entrants sufficiently high to permit incumbent firms to restrict output and raise prices for a significant period of time.[70] Governmental restrictions may also create partial or absolute barriers to entry.

The record evidence indicates that barriers to entry into the bread baking industry are not particularly high. Three potential barriers to entry have been suggested in this industry. First, complaint counsel argue that the difficulty of acquiring retail shelf space for new bread products makes entry difficult. CAB at 21. This does not appear likely, because it assumes that retail grocers cannot easily adjust the size of their bakery sections to include promising new brands, and that any given prospective entrant will not be able to secure shelf space in any retail grocery outlets. The record does not contain any significant evidence to support these assumptions. **[45]**

Second, the ALJ has suggested that making expenditures associated with developing a franchise for advertised label bread represents a barrier to entry. It is true that product differentiation may in some circumstances represent such a barrier. However, as noted above, the Commission has determined that product differentiation should be treated as a barrier to entry only if it makes new entry contingent upon non-recurring outlays substantial enough to permit incumbent firms to restrict output and raise prices for a significant period of time.[71] In this case, that condition is not satisfied because private label and captive label breads—which do not ordinarily require more than minimal promotional support—have been and continue to be both successful and a significant constraint upon advertised label bread sales.

Third, the ALJ has suggested that "the propensity of the large multi-plant companies to engage in below cost pricing" represents a barrier to entry. ID at 92. However, there is little in the record to suggest that multiplant economies of scale, or any other technological factors, for that matter, deter entry. *See, e.q.,* Jakacki, Tr. 10282. In any event, allegations of predatory pricing represent the central issue in this case, and we conclude in Part III.D. below that Continental's pricing behavior did not violate the Commission's predatory pricing standard. **[46]**

[69] Joskow and Klevorick, *supra* note 59, at 227.

[70] *General Foods Corp., supra* note 7, ¶22,142 at 22,981, *citing* R. Posner, *Antitrust Law: An Economic Perspective* 59 (1976). Relevant entry costs may include production, distributional and promotional expenses.

[71] *General Foods Corp., supra* note 7, ¶22,142 at 22,981.

The market share data developed above, in conjunction with the absence of any countervailing industry characteristics, persuade us that even if Continental had made sales at prices below average variable cost in some areas for a significant period of time, such pricing behavior could not have created a dangerous probability that Continental would acquire monopoly power in any of the relevant markets. Since establishing a dangerous probability of success is an essential element of the attempted monopolization offense, the Commission has therefore determined to reverse the ALJ and dismiss that portion of the complaint. [47]

III. SECTION 2(a) OF THE CLAYTON ACT

Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act, provides

> That 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. . . .[72]

In this case, Count II of the complaint alleges that Continental discriminated

> in price, directly or indirectly, between different purchasers of bread, by selling bread of like grade and quality to some of such purchasers at substantially higher prices than to other of such purchasers.

This allegation has evolved into two more specific allegations: (1) that Continental sold its advertised label bread, secondary label bread, and/or private label bread at different prices to some purchasers than to others in all five relevant geographic [48] markets; and (2) that Continental sold its private label hot dog and hamburger buns at higher prices to some purchasers than to others in the Cleveland market. This part of the opinion evaluates these allegations.[73]

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[72] 15 U.S.C. 13(a). Section 2(a) also includes a cost justification defense, and several other miscellaneous provi-ons.

[73] In *General Foods Corp.*, the Commission concluded that it did not need to determine whether General Foods' nduct satisfied the jurisdictional and predatory pricing components of a Section 2(a) violation because it was nable to find *any* prospect of injury to competition from the events described in [the] record." *General Foods* ırp., *supra* note 7, ¶22,142 at 22,988 (emphasis added). The Commission determined that the relevant markets ssue were larger than the sales districts that complaint counsel had alleged, and that because complaint counsel

(footnote cont'd)

A. *Preliminary Jurisdictional Issues*

Like other parts of the Clayton Act, Section 2(a) includes a variety of jurisdictional requirements that must be satisfied before the substantive prohibitions of the subsection apply. One commentator has summarized these jurisdictional requirements in the following fashion: **[49]**

> In order to bring the substantive portions of the Act into play, there must be (1) two or more consummated sales, (2) reasonably close in point of time, (3) of commodities, (4) of like grade and quality, (5) with a difference in price, (6) by the same seller, (7) to two or more different purchasers, (8) for use, consumption, or resale within the United States or any territory thereof, (9) which may result in competitive injury. Furthermore, (10) the "commerce" requirement must be satisfied. All ten of these jurisdictional elements must be met in order to invoke the power of the Federal Trade Commission or the courts to consider the lawfulness of pricing transactions.[74]

Seven of these requirements—all except the "like grade and quality," commerce, and competitive injury requirements—are not in dispute, and the evidence supports concluding that they have been satisfied in each of the five relevant geographic markets. In each of these markets, Continental made at least two sales—reasonably close in time—of commodities at different prices to two or more different purchasers "for use, consumption, or resale within the United States." At certain times from 1964 through 1969 in the Denver market, Continental sold private label bread from its Denver bakery (under the "Tender Crust" label) to Associated Grocers at prices that were typically between one cent and three cents lower per one-pound loaf than the prices it charged other purchasers for its advertised label Wonder Bread **[50]** products.[75] At certain times from 1966 through 1968 in the Twin Cities market, Continental sold Wonder Bread, secondary label bread (under the "Wonder Country Style" label) and private label bread from its Minneapolis bakery at different prices to different purchas-

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had not alleged any larger markets, the Commission was "constrained on review from finding that respondent attempted to monopolize some larger market." *Id.* at 22,982 and n.56. Hence, even if General Foods had controlled one hundred percent of sales in one of its sales districts, the Commission concluded that it would not have possessed monopoly power, because firms outside the district would have constrained that power. *Id.* at 22,983. Moreover, the Commission found that competition in the ground coffee industry was "healthy and virtually invulnerable to the assaults of any one firm. . . ." and concluded: "Healthy competition does not violate the Robinson-Patman Act." *Id.* at 22,988–89. In short, the Commission concluded that there was *no* reasonable possibility that price differences charged by General Foods could injure competition. *Id.* at 22,988, *citing Falls City Industries, Inc.* v. *Vanco Beverage, Inc.*, 103 S.Ct. 1282, 1288 (1983). In this case, by contrast, the relevant product and geographic markets are well defined, and the record evidence does not permit us to conclude that competition within these markets is so vigorous that *no* reasonable possibility of harm to competition from discriminatory pricing could be established.

[74] E. Kintner, *A Robinson-Patman Primer* 35 (2d ed. 1979); *accord*, L. Sullivan, *Handbook of the Law of Antitrust* 679–80 (1977).

[75] ID at 82; IDF 66, 67, 83. Continental's contracts with Associated Grocers during this period required its Tender Crust wholesale price to be at least one cent lower than its Wonder Bread wholesale price. IDF 78.

ers.[76] At certain times from 1970 through 1973 in the Southern California market, Continental sold private label bread to several retail grocery chains at prices lower than those it charged other purchasers for Wonder Bread. IDF 217. At certain times between 1972 and 1974 in the Northern California market, Continental sold private label bread from its San Francisco Bay Area bakeries to several retail grocery chains, at lower prices than it charged other purchasers for Wonder Bread.[77] Finally, during 1973 and 1974 in the Cleveland market, Continental sold private label bread from its Akron bakery to Pick N Pay (hereinafter "PNP"), a large local retail grocery chain, at prices that were lower than those it charged other purchasers for Wonder Bread from its Akron bakery. IDF 311, 328, 329, 338. At certain times during that period, it also charged PNP lower prices for private label hot dog and hamburger buns than it charged other purchasers. IDF 311, 332, 339, 353, 356. [51]

As the foregoing analysis suggests, Continental charged different prices for private label and advertised label bread products in each of the five relevant geographic markets, and its conduct consequently satisfies seven of the ten jurisdictional requirements.[78] The three disputed jurisdictional issues are discussed below.

B. *The Like Grade and Quality Requirement*

One might reasonably argue that private label and advertised label bread products are not "commodities of like grade and quality" because the advertised label bread products consistently sell at a higher price than their physically identical private label counterparts. *See* IDF 36. That persistent price differential indicates that consumers perceive some differences in quality between advertised label and private label bread products, suggesting in turn that the cross-elasticity of demand between the two may not be extremely high. Moreover, although the cross-elasticity of supply between private label and advertised label bread is high at the production level, it is probably considerably lower at the distribution level because the sale of advertised label bread typically requires substantial [52] promotional efforts not needed to sell private label bread.[79] However, the Supreme

[76] IDF 106, 118, 120, 121, 125, 128–130.

[77] IDF 231, 233, 249, 258, 263, 272–278. These data exclude November, 1972–January, 1973, when Continental's bakeries were closed by a labor strike. IDF 260; CPF 12–79.

[78] Continental argues that in primary line cases "the lower price must be shown to have been subsidized, made possible, by the higher price." RAB at 30. However, the Supreme Court has indicated that a price discrimination "is merely a price difference," without incorporating a subsidization requirement. *FTC* v. *Anheuser-Busch, Inc.*, 363 U.S. 536, 549 (1960); *accord, William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1040.

[79] This does not mean that private label and advertised label bread should not be treated as part of the same relevant product market, for purposes of the Sherman Act. The fact that two items command different prices does not necessarily establish that they are different products. The key issue is whether cross-elasticities of demand and supply are sufficiently high to make the prices of the two items substantially interdependent. The record evidence indicates that cross-elasticities of demand and supply between advertised label and private label bread products are sufficiently high to make them part of the same product market. Indeed, the ALJ pointed out:

(footnote cont'd)

Court has determined that physically identical private label and advertised label products—regardless of distributional differences—should be treated as commodities of "like grade and quality" under the Clayton Act. In *FTC* v. *Borden* the Court rejected Borden's claim that private label and Borden-brand evaporated milk—otherwise indistinguishable—should be treated as different "grades" because the Borden brand regularly sold at a higher price than the private label **[53]** brand.[80] The Court determined that since the two products were "physically and chemically identical," they were of like grade and quality, despite their persistently different prices.[81] The Commission has therefore determined to treat advertised label and private label bread products as commodities of "like grade and quality."

C. *The Commerce Requirement*

The commerce requirement can be broken down into three distinct segments. First, the "person" involved must be "engaged in commerce." Second, the price discrimination alleged must occur in the course of such commerce.[82] Third, at least one of the sales that create the alleged price discrimination at issue must be "in interstate commerce,"[83] although it does not matter whether the sale at the higher price or the sale at the lower **[54]** price moves across a state line.[84] If the third requirement can be satisfied, then the first two requirements must necessarily also be satisfied.[85]

The courts have interpreted the commerce requirement differently in primary line and secondary line Section 2(a) cases. In primary line cases, it is sufficient to establish that the seller made sales at different prices in two or more states, even though the areas in which the discriminatory sales were made are not part of the same geographic market. In *Moore* v. *Mead's Fine Bread Co,* the Supreme Court noted that the defendant sold bread it manufactured in New Mexico to

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> A large retail price spread between captive and private label bread, on the one hand, and the advertised label bread, on the other, will result in a loss of sales of advertised label bread. If this price spread is reduced the captive and private label products will lose sales and there will be an increase in sales of advertised label bread.

IDF 36; *accord,* Nissen, Tr. 10139; Metz, Tr. 10239–40. In short, as the price differential increases or declines, the quantity of private label bread products demanded will respectively increase or decline. However, it is important to recognize that advertised label bread and private label bread are not *identical* products; they are differentiated in the minds of consumers to a significant degree.

[80] *FTC* v. *Borden Co.,* 383 U.S. 637, 640, 645–46 (1966).

[81] *Id.* at 638, 640. Real differences in quality may of course place products in different "grades." *Id.* at 644 n.5.

[82] *Standard Oil Co.* v. *FTC,* 340 U.S. 231, 236–38 (1951).

[83] *Gulf Oil Corp.* v. *Copp Paving Co.,* 419 U.S. 186, 195 (1974). By contrast, the Federal Trade Commission Act applies to unfair methods of competition "in *or affecting* commerce." 15 U.S.C. 45(a)(1) (emphasis added).

[84] *Moore* v. *Mead's Fine Bread Co.,* 348 U.S. 115, 119 (1955); *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.,* 668 F.2d 1014, 1043–44 (9th Cir.), *cert. denied,* 103 S.Ct. 57 (1982). We do not need to determine whether *de minimis* interstate sales are sufficient to satisfy this jurisdictional requirement because Continental's sales at different prices were significant in each of the relevant markets. *Compare William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.,* 668 F.2d at 1044 and n.54 *with Food Basket, Inc.* v. *Albertson's Inc.,* 383 F.2d 785, 788 (10th Cir. 1967).

[85] *See, e.g., Lehrman* v. *Gulf Oil Corp.,* 464 F.2d 26, 36–37 (5th Cir.), *cert. denied,* 409 U.S. 1077 (1972); *Liquilux Gas Servs., Inc.* v. *Tropical Gas Co.,* 303 F.Supp. 414, 416–17 (D. P.R. 1969).

customers in Texas at a price higher than the price it charged to certain customers in New Mexico.[86] As a consequence, the Court determined that the primary line discrimination alleged in the complaint satisfied the [55] commerce requirement of Section 2(a).[87] A number of courts have more recently taken the position, however, that the discriminatory sales at issue must originate from the same plant. In *Willard Dairy* v. *National Dairy,* the Sixth Circuit concluded that Section 2(a) did not apply to allegedly predatory sales in Willard, Ohio by an interstate defendant because the plant that the defendant used to supply the Willard area was used only for intrastate sales; the defendant did not sell wholesale milk from that plant in any other state.[88] The court pointed out that

> the fact that the defendant also made interstate shipments from *other* than its Shelby, Ohio plant to areas in which the plaintiff did not engage in business is immaterial to the issue in the case.[89] **[56]**

These cases establish that in order to satisfy the commerce requirement in a primary line case, the defendant that makes the allegedly discriminatory sales at issue in one state must also make sales of the same product from the same plant in other states.[90]

In this case, the commerce requirement is satisfied—for primary line purposes—in each of the relevant geographic markets. In the Denver market, Continental's Denver bakery produced both the private label bread that it sold to Associated Grocers (with members in five different states) and the advertised label Wonder Bread that it sold to retailers in Colorado, Wyoming, and Nebraska. IDF 53–55, 57. In the Twin Cities market, Continental's Minneapolis bakery produced both the private label bread sold to three large chain stores and the Wonder Bread and Wonder Country Style bread sold to other retailers in Minnesota and Wisconsin. IDF 103, 106. It also supplied the Continental bakery in Rochester with bakery products that were in turn shipped to other Minnesota and Wisconsin communities. IDF 103–104. In the Southern California market, Continental's Beverly Hills and DiCarlo (San Pedro) bakeries produced both the private

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[86] *Moore* v. *Mead's Fine Bread Co.,* 348 U.S. at 116–17.

[87] Respondent argues that the commerce requirement cannot be satisfied because the discriminatory sales allegedly injured competition only within the relevant geographic markets. RAP at 31. However, that is not the standard the Supreme Court has adopted in primary line cases. It is enough simply to show that some of the sales from a given plant were made at different prices in different states.

[88] *Willard Dairy Corp.* v. *National Dairy Products Corp.,* 309 F.2d 943, 946 (6th Cir. 1962), *cert. denied,* 373 U.S. 934 (1963).

[89] *Id.; accord, Borden Co.* v. *FTC,* 339 F.2d 953, 955 (7th Cir. 1964); *Beatrice Foods Co.,* 76 F.T.C. 719, 822 (1969), *aff'd sub nom. Kroger Co.* v. *FTC,* 438 F.2d 1372 (6th Cir.), *cert. denied,* 404 U.S. 871 (1971).

