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Private Enforcement of Predatory Price Laws under the California Unlawful Practices Act and the Federal Antitrust Acts

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Private Enforcement of Predatory Price Laws Under the California Unlawful Practices Act and the Federal Antitrust Acts

James R. McCall*

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The commercial practice of knowingly selling below cost with the intent to injure competitors or to injure competition has long been considered unlawful by American courts and state legislatures.¹ The practice of below cost selling is usually called

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1. See Robert B. Jones, Comment, *Regulation of Business-Sales-Below-Cost-Statutes-The Elements of Violation and the Defense of Meeting Competition*, 58 MICH. L. REV. 905, 905-10 (1960). Beginning with South Carolina in 1902, 31 states had enacted statutes prohibiting below cost sales by 1958. *Id.*

"predatory" pricing,² while a variation of the practice is known as "loss leader" pricing.³ These practices have been prohibited by federal and California law for over fifty years,⁴ but the scope and current nature of the state and federal prohibitions differ significantly.

While federal predatory price prohibitions are much better known, the change in the economic perspective of federal antitrust courts has resulted in a dramatic narrowing of the application of those laws. Meanwhile, the California statutory prohibitions continue to have the broadest possible application. This is principally because the California statute was drafted to apply to a much broader range of commercial activity than the federal laws,⁵ and the operational concept of "cost" now used in federal courts is both restrictive and problematic when compared to the precise definition of the term found in California statutes.⁶ The federal antitrust law applicable to business activity in California is, for the most part, controlled by opinions of the United States Court of Appeals for the Ninth Circuit, and the difference between California law and the law developed in Ninth Circuit opinions on predatory pricing is very dramatic.⁷ While the federal antitrust statutes applied to predatory pricing are generally familiar to trade regulation attorneys throughout the country, the California statute, which is the Unlawful Practices Act⁸ (UPA or Act),

2. See, e.g., *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 219-27 (1993) (reviewing federal "predatory pricing" decisions of the last 30 years in considering an alleged violation of the Robinson-Patman Act); *Standard Oil Co. v. United States*, 221 U.S. 1, 43 (1911) (noting the significance of predatory pricing under section 2 of the Sherman Act); see also *infra* Part II.A. (discussing section 2 of the Sherman Act and section 2(a) of the Robinson-Patman Act).

3. See CAL. BUS. & PROF. CODE § 17044 (West 1987); *infra* Part III.

4. See *infra* Parts I, II (discussing laws prohibiting the general practice of predatory pricing); see also *infra* Part III (discussing the more specific statutory prohibition of loss leader pricing).

5. See *infra* Part II.B.1.

6. See *infra* Part I.C.

7. The views of the Ninth Circuit on measuring predatory price law cost are singular in being narrow and unclear. See *infra* notes 60-95 and accompanying text. Therefore, the state-federal law comparison of the predatory price cost concept contained in this Article is more extreme than would be the case were the comparison between the federal and state laws applicable to predatory pricing in a state located in a different federal circuit.

8. CAL. BUS. & PROF. CODE §§ 17000-17101 (West 1987 & Supp. 1996). The Act prohibits territorial price discrimination in § 17040, as well as predatory pricing in § 17043, see *infra* Part II.B.1., loss leader pricing in § 17044, see *infra* Part III, and secret rebates in § 17045. The UPA prohibition of territorial price discrimination, as a practical matter, is very similar to the prohibition of "primary line" price discrimination contained in sections 2(a) and 2(b) of the federal Robinson-Patman Act (RPA); the only significant difference being that the UPA prohibition applies to discrimination in the sale of any type of product, while the RPA applies to discrimination only in the sale of goods. Compare CAL. BUS. & PROF. CODE § 17024 (West 1987) with 15 U.S.C.A. § 13(a) (West 1973).

