

# THE NATIONAL LAW JOURNAL

## Antitrust Law Predatory Purchasing?

Janet L. McDavid · Jessica L. Ellsworth

Whether a company that allegedly purchased too much or paid too much for raw materials violated the antitrust laws is currently before the U.S. Supreme Court in a petition for writ of certiorari in *Weyerhaeuser Co. v. Ross-Simmons Hardware Lumber Co. Inc.*, petition filed, No. 05-381 (Sept. 23, 2005).

In 1993, the Supreme Court held that the line between aggressive competition on the merits and "predatory" conduct in violation of the Sherman Act involves two requirements. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). First, a company with significant market power must sell its product at a price below cost. In addition, the company must have a dangerous probability of being able to drive up prices to recoup the losses it incurred from below-cost sales. Recoupment happens because the company no longer has competitors, which makes the predatory scheme economically rational.

The Supreme Court was clear in *Brooke Group* that conduct is predatory and violates the antitrust laws only when a company meets both these requirements: It must accept short-term losses from below-cost sales and then be able to recoup those losses. This relatively high standard for liability recognizes both the danger of discouraging legitimate price competition and the fact that predatory schemes are self-detering because they are so unlikely to succeed.

The legal issue in *Weyerhaeuser* is whether the *Brooke Group* requirements also apply to conduct on the purchasing side of the market. In a decision with profound ramifications for purchasing decisions nationwide, the 9th U.S. Circuit Court of Appeals ruled they do not. It limited the *Brooke Group* standard to predatory selling, and instead set a standard for predatory buying that can only be characterized as vague, open-ended and subjective. For businesses trying to interpret and conform their behavior to the 9th Circuit's standard, there is little to go on; the standard essentially gives a jury unlimited discretion to impose antitrust liability for a company's purchasing decisions that it feels are unfair.

### **The 9th Circuit's decision on predatory buying**

Despite recent efforts by the Supreme Court to encourage vigorous competition and to provide meaningful guidance through clear, bright-line rules, the 9th Circuit failed to do just that. *Weyerhaeuser Co.*, a major forest products firm in the Pacific Northwest, buys alder sawlogs and cuts those logs to produce and

sell finished alder lumber. A number of competing sawmills sued Weyerhaeuser in 2001, claiming that the company had violated federal antitrust law by overbidding for sawlogs. They alleged that Weyerhaeuser had paid more "than necessary" for sawlogs, had bought "more sawlogs than it needed" and had bought sawlogs at prices that prevented competing mills "from obtaining the logs they needed at a fair price." *Confederated Tribes of Siletz Indians of Oregon v. Weyerhaeuser Co.*, 411 F.3d 1030, 1037 n.8 (9th Cir. 2005). There was no dispute that Weyerhaeuser sold its alder lumber at a profit, that it sold all of the alder lumber it could produce and that the price of finished alder lumber went down during the relevant time frame.

Nonetheless, the 9th Circuit affirmed a jury verdict imposing treble damages on Weyerhaeuser. There was no question that if the *Brooke Group* standard applied to predatory buying claims, Weyerhaeuser would have prevailed. The evidence did not show that Weyerhaeuser met either of the *Brooke Group* requirements. It never operated at a loss (i.e., there were no below-cost sales) and there was no evidence that recoupment could occur. The main complaint of the competing sawmill plaintiffs was that Weyerhaeuser was willing to pay more for timber, so that less efficient competitor sawmills could not match the prices Weyerhaeuser paid and therefore could not purchase all of the sawlogs they wanted while still making a profit.

The 9th Circuit held that the *Brooke Group* standard, including its below-cost and recoupment requirements, did not apply to purchasing decisions, and in particular to purchasing decisions in a relatively inelastic market. Instead, it approved a jury instruction that simply asked whether Weyerhaeuser "purchased more logs than it needed or paid a higher price for logs than necessary" so as to prevent certain competitors "from obtaining the logs they needed at a fair price." 411 F.3d at 1037 n.8. The court provided no guidance for limiting a jury's determination of what is more raw material than needed, a higher price than necessary or a price fair to competitors.