[90] This suggests that an interstate firm may be able to avoid the primary line proscriptions of Section 2(a) by using a local plant that sells its products solely intrastate. Kintner, *supra* note 74, at 95; *see Bacon* v. *Texaco, Inc.,* 503 F.2d 946, 948–49 (5th Cir. 1974) (*per curiam*), *cert. denied,* 420 U.S. 1005 (1975); *Kane* v. *Martin Paint Stores, Inc.,* 1974–2 Trade Cas. (CCH) ¶75,296 (S.D.N.Y. 1974), at 97,914–15.

label bread sold to large retail chains and the advertised label bread sold to other retailers, including [57] bread that was sold and delivered—through Continental's San Diego bakery—to customers in Arizona. IDF 177, 179, 201, 217. In the Northern California/Western Nevada market, Continental's San Francisco Bay Area bakeries produced both the private label bread sold to several chain grocery stores (some with stores in both California and Nevada) and the advertised label bread sold to other retailers.[91] Finally, in the Cleveland market, Continental's Akron bakery produced both the private label bread sold to PNP in the Cleveland area, and the Wonder Bread and Wonder Country Style Bread sold to customers in both Ohio and [58] Pennsylvania.[92] As a consequence, the commerce requirement for primary line jurisdiction is satisfied in all five relevant geographic markets.[93] [59]

The commerce requirement for secondary line cases is more restrictive. In *Mayer Paving* v. *General Dynamics*, the Seventh Circuit concluded that in determining whether "either or any" discriminatory sale is in commerce, only the purchases of the allegedly injured purchaser and its competitors can be considered.[94] The Court pointed out that

> to the extent customers on different sides of a boundary line do not compete with each other, no adverse competitive effects on the customer level can ensue from the supplier's price variations.[95]

The Court distinguished this conclusion from the Supreme Court ap-

[91] IDF 229, 231–33; *accord, William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1044. Continental operated bakeries in San Francisco, Oakland and Sacramento. However, their output is considered collectively because each bakery supplied bread products to—and transshipped bread products through—each of the others. IDF 231.

[92] IDF 285–287, 347; CPF 13–126, 13–143 through 13–145, 13–147, 13–148. Although Continental did not ship Wonder Bread directly from the Akron bakery to retailers in other states, the Akron bakery supplied the Youngstown bakery with Wonder bread on a daily basis, and Youngstown in turn sold that bread daily to retailers in both Ohio and Pennsylvania. As long as the practical economic continuity of the interstate sales are unbroken—that is, the goods are shipped in a completely unchanged state, with no hiatus for repacking or warehousing—sales such as these satisfy the "in commerce" requirement. *Compare Belliston* v. *Texaco, Inc.*, 455 F.2d 175, 178–80 (10th Cir.) (interstate shipment of crude oil not sufficient to place sales of gasoline refined from crude oil in interstate commerce), *cert. denied*, 408 U.S. 928 (1972); *L.M.T., Inc.* v. *House of Sobel*, 1979–2 Trade Cas. ¶62,817 (N.D. Cal. 1979) ("practical economic continuity" not maintained where defendants ordered liquor for general inventory, rather than to meet the needs or orders of specific customers) *with Foremost Dairies, Inc.* v. *FTC*, 348 F.2d 674, 677–78 (5th Cir.), *cert. denied*, 382 U.S. 959 (1965) (milk passed in "steady flow" from Colorado farms through Santa Fe processing plant to retail grocery stores in Albuquerque). I am indebted to Commissioner Bailey for this point.

[93] The Commission does not accept the ALJ's conclusion that all of Continental's sales—including the allegedly discriminatory sales—are in commerce because all local grocery chains negotiate their bread purchases with a "corporation located in New York." ID at 80. As the Commission has indicated previously, "Interstate negotiation . . . alone is insufficient to fulfill the commerce requirement of the Robinson-Patman Act . . ." *Beatrice Foods Co.*, 76 F.T.C. at 822; *accord, Borden Co.* v. *FTC*, 339 F.2d 953, 955 (7th Cir. 1964).

[94] *Mayer Paving & Asphalt Co.* v. *General Dynamics Corp.*, 486 F.2d 763, 769 (7th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *accord, McGoffin* v. *Sun Oil Co.*, 539 F.2d 1245, 1248 (10th Cir. 1976); *Myers* v. *Shell Oil Co.*, 96 F.Supp. 670, 675–76 (S.D. Cal. 1951); *Beatrice Foods Co.*, 76 F.T.C. at 822.

[95] *Mayer Paving & Asphalt Co.* v. *General Dynamics Corp.*, 486 F.2d at 770, *quoting* F. Rowe, *Price Discrimination Under the Robinson-Patman Act* 179 (1962).

proach in primary-line cases by noting that injury to competition among *sellers* may arise if the discriminating seller can subsidize its lower prices for product from a given plant in one state with higher prices for product from that same plant in other states. By contrast, injury to competition among *buyers* may arise only if the favored and disfavored buyer(s) compete with one another in a relevant geographic market.[96] In short, secondary line injury cannot be established—because the jurisdictional commerce requirement cannot be satisfied—in any relevant secondary line geographic market that does not cross **[60]** state lines, because by definition favored buyers in that market do not compete with disfavored buyers in other markets.[97]

In this case, allegations of secondary line violations of Section 2(a) extend only to the Northern California/Western Nevada market and the Cleveland market. Of course, the relevant geographic markets for secondary line retail grocery sales are considerably smaller than the relevant geographic markets for primary line wholesale and captive bakery sales. The Commission has used Standard Metropolitan Statistical Areas (SMSAs) as a good approximation of relevant geographic markets in a number of recent retail grocery store merger cases.[98] At least one retail grocery market in the Northern California/Western Nevada area satisfies the commerce requirement, because disfavored retailers in Reno and Sparks, Nevada that purchased Wonder bread products from Continental arguably competed with favored retailers in California that purchased private label bread products from **[61]** Continental.[99] However, the second market, the Cleveland retail grocery market, does not satisfy the secondary-line commerce requirement, because it does not include any areas outside Ohio. The Cleveland SMSA consists of Cuyahoga, Lake, Medina and Geauga Counties, all of which lie within the confines of the state of Ohio. CPF 13–32. Moreover, the market area of PNP, the retail grocer that allegedly received lower prices, apparently does not extend beyond greater Cleveland, so that PNP does not compete with any retailers located outside Ohio. RRB at **[62]** 28; *see* CX 992–E. Therefore, the allegation of secondary line discrimination in Cleveland must be dismissed because it does not satisfy the "in commerce" jurisdictional

[96] *Id.*

[97] *Falls City* v. *Vanco* is not inconsistent with this conclusion. There, the District Court had concluded that although the two buyers involved could not sell to the same retailers, they nevertheless competed with one another because the relevant geographic market at *retail* included both the Indiana county and the Kentucky county involved. *Falls City Industries, Inc.* v. *Vanco Beverage, Inc.*, 103 S.Ct. 1282, 1287 (1983).

[98] *E.g., Grand Union Co.,* 3 Trade Reg. Rep. (CCH) ¶22,050 (July 18, 1983), at 22,708; *Albertson's, Inc.,* 97 F.T.C. 343, 345 (1981) (allegation in complaint issued with consent); *Godfrey Co.,* 97 F.T.C. 456, 458 (1981) (allegation in complaint issued with consent).

[99] CPF 12–125 through 12–129; CPF 12–187 through 12–201. The relevant retail grocery market arguably includes both the Nevada communities of Reno, Sparks, and Lake Tahoe and the California Lake Tahoe area.

requirement.[100]

D. *The Injury To Competition Requirement.*

In order to establish the injury to competition component of a Section 2(a) violation, the Commission must establish that the price discrimination at issue may substantially "lessen competition or tend to create a monopoly in any line of commerce." 15 U.S.C. 13(a). More precisely, this implies that the Commission must establish a "reasonable possibility that a **[63]** price difference may harm competition."[101] The injury to competition standards in primary line and secondary line cases differ, however, and we must therefore discuss the allegations of primary line and secondary line injury separately.

1. Primary Line Injury

In order to establish primary-line injury, complaint counsel must establish that the price differences at issue either injured or threatened to injure competition at the primary level; that is, among competing sellers.[102] That showing may be effected either (1) by means of a detailed market analysis establishing that the discrimination at issue actually injured competition or (2) by establishing predatory intent, from which competitive injury may be inferred.[103] Under the first approach, it is not enough simply to establish that individual sellers have been **[64]** injured, or that some competitors have left the market.[104] Direct evidence that competition among sellers has been

[100] Since Section 5 of the Federal Trade Commission Act can be used to fill inadvertent gaps in the coverage of the Robinson-Patman Act—to an extent consistent with the "spirit" of that Act—it might be possible for the Commission to apply the more expansive jurisdictional coverage of primary line cases to secondary line cases. There are at least two reasons not to take that approach. First, the more restrictive approach is more consistent with economic theory in this case. Grocery retailers compete with one another in SMSA markets, and a pair of discriminatory prices can therefore injure disfavored retailers only if sales at both prices in the pair are made in the same SMSA. Second and more generally, the Commission has concluded that

> unlike the Sherman and Clayton Acts, the underlying goal of the Robinson-Patman Act is the protection of competitors, not competition. Accordingly, the "spirit" theory must be applied with great caution in the context of cases brought under that Act.

General Motors Corp., 3 Trade Reg. Rep. (CCH) ¶22,165 (June 21, 1984), at 23,023. [103 F.T.C. 641]

[101] *Falls City Industries, Inc.* v. *Vanco Beverage Co.*, 103 S.Ct. 1282, 1288 (1983); *accord, Corn Products Refining Co.* v. *FTC*, 324 U.S. 726, 742 (1945). Complaint counsel need not show that the discriminations alleged actually injured competition. *J. Truett Payne Co.* v. *Chrysler Motors Corp.*, 451 U.S. 557, 562 (1981).

[102] *Double H Plastics, Inc.* v. *Sonoco Products Co.*, 5 Trade Reg. Rep. (CCH) ¶65,949 (3d Cir. April 20, 1984), at 68,102; *O. Hommel Co.* v. *Ferro Corp.*, 659 F.2d 340, 346 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982).

[103] *Double H Plastics* v. *Sonoco*, ¶65,949 at 68,102; *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.*, 718 F.2d at 1439; *O. Hommel Co.* v. *Ferro Corp.*, 659 F.2d at 347; *Pacific Engineering & Prod. Co.* v. *Kerr-McGee Corp.*, 551 F.2d 790, 798 (10th Cir.), *cert. denied*, 434 U.S. 977 (1977); *National Dairy Products Corp.* v. *FTC*, 412 F.2d 605, 612–13 (7th Cir. 1969); *Beatrice Foods Co.*, 76 F.T.C. at 799.

[104] *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1042 (the fact that the plaintiff suffered losses and eventually ceased operations is not enough to establish a Section 2(a) violation); *O. Hommel Co.* v. *Ferro Corp.*, 659 F.2d at 347; *International Air Industries, Inc.* v. *American Excelsior Co.*, 517 F.2d 714, 721–22 (5th Cir. 1975), *cert denied*, 424 U.S. 943 (1976); *Anheuser-Busch, Inc.* v. *FTC*, 289 F.2d 835, 840 (7th Cir. 1961) (other competitors losing market share does not demonstrate injury); *General Foods Corp., supra* note 7, ¶22,142 at 22,989 and n.76 (Commission Opinion), 22,992 (Bailey, Commissioner, concurring); *Beatrice Foods Co.*, 76 F.T.C. 719, 800 (1969), *aff'd sub nom. Kroger Co.* v. *FTC*, 438 F.2d 1372 (6th Cir.), *cert. denied*, 404 U.S. 871 (1971); *Lloyd A. Fry Roofing Co.*, 68 F.T.C. 217, 260 (1965), *aff'd*, 371 F.2d 277 (7th Cir. 1966).

injured[105] must be developed.[106] Under the second approach, in lieu of direct evidence of anticompetitive effects, the Commission must establish injury to competition by rebuttable inference from predatory intent, which can in turn be established either directly or by rebuttable inference from predatory **[65]** conduct.[107] When predatory intent or predatory pricing are relied upon to establish primary line injury to competition in violation of Section 2(a), the standards that govern the intent and conduct components of the attempted monopolization offense should apply.[108] For example, the Ninth Circuit has concluded that where **[66]**

> a price differential threatens a primary line injury, . . . Section 2 of the Sherman Act . . . and Section 2(a) of the Clayton Act . . . are directed at the same economic evil and have the same substantive content . . .[109]

The record does not contain any direct evidence suggesting that Continental's behavior injured competition. It is true that a number of bakeries, including Laub in Cleveland, Old Homestead in Denver, and Inglis in northern and southern California exited their respective markets at some point during the corresponding relevant time period. However, there is little evidence to the effect that these exits were occasioned by Continental's behavior, rather than by poor management, inefficiency, an overall reduction in the demand for white bread, or other unfortunate but nevertheless perfectly competitive explanations. Moreover, even if the exit of one or more of these bakers could be attributed to the conduct of Continental, that would not be sufficient to establish the requisite injury to competition unless Continental's behavior could be characterized as predatory or otherwise anticompetitive. Vigorous, legitimate competition forces less efficient

[105] The "substantial lessening of competition" component of a Section 2(a) offense may be somewhat easier to satisfy than the "dangerous probability of successful monopolization" requirement for proving attempted monopolization under the Sherman Act. *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1042. However, when *no* showing of predatory conduct can be made it is highly unlikely that the Section 2(a) injury to competition requirement can be satisfied by direct evidence. *Id.; Anheuser-Busch* v. *FTC*, 289 F.2d at 843–44.

[106] For an example where the Commission determined that *no* reasonable possibility of injury to competition existed, *see* noted 73, *supra*.

[107] *O. Hommel Co.* v. *Ferro Corp.*, 659 F.2d at 347; *Janich Bros.* v. *American Distilling Co.*, 570 F.2d 848, 855 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978); *Beatrice Foods Co.*, 76 F.T.C. 719, 799–800 (1969), *aff'd*, 438 F.2d 1372 (6th Cir.), *cert. denied*, 404 U.S. 871 (1971). As the Ninth Circuit has pointed out, however,

> *direct* evidence of intent alone can be ambiguous and misleading. . . . Especially misleading here is the inveterate tendency of sales executives to brag to their superiors about their competitive prowess, often using metaphors of coercion that are compelling evidence of predatory intent to the naive. Any doctrine that relies upon proof of intent is going to be applied erratically at best.

William Inglis & Sons Baking Co. v. *ITT Continental Baking Co.*, 718 F.2d at 1028 and n.6 (emphasis added).

[108] *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.*, 718 F.2d at 1439; *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1041–42; *O. Hommel Co.* v. *Ferro Corp.*, 659 F.2d at 348; *Janich Bros., Inc.* v. *American Distilling Co.*, 570 F.2d 848, 855 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978); *Pacific Engineering & Production Co.* v. *Kerr-McGee Corp.*, 551 F.2d 790, 798–99 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977); *International Air Industries* v. *American Excelsior Co.*, 517 F.2d 714, 720 n.10 (5th Cir. 1975), *cert. denied*, 414 U.S. 975 (1976).

[109] *Janich Bros., Inc.* v. *American Distilling Co.*, 570 F.2d at 855.

firms to exit constantly; that in fact is a frequent consequence of vigorous competition.

We must therefore determine whether the requisite injury to competition may be inferred from Continental's pricing behavior. We have already determined that sales at prices equal to or greater than average variable cost will be strongly **[67]** presumed to be legitimate, and that sales at prices below average variable cost will be presumed to be predatory. This standard should apply to defining predation under Section 2(a) of the Clayton Act, as well as to satisfying the specific intent and anticompetitive conduct components of the attempted monopolization offense under Section 2 of the Sherman Act. Therefore, sales at prices that equal or exceed average variable cost cannot ordinarily satisfy the predation element of primary line injury to competition under Section 2(a).[110]

The first step in such an analysis must necessarily be to determine the contours of the product that Continental allegedly sold at prices below average variable cost. Professor Areeda has recently argued that in determining whether one should consider the prices and costs associated with a single product, or those associated with an entire line of products, the crucial issue should be the contours of the product or line that rival firms can sell. When competing firms can sell the same line of products that the alleged predator can sell, selling a single product in that line at prices below average variable cost cannot exclude equally efficient competing firms, which can match those prices as long as overall revenues exceed the variable costs **[68]** associated with the product line as a whole.[111] In this case, the instrument of predation should be defined at least broadly enough to include the full line of private label white pan bread products that Continental sold in each market. As Continental has pointed out, "[r]etailers do not buy, and wholesalers do not sell, simply one item in a line."[112] As a consequence, if a wholesaler wishes to supply private label bread to a given retailer, it typically must supply an entire line of white bread products, including the most popular loaf sizes and hamburger and hot dog rolls. The record evidence does not establish that competing bakers could not, like Continental, produce an entire line of private label white pan bread products. Therefore, to the extent that an entire line of white bread constitutes the minimum product offering necessary for a baker to stay in business, only prices

[110] *D.E. Rogers Associates, Inc.* v. *Gardner-Denver Co.,* 718 F.2d at 1439; *O. Hommel Co.* v. *Ferro Corp.,* 659 F.2d at 349–50; *Pacific Engineering & Prod. Co.* v. *Kerr-McGee Corp.,* 551 F.2d 790, 797–98 (10th Cir.), *cert. denied,* 434 U.S. 879 (1977); *see International Air Industries, Inc.* v. *American Excelsior Co.,* 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied,* 424 U.S. 943 (1976).

[111] P. Areeda, *Antitrust Law Supplement* 145–46 (1982).