Recent opinions addressing § 17040 claims include: *Harris v. Capitol Records Corp.*, 64 Cal. 2d 454, 460-61, 413 P.2d 139, 143-44, 50 Cal. Rptr. 539, 543-44 (1966) (discussing distinctions between primary and secondary competition in § 17040 claims); *ABC Int'l Traders, Inc. v. Matsushita Elec. Corp.*, 50 Cal. App. 4th 393, 400-01, 48 Cal. Rptr. 2d 415, 420 (1995), review granted, 912 P.2d 1146, 51 Cal. Rptr. 2d 199 (1996) (unpublished) (affirming the dismissal of a UPA claim because of the plaintiff's failure to show primary line injury); and *Penner v. Breitling*, No. C-93-4308 SI, 1996 WL 182202, *4 (N.D. Cal. Apr. 8, 1996) (holding that the plaintiff, an owner of a retail watch store, offered insufficient evidence to support a locality discrimination claim against a watch distributor). The California and federal law on price discrimination and secret rebates are beyond the scope of this Article.

is known by a small fraction of the lawyers practicing in the state. Given the importance of the California market to the majority of the nation's businesses, the UPA and its application to predatory pricing practices should be appreciated by all trade regulation attorneys. The possibility of large treble damage judgments under the UPA⁹ and the fact that the California statute has been copied in other states¹⁰ are additional reasons why the Act and the case law interpreting it should be better known.

In private litigation, two provisions of the federal antitrust law have been held to prohibit predatory pricing: section 2 of the Sherman Act¹¹ and section 2(a) of the Robinson-Patman Act (RPA).¹² A more detailed discussion of the terms of these sections is in subparts I.B. and II.A.,¹³ but it should now be noted that section 2 of the Sherman Act makes it illegal to "monopolize, or attempt to monopolize . . . any part of the trade or commerce among the several states,"¹⁴ and the RPA makes it unlawful for a seller "to discriminate in price between different purchasers" of goods sold in interstate commerce "where the effect of such discrimination may be . . . to

9. See *infra* Part II.B.4. (discussing damages under the UPA).

10. The UPA was the first modern comprehensive state predatory pricing statute. See Jones, *supra* note 1, at 908; J. Thomas McCarthy, *Whatever Happened to the Small Businessman? The California Unfair Practices Act*, 2 U.S.F. L. REV. 165, 169 (1968). The California statute had its roots in 1913 legislation prohibiting unfair competition and discrimination. Ewald T. Grether, *Experience in California with Fair Trade Legislation Restricting Price Cutting*, 24 CAL. L. REV. 640, 645 (1936); see 1913 Cal. Stat. ch. 276, at 508-10 (enacting the UPA). The initial statute apparently was not widely used except in the public utility field and was, for the most part, "dormant." Grether, *supra*, at 645.

The UPA was amended in 1935 by the addition of the defense of meeting competition. See Jones, *supra* note 1, at 908; see also 1935 Cal. Stat. ch. 477, at 1546 (amending the UPA). During the next two years, six states (Arkansas, Colorado, Hawaii, Kentucky, Montana, and Wyoming) adopted legislation almost identical to the 1935 California statute. In 1937 the UPA was again amended to require that the below cost seller had "a purpose to injure competitors or to injure competition." Jones, *supra* note 1, at 909 n.35 (emphasis added); see CAL. BUS. & PROF. CODE § 17043 (West 1987).

Currently, the six original states that adopted the UPA have retained language nearly identical to the California act after the 1937 amendments. The major exception to this statement is the "injurious intent" provision. See ARK. CODE ANN. § 4-75-209 (Michie 1987); COLO. REV. STAT. ANN. § 6-2-105 (West Supp. 1992); HAW. REV. STAT. ANN. § 481-3 (Michie 1993); KY. REV. STAT. ANN. § 365.030 (Michie 1996); MONT. CODE ANN. § 30-14-209 (1995); WYO. STAT. ANN. § 40-4-107 (Michie 1993). At the present time a large number of the states have predatory pricing laws much like the UPA. See Jonathan Moore Peterson, Comment, *Taming the Sprawlmart: Using an Antitrust Arsenal to Further Historic Preservation Goals*, 27 URB. LAW. 333, 356-64 (1995). These laws typically prohibit below cost sales with injurious intent. *Id.* at 358.