The court's reason for rejecting the *Brooke Group* standard was that consumers directly benefit from predatory selling in the short term because goods are sold at lower prices, which can often foster competition. In contrast, the court felt that predatory purchasing is less likely to benefit consumers or stimulate competition. The 9th Circuit drew this distinction even though it recognized that both sides of the market-buy side and sell side-affect consumer welfare.

The court also recognized that when a higher price is paid for raw materials, there is an incentive for new companies to enter the market selling those raw materials or substitutes. But the court concluded that the liability standard for predatory buying cases "need not be as high as in predatory pricing cases." It focused on the different nature of the market (elastic v. relatively inelastic) and different economic circumstances (monopoly v. monopsony) to distinguish *Brooke Group*. Weyerhaeuser has sought Supreme Court review of the 9th

Circuit's refusal to apply *Brooke Group* to purchasing.

The 9th Circuit's holding undoubtedly makes it easier for a plaintiff to bring an antitrust action for predatory buying. A plaintiff would merely need to allege that it could not buy as many inputs as it wanted at a price that was "fair" and that the competitor was buying too many inputs at a price that was "too high"; it would be up to a jury to determine what was a fair price and how many inputs were too many or not enough.

The ambiguity and lack of a clear standard in the 9th Circuit's decision re-introduces the uncertainty that *Brooke Group* resolved years ago. The 9th Circuit's standard completely lacks concrete guidance on where permissible competition ends and predatory buying begins. Without a transparent, objective and administrable standard, companies cannot know where the line is between aggressive competition-which the antitrust laws seek to encourage-and anti-competitive behavior-which the antitrust laws seek to punish.

The result of the ambiguity is that neither buyers nor sellers can know how to compete aggressively and independently without risking a jury finding them in violation of the law. Purchasers of raw materials will not engage in vigorous competition to purchase raw materials; offering a higher price for raw materials than competitors could lead to being sued by competitors over their preference to pay less for that input. How is a buyer to know whether the price it chooses to offer for raw materials will strike a jury as "higher than necessary"? Or what a jury will consider a "fair" price? Or how many inputs a competitor "needs" to buy? Instead, purchasers will have an incentive to coordinate so that they know how much their competitors are offering to pay for the raw material and how much of the raw material the competitors feel they need, thereby risking a violation of § 1 of the Sherman Act.

### **Efficient purchasing decisions will be stymied**

The overall effect of the decision will be to deter companies from making efficient purchasing decisions and adjusting to rapidly evolving market conditions. Ironically, this will foster inefficiencies that harm, rather than help, consumers. Companies are likely to be more cautious about acquiring critical inputs necessary to meet future demand, to be discouraged from innovations that allow better processing, and to proceed with care when seeking to minimize transaction costs or pay a premium for a steady supply of materials from a particular supplier. The decision requires more efficient firms to guarantee that less efficient rivals can stay in business. It also limits a company's ability to adjust the prices it pays for goods and services for any purpose, from meeting increased demand to redesigning an inventory policy to effecting an innovation in input processing.

The Supreme Court has not yet agreed to review the case, but it should. Companies have operated for over a decade with the understanding that *Brooke Group* sets the standard for predatory conduct that violates the Sherman Act, an understanding that the 9th Circuit's decision has thrown into confusion.

Competitors need to know the rules of the road so that they can behave lawfully while still providing customers the benefits that result from competition. The Supreme Court has often counseled that the antitrust laws protect competition, not competitors, but the 9th Circuit's decision protects inefficient competitors, which can now use the decision to shield themselves from losing profits or market share to more efficient competitors. That never has been-and should not be-the goal of the antitrust laws.

*Janet L. McDavid is a partner, and Jessica L. Ellsworth is an associate, at Washington's Hogan & Hartson. McDavid is an antitrust lawyer and was formerly chair of the American Bar Association Section of Antitrust Law. Ellsworth specializes in appellate litigation. Along with Jonathan S. Franklin, an appellate litigation partner at the firm, they filed an amicus brief in support of Weyerhaeuser's petition for writ of certiorari on behalf of The Business Roundtable and the National Association of Manufacturers.*