[112] RAP at 33, *citing* Biechner, Tr. 3553–54, Jones, Tr. 3700.

that cause revenue to fall below variable cost for the entire line could conceivably force equally efficient competitors out of business.

The case law supports considering at least the whole line of private label white bread sales in the aggregate. In *Janich* v. *American Distilling,* the Ninth Circuit considered allegations that the defendant had attempted to monopolize the sale of private label gin and vodka in California, and had sold gin and [69] vodka of like grade and quality at discriminatory prices.[113] The Court of Appeals determined that whether the defendant sold gin and vodka at predatory rices should be determined by considering its prices and costs for its full line of gin and vodka products, rather than simply its half gallon sizes of gin and vodka.[114] The Court indicated that

> [t]he product must be such that if predatorily priced, rivals are likely to be driven out of the market or excluded, allowing the firm to raise prices. . . .[115]

A strong argument can be made, however, that the instrument of predation in this case should be defined more broadly, to include both advertised label and private label white pan bread products. The relevant product market includes both advertised label and private label bread products, because the cross-elasticity of supply between them is relatively high, and the cross-elasticity of demand between them is at least somewhat significant. Moreover, the Supreme Court determination that physically identical private label and advertised label products should be considered to be of "like grade and quality" requires [70] us to treat advertised label and private label white pan bread as commodities of like grade and quality in satisfying that jurisdictional requirement of the Clayton Act.

Defining the instrument of predation to include both advertised label and private label white pan bread products would be consistent with the determination that the instrument of predation should encompass the product or line of products that rival firms can sell. The record evidence indicates that almost all of the major wholesale bakers in the five relevant geographic markets, including the firms that exited those markets during the relevant time periods (Old Homestead in Denver, Prosser and Gordon in Southern California, and Inglis in Northern California/Western Nevada), marketed an advertised label white pan bread product, and nearly as many marketed

[113] *Janich Bros., Inc.,* v. *American Distilling Co.,* 570 F.2d 848, 852 (9th Cir. 1977), *cert. denied,* 439 U.S. 829 (1978).

[114] *Id.* at 856; *accord, ILC Peripherals* v. *International Business Machines,* 458 F.Supp. 423, 433 (N.D. Cal. 1978), *aff'd,* 636 F.2d 1188 (9th Cir. 1980), *cert. denied,* 452 U.S. 972 (1981). The opinion in *Janich* does not indicate whether the defendant sold branded gin and vodka, as well as private label gin and vodka, in California.

[115] *Janich Bros., Inc.* v. *American Distilling Co.,* 570 F.2d at 856. The Court did recognize that in some cases "a given size might be so significant that a chain retailer would select the overall line on the basis of that size. . . ." *Id.*

private label bread as well.[116] The record evidence confirms that a wholesaler that produces private label bread for a given retailer almost always makes substantial sales of its advertised label bread as a part of the deal. Continental argues that increased advertised label sales are "an essential ingredient of any private label transaction;" that it sells "a [71] bread line of various items at different prices under two labels," and assesses profitability on a full line basis; and that "the composite price of the entire line" is the relevant price.[117] In Denver, for example, as complaint counsel themselves indicate, Continental expected to make substantial Wonder bread sales through Associated Grocers retailers as a consequence of its Tender Crust private label program for those grocers. CAB at 54, *citing* L. Johnson, Tr. 7201, CX 1522 D–E. Therefore, it may be perfectly logical for a firm like Continental to sell private label and advertised label bread as a package, offsetting lower prices for and profits from private label bread with higher prices for and profits from greater advertised label bread sales. In fact, Continental argues that if it were to refuse to sell private label products at prices below full cost, its advertised label sales would decline. RAP at 26. As a result, even if prices for Continental's private label bread did not always cover the variable costs associated with private label sales, that arguably should not be considered predatory unless those losses were sufficiently high to push overall revenues—including advertised label revenues—below variable cost.

At least one recent Court of Appeals opinion has taken this approach. In *Pierce Packing Co.* v. *John Morrell & Co.,* the Ninth Circuit considered allegations that the defendant had attempted to monopolize the Montana "pork and pork products" market by selling "pork loins, private label bacon and private label [72] frankfurters" at prices below cost.[118] At trial, the district court judge had permitted the defendant to introduce evidence concerning "sales of unrelated products" to "show that [defendant's] total Montana sales were profitable and that the relevant products were not sold below marginal cost."[119] The Court of Appeals concluded that the evidence was properly admitted because it

[116] IDF 56–58, 107–110, 181–182, 185–186, 234–238, 288. The only possible exceptions may have been Laub in Cleveland, which made 58% of its sales to restaurants and also sold many specialty breads, and Ward in Cleveland. IDF 289–290. Any wholesaler that can produce advertised label bread can produce private label bread just as easily. The wholesale bakers that exited therefore could have marketed both private label and advertised label bread just as Continental did. It would be more difficult for an exclusively private label baker to begin marketing advertised label bread as well, because of the time and promotional costs associated with developing an advertised label.

Laub's strong emphasis upon restaurant and specialty sales makes it unlikely—contrary to Commissioner Bailey's suggestion—that Continental's prices to retail grocers were "a major cause" of Laub's exit from the Cleveland market.

[117] RAP at 33, *citing* Biechner, Tr. 3553–54; Jones, Tr. 3700; Nissen, Tr. 10145–48; Inglis, Tr. 3786; Dierker, Tr. 9790–91.

[118] *Pierce Packing Co* v. *John Morrell & Co.,* 633 F.2d 1362, 1363 (9th Cir. 1980).

[119] *Id.* at 1364.

made the fact of the profitability of [defendant's] Montana operations, both generally and with respect to pork and the particular pork products involved in this case, more probable than it would have been without the evidence.[120]

In short, the Court of Appeals sustained the consideration of the profitability of "pork and pork products," rather than simply price-cost comparisons for pork loin and private label bacon and frankfurters, in determining whether predatory pricing had in fact occurred. The same principles arguably should be applied here. Continental's overall revenues from and variable costs **[73]** associated with its sales of all white pan bread products—both advertised label and private label—should quite logically be considered in determining whether it sold products at prices below average variable cost.[121]

The record evidence in this case does not satisfy the test for predatory pricing that the Commission has adopted, whether or not advertised label and private label sales are considered together. As we indicated *supra,* sales at prices that equal or exceed average variable cost will be presumed to be legitimate, while sales at prices below average variable cost will be presumed to be predatory. The Administrative Law Judge determined that Continental sold certain white bread products at prices below average variable cost on a number of occasions. However, to make that determination, the ALJ assumed that Continental's variable costs were uniformly and persistently **[74]** equal to eighty percent of its "total allocated costs." IDF 45. There are two important difficulties with this assumption. First, it is unrealistic to assume that Continental's variable costs were always equal to eighty percent of its total allocated costs, throughout the period of time under consideration in this case, and in each of the five separate relevant geographic markets. Second, the ALJ derived the eighty percent figure by comparing Continental's variable costs in 1971 with its *revenues* in 1971, rather than with its total *costs.* IDF 45; *see* CX 262C–D. Since revenues frequently differ from total costs, there is no way of knowing whether the eighty percent figure accurately reflects the relationship between Continental's variable and total allocated costs. For these reasons, the Commission has determined not to rely

120 *Id.*

121 In the collateral Northern California private litigation, neither the District Court nor the Court of Appeals expressly addressed the question of whether advertised label and private label bread sales should be considered separately or together. *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.,* 461 F.Supp. 410 (N.D. Cal. 1978), *rev'd on other grounds,* 668 F.2d 1014 (9th Cir. 1982), *cert. denied,* 103 S.Ct. 57 (1982).

The Commission has in the past taken the position that private label and branded label sales should not be aggregated to determine whether sales of private label milk at lower prices than advertised label milk to a retailer represented unlawful *secondary*line discrimination. *Beatrice Foods Co.,*76 F.T.C. 719, 805–07 (1969), *aff'd sub nom. Kroger Co.* v. *FTC,* 438 F.2d 1372, 1379 (6th Cir. 1971), *cert. denied,* 404 U.S. 871 (1971). However, the Commission noted that the key issue is whether the favored retailer is given a competitive advantage over competing retailers as a consequence of being able to purchase the cheaper private label milk. *Beatrice Foods Co., supra,* 76 F.T.C. at 806. That position arguably should not apply when disfavored retailers may also purchase private label products at the same price. *Borden Co.* v. *FTC,* 381 F.2d 175, 180 (5th Cir. 1967).

upon the [75] "eighty percent" assumption that the ALJ developed. The following subsections apply more traditional evaluative techniques to Continental's pricing conduct in each of the five relevant geographic markets.[122]

a. Denver Market

Prior to 1964, the ALJ determined that in the Denver market,

> wholesale bakers did not compete on the basis of the wholesale or retail prices of their products. . . . There were meetings or communications between them prior to any price move, which all the wholesale bakers took at the same time.

IDF 63. Largely as a consequence of this arrangement, no wholesaler sold private label bread. IDF 65. However, in early 1964, after three years of effort, Associated Grocers—a cooperative of independent retail grocery stores together accounting for four percent of retail grocery sales in the Denver area—induced Interstate and Continental to negotiate the development of a private label program. IDF 67, 68. In August, 1964 Continental entered into a written agreement to supply [76] Tender Crust private label bread—including one pound expanded loaf, 1.25 pound round top, 1.25 pound sandwich bread, and hamburger and hot dog buns—to members of Five States, a cooperative company that Associated Grocers organized for its private label program. IDF 69–72. The agreement provided, *inter alia,* that in the event that Continental reduced its advertised label prices below their June, 1964 level, it would reduce the corresponding Tender Crust price to at least one cent below the advertised label price.[123] Continental expected a price of $.175 for its one pound Tender Crust loaf to generate revenues forty-six percent above variable cost, because its "cost to the doors of its plant"—including direct costs plus "other manufacturing," "operating," "office," and "packers"—would be nine and one-half cents per one pound loaf. Continental expected its other private label products to make similar revenue contributions. CX 1525 A, C–K. Continental retained the Tender Crust private label business until the middle of 1978, and then reacquired it in late 1979. IDF 94.

Complaint counsel argue that Continental sold Tender Crust at prices below average variable cost at various times between 1965 and

[122] The ALJ's assumption as to the relationship between Continental's variable and total allocated costs does not in any event establish any significantly lengthy instances of sales at prices below average variable cost, as the discussion in each subsection indicates.

In conducting our analysis, we emphasize the evidence that complaint counsel presented, because complaint counsel bear the burden of proving sales at prices below average variable cost, and if the evidence they adduce is not adequate, then a finding of sales at such prices cannot be sustained. The cost evidence in the record might be considerably better if Continental had supplied certain subpoenaed accounting forms in a timely fashion, or if complaint counsel had been willing to accept Continental's later tender of the forms after the entry of a sanctions order against it. The sanctions order is discussed in Part IV, *infra.*

[123] IDF 73, 78. In 1967, this prescribed differential was increased to three cents. IDF 80.

1967. CPF 8–191, 8–192. As support for that position, they argue that (1) Continental's total costs for producing Tender Crust in the third quarter of 1967 amounted to $.1659 per one-pound loaf; (2) eighty percent of that figure is $.1327; (3) in 1965, Continental sold 10,000 loaves of Tender Crust to [77] one grocer for $.125 per loaf; (4) from June, 1965 to February, 1966, Continental sold Tender Crust to another grocer for $.125 per loaf; and (5) in the fall of 1967, Continental sold Tender Crust for $.1305 per loaf. CPF 8–191, 8–192; *see* CAB at 28. The ALJ relied upon the foregoing data and cost assumptions to conclude that Continental sold Tender Crust at prices below average variable cost in November, 1967 and March, 1968. IDF 82, 83, 85.

These data cannot support a finding that Continental sold Tender Crust at prices below average variable cost for a significant period of time. As we indicated *supra*, we cannot assume that Continental's variable costs were always eighty percent of its total costs, whether in 1967 or otherwise; a more detailed depiction of actual average variable costs must be used. That is particularly important where, as here, the respondent argues that its variable costs were considerably lower. Continental argues that its variable costs per one pound loaf amounted to only $.095 per loaf at the time it entered the [78] Tender Crust contract in July, 1964,[124] and the prices at issue exceeded that figure by an estimated three cents to eight cents per loaf during the cited time periods. CX 1728. Moreover, the sales cover one pound Tender Crust bread alone; there is no evidence that if all Tender Crust private label products were included—including other loaf sizes and hamburger and hot dog buns—revenues would not have exceeded costs by an even greater degree. Furthermore, these data all relate to private label sales alone. There is apparently no evidence in the record that—when private label and advertised label sales are aggregated—Continental made sales at prices below average [79] variable cost. In the absence of any other evidence that Continental sold white bread at prices below average variable cost in Denver, the Commission has determined to dismiss the Section 2(a) count as to that market.[125]

[124] RAP at 20, 50, *citing* CX 1525; RPF 123. CX 1728, which sets forth the expenses associated with sales of one pound loaves of Wonder bread and Tender Crust from the first quarter of 1964 through the last quarter of 1967, indicates that the "cost to doors" associated with a one-pound loaf of Tender Crust increased from $.09 in the third quarter of 1967, when the private label contract with Associated Grocers began, to as much as $.10 in the third quarter of 1966, and then declined to $.098 in the fourth quarter of 1967. CX 1728C, 1728Y, 1728Z–5.

Complaint counsel argue that CX 1728 should be disregarded because it is "contradicted by the regular business records of CBC" and because some of the costs used were estimated as percentages of list price. CAB at 61–62. However, the "regular business records" cover overall plant operations, while CX 1728 covers only one pound Wonder bread and Tender Crust bread. Moreover, most of the costs employed were actual; only a few were estimated on the basis of percentages of list prices. CX 1722H, R–Y, Z–21 through Z–31.

[125] In the private suit against Continental in Denver the Court of Appeals sustained a finding of liability under Section 2(a) of the Clayton Act. *Continental Baking Co.* v. *Old Homestead Bread Co.*, 476 F.2d 97 (10th Cir.), *cert. denied*, 414 U.S. 975 (1973). However, the Court noted that the record contained evidence of "sales below cost" for only "a very short period" and therefore appears to have relied primarily upon Continental's construction of

(footnote cont'd)

b. *Twin Cities Market*

In this market, complaint counsel argue that Continental sold Wonder roundtop and sandwich breads from its Minneapolis bakery at prices below average variable cost for one and one-half months in the middle of 1967. CPF 9–98; *see* CAB at 28. As support for that position, they point out that during that period (1) Continental's fully allocated costs of manufacturing and distributing those products were $.2512 and $.2513 per loaf respectively; (2) eighty percent of $.2512 is $.201; and (3) Continental sold Wonder roundtop and sandwich breads for $.20 per loaf during the one and one-half month period. CPF 9–96, 9–98; *see* CAB at 28. Complaint counsel also argue that Continental sold Pantry Pride (a controlled label bread) at a price below average variable cost for two months in late 1967. CPF 9–111; *see* CAB at 28. As support for that position, they [80] point out that during that period: (1) $.156 per loaf represented eighty percent of Continental's fully allocated costs; and (2) Continental sold Pantry Pride for $.1519 per loaf. The ALJ relied upon these data to conclude that Continental sold Wonder round top and sandwich bread at prices below average variable cost for one and one-half months in 1967, and sold Pantry Pride to a Minneapolis retailer at prices below average variable cost for two months in 1967. IDF 128, 131. However, these calculations also rely upon the "eighty percent" assumption, and there apparently is no other record evidence that Continental sold any white bread products at prices below average variable cost in the Twin Cities market. The Commission has therefore determined to dismiss the Section 2(a) count as to that market.

c. *Southern California Market*

In this market, Continental's bakeries included plants in Beverly Hills, San Pedro, and San Diego. IDF 175–177. Complaint counsel argue that Continental sold a number of private label white pan bread products from the Beverly Hills bakery at prices below average variable cost in the Southern California market for a four-week period ending in August, 1973. As support for this position, complaint counsel cite Continental's own "reckoning" in an internal study that its "total gross sales" were less than its [81] "total variable costs."[126] However, it is important to note that the study covered a large num-

a large new plant in 1962 to sustain the requisite finding of predatory intent. *Id.* at 104–05. As we have noted *supra*, there are a variety of perfectly legitimate reasons for constructing new, more efficient plants and then selling at prices sufficiently low to maximize production efficiency and minimize unit costs. We therefore decline to adopt the conclusion of the Court of Appeals.