11. 15 U.S.C.A. §§ 1-7 (West 1973 & Supp. 1996).

12. 15 U.S.C.A. §§ 13-13b, 21a (West 1973). The provision of the RPA that prohibits below cost selling directly is section 3, which is enforced exclusively by the United States Department of Justice by criminal prosecutions. See *Nashville Milk Co. v. Carnation Co.*, 238 F.2d 86, 90 (7th Cir. 1956), *aff'd*, 355 U.S. 373 (1958). Because there is no private remedy for a violation of section 3 of the RPA, that section is beyond the scope of this Article. RPA section 2(a) private enforcement cases have sometimes involved predatory pricing, but the factual context for that pricing always involved price discrimination. See *infra* notes 129-32 and accompanying text.

13. See *infra* Parts I.B., II.A.

14. 15 U.S.C.A. § 2 (West Supp. 1996).

injure . . . competition.”¹⁵ Through case law interpretation described below, “predatory” price sales have sometimes been declared illegal, either when the seller is a monopolist under section 2 of the Sherman Act or when the seller discriminates in price between two buyers in the interstate sale of goods under section 2 of the RPA.¹⁶ Under both statutes a predatory price is now held to be one that is below the seller’s costs.¹⁷

Business and Professions Code § 17043 in the California UPA specifically prohibits sales of any product “at less than the cost thereof . . . for the purpose of injuring competitors or destroying competition.”¹⁸ The purpose or “intent” requirement is not particularly daunting due to a statutory presumption.¹⁹

In predatory pricing litigation under any of the three statutes, the crucial determination is what constitutes the seller’s cost on a given sale. The UPA specifies a measure of cost to be used,²⁰ but the applicable federal cost concept, developed through case law, is more ambiguous.²¹ Complicating the matter further is the fact that the topic of cost definition involves issues and terms unfamiliar to many lawyers.²² Nonetheless, the difference in cost concepts will be the controlling consideration in a sophisticated appraisal of the potential liability of a firm for sales activity challenged as predatory pricing. Accordingly, the cost concept is the first topic discussed in Part I.²³

The cost concept discussion is followed by a comparison of the other elements and significant features of the prohibitions in the applicable federal statutes and the UPA.²⁴ A discussion of the treatment of “loss leader” pricing under the federal statutes and the UPA is next,²⁵ and the Article concludes with a general summary and comparison of the federal and California statutes discussed in this Article.

15. Clayton Act § 2(a), 15 U.S.C.A. § 13(a) (West 1973) (the best known provision of the RPA-amended sections of the Clayton Act).

16. See *infra* Part I.B.

17. See *Brooke Group*, 509 U.S. at 221. *Brooke Group* leaves the measure of “cost” undetermined. At one time the predatory price concept under the RPA apparently did not require that the defendant’s price be below any measure of cost. See *infra* text accompanying note 27 (discussing *Moore v. Mead’s Fine Bread Co.*, 348 U.S. 115 (1954)).

18. CAL. BUS. & PROF. CODE § 17043 (West 1987).

19. *Id.* § 17071 (West 1987).

20. See *infra* Part I.C.

21. See *infra* Part I.B.

22. See *infra* notes 37-41 and accompanying text (discussing the concepts of average, total, variable, and marginal costs).