[126] CPF 11–46, *citing* CX 441F ("McCoy 1 lb. white"), Z–170 ("B&S Reg"), Z–171 ("B&S Buttermilk"), Z–188 ("Jordano 8 pk. Bun"), Z–198 ("Stop'n Go 8 pk. Dog"), Z–199 ("Mayfresh 8 pk. Dog"). Continental's calculations were apparently made as part of "a special, one-time 'profit by variety' study" of the Beverly Hills bakery in August, 1973. RPF 325.

ber of varieties of bread products, and the fact that revenues from six of them may not have covered all variable costs during one four-week period cannot therefore support a finding that Continental sold its complete white bread private label line, or its complete white bread advertised label line, at prices below average variable cost during that period. Continental argues that its study indicates that it sold every brand and size of white pan bread from the Beverly Hills bakery, of which there were several dozen, at prices higher than "incremental costs," with the exception of one that represented less than one percent of the sales of the bakery. RPF 325, *citing* CX 441E. Continental argues in addition that "when the profits of Wonder white bread are included, the total white bread sales of the Beverly Hills bakery were profitable on a full cost basis." *Id., citing* CX 441. Continental argues further that its standard cost reports for the bakery for June, 1973 through January, 1974 show a sixty percent gross profit margin for advertised label bread, and a forty percent gross profit margin for private label bread, during that period.[127] The ALJ apparently concluded that the record evidence was not [82] sufficiently strong to establish that Continental made any sales in this market at prices below average variable cost. *See* IDF 219, 222.

On balance, the record evidence does not support concluding that Continental engaged in predatory pricing in the Southern California market. Complaint counsel cite only four weeks of sales at prices below average variable cost, and the Commission predatory pricing standard requires a showing of sales at prices below average variable cost for a significant period of time to create a presumption of predatory pricing. A single isolated month of sales at such prices cannot satisfy that standard. Moreover, as in the other markets, the evidence that complaint counsel have developed focuses upon different "types" of private label white pan bread—in this case, sales of only one or a few private label bread varieties—rather than focusing upon all private label bread products collectively. Furthermore, the record evidence does not establish that Continental made any white pan bread sales in the Southern California market at prices below average variable cost, when both advertised label and private label bread sales are aggregated. The Commission has therefore determined to dismiss the Section 2(a) count as to this market. **[83]**

d. *Northern California/Western Nevada Market*

Continental served this market from three bakeries located in San Francisco, Sacramento and Oakland; the first two produced variety and white pan breads and cake products, while the Oakland bakery produced just variety and white pan breads. IDF 231. Complaint coun-

[127] RPF 326, *citing* CX 433-Z31, CX 435C, CX 436D, CX 437C, CX 438C, CX 439G.

sel argue that Continental sold certain products at prices below average variable cost in this market.[128] More particularly, complaint counsel argue that Continental sold private label "cello" (one pound "expanded" loaf) at prices below average variable cost (1) for four weeks, ending on July 22, 1972 from its Oakland and San Francisco bakeries; (2) for four weeks, ending on August 19, 1972 from its Sacramento bakery; (3) for five weeks, ending March 30, 1974 from its Oakland bakery; (4) for four weeks, ending February 23, 1974 from its San Francisco bakery; (5) for five weeks, ending June 9, 1974 from its Oakland bakery; (6) for four weeks, ending April 27, 1974 from its San Francisco bakery; and (7) for five weeks, [84] ending September 28, 1974 from its Oakland bakery.[129] Continental admits in response that it sustained "bookkeeping losses on a full cost basis in 1971–74 because of federal price controls, the labor strike and substantial cost escalations . . ." RPF 394. However, Continental argues that its plants always had a "positive cash flow" during that period; that in every quarter from 1972 through 1975 its private label price "substantially exceeded the marginal cost of producing and selling those items. . . . (by about 35%);" and private label products contributed profits of $2.8 million during those years.[130] [85]

The ALJ apparently did not evaluate or rely upon the foregoing evidence. Instead, he simply assumed that "Continental's [total] costs were comparable to American's" in 1973; assumed that Continental's average variable costs were eighty percent of American's total costs; and therefore concluded that Continental's $.172 price for its private label bread during the July, 1972 - August, 1973 period was lower than its average variable cost during that period. IDF 249, 254.

The study that complaint counsel rely upon to establish sales at prices below average variable cost—CX 3010—is helpful, but it suffers from two major deficiencies. First, the data for 16 ounce white round top bread, 24 ounce white round top bread, and hamburger and hot dog buns should be aggregated, in order to determine whether revenues from sales of those products collectively fell below variable costs

[128] CAB at 28, *citing* CPF 12–144, 12–146, 12–149, 12–150; CAB at 71–72, *citing* CX 3010, IDF 252, 254, 255.

[129] CPF 12–144, 12–146, *citing* CX 3010A; *see* CAB at 71; RX 3010; Diener, Tr. 12227, 12230–78. Complaint counsel also argue that Continental sold a number of individual bread varieties at prices below average variable cost during the five week period ending on September 9, 1973. CPF 12–147, 12–148, 12–150, *citing* CX 733. However, as we have noted *supra*, disaggregation beyond the level of private label white pan bread and advertised label white pan bread is not appropriate. Moreover, the variable costs associated with *all* of the individual bread varieties in CX 733 cited by complaint counsel exceeded revenues from sales of those varieties by only $1,207 during the cited period. By way of contrast, the collective revenues from sales of the third variety listed in CX 733—and CX 733 covers a large number of varieties—exceeded the total variable costs associated with sales of that variety by $9,027. *See* CX 733C. Complaint counsel criticize Continental's treatment of certain costs as fixed and others as variable for certain other varieties in CX 733. CPF 12–149. However, they do not provide any indication of whether any sales at prices below average variable cost would be shown if all private label white pan bread were aggregated, and all advertised label white pan bread were aggregated.

[130] RPF 394–396, *citing* RX 125, RX 3010–A. Continental argues that its "marginal cost" for northern California sales amounted to about eleven cents per loaf at the time it lowered its price to $.172 in 1972.

in any of the relevant time periods. As we noted *supra*, the instrument of predation should at least include the aggregated sales of all private label white pan bread products. It is not clear from the record whether these three products alone accounted for all of Continental's private label line; if it also sold other private label products from its Bay Area plants, then the costs and revenues associated with those sales should be aggregated as well. In any event, when sales of the three identified products are aggregated, one finds that collective revenues from sales of these products exceeded variable costs as defined by complaint counsel in all three of the 1972 time periods during which [86] predatory pricing allegedly occurred.[131] Of the remaining five periods that complaint counsel cite, the data for the two periods in the second quarter of 1974 are less useful because they do not account for the revenues and costs associated with sales of hot dog and hamburger buns during those periods. Since hot dog and hamburger buns account for a substantial portion of the private label revenues from each of the three Bay Area plants, it is possible that total private label revenues might actually have exceeded variable costs as defined during one or both of those periods had the revenues and costs associated with hamburger and hot dog bun sales been included.

That leaves three time periods—a five-week period ending in March, 1974 concerning the Oakland bakery; a four-week period ending in February, 1974 concerning the San Francisco bakery; and a five-week period ending in September, 1974 concerning the Oakland bakery—during which aggregate private label revenues may have fallen below variable costs as complaint counsel have defined them. There are, however, four significant impediments to basing a finding of liability upon these data. First, they assume that a variety of costs should be treated as completely variable, when at least portions of them probably should be treated as fixed, particularly over the very short periods of [87] time at issue.[132] In particular, at least portions of the costs associated with such items as "local plant vehicular expense," "tractor trailer equipment," "vacation pay," "health and welfare pension fund," "sales supervisors' salaries," "garage labor," and "executive" should very probably be treated as fixed costs, particular-

[131] Sales of these products from the Oakland, San Francisco, and Sacramento bakeries respectively generated revenues of $1,012, $118, and $813 over variable costs as complaint counsel have defined them during these periods.

[132] The study assumed that the following items are variable costs: vehicle, accident, sundries, fuel, transport abor, local plant vehicular expense, outside express and freight, operating labor, packers, electric power, repairs nd renewals, telephone, telegraph, janitor supplies, rent, lease cars, tractor trailer equipment, vacation pay, illness ayments, health and welfare pension fund, transport carriers, cartons and selling tapes, sales managers, salesiens' salaries and commissions, sales supervisors' salaries, other route labor, sales contests and prizes, special ability and retroadjustments, payroll taxes, garage labor, executive, supplies, repairs, tires. By contrast, Continenl argues that when a bakery has unused capacity, only six items should be treated as variable: the cost of gredients, the cost of the wrapper, salesmen's commissions, direct production labor, oven fuel, and pan grease. e first three items account for more than ninety percent of variable cost. RAP at 19–20, *citing* Dierker, Tr. 17–18, 9727, 9760.

ly in connection with the four or five week periods the data cover. It is unclear whether revenues would still fall below variable costs in any of these three periods if these adjustments were made. The second problem is that the cited time periods are too short and episodic to satisfy the Commission standard for predatory pricing. Third, as we have indicated *supra,* it would be perfectly logical to aggregate branded and private label sales in this industry to evaluate alleged predatory pricing, and the record evidence does not establish any such sales when Continental's Northern California/Western Nevada sales are aggregated in that fashion. [88]

Fourth and finally, Continental may assert as a complete defense in response to the foregoing data that those sales simply represented a good faith effort to meet the competition of competing firms. The Supreme Court recently determined that "territorial price differences that are in fact responses to competitive conditions" satisfy the requirements of the meeting competition defense.[133] In short, if a seller has a good reason to believe that competing firms are charging lower prices in a particular market, it may respond with comparably low prices on a *territorial* basis, rather than on a customer-by-customer basis.[134] The Court determined that this standard would be satisfied

> by showing that a reasonable and prudent businessman would believe that the lower price he charged was generally available from his competitors throughout the territory and throughout the period in which he made the lower price available.[135]

The Court also determined that the defense could be asserted even if the prices at issue were offered to secure new customers, rather than to retain old customers.[136]

The record evidence establishes that the prices noted above were offered as part of a good faith effort to meet the competition of competing sellers. In early 1972, Inglis began [89] selling one pound private label bread for seventeen cents per loaf; Campbell-Taggart took the Wentz private label account from Continental by offering one pound bread for seventeen cents per loaf; and American lowered its private label price to $.172 per loaf after discovering that Campbell-Taggart had adopted $.172 as its market-wide price, and had offered that price to Food Fair, one of American's private label customers.[137] American then offered that price to Mayfair Stores, a large Continental private label account, to cover its private label purchases throughout the

[133] *Falls City Industries, Inc.* v. *Vanco Beverage, Inc.* 103 S.Ct. 1282, 1295 (1983).
[134] *Id.* at 1295–97.
[135] *Id.* at 1297.
[136] *Id.* at 1294–95.
[137] RAP at 57, *citing* RX 30–32, RX 34–44; McGinley, Tr. 3975–80, 3985–86; CX 647; Temkin, Tr. 4297–98, 4305; Frielink, Tr. 3380–82.

Northern California/Western Nevada market. RAP at 58, *citing* RX 93; Temkin, Tr. 4298–99. After learning of this offer, and that the same price had been offered to 7-Eleven Stores, the largest private label buyer in the area, and to Cala Markets, Continental lowered its private label price throughout the market to $.172.[138] That price persisted until August, 1973; the market price then increased to $.22 in September, 1973. RAP at 59, *citing* CX 780. In its opinion in the collateral private litigation between Inglis and Continental in Northern California, the Ninth Circuit Court of Appeals accepted this account and concluded: **[90]**

This reveals much about the way the market for private label bread operated during the complaint period. Although the record does not always identify which of Continental's competitors initiated a price reduction, it does reveal how a price reduction to one customer quickly became the prevailing market price. Each bakery ignored this new price at its peril. Because the number of private label accounts was not large, buyers for those accounts communicated with each other and with all of the wholesale bakeries. Price reductions to one account did not long remain secret. We conclude, therefore, that there was a reasonable basis for Continental's assumption that a new price offered to one of its accounts by a competitor, which Continental did verify, would become available, with or without its assistance, to all of its existing and prospective customers. The weight of the evidence supports Continental's claim that its price reductions were good faith responses to competition. There was no need for Continental to verify that each customer had actually received a competitor's offer of an equally low price, as it did in the case of advertised bread.[139]

The record evidence before us supports this conclusion. Complaint counsel argue that American's offers did not justify Continental's marketwide price reduction because the offer to Mayfair covered only the Bay Area; Cala Markets operated stores only in San Francisco; and the Regional Vice-President who lowered Continental's price "was not certain of any offer to 7–11 **[91]** Stores" before he lowered the price.[140] The ALJ appears to have relied primarily upon the first point to reject the meeting competition defense in his decision. *See* IDF 250. However, in *Falls City* the Supreme Court made it clear that the defense should be sustained when it is "reasonable and prudent" to believe that the lower price offered is generally available from competing firms in the relevant market during the relevant time period; universal availability and complete certainty are not required. Price competition was so intense in the Northern California

[138] IDF 249; RAP at 58; Frielink, Tr. 3223–24, 3294–97, 3379–83. The ALJ suggests that no other wholesalers sold private label bread at this price throughout the market. IDF 250. However, Continental argues that Campbell-Taggart and American also quoted a single private label price to all their customers. RAP at 59 n.1, *citing* McGinley, Tr. 3975–80, Frielink, Tr. 3381–82.

[139] *William Inglis & Sons Baking Co.* v. *ITT Continental Baking Co.*, 668 F.2d at 1047. The Court nevertheless reversed the district court's judgment notwithstanding the verdict on the issue, because although it believed its conclusion to be the *most* reasonable conclusion, it could not say that it was the *only* reasonable conclusion possible. *Id.* at 1047–48. It remanded that issue, *inter alia*, to the district court for a new trial.

[140] CAB at 69–70, *citing* McGinley, Tr. 3980, Frielink, Tr. 3229, 3383.

market during the relevant period that Continental could reasonably have believed that the $.172 price its competitors were offering was generally available throughout the market, and that it would lose its private label accounts if it did not match those competing offers immediately.[141] The Commission has therefore determined to dismiss the primary line count in the Northern California/Western Nevada market.

e. *Cleveland Market*

The allegations of anticompetitive conduct in the Cleveland market arise primarily from a contract Continental negotiated in 1972 to supply private label bread products to Pick N Pay, a local grocery chain that had theretofore operated its own captive bakery. IDF 305. The ALJ found that during this period: **[92]**

> There was excess bread capacity that could service the Cleveland market, especially Continental's Akron bakery which was operating at about 50% of capacity, *i.e.*, one and 1/4 shifts. . . .

IDF 300. As a consequence, the Akron bakery was generating pre-tax losses of over $3,000 per week, and Continental was seriously considering closing it. IDF 305. Continental believed that if it began to supply private label bread to PNP, it could convert its Akron bakery's losses into a "substantial profit," and realize a profit net of "fully allocated costs" of $240,000 or more per year.[142] Moreover, Continental expected to increase its sale of branded label products to PNP; in fact, its sale of Wonder bread products to PNP increased by $20,000 per week after it began to supply private label products. IDF 317. The contract became effective in July, 1973. CAB at 74. However, the cost of providing private label bread to PNP turned out to be much higher than Continental had expected. IDF 319. As a consequence, Continental renegotiated its contract with PNP to secure higher prices in September, 1974. IDF 328–332.

Complaint counsel argue that Continental sold private label bread to PNP at prices below average variable cost "on both a single product and total [private label] business basis." CAB at 31. As support for that position, they argue that (1) in the **[93]** four week August, 1973 accounting period Continental's revenues from its total private label sales to PNP fell below the variable costs associated with those

[141] McGinley, Tr. 3976; Johnson, Tr. 3892. I am indebted to Commissioner Bailey for her assistance in resolving the meeting competition issue.

[142] IDF 305, 315. This figure was derived by converting the weekly estimate of at least $6,000 in profits in IDF 315 into an annual profits estimate, and then subtracting $70,000 in annual "proof of performance" payments. Continental paid $210,000 to PNP from 1973 through the first three months of 1976, or approximately $70,000 per year, to "reimburse Pick N Pay for promotions of private label products commensurate with the estimated book value of the Pick N Pay bakery." IDF 313.

sales,[143] and its revenues from its overall sales of *all* products to PNP fell below the variable costs associated with those sales;[144] (2) in the five-week December, 1973 accounting period, Continental's revenues from its total private label sales to PNP fell below the variable costs associated with those sales;[145] and (3) in the four week May, 1974 accounting period, Continental's revenues from its total private label sales to PNP fell $16,600 below its variable costs.[146] In short, complaint counsel argue that [94] when Continental's total private label white pan bread product sales to PNP are considered, its revenues from those sales did not cover its variable costs in July, 1973, December, 1973 and May, 1974.[147]

Continental argues in response that "The profitability of the PNP private label account was never significantly below break-even on a variable cost basis." RPF 479. Continental argues, for example, that (1) in August, 1973 private label sales showed a "weekly profit" of $690; (2) in December, 1973, private label sales showed a "variable profit" of $286 per week; (3) in December, 1973 and January, 1974 the whole line of private label bread and buns produced an incremental profit of $658 per week; (4) in May, 1974 the Pick N Pay "account as a whole broke even on an incremental basis . . .;"[148] and (5) under the contract renegotiated with PNP in 1974, private label sales alone generated profits in the first three months of [95] 1976, in July, 1976, and in August, 1977.[149] In short, Continental argues that its revenues from the PNP account usually covered the variable costs associated with that account. Continental admits that some of its documents from the contract renegotiation period show that it incurred full cost and some variable cost losses when its private label sales to PNP are considered in isolation. RPF 480. However, Continental argues that the relevant measure should be whether Continental earned greater *total* profits (or incurred fewer losses) on both advertised label and private label sales as a consequence of the PNP private label contract.

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[143] CAB at 86, *citing* CX 800B, CX 883C. CX 883C actually shows that revenues exceeded variable costs by $690. However, complaint counsel argue that $5,384—4/52 of the $70,000 annual promotional payment—should be treated as a variable cost and subtracted from that figure. CAB at 86.

[144] CAB at 85–86, *citing* CX 800B; CPF 13–205, 13–207.

[145] CAB at 86, *citing* CX 2639T. CX 2639T actually shows that revenues exceeded varible costs by $286, but complaint counsel argue that $6,730—5/52 of the $70,000 annual promotional payment—should be treated as a variable cost and subtracted from that figure. CAB at 86.

[146] CPF 13–262, 13–263, 13–266, 13–267, *citing* CX 2608B, CX 2610, CX 2636C, CX 2665A.

[147] Complaint counsel also argue that Continental sold certain individual varieties of bread to PNP at prices below average variable cost or "total direct cost" or "cost to doors" at various times throughout the relevant period. CPF 13–265, *citing* CX 2639Z–4 (two varieties; however, a third variety, one pound white bread was priced significantly *above* average variable cost); CPF 13–266, 13–267, *citing* CX 911Z–34 (one variety), CX 915F,H,I (three varieties), CX 2677A,E,O (three varieties); CAB at 86; *citing* CX 2632 (two varieties), CX 2639Z–4 (two varieties); CAB at 87, *citing* CX 2678 (five varieties; however, total revenues on all varieties exceeded total cost to doors by $8,838). We have already noted, however, that revenues and costs should at a minimum be aggregated across the entire private label or advertised label line.

[148] RPF 479, *citing* CX 883C, CX 2639R, CX 2639A–Q, and CX 2636–C.

[149] RPF 481, *citing* CX 829, CX 2616–A, CX 2615, CX 2658, CX 2668, CX 2661, CX 2660, RX 309, Schmidt, Tr. 11189, 11191, 11192.

RPF 480. That measure would account for profits and losses attributable to advertised label sales, as well as to private label sales.

The ALJ considered these arguments and reached the following conclusions: (1) the Akron bakery sustained a $16,000 loss on its PNP private label contract in the four-week period ending on August 25, 1973;[150] (2) in December, 1973, Continental's private label prices to PNP covered incremental costs for "8 Pack" hamburger and hot dog buns and one pound white bread loaves, but did not cover incremental costs for 20 oz. and 24 oz. white bread loaves;[151] (3) in May, 1974 Continental "basically broke even on the total [PNP] business" on an incremental basis, losing $16,000 [96] on PNP private label and making $15,100 on sales of branded products to PNP;[152] (4) in January, 1976 Continental sold its 24 oz. "Giant Sandwich" loaf and "8 Pack" hamburger buns at prices below incremental costs;[153] (5) during the first three months of 1976, Continental sold "three other bun varieties" under the contract at prices below "incremental costs;"[154] and (6) in July, 1976 Continental's private label sales under the contract produced losses on both a "full load" and a "variable" basis.[155] In short, the ALJ found that Continental's revenues from its overall private label sales to PNP fell below the variable costs attributable to those sales only in August, 1973, May, 1974, and July, 1976.

The foregoing summaries prepared by the parties and by the ALJ do not provide the kind of detailed itemization of the costs that should respectively be treated as fixed and variable during the relevant time period that is needed to determine whether Continental actually sold white pan bread products at prices below average variable cost for a significant period of time in the Cleveland market. In any event, complaint counsel identify only three non-consecutive months in which Continental's revenues [97] from total private label sales to PNP may not have covered the variable costs associated with those sales. The ALJ does not endorse complaint counsel's conclusion as to December, 1973 and identifies only one additional month over two years later in which such an imbalance may have occurred. These discontinuous and short-lived instances cannot satisfy the Commission standard for predatory pricing.

In her concurring and dissenting opinion, Commissioner Bailey discusses her own analysis of prices and costs in the Cleveland market. Commissioner Bailey's more detailed price-cost comparisons do

[150] IDF 320, *citing* CX 800–B, CX 882, CX 2628.

[151] IDF 322, *citing* CX 2632–A–F, CX 2639–H–K.

[152] IDF 324, *quoting* Breines, CX 2608–B. This figure does not account for the $70,000 annual payment for "proof of performance." IDF 324, *citing* CX 2693–A–B. However, it apparently does account for private label variety, premium, and sweet good sales, as well as white bread sales.

[153] IDF 334, *citing* CX 2669–A.

[154] IDF 335, *citing* CX 2668–B.

[155] IDF 336, *citing* CX 2661–C.

not, however, affect the conclusion that Continental's pricing behavior did not violate the Commission standard. In conducting her analysis, Commissioner Bailey treated almost all selling and distribution costs as variable.[156] In addition, she treated Continental's reimbursement of PNP's private label promotional expenses as a variable cost.[157] Finally, she relied upon the same documents—but not the eighty percent assumption—that the ALJ relied upon in making his cost calculations.[158] Commissioner Bailey found that Continental sold white pan bread to PNP under the private label contract at prices below average variable cost during the [98] months of June, 1974 (87.0% of average variable cost) and July, 1976 (99.3% of average variable cost).[159]

Commissioner Bailey's calculations provide a helpful comparison of prices and costs under the PNP private label contract. However—like the calculations of complaint counsel and the ALJ—they do not create a presumption that Continental violated the Commission standard. They reveal only two months—over two years apart—when Continental's revenues from its private label white pan bread sales to PNP under the contract failed to cover variable costs, and the percentage point shortfall in the second month was very small. Two widely-separated months of sales at prices below average variable cost are simply not sufficient to satisfy the "significant period of time" requirement of the Commission predation standard.

The allocation of expenses between fixed and variable costs in Commissioner Bailey's analysis creates additional difficulties. In particular, at least a portion of Continental's reimbursement to PNP of promotional expenses associated with its [99] private label bread sales should be treated as a fixed rather than a variable cost. Continental believed that "any baker who secured [PNP's private label] business would either have to purchase [PNP's captive] bakery assets or compensate Pick N Pay for their book value."[160] Instead of simply paying for the assets, however, the parties agreed that Continental would pay $210,000, an equivalent amount, to PNP over the July, 1973–April,

[156] Concurring and dissenting opinion of Commissioner Bailey at 12, *citing* Gase, Tr. 9421–22, RX 309, CX 2661.

[157] *Id.* at 12–13 and n. 16.

[158] *Id.* at 14, *citing* IDF 320–325, 347.

[159] *Id.* at 14. Commissioner Bailey also found that Continental collectively sold *all* of its private label products to PNP (including variety, premium and sweet goods, as well as white pan bread) at prices below average variable cost during four months (two of which were consecutive) in 1973 and 1974. However, given their differences, variety, premium and sweet goods probably should not be included in the same relevant product market as white pan bread products. Moreover, such products and white pan bread do not in any event appear to be goods of "like grade and quality," since they are not physically identical.

Contrary to Commissioner Bailey's assertion (*id.* at 20), the record evidence does not indicate that Continental sold private label bread products to PNP at prices below fully allocated cost for four years. As she herself points out, the documents she relies upon "do not detail every month of the four year period, but summarize performance at irregular intervals . . ." *Id.* at 11 n. 15.

[160] RAP at 64–65, *citing* CX 2683, Vail, Tr. 9968, 9971–72. A number of other retailers had insisted upon and received similar commitments when they switched from captive baking to purchasing private label bread from wholesalers. *Id.* at 65 n.1.

1976 period when PNP presented proof of promotional efforts such as advertising.[161] Nevertheless, even if the payments are treated as entirely promotional, at least a proportion should be treated as fixed costs, because of the investment component of promotional efforts that we have described *supra.* Treating some of the reimbursement to PNP in that fashion would of course reduce Continental's average variable costs to some degree, although the record evidence does not establish the percentage of the payment that should be excluded from variable costs. It seems likely, however, that the difference would at least be substantial enough to place Continental's revenues from private label sales to PNP in July, 1976 above variable costs, leaving only the month of June, 1974 as an instance of sales at prices below average variable cost. **[100]**

Apart from these considerations, it is important to recognize that the evidence discussed above relates only to private label sales of white pan bread to PNP. It does not indicate whether the findings of sales at prices below average variable cost would persist if Continental's sales of branded white pan bread products were also considered. If the latter sales were considered, then the $16,000 loss on private label sales to PNP in May, 1974 would be countered almost completely by Continental's $15,100 in revenue above incremental costs from sales of branded products to PNP, yielding a net loss below incremental costs of only $900. IDF 324. Adopting the same approach with respect to the second instance in July, 1976 might produce the same result, although the ALJ did not include a finding as to Continental's revenues from branded products sold to PNP during that month. In addition, it should be noted that the price cost comparisons focus only upon Continental's sales to PNP; they do not represent an aggregation of costs and revenues associated with private label sales from the Akron plant to *all* private label buyers.[162] Including private label sales to firms other than PNP might very well indicate that revenues from all private label sales from the Akron plant exceeded the variable **[101]** costs associated with those sales throughout the relevant period. For all of these reasons, the Commission has therefore determined to dismiss the Section 2(a) primary line count in the Cleveland market.

2. Secondary Line Injury

The Commission must similarly establish a "reasonable possibility that a price difference may harm competition" in order to establish secondary line liability; that is, that the price discriminations alleged

[161] *Id.* at 65, *citing* Kravitz, Tr. 5435–37, Vail, Tr. 9971, 9977.

[162] By contrast, the price-cost comparisons developed for the Northern California/Western Nevada market focus upon all private label bread sales from the Oakland, San Francisco, or Sacramento plants.

may have injured competition among competing buyers.[163] The Supreme Court has indicated that substantial price differentials between competing purchasers over time are sufficient to give rise to an inference of injury to competition.[164] However, the only remaining price differential at issue in the secondary line aspect of this case concerns a price disparity between advertised label bread (Wonder bread) and private label bread in the Northern California/Western Nevada market. The Supreme Court has recognized that in these circumstances the difference in wholesale prices may be accounted for by the existence of a consumer preference for the advertised label product, and that preference "should receive due legal recognition" in determining [102] whether an injury to competition has occurred.[165] As a consequence, it is not enough to establish in this case that Continental sold private label bread to a favored retailer at a lower price than the price at which it sold Wonder Bread to competing retailers. Such a difference may simply reflect a consumer preference for Wonder Bread at the retail level, and hence be perfectly legitimate, because the private label bread has a limited consumer franchise while the advertised brand is largely pre-sold through national advertising.[166] The record evidence indicates that the price Continental charged four grocery retailers for private label white bread products ranged from 25 percent to 38 percent lower than the price it charged two other retailers for Wonder bread between January, 1972 and December, 1974. These differentials are substantial, but there is no reason to believe that consumer preferences and the substantially greater costs associated with promoting Wonder bread do not largely or completely account for them.

Moreover, as we indicated *supra,* the prices that Continental charged for private label white pan bread products in Northern California were in any event simply a good faith effort to meet [103] the competition of rival bread manufacturers. The Commission has therefore determined to dismiss the secondary line count in the Northern California/Western Nevada market.

[163] *Falls City* v. *Vanco,* 103 S.Ct. at 1288.

[164] *Id.* at 1289; *accord, Beatrice Foods Co.,* 76 F.T.C. 719, 801 (1969), *aff'd sub nom. The Kroger Co.* v. *FTC,* 438 F.2d 1372 (6th Cir.), *cert. denied,* 404 U.S. 871 (1971), *citing United Biscuit Co. of America* v. *FTC,* 350 F.2d 615 (7th Cir. 1965), *cert. denied,* 383 U.S. 926 (1966) and *Foremost Dairies, Inc.* v. *FTC,* 348 F.2d 674 (5th Cir.), *cert. denied,* 382 U.S. 959 (1965).

[165] *FTC* v. *The Borden Co.,* 383 U.S. 637, 646 (1966); *accord, Borden Co.* v. *FTC,* 381 F.2d 175, 180–81 (5th Cir. 1967).

[166] *Borden Co.* v. *FTC,* 381 F.2d 175, 180–81 (5th Cir. 1967); *Beatrice Foods Co.,* 76 F.T.C. at 808–09; FTC Policy With Respect to Anticompetitive Practices In the Marketing of Gasoline, 3 Trade Reg. Rep. (CCH) ¶10,373 (1967). The ALJ concluded, without citing any evidentiary support, that some of the differentials were larger than any differential that could be attributed to consumer preferences. ID at 88. In the absence of any evidence to support that conclusion, we cannot accept it.

IV. SANCTIONS IMPOSED BY THE ADMINISTRATIVE LAW JUDGE

One final issue must now be addressed, relating to the imposition of discovery sanctions against Continental by the first ALJ to preside over this case. Resolving this issue is very important to preserving the integrity of the adjudicative process, and the Commission wishes to strongly reaffirm the power of Administrative Law Judges to impose such sanctions, as appropriate, in adjudicative proceedings. The relevant facts are as follows. In February, 1976, at the request of complaint counsel, ALJ Harry R. Hinkes issued a subpoena to Continental for certain documentary material.[167] Shortly thereafter, Continental filed a motion to quash or limit the subpoena.[168] In late March the ALJ denied that motion, but after an April prehearing conference he deferred Continental's obligation to comply with [104] the subpoena until July.[169] After several subsequent months of negotiation, complaint counsel reduced the scope of certain subpoena specifications on which compliance had been delayed. At a prehearing conference in October the ALJ ordered Continental to comply with the modified subpoena, and to submit a progress report on its compliance by December 10, 1976. Tr. 180–81. On that date counsel for Continental advised the ALJ that it would not comply with the portions of the modified subpoena requiring the production of four types of accounting forms, Forms 430 (cake portion only), 521, 526 and 528.[170] Form 430 reveals the volume of production and sale of each variety of bread and cake in units, weight and dollars. Forms 521, 526 and 528 provide, in differing degrees of aggregation, the expenses associated with baking groups of products, such as all bread, all cake, or all bread and cake combined. In conjunction with "recipes" that Continental did provide—showing how much of each ingredient and how much labor and baking time are used for each variety—complaint counsel believed that these forms would permit the [105] allocation of "all bread," "all cake," or "all bread and cake" costs to different bread varieties on the basis of units, weight, and value.[171]

Continental argued that the subpoenaed forms were not relevant to

[167] Mr. Hinkes served as the ALJ for this case until July, 1977. At that point, he asked to be relieved of his responsibilities for the case because he would shortly be presiding over the trial in *Kellogg Co.* Notice To Daniel H. Hanscom, Chief Administrative Law Judge (July 26, 1977). This case was then assigned to Miles J. Brown. Order Substituting Administrative Law Judge (August 2, 1977).

[168] Motion To Limit Or Quash Subpoena Duces Tecum (March 4, 1976).

[169] Order Denying Respondent's Motion To Quash Complaint Counsel's Subpoena of February 20, 1976, And Setting Prehearing Conference (March 18, 1976); Order Rescheduling Return On Complaint Counsel's Subpoena Duces Tecum Directed to ITT-Continental (April 19, 1976).

[170] Memorandum In Support of Complaint Counsel's Application For Sanctions Under Rule 3.38 (December 29, 1976), at 6–12.