23. See *infra* Part I.

24. See *infra* Part II.

25. See *infra* Part III.

I. THE DIFFERENT COST CONCEPTS

A. Introduction

The prohibitions contained in the antitrust laws are, for the most part, broad proscriptions of essentially undefined, but pejoratively stated, conduct.²⁶ During the period of the Warren Court (1953-1969), these prohibitions generally received expansive interpretations, and in keeping with the general tendency, the Court held that low price selling in one market by a multi-market seller could be prohibited by section 2(a) of the RPA, without regard to whether the seller sold below its cost, when it discriminated in the selling price for a favored buyer.²⁷

By 1980, the era of expansive application of the antitrust acts by federal courts had ended.²⁸ Since that year, the United States Supreme Court has consistently scaled back the reach of provisions in those acts that apply to below cost pricing.²⁹ As will be seen, the most recent opinion of the Court on the issue of the measure of cost in predatory pricing reflects this dominant trend in contemporary federal antitrust law.³⁰

The UPA, in contrast to the federal antitrust statutes, is precisely drawn to eliminate defined commercial practices such as predatory pricing. Therefore, changing judicial perspectives on antitrust enforcement have far less influence on the development of California predatory pricing law than on the development of the federal counterparts. Accordingly, there has been no indication by California courts that the application of the UPA will be limited by judicial interpretation.³¹ In fact, California courts have shown an increasing readiness to apply the UPA prohibitions in complex and arguably ambiguous situations.³²

26. For example, the Sherman Act, in sections 1 and 2, respectively, condemns "contract(s) . . . in restraint of trade" and firms that "monopolize" markets. 15 U.S.C.A. §§ 1, 2 (West 1994). Also note that section 7 of the Clayton Act prohibits mergers that produce an effect that may substantially "lessen competition" in any market. 15 U.S.C.A. § 18 (West Supp. 1996).

27. See *Moore v. Mead's Fine Bread Co.*, 348 U.S. 115, 119-20 (1954); see also *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685, 702-03 (1967) (holding that three discriminating sellers could be in violation of section 2(a) of the RPA without proof that the low prices they charged favored buyers were below cost, as long as the low-priced sales made a competitor lose sales and retire from the market).

28. The two Supreme Court opinions that are generally recognized as indicating the Court's change from an expansive interpretation are *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974) and *Continental T.V. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

29. See *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543 (1990) (interpreting the RPA); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588-91 (1986) (discussing "predatory pricing"); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) (interpreting section 2 of the Sherman Act); *Truett-Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 562 (1981) (limiting available damages under the RPA).

30. See *infra* notes 43, 58-59, 77-78 and accompanying text (discussing *Brooke Group*).

31. See, e.g., *G.H.I.I. v. MTS, Inc.*, 147 Cal. App. 3d 256, 271, 195 Cal. Rptr. 211, 220 (1983) (holding it is proper to expand statutory treble damage liability for secret rebate violations to buyers who receive them because UPA provisions are to be construed liberally).

32. More recent opinions show an expansive attitude toward California Business and Professions Code § 17043. See *Turnbull & Turnbull v. ARA Transp., Inc.*, 219 Cal. App. 3d 811, 824-25, 268 Cal. Rptr. 856, 863-64 (1990) (upholding § 17043 and the use of a "fully allocated cost" under the section against the claim that each was

The UPA is precise in its definition of “cost”³³ for the purpose of determining whether a seller is selling below cost. More importantly, the Act specifies that the measure of cost is the measure that produces the highest possible figure for the vital comparison between seller price and seller cost.³⁴ This makes it significantly easier for the plaintiff to prevail in an action. To explain why this is so requires the following review of the different measures of cost that could be used to determine a seller’s cost.

What the layperson thinks of as the “cost” of producing a product is essentially what an economist would call the “total cost” of producing the item, meaning all costs incurred to produce the item including labor, materials, overhead, or any other type of cost.³⁵ To determine the average total cost of producing a product, the total of all costs incurred in the production process is divided by the “output,” or total number of units of the product produced. Laypersons probably would refer to this figure as the “average cost,” while the economist’s term is “average total cost.”