[171] *Id.* at 9. Complaint counsel defined a "variety" of bread—such as "one pound white pan private label" or "18 ounce hearth rye loaf"—to be "a product which is identified separately on ITT-Continental's detailed accounting records." Complaint Counsel's Answer to Respondent's Motion For Oral Argument And Leave To File Additional Memorandum (April 20, 1977), at 2 n.**.

this case because, it alleged, the Commission had not endorsed and probably would not endorse complaint counsel's "current efforts to develop cost figures for individual bread varieties . . .".[172] Continental argued that, during the relevant period, it had only kept "cost and profit and loss records on the basis of the full bread product line (as distinguished from the cake line and the sweet goods line). . . .;" that complaint counsel had previously requested and received those records; and that those records

> show that in the various bakeries Continental's overall bread sales were profitable most of the time and that when they showed a loss it was only on a fully allocated basis which nevertheless contributed to overall plant profit.[173] **[106]**

Continental also argued that because it "did not keep cost figures by variety" during the relevant period, the fact that a given variety of bread might have been sold at prices below cost could not establish that those sales were made with the requisite predatory intent.[174]

In late December, 1976 complaint counsel applied to the ALJ for the imposition of a number of discovery sanctions—including adverse inferences and evidentiary restrictions—against Continental.[175] On March 22, 1977 ALJ Hinkes entered the following order:

> *It is ordered,* That complaint counsel are deemed to have established that ITT Continental has sold bread below cost no matter how cost is measured in the following geographic markets during the following time periods:

Akron, Ohio	1970 through 1974;
Beverly Hills, California	1967 through 1974;
Denver, Colorado	1964 through 1968;
Minneapolis, Minnesota	1964 through 1970;
Oakland, California	1967 through 1974;
Rochester, Minnesota	1964 through 1970;
Sacramento, California	1967 through 1974;
San Francisco, Calif	1967 through 1974;
San Pedro, California	1967 through 1974;
Seattle, Washington	1968 through 1973; and
Youngstown, Ohio	1970 through 1974.

> *It is further ordered,* That ITT Continental may not introduce into evidence or otherwise rely upon the documents which ITT Continental has failed to produce. **[107]**
>
> *It is further ordered,* That ITT Continental may not object on the grounds that the withheld documents are better evidence, to complaint counsel's introduction and use of other relevant material and reliable evidence that ITT Continental made sales below

[172] Letter from John H. Schafer, Counsel for Respondent, to the Honorable Harry R. Hinkes (December 10, 1976), at 2–3.

[173] *Id.* at 3. Continental argued that when the Commission issued the complaint in this case, it only had the overall "bread line" cost and profit evidence before it. Request For Pre-Hearing Conference and Alternative Request For Leave To File Further Memorandum (February 4, 1977), at 3.

[174] Letter from John H. Schafer, *supra* note 172, at 4.

[175] Complaint Counsel's Application For Sanctions Under Rule 3.38 (Dec. 29, 1976).

cost in the geographic markets and for the time periods specified.[176]

On March 23, the ALJ permitted Continental to apply to the Commission "for a review" of his order on the narrow policy question of whether it would be more appropriate for the Commission to seek District Court enforcement of the subpoena at issue than for the ALJ to issue the sanctions order.[177] Continental filed its appeal shortly thereafter. In explaining its earlier refusal to supply the subpoenaed documents, Continental once again argued (1) that the documents were not relevant because the Commission had relied only upon "full bread line figures" when it issued the complaint; and (2) that the documents could not in any event establish that Continental **[108]** "knowingly sold below cost with intent to injure and destroy competition and competitors" because it did not know what its individual variety costs were when it marketed the products.[178]

On June 29, 1977 the Commission denied Continental's appeal, concluding that the issue certified did not warrant interlocutory review.[179] Shortly thereafter, on July 8, 1977 Continental notified the ALJ that it would provide all of the documents at issue; however, complaint counsel argued in response that Continental's offer should be declined. Continental nevertheless collected the responsive documents and tendered them to complaint counsel; on September 9, 1977 complaint counsel refused to accept them.[180] In September Continental moved to set aside the sanctions order, with the understanding that it would provide the subpoenaed documents. In November the ALJ denied the motion.[181] Continental again moved for rescission of the sanctions order in July, 1979, at the conclusion of the case in **[109]** chief, noting that complaint counsel could present the evidence during their rebuttal case and that Continental would waive "any right to present rebuttal evidence on the matter."[182] Complaint counsel

[176] Order Imposing Sanctions (March 22, 1977), at 2 (citations omitted). The order defines "bread" to include white pan bread, bread type rolls, and related products, and describes each "geographic market" as "the location of an ITT Continental bread plant" and the area surrounding it. *Id.* nn.2,3.

[177] Order Allowing ITT-Continental's Appeal Of Order of February 16, 1977 (March 23, 1977). The ALJ did not certify the questions of the validity of Section 3.38 of the Commission Rules of Practice or the propriety of the underlying subpoena.

[178] Application For Review Of Ruling Of Administrative Law Judge (March 30, 1977) at 3–4. Continental also argued that compliance with the subpoena would be costly and time-consuming. Complaint counsel later indicated that simply analyzing the data in the subpoenaed forms would require "a minimum of a year" after the material had been supplied. Complaint Counsel's Response To Show Cause Order (Sept. 29, 1977), at 2 n.**.

[179] Order Denying Application For Review (June 29, 1977), at 2.

[180] Motion To Set Aside Orders Granting Application And Imposition Of Sanctions (Sept. 30, 1977), at 2; Answer To Respondent's Motion To Set Aside Orders (Oct. 14, 1977), at 4.

[181] Order Denying Motion To Set Aside Orders Granting Application For And Imposition of Sanctions Under Section 3.38 of the Commission's Rules of Practice (November 7, 1977). The ALJ later denied Continental's subsequent motion for an interlocutory appeal of his order. Order Denying Respondents' Request For Interlocutory Appeal (November 28, 1977).

[182] Respondents' Motion To Rescind "Order Imposing Sanctions" Of March 22, 1977 (July 16, 1979), at 10–11.

once again opposed the motion, and the ALJ subsequently denied it.[183]

One last incident involving the documents covered by the sanctions order occurred the following year. In March, 1980, after Continental had concluded its defense case, complaint counsel served an extensive subpoena on Continental to secure evidence for its rebuttal case. Specification 32 of that subpoena sought documents "sufficient to show the Company's profits or losses on white pan bread alone" for most of Continental's bakeries during the 1969–1979 period.[184] Although Continental moved to quash the subpoena, it offered the documents covered by the sanctions order to partially comply with Specification 32, and delivered them to complaint counsel on March 24, 1980. Complaint counsel refused to accept the documents and later returned them, arguing that the documents were not responsive because they related to costs rather than profitability, and that [110]

> it would be patently absurd for us inadvertently to abandon the adverse inferences upon which we have relied for four years. We did not intend to do so. Moreover, if Mr. Wachter's critique can only be met at that price, we shall forego the luxury.[185]

Complaint counsel simultaneously filed an application to modify the subpoena by waiving production of the documents covered by the sanctions order.[186] On April 15, 1980 the ALJ granted Continental's motion to quash in part and struck most of the subpoena specifications, including Specification 32.[187]

The current significance of the adverse inferences that the sanctions created is somewhat unclear. The ALJ briefly described the sanctions order in his opinion, but did not rely upon any inferences derived from that order in reaching his decision. *See* ID at 3–4. In their appeal brief, complaint counsel refer to the adverse inferences in the sanctions order as "an alternative ground of support for the conclusion that respondents sold below average variable cost." CAP at 6 n.4. In their answering brief, complaint counsel argue that "The adverse inferences in this [111] case, CCPF 2–7, are a sufficient ground for finding predatory conduct and intent."[188] Finally, in the oral argument before the Commission, complaint counsel indicated:

> At this stage of the case we rely on one element of that [sanctions] order, that Continen-

[183] Order Denying Respondents' Motion To Rescind "Order Imposing Sanctions" Of March 22, 1977 (September 28, 1979).

[184] Complaint Counsel's Application For Issuance Of A Subpoena Duces Tecum To ITT Continental (March 7, 1980) (Instructions), at 17.

[185] Motion To Modify Order Of March 22, 1977 And To Admit RX 125 (March 28, 1980), at 2–3; Complaint Counsel's Opposition To Motion To Quash March 1980 Subpoena (April 7, 1980), at 15–16; Response To Motion To Modify Order Of March 22, 1977, And To Admit RX 125 (April 9, 1980), at 3–4.

[186] Application To Modify March 1980 Subpoena To ITT Continental Baking Company, Inc. (April 7, 1980), at 2.

[187] Order Limiting Complaint Counsel's Discovery As To Their Case-In-Rebuttal (April 14, 1980).

[188] CAB at n.1; *see also id.* at 28 (relying upon CPF 2–7, *inter alia*, in an effort to show sales at prices below average variable cost), 43.

> tal should not be allowed to rely on documents they did not produce to [complaint] counsel. On that ground the cost study Mr. Schafer attempted to introduce [RX 125], [was] properly held out, only certain portions were allowed in. Judge Brown did not rely on the adverse inferences relied upon by Judge [Hinkes].[189]

In short, although complaint counsel relied extensively upon the adverse inferences prescribed by the sanctions order in their briefs to the ALJ, they appear to have reduced that reliance to some degree during the appeal phase of this proceeding.

The adverse inference rule upon which the sanctions order in this case relies

> provides that when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him.[190]

The power of federal courts to impose discovery sanctions such as adverse inferences pursuant to Rule 37(b) of the Federal Rules of Civil Procedure is well established. Most courts have sustained an analogous power on the part of federal administrative agencies **[112]** to draw adverse inferences from the failure to produce relevant evidence and the Commission has adopted that position with respect to its own adjudications.[191] If the evidence at issue has been subpoenaed and the party involved declines to comply with the subpoena in order to suppress the evidence, that may strengthen the adverse inference to be drawn from the failure to provide the subpoenaed material.[192] By contrast, the inference may be weakened by a strong alternative explanation for the failure to provide subpoenaed material, such as an effort to avoid the public disclosure of trade secrets for which one or **[113]** more patents are pending.[193] Administrative agencies may also prohibit an entity that deliberately withholds relevant subpoena-

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[189] Oral Argument Transcript at 33–34.

[190] *International Union (UAW)* v. *NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972).

[191] *P.R. Mallory & Co.* v. *NLRB*, 400 F.2d 956, 959 (7th Cir. 1968); *NLRB* v. *A.P.W. Products Co.*, 316 F.2d 899, 903–04 (2d Cir. 1963); *NLRB* v. *Wallick*, 198 F.2d 477, 483 (3d Cir. 1952); *NLRB* v. *Remington Rand, Inc.*, 94 F.2d 862, 868 (2d Cir.), *cert. denied*, 304 U.S. 576 (1938); *Market Development Corp.*, 95 F.T.C. 100, 223–27 (1980) (dictum); *American Medical Association*, 94 F.T.C. 701, 1027–29 (1979), *aff'd*, 638 F.2d 443 (1980), *aff'd by an equally divided Court per curiam*, 455 U.S. 676 (1982). *But see NLRB* v. *International Medication Systems, Ltd.*, 640 F.2d 1110, 1115–16 (9th Cir. 1981).

This conclusion is not inconsistent with the more general principle that administrative agencies cannot compel obedience to compulsory process by imposing fines or imprisonment. *ICC* v. *Brimson*, 154 U.S. 447, 485 (1894). Discovery sanctions such as adverse inferences are considerably different from the imposition of fines or imprisonment through the contempt power because they do not actually compel the production of subpoenaed materials. They simply give the subpoenaed party the option of either complying with the subpoena or facing the adoption of adverse inferences. If the party chooses the latter course, it will not suffer any injury unless an order is subsequently entered against it on the basis of the inferences involved, and it can secure judicial review of the propriety of the inferences on appeal.

[192] *International Union (UAW)* v. *NLRB*, 459 F.2d at 1338. *But see NLRB* v. *International Medication Systems, Ltd.*, 640 F.2d at 1115 n.3.

[193] *Evis Mfg. Co.* v. *FTC*, 287 F.2d 831, 842–47 (9th Cir.), *cert. denied*, 368 U.S. 824 (1961); *but see Charles Of The Ritz Dist. Corp.* v. *FTC*, 143 F.2d 676, 678 (2d Cir. 1944).

ed material from relying upon that material in its own presentations.[194] The central purpose of these sanctions is to "maintain the integrity of the hearing process."[195]

Rule 3.38(b) of the Commission Rules of Practice provides in relevant part that an Administrative Law Judge or the Commission may impose sanctions such as those imposed in this case when a party fails to comply with (1) a subpoena, (2) an order for the production of documents, or (3) an order issued by the Commission or an ALJ as "a ruling upon a motion concerning such an order or subpoena or upon an appeal from such a ruling..." The Rule indicates that the Commission or an ALJ [114] may impose these sanctions to permit the "resolution of relevant issues and disposition of the proceeding without unnecessary delay . . ." The Commission has developed some more specific principles to help determine when one or more of these sanctions should be applied. In *American Medical Association,* the Commission stated:

> Application of the adverse inference rule may only be made when the party's failure to produce documentary or other evidence is not adequately explained. Thus, the adverse inference rule makes the conduct of the person withholding the material an evidentiary fact in and of itself. The resulting inference may be strong or weak, depending on the person's conduct and the surrounding circumstances. For example, an inference drawn against a respondent offering a weak explanation for its refusal to produce relevant evidence will be stronger than an inference drawn against a respondent providing a more plausible explanation.[196]

The Commission concluded that the Administrative Law Judge had properly adopted an adverse inference against the respondent for failing to supply certain subpoenaed materials. The Commission noted that it was highly unlikely that the AMA's jurisdictional challenge to the subpoena—directed at its principal defense—would succeed, and that the AMA, despite its jurisdictional doubts, had nevertheless complied with every other subpoena issued in the case. In conjunction with the absence of "a strong [115] explanation for noncompliance," these facts persuaded the Commission to conclude

[194] *NLRB* v. *C.H. Sprague & Son Co.,* 428 F.2d 938, 942 (1st Cir. 1970). The Court noted that this conclusion might not have been valid if the company had taken the position "that all the information sought by the subpoena was irrelevant." *Id.* However, the firm had admitted that the requested information was relevant, and had offered no justification for failing to comply with the subpoena. *Id.*

Administrative agencies may also decline to permit a firm that withholds subpoenaed material from later producing secondary evidence to prove what could have been conclusively established if the subpoena had been honored. *NLRB* v. *American Art Industries, Inc.,* 415 F.2d 1223, 1229–30 (5th Cir. 1969), *citing Bannon Mills,* 146 N.L.R.B. 611 (1964); *but see NLRB* v. *International Medication Systems, Ltd.,* 640 F.2d 1110, 1115–16 (9th Cir. 1981).

[195] *NLRB* v. *American Art Industries, Inc.,* 415 F.2d 1223, 1230 (5th Cir. 1969); *accord, NLRB* v. *C.H. Sprague & Son Co.,* 428 F.2d 938, 942 (1st Cir. 1970); *International Union (UAW)* v. *NLRB,* 459 F.2d 1329, 1338 (D.C. Cir. 1972).

[196] *American Medical Ass'n,* 94 F.T.C. at 1027; *accord, Market Development Corp.,* 95 F.T.C. at 226 (dictum).

that the adverse inferences had been properly drawn.[197]

More recently, in *Grand Union,* the Commission elaborated upon its earlier analysis to conclude that sanctions under Rule 3.38 should be imposed only if (1) production of the requested material has been mandated by a subpoena or specific discovery order issued by an ALJ or the Commission and directed at the party (or its officer or agent) from whom the material is sought; (2) the party's failure to comply is unjustified; and (3) the sanction imposed "is reasonable in light of the material withheld and the purposes of Rule 3.38(b)."[198] The Commission noted with respect to the third requirement that "[a]n adverse ruling is a severe sanction to be imposed only in extraordinary circumstances."[199] The Commission agreed with the ALJ that adverse inferences against complaint counsel would have been inappropriate because the delay in furnishing certain information to the respondents had been the product of a misunderstanding, and complaint counsel had made a good faith effort to disclose all requested data to the respondents as they became aware of it.[200] **[116]**

The foregoing principles have led the Commission to conclude that it should not rely upon the adverse inferences that the ALJ prescribed in his sanctions order in this case. In this sort of situation, Rule 3.38 should be interpreted to permit the party that fails to supply the required documents to tender them within a reasonable period of time *following* the issuance of an order imposing sanctions. Prior to that time, a party that elects to contest portions or all of an order for the production of documents or other materials does not know whether the ALJ or the Commission will in fact impose some or all of the available sanctions, modify the terms of the subpoena or order, or instead apply to a district court for enforcement.

This approach would be consistent with the procedure adopted in *International Union.* There, the Court of Appeals confronted a respondent in an NLRB proceeding that had for seven years refused to provide clearly relevant documents in response to an NLRB subpoena. The Court of Appeals nevertheless directed the NLRB to draw an adverse inference from that failure to produce only if the respondent failed to produce the documents at issue within thirty days after the entry of the Court's order.[201] The court indicated that

> in order to be absolutely certain that no miscarriage of justice occurs, we think the company should be given one last chance to come forward with the documents. Now that the consequences of suppression have been made abundantly clear, surely Gyro-

[197] *American Medical Ass'n,* 94 F.T.C. at 1028.

[198] *Grand Union Co.,* 3 Trade Reg. Rep. (CCH) ¶22,050 (July 18, 1983) at 22,731.

[199] *Id.* at 22,732.

[200] *Id.* at 22,730–22,731.

[201] *International Union (UAW)* v. *NLRB,* 459 F.2d at 1347–48.

dyne will produce the rehiring records if they are in any way exculpatory. If the company still prefers [117] suppression—even at the price of having its cost-cutting defense stricken—then the tenor of the documents will be obvious to all.

By permitting Gyrodyne a last chance to come forward with the documents, however, we do not mean to suggest that the proceedings may be delayed indefinitely while Gyrodyne ponders its decision. We have seen quite enough pondering—and not nearly enough deciding—already. Therefore, the Board should allow the company 30 days to produce the rehiring records. If, by the end of that time the company has still not come forward with the evidence, the consequences outlined above should swiftly follow.[202]

In this case, the ALJ simply imposed the sanctions at issue without giving Continental the alternative of tendering the disputed documents within a limited period of time—thirty days would probably have been a useful maximum—after the finalization of his order. The ALJ then certified for appeal to the Commission the policy question of whether the Commission should rely upon his adverse inferences or should instead seek federal district court enforcement of the subpoena at issue. Once the Commission determined that interlocutory appeal of the ALJ's order was not appropriate, and remanded the issue to the ALJ, Continental immediately tendered the disputed documents. Nevertheless, the ALJ refused to withdraw the adverse inferences entered earlier, and instead permitted complaint counsel to refuse to accept the disputed documents. The ALJ should have permitted Continental to tender the disputed documents within thirty days after the Commission denied Continental's appeal, and should have withdrawn the adverse inferences once Continental did [118] so.[203] That approach would have provided a better resolution of the cost issue than the sanctions order, and the purpose of Rule 3.38(b) is after all to induce parties to supply subpoenaed material. We should note that if the ALJ had prescribed an additional time period within which to tender the subpoenaed documents, and Continental had refused to supply them within that time period, then reliance upon the ALJ's sanctions order—to [119] determine in particular that Continental sold bread at prices below average variable cost—would have been entirely appropriate.[204]

[202] *Id.* at 1348.

[203] This is not to suggest that an ALJ order adopting discovery sanctions must always be certified for appeal to the Commission. The Commission Rules give ALJs the authority to determine the proper scope of discovery orders, and to impose sanctions for failure to comply with such orders when appropriate; certification will be appropriate only in unusual circumstances. If an ALJ does not certify the imposition of discovery sanctions to the Commission for appeal, then the party involved would be required to provide the subpoenaed materials within thirty days or some other possibly shorter prescribed period after the entry of the ALJ's sanctions order in order to have the sanctions withdrawn.

Continental's explanations for its behavior, which are described above, might conceivably weaken the strength of the inferences to be drawn from Continental's failure to produce the subpoenaed documents to some degree. However, we need not resolve that issue because of our determination that the procedure for imposing the sanctions should have been modified. We do note that ALJs are quite capable of resolving relevance questions relating to discovery orders, and we urge them to do so as expeditiously as possible.

[204] Permitting a short period such as thirty days within which required documents may be tendered after the entry of a sanctions order need not necessarily delay Commission adjudicative proceedings. The Commission Rules

(footnote cont'd)

The discovery sanctions set forth in Rule 3.38(b) represent a legitimate and necessary procedure, and the Commission will vigorously apply them when necessary to remedy an unjustified failure to comply with a valid subpoena or other discovery order. The Commission has, however, determined for procedural reasons not to rely upon the adverse inferences in the ALJ's sanctions order in this case.

V. CONCLUSION

The Commission has concluded that Continental did not violate Section 5 of the Federal Trade Commission Act or Section 2(a) of the Clayton Act. The Commission has therefore determined to dismiss the complaint in this matter in all respects.

COMMISSIONER PATRICIA P. BAILEY,
CONCURRING IN PART AND DISSENTING IN PART*

After I presented the draft of this opinion to the Commission for consideration, it became clear that the Commission was unanimous in its view as to the disposition of most of the case. That is, regardless of the cost standard used to define "predatory pricing," those parts of the case involving St. Paul/Minneapolis, Denver, Northern California and Southern California, should be dismissed for failure to establish a violation of either Section 2 of the Sherman Act or Section 2(a) of the Robinson-Patman Act.

A majority of the Commission, however, disagreed with the cost standard contained in my draft and therefore disagreed also with that section of the draft involving Cleveland because the standard presented resulted in a finding of Robinson-Patman primary line liability in that market.

Thus, I concur in the opinion of the Commission in this case with respect to the dismissal of all Sherman Acts charges and all Robinson-Patman charges outside of Cleveland, although I do not necessarily ascribe to various modifications as to nuance and emphasis in those portions of the opinion. In particular, as I stated in connection with the final decision in *General Foods Corporation,* Docket 9085 [103 F.T.C. 204 (1983)], I do not agree that product differentiation is only rarely an entry barrier. Nor do I see the necessity for a lengthy discussion of national market trends when the focus of the case is on local markets. [2]

The crux of my dissent concerns the question of how to distinguish

currently permit parties to file motions to quash subpoenas and other discovery orders, and delay compliance with those orders until the motions have been ruled upon. If an ALJ felt such a procedure to be appropriate, he or she could, consistent with the rules, prescribe sanctions for the failure to produce subpoenaed materials within a prescribed period at the same time that he or she denies a motion to quash the subpoena or other order at issue.

* Commissioner Pertschuk joins in this separate statement.

a predatory price from a legitimate competitive price. The majority's approach is too rigid and, as we are dealing with a still developing and controversial area of law, their approach is prematurely strict.

Predatory Pricing

Few issues in antitrust law have produced such a gallimaufry[1] of economic theory and legal precedent. Since 1975 there has been "a virtual explosion in the legal and economic literature dealing with predatory pricing." Brodley & Hay, *Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards,* 66 Cornell L. Rev. 738, 740 (1981). At least nine different economic theories for detecting predation have been advanced,[2] and the courts have been both selective and [3] idiomatic in applying these tests.[3] In these circumstances it is neither fruitless nor presumptious for the Commission to forge its own rule. However, that rule should be a flexible, cautious one, capable of assimilating new learning on the subject and avoiding excessive leniency or harshness to either plaintiffs or defendants. The majority's approach, it seems to me, is less an analytical tool than a conclusory statement which can fairly be characterized as follows: price discriminations are either harmless or justified, thus, price predation does not exist. I cannot share their confidence on this point; nor do I believe there would be such an outpouring of academic and judicial debate if the issue were all that clear.

Accordingly, my approach, described more fully below, would be a phased series of structural and firm-specific inquiries, incorporating a cost-price benchmark for legality which varies [4] depending on the circumstances of the case. While I agree with the majority that prices

[1] "This is one of the greatest Gally-maufries that ever I saw; but it was intended as an Antidote against Plague." Salmon, *Pharm.* (1678)

[2] The seminal discussion recommended a short-run marginal cost pricing rule using average variable cost as a practical surrogate for marginal cost. Areeda & Turner, *Predatory Pricing and Related Practices of Section 2 Under the Sherman Act,* 88 Harv. L. Rev. 697 (1975). This proposal was challenged for disregarding the risk that a dominant firm can successfully pursue a strategy of sacrificing short-term profit for long-term benefits in order to exclude actual or threatened competition. Scherer, *Predatory Pricing and the Sherman Act: A Comment,* 89 Harv. L. Rev. 869 (1976) (offering an economic model for testing cost based rules and suggesting a broad rule-of-reason approach). Other commentators proposed long-run pricing rules that emphasized different cost factors. R. Posner, *Antitrust Law: An Economic Perspective,* 184–196 (1976) (presumptively condemning sales below average total cost with intent to exclude a competitor); Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy,* 89 Yale L.J. 213 (1979) (proposing a two-tier test: only if monopolistic conditions exist in the market may pricing below the average variable cost be conclusively illegal, or pricing below average total cost be presumptively illegal under specified conditions). Other economists recommend approaches focusing on output changes or the timing of price cuts. Williamson, *Predatory Pricing, a Strategic and Welfare Analysis,* 87 Yale L.J. 284 (1977) (barring dominant firms from expanding output or selling below full cost to forestall entry); Baumol, *Quasi-Permanence of Price Reductions: A Policy of Prevention of Predatory Pricing,* 89 Yale L.J. 1 (1979) (barring price increases by a dominant firm for a specified period after its price cuts drive competitors from the market). Although not proposing a specific legal standard, two commentators have drawn attention to the prerequisites for successful entry-deterrance conduct. Salop, *Strategic Entry Deterrance,* 69 Am. Econ. Rev. 335 (1979); Spence, *Entry, Capacity, Investment and Oligopolistic Pricing,* 8 Bell J. Econ. 534 (1977). And finally, at least one commentator has argued that there should be no standard at all, since no problem exists. R. Bork, *The Antitrust Paradox* 154 (1978).

[3] Hurwitz & Kovacic, *Judicial Analysis of Predation: the Emerging Trends,* 35 Vanderbilt L. Rev. 63 (1982).

above average total cost (ATC) are legal, I disagree strongly with the "often conclusive" presumption of legality they assign to prices below ATC but above average variable cost (AVC). As my analysis of the Cleveland market demonstrates, I believe such prices can be predatory, particularly as they approach the AVC line and if they continue for some time. On the other hand, in some market conditions prices in the zone between ATC and AVC can be legitimate. Therefore, looking at the facts of each case rather than relying on near-conclusive presumptions is, for me, the only responsible way to decide the issue. Finally I would attach a much stronger presumption of illegality to prices below AVC than does the majority; I would limit the number of excuses for pricing at that level, and I suspect I would find the conduct to have anticompetitive effects after a much briefer predatory pricing incident than the majority.

Aside from the use of near conclusive presumptions, the majority's tests are no more efficient than the one I propose: cost definitions must be made under either. We are in agreement on the propriety of the "leap-frog" analytic technique as announced in *General Foods Corp,* D. 9085 [103 F.T.C. 204 (1983)]. That is, we all agree on avoiding the time and resource-consuming quagmire of cost-based pricing rules if easier preliminary inquiries reveal that below cost pricing either could not result in successful predation or is shielded by a legal defense. Therefore, I would first examine competition in the alleged market to see whether [**5**] and what kind of predation is possible. The existence of entry barriers and the strength of respondent's market power are significant factors. Also important are the level of capacity in the market and duration of the alleged predatory incident.

I believe that the relevant measure of capacity utilization is that of the market and not that of the respondent because, in order to predate, a firm must always have some excess capacity. Zerbe and Cooper, *An Empirical and Theoretical Comparison of Alternate Predation Rules,* 61 Texas L. Rev. 655, 682 (1982). Otherwise, it cannot serve its rival's former customers when exit is induced. Thus, finding that the respondent has excess capacity may not be exculpatory. However, if capacity utilization is very low throughout the market, competitive market conditions may have forced respondent to price at or below its short term marginal costs in a desperate effort to avoid the even greater losses of temporarily closing or leaving the market altogether.[4] On the other hand, where the market does not face substantial excess capacity, pricing below marginal cost begins to look suspect, because competition should force prices to at least that level. (Areeda

[4] *See, e.g.,* Williamson, *supra,* 87 Yale L.J., 284 (1977); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.,* 461 F.Supp. 410, 418–19 (N.D. Cal. 1978), *aff'd in part and rev'd in part,* 668 F.2d 1014 (9th Cir. 1981), *cert. denied,* 103 S.Ct. 57 (1982); *ILC Peripherals Leasing Corp. v. IBM Corp.,* 458 F.Supp. 423 (1978), *aff'd per curiam sub nom. Memorex Corp. v. IBM Corp.,* 636 F.2d (9th Cir. 1981), *cert. denied,* 452 U.S. 972 (1981).

& Turner, *supra,* 88 Harv. L. Rev. at 702) The inference is that prices were lowered, not in response to competition, but rather in anticipation of their destructive [6] effect upon competitors and consequent enhanced market position of respondent.

Having established the competitive setting, I would then determine the relevant measure of cost. There is a general consensus that pricing below marginal cost gives rise to a presumption of illegality.[5] There is much argument, however, on what accounting definition of cost is the proper evidentiary surrogate for that elusive economic benchmark, which is not recorded on a firm's business records. Some courts and commentators have suggested that a company's prices be compared to its average total cost (ATC);[6] others have suggested average variable cost (AVC);[7] still others have suggested a middle course.[8] In my view, no one cost standard is always appropriate; [7] rather, the market setting dictates the choice. Price below ATC can be predatory where there is a high level of capacity utilization in the market, and pricing below AVC is presumptively predatory. For me, the presumption against legitimate prices below AVC is very strong,[9] but could be rebutted by a showing of excess market capacity as discussed above. Furthermore, I would take the duration of the alleged predatory incident into consideration. When the more lenient ATC standard is used, the low prices must endure for some significant period of time. As the price level approaches AVC, however, the scope of harmful duration may be shortened. When price falls below AVC an even shorter span of low pricing may be deemed potentially harmful. Of course, the presumptions of harm to competition derived from the level and duration of the price reduction ultimately must be tested against any evidence the record may contain about actual impact of respondent's conduct upon competition.[10] Thus, if it is clear from a preliminary examination of the record that the market continued to function competitively after the alleged predatory incident, the case may be

[5] *See generally,* Areeda & Turner, *supra,* 88 Harv. L. Rev. at 712, 733.

[6] Posner, *supra; Transamerica Computer Co. v. IBM Corp.,* 698 F.2d 1377 (9th Cir. 1983) (prices *above* ATC are not *per se* lawful, but plaintiff must prove predation by clear and convincing evidence), *cert. denied* 104 S.Ct. 370 (1983); *but see Barry Wright Corp. v. ITT Grinnell Corp.,* 1980–81 Trade Cas. ¶63,862 (D. Mass. 1981) *aff'd* 1984–1 Trade Cas. ¶65,787 (1st Cir. 1983) (prices above ATC conclusively lawful).

[7] Areeda & Turner, *supra; Northeastern Telephone Co. v. AT&T Co.,* 651 F.2d 76 (2d Cir. 1981), *cert. denied,* 455 U.S. 943 (1982); *International Air Industries Inc. v. American Excelsior Co.,* 517 F.2d 714 (5th Cir. 1975), *cert. denied,* 439 U.S. 829 (1978).

[8] Zerbe and Cooper, *supra* (compare prices to ATC unless excess capacity exists; in that case, compare to AVC); Joskow and Klevoric, *supra;* and *compare* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., supra (price below ATC is predatory if accompanied by other proof of predatory intent) with *MCI Communications Corp. v. AT&T,* 708 F.2d 1081 (7th Cir.), *cert. denied,* 104 S.Ct. 234 (1983) (conclusive presumption of legality for prices exceeding long-run incremental costs; very little weight attached to subjective evidence of intent).

[9] Areeda & Turner would make it a conclusive presumption, 88 Harv. L. Rev. at 733, as do Joskow and Klevoric, under specified market conditions, 89 Yale L.J. at 252.

[10] Post-predation evidence is not a necessary element of a predation case, but often exists, given the slow process of antitrust litigation, as in this case. Where it appears in the record, it should be considered.

dismissed without tracing the elaborate steps of the cost-price quadrille.

I agree with the majority that the issue of pricing below cost is reached in only one of the five markets examined in this [8] case. The Sherman Act counts cannot survive in any city, once a market definition including captive bakers is accepted. I agree that the Robinson-Patman counts are dismissed because of a valid meeting competition defense in Northern California, and lack of data from which to generate accurate cost-price comparisons in Southern California and St. Paul/Minneapolis. In these last two markets I would add my own conclusion that there has been a demonstrable lack of anticompetitive effects. In both markets the sum total of competitors remained practically unchanged after the alleged predatory incidents.

In the Denver market I would dismiss the Robinson-Patman count on the grounds of a valid cost-justification defense. Virtually the only cost data in the record is contained in an accounting study prepared by Continental for the *Old Homestead* litigation. That study shows that for the last eight weeks of 1967 Continental priced the one pound Tender Crust bread loaf below average variable cost. Setting aside the questions of whether the one pound loaf is an adequate vehicle for predation and whether an eight week period is sufficiently long for effective predation, and assuming, *arguendo*, that the study is entirely free from methodological error,[11] the case for predatory [9] intent must still fail. Whatever else it may prove, the *Old Homestead* study clearly shows that the difference in price between Tender Crust and Wonder products was cost justified.

Advertising expenses are a specific line item on the cost study: Wonder Bread had known advertising expenses, while Tender Crust, as a private label brand, had none. The *Old Homestead* cost study consistently shows (1964–1969) that costs of advertising Wonder exceeded the price difference between Tender Crust and Wonder, even when discounts are included in the calculation.[12] The study also shows other specific costs which are generally higher for Wonder than

[11] Complaint counsel are in the anomalous position of urging that CX 1728, which shows sales above fully allocated costs for 1964 through October, 1967, be disregarded because of faulty methodology—except as it pertains to the last eight weeks of 1967, when sales below average variable cost are shown. (CCAB, 62)

In brief, complaint counsel contend that respondent erred in allocating production costs between Tender Crust and Wonder Bread on the basis of sales price. (CX 1722U–X, Z) For purposes of this allocation, the sales price was assumed to be the same for Wonder as for Tender Crust, in recognition of the fact that the two labels surround identical products. Complaint counsel would have allocated costs "in proportion of units, weights and values". (Memorandum in Support of Complaint Counsel's Application for Sanctions Under Rule 3.38, December 29, 1976, p. 9) For Robinson-Patman purposes we need not decide between these allocation methods, since both sides apparently agree that Wonder and Tender Crust should have identical amounts of allocable costs assigned to them, under any allocation method. Thus all non-specifically allocable expenses cancel out and can be bypassed when evaluating the cost justification defense, which rests on specific expenses, as described above.

[12] The ALJ incorrectly stated that CX 1728 does not show discounts on Tender Crust. (IDF 83; ID at 86) It does show such discounts, on the line headed "Other Selling Expenses." (CX 1722Z–5)

Tender Crust, such as returns and route labor;[13] but the high advertising costs alone can establish a complete cost justification defense. Indeed, it [10] is clear that throughout the relevant period Continental made more money on Tender Crust, or at least lost less in loss periods, than it did on the Wonder label. Since the price differentials were cost-justified, I would dismiss the Robinson-Patman case. This leaves Cleveland as the only market in which to demonstrate our differing approaches. My analysis is as follows.

Cleveland

In this market between 1973 and 1977 ITT-Continental allegedly captured and kept, by means of below cost sales, a large private label white pan bread account, thus causing primary line competitive dislocations which were still observable in 1980.

The preconditions for predation were certainly present in the Cleveland area in the early 1970's. The record shows no new entry between 1970 and 1980, a decade which reaches significantly before and beyond the alleged predatory conduct. On the eve of the incident, almost no baker serving the market had excess production capacity. Millbrook and Ward's, the first and second-ranked wholesale bakers were both running at least two full shifts a day. (IDFs 290, 308) Other bakers were similarly at full capacity, according to several witnesses, including Joseph Signore, Continental's then-Regional Vice President. (Bateman Tr. 5775; Gase Tr. 9375–76; Signore Tr. 9989–90, 10051) The exception was Continental, whose white pan bread plant at Akron was operating at only 50%–60% of capacity (1 1/4 shifts). (IDF 300) [11]

Joseph Signore, the chief architect of Continental's drive to secure the aforementioned private label contract, recognized that Continental's unique under-capacity situation could be used not only to win the private label account, but also to make Continental the "dominate [sic] factor on the market." (CX 2683B).

In these circumstances, I would infer predatory intent and effect from sales below fully allocated cost (FAC)[14] even if sales were not below average variable cost. The place I find such sales is in the private label contract which Continental negotiated with Pick'N'Pay (PNP), a major grocery store chain in the Cleveland area. That contract was signed on July 13, 1973, and amended September 25, 1974. (IDFs 311, 328) The record contains a variety of data (cost studies,

[13] The full rack service offered with Wonder Bread included pick-up of stale bread; no pick up of returns was offered in the private label program. (CX 1722Z–4) Because of a union contract, bakers paid lower commissions to route salesmen on private label bread than they did on advertised label bread. (CX 1722Z–43)

[14] Fully allocated cost, sometimes called full cost, is used as a surrogate for average total cost in this case because Continental's records did not show ATC, an economic concept which in essence is FAC plus a normal return on investment. FAC is thus a more lenient proxy for marginal cost than is ATC. (Areeda & Turner have noted that normal return on investment is "a figure usually not determinable with any precision." 88 Harv. L. Rev. at 709)

analyses and monthly sales reports) by which the profitability of the contract may be tracked from its inception through August 1977.[15]

Nevertheless there are further definitional questions about the PNP contract which must be answered before one can determine if white pan bread was sold below cost. The written agreement **[12]** (CX 803) was not the full extent of Continental's obligations. There were also a variety of "side bar" agreements to lease PNP's trucks, racks, and dollies and rent the PNP warehouse for the early months of the contract. Continental negotiators made such obligations contemporaneously with the formal, written contract and Continental honored those obligations. (IDFs 313, 314) Therefore, where the Continental internal cost studies assign these costs to the account (*e.g.*, CX 2680) I have included these costs in my calculations.

A second issue concerns what costs should be considered variable under the PNP contract. The appeal briefs set up quite a conflict on this point, with complaint counsel arguing that virtually all selling and distribution costs are variable, and respondents' counsel asserting that sales commissions are the only truly variable selling expense. However, Continental's internal cost studies belie the theories of respondents' counsel. Uniformly these studies, supported by testimony of Continental's employees, describe almost all selling and distribution costs as variable. (*See, e.g.*, Gase Tr. 9421–22; RX 309; CX 2661). Accordingly, I have taken the Continental's variable cost calculations as given, and have not subtracted out such items as sales management and vehicular costs, as respondents' counsel advocate.

I have, however, included in my cost calculations one variable not shown in the primary Continental cost records. As noted, Continental made many auxiliary, verbal commitments to the July 13, 1973, written agreement with PNP. (IDFs 313, 314) One **[13]** was to reimburse PNP for promotions of private label products. (IDF 313). While these payments were known to the Continental management level, they were not disclosed to the accountant who prepared the line profit studies. (Vail Tr. 9971–72, 9981–82; Schmidt Tr. 11163–64; CX 2626A, N, O) Accordingly these studies lack that item. While respondents' counsel made no attempt to argue that the promotional payments are a fixed cost[16]—indeed, the payments are classic examples of a variable cost, since they fluctuate directly with changes in output—they never-

[15] The documents do not detail every month of the four year period, but summarize performance at irregular intervals, providing the nine data points which are referenced in the tables, *infra*.

[16] Continental may have had the option of incurring these costs in a lump sum, one-time fixed form as a purchase of PNP's bakery assets. (Vail Tr. 9968, 9972). The promotional payment obligation was subject to an outer limit of the estimated book value of those assets. (IDF 313) However, the fact that these costs could have been structured differently is speculative and irrelevant; no doubt other terms of the contract would have been different if Continental had committed to an upfront payment of $210,000. In the contract as performed, that sum was stretched over three years, and conditioned to bread output. Its effect on the cost of both the total contract and the white pan bread line was variable.

theless made no effort to correct the incomplete contemporaneous variable profit calculations. Such adjustments can be made, since the amount of promotional payments is known. (CX 2682; Breines Tr. 11098–11100) They should be made, since the amount is significant: approximately $210,000 between July 1973 and April 1976. (IDF 313) I have made those adjustments.[17] [14]

This brings me to the relevant cost calculations. It should be emphasized that they are based on the same documents which the ALJ used to reach his cost conclusions (IDFs 320–325, 347). My review, however, had to be more precise inasmuch as I neither accept his ruling that average variable cost (AVC) always amounted to 80% of fully allocated cost (FAC); nor would I find liability on the mere fact of sales below FAC. The degree by which costs of either type exceed prices must be closely observed.

My calculations are set forth in the following tables:

Table 1

Month(s) & Year	Price as a Percent of Average Variable Cost for White Pan Bread
June 1974	87.0%
January 1976	101.0%
January-March 1976	101.0%
July 1976	99.3%
August 1977	110.0%

Table 2

Month(s) & Year	Price as a Percent of Fully Allocated Cost for White Pan Bread
December 1973	Price below FAC on a per-unit basis for each white pan bread product, ranging from 99.99% of FAC to 91.0% of FAC, exclusive of promotion payments
May 1974	81.0%
June 1974	77.5%
December 1975	82.4%
January 1976	81.5%
January-March 1976	81.7%
July 1976	79.0%
August 1977	77.9% **[15]**

[17] The promotional payments apparently were in support of the white pan bread products only. Therefore, in arriving at the cost figures for white pan bread products I attributed all of the promotional payments to those products.

Thus, between 1973 and 1977 Continental persistently priced far below FAC on the white pan bread items in the PNP contract. For four years the white pan bread price was consistently about 20% less than fully allocated cost. This deep a cut below FAC often approached the AVC level and twice fell below the AVC level. White pan bread was sold at such a loss that the entire private label contract never made a profit on a FAC basis during this time.[18] (IDF 347; Gase Tr. 9402) [16]

The inference of predation raised by cost data is confirmed by a survey of the marketplace before and after Continental won the PNP contract. In 1971 there were five strong independent bakers in the Cleveland market, plus a scattering of smaller bakers. The five top companies were of roughly equal strength, and there was no price leader among them. (IDF 299) Far from being the leader of the pack, Continental shared third rank with American. (IDF 296)

By 1980 Continental shared dominance of the market with Interstate. Those two were the acknowledged price leaders. (IDF 342) Laub, one of the top five firms in 1970 left the market completely after losing its PNP shelf space to Continental. (IDF 318, 341) American,

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Table 3

Month(s) & Year	Price as a Percent of Average Variable cost for the Private Label Account
August 1973	98.1%
December 1973	98.2%
May 1974	92.2%
June 1974	89.0%
January 1976	106.3%
January-March 1976	103.7%
July 1976	101.0%
August 1977	108.4%

Table 4

Months(s) & Year	Price as a Percent of Fully Allocated Cost for the Private Label Account
August 1973	98.6%
December 1973	Price below FAC on a per-unit basis for all but two low-volume varieties, therefore price below FAC for entire private label account
May 1974	86.1%
June 1974	79.8%
December 1974	84.5%
January 1976	83.9%
January-March 1976	82.6%
July 1976	79.6%
August 1977	81.7%

Continental's erstwhile head-to-head competitor, had slipped to sixth place, behind even Nickels and Schwebel, bakers which Continental's regional vice president assessed as "not strong factors, grocery-wise". (Gase Tr. 9533; IDF 342) The market is clearly less competitive in 1980 than it was in 1970.

Having determined that the PNP contract was predatory for as much as four years, I turn to the question of whether Continental has any recognizable defenses.

The tortured history of Continental's negotiations for the PNP private label account is ably set forth by the ALJ at IDFs 305–314. My reading of the record, which consists mainly of testimony of persons involved in both sides of the negotiations, convinces me that the ALJ correctly concluded that Continental has no "meeting competition" defense under Section 2(b) of the [17] Robinson-Patman Act.[19] (ID, p. 85) This is abundantly clear with regard to the renegotiated 1974 contract, as there is not the slightest evidence in the record that Continental believed its offers, which were still far below FAC, to be in good faith response to any competing offers. As for the original July 1973 terms, it appears that the prices were decreased and contractual obligations increased several times in the early part of the year, significantly after competing bidders' offers had lapsed and after Vail, Continental's vice president in charge of national accounts, became confident that Continental would become PNP's supplier of private label bread.[20] (IDFs 309, 310; CXs 803, 809, 839, 884)

A second defense which respondents raise in Cleveland is the argument that Laub was not harmed by the effects of the PNP contract. In other words, they argue that the causes of Laub's demise were business problems unrelated to Continental's low cost sales.

My examination of the record convinces me that Continental's conduct, though not the sole cause, was a major cause of Laub's closing. In the early 1970's Laub had been losing significant [18] restaurant business and some small grocery accounts, often to Continental;[21] but its overall business, especially the grocery side, was definitely operational. It had a fully automated, very efficient plant, an aggressive sales force, and the label rights to a nationally-recognized label, "Sunbeam bread". (Stonbraker Tr. 5529, 5563–66, 5598; Bronczek Tr. 5710–

[19] It should be noted that, in Cleveland, any meeting competition defense is limited to the competing bids for the PNP contract. It is not an "area-wide" defense such as the Commission considers in the Northern California market.

[20] PNP originally was interested in dock delivery to its warehouse and received several bids on this proposition. (Kravitz Tr. 5394–95) However, when PNP changed its terms to store drop those bids were not renewed. (Kravitz 5393–95, 5408; Schwebel Tr. 5817; Bogolmony Tr. 5869; Bateman Tr. 5777 CX 884) Signore had only the most general belief that other companies might be in the running for the contract; after 1972 he was not aware of any specific competitive offers. (Signore Tr. 9993–9994, 10031)

[21] Complaint counsel devote some time to CBC's "potshotting" of Laub restaurant accounts; the Initial Decision also notes CBC's inroads here. (IDF 301–303) However, since the record contains no indication that these sales were won by predatory means, I have not considered these practices to be part of the case.

11) In 1973 Laub had approximately 54 grocery routes, which compares favorably with the 68 routes of Interstate, the market's then leading wholesale baker. (IDF 288; Stonbraker Tr. 5588)

In 1973, PNP was Laub's largest customer, and Laub's bread enjoyed the largest share of the branded portion of PNP shelf space. (Stonbraker Tr. 5590–91) As a result of the Continental contract, Laub's all-important white pan bread sales to PNP declined drastically. Laub's white pan bread products were simply edged off the shelf by Continental's private label and advertised brands. (IDFs 317, 318) Moreover, the loss of general exposure to consumers through the PNP stores also hurt Laub's sales through other outlets. (Stonbraker Tr. 5605–5606) The loss of volume associated with exile from the PNP stores had an immediate effect: Laub was forced to consolidate delivery routes, but even that cost-cutting measure was not enough to save the company and within six months the bakery had shut down. "You just can't go on when your volume is not there." (Stonbraker Tr. 5608) **[19]**

I think this chain of causality is fairly strong, and it becomes more so when we note that Interstate, though considerably larger and healthier than Laub, also suffered from losing PNP shelf space to Continental. (Meehan Tr. 5341) Clearly, the PNP account would be very important to any supplier, and its loss could be the final straw to a smaller bakery such as Laub.

Of course, actual injury and permanent loss of sales need not be proven to show a violation of the Robinson-Patman Act; but such facts are convincing evidence of a violation. *National Dairy Products Corp. v. FTC*, 412 F.2d 605 (7th Cir. 1969). Here Continental's long, deep cuts in the price of white pan bread create such a possibility of harm to competition that a violation of the act must be found, absent some showing that the probable effect did not take place. Respondents have not made such a showing. To the contrary: all the evidence in the record points to a market much less competitive now than it was a decade ago; with Continental's dominance unchallenged by either new entrants or existing competitors. Moreover, the loss of at least one independent baker seems directly related to Continental's predatory pricing between 1973 and 1977. Accordingly, I would have found that Continental's discriminatory prices on white pan bread in the Cleveland market from 1973 to 1977 caused primary line injury in violation of Section 2(a) of the Robinson-Patman Act.

Conclusion

The difference between my views on predation and that of the Commission majority was sketched out in my partial dissent to the *General Foods* opinion and earlier in my dissent to the decision **[20]** not to seek *certiori* in the *Borden (ReaLemon)* matter. The majority opts for a series of assumptions that places the danger zone well below AVC ("properly defined", of course). It is inconceivable to me that any firm could fail to show prices safely above this line, given the wealth of acceptable excuses listed by the majority, not to mention the requirement of a "significant," wholly continuous period of low prices. (Apparently four years—the time of below cost sales in Cleveland—is not "significant" enough).

The approach I have outlined is assailed principally because it is subject to accounting ledgerdemain. To this I answer, so is any test where the definition of cost is at issue.[22] I do freely admit to one of the criticisms leveled at my approach by the majority: it does not foster as much industry certainty as their AVC test. Certainly, my approach would require a modicum of structural and firm-specific inquiry. Nevertheless, I believe it is a practical, workable standard. In contrast, the majority's AVC test gives near absolute business certainty after one reading: in the words of Cole Porter, "Anything goes." It would be simpler, and surely a great saving of everybody's time, if the Commission today had simply announced that it does not believe predatory pricing exists.

FINAL ORDER

This matter has been heard by the Commission upon the appeals of complaint counsel and respondent from the initial decision and upon briefs and oral argument in support of and in opposition to the appeals. For the reasons stated in the accompanying Opinion, the Commission has determined to reverse the initial decision. Respondent's appeal is granted and complaint counsel's appeal is denied. Accordingly,

It is ordered, That the complaint is dismissed.

Commissioners Pertschuk and Bailey dissented in part and concurred in part.

[22] For example, the majority would amortize promotional and advertising expenses over a product's goodwill life cycle (presumably established by the promotor's testimony as to his fondest expectations). If this isn't an arbitrary variable, fraught with accounting peril, what is?