The total cost of production of a product is the sum of two distinct types of costs: fixed costs and variable costs.³⁶ Fixed costs are those that do not vary with output and typically include management expenses, depreciation, property costs, and other irreducible outlays. Average fixed cost is the sum of all fixed costs divided by output.

Variable costs, on the other hand, vary with the amount of output and include outlays for materials and labor. Average variable cost is the sum of all variable costs divided by output. Average fixed cost plus average variable cost equals the average total cost of producing (or distributing) a product.

preempted by federal law); *E & H Wholesale, Inc. v. Glaser Bros.*, 158 Cal. App. 3d 728, 733-38, 204 Cal. Rptr. 838, 841-45 (1984) (holding that a prima facie case under § 17043 was made out by proof of a sale below cost and a diversion of business to defendant from competitor); *Paramount Gen. Hosp. Co. v. National Med. Enters., Inc.*, 42 Cal. App. 3d 496, 502-04, 117 Cal. Rptr. 42, 47-49 (1974) (holding that § 17043 is applicable to individual portions of a contract and indicating broad coverage of the section to include leases of real property).

The expansive interpretations in recent opinions noted in the preceding paragraph represent a change from the somewhat grudging attitude the state appellate courts took toward the section, as found in earlier state appellate court opinions. *See Tri-Q, Inc. v. Sta-Hi Corp.*, 63 Cal. 2d 199, 207, 45 Cal. Rptr. 878, 882 (1965) (holding that no intent to injure competitors was proven); *Independent Journal Newspapers v. United W. Newspapers, Inc.*, 15 Cal. App. 3d 583, 586, 93 Cal. Rptr. 299, 301 (1971) (requiring a highly specific pleading of facts showing below cost sales).

33. *See CAL. BUS. & PROF. CODE* § 17026 (West 1987) (clarifying that “cost” refers to production costs, such as “the cost of raw materials, labor, and distribution costs, such as the invoice or replacement cost . . . plus the cost of doing business”); *id.* § 17029 (West 1987) (defining “cost” as “all costs of doing business incurred in the conduct of the business and shall include without limitation the following items of expense: labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance and advertising”).

34. *Id.* § 17026 (West 1987); *see infra* Part I.C.

35. For convenience in the following discussions of price theory costs, “producing” will include distributing and “producer” will include wholesalers and retailers as well as manufacturers, and the term “produce” will include the purchasing and resale activity of wholesalers and retailers.

36. Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 700 (1975).

Economists recognize an additional cost concept that is generally beyond the frame of reference of laypersons, the idea of "marginal cost." Marginal cost is the addition to total cost that will be incurred if and only if an additional unit of output is produced and sold by a manufacturing firm.³⁷ Because producers seldom think in terms of producing only one additional unit,³⁸ marginal cost is almost an entirely theoretical concept. The actual marginal cost is also extremely hard to determine for the majority of producers.

Anticipating the result of the discussion to follow, the UPA adopts the average total cost of the seller as the crucial measure of "cost."³⁹ The measure of seller cost in the federal law of predatory pricing is less certain, but it appears from the latest decision of the United States Supreme Court addressing this issue that average variable cost is the mandated measure of cost.⁴⁰ The position of the Ninth Circuit on the issue is quite ambiguous and apparently can be clarified only by a definitive direction from the Supreme Court.⁴¹

B. The Federal Antitrust Law Concept

The recent Supreme Court opinion in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*⁴² holds that the measure of cost for predatory price litigation under the RPA will be the same as the measure of cost for predatory price litigation under section 2 of the Sherman Act.⁴³ Initially suggested in an influential law review article by Professors Phillip Areeda and Donald Turner,⁴⁴ the Ninth Circuit adopted the view that the cost concepts under the two statutes were the same nineteen years ago.⁴⁵

The Areeda and Turner article also played a significant role in changing the view of antitrust courts toward the subject of predatory pricing. Before their article appeared in 1975, the general judicial view of predatory pricing was that it occurred

37. In the case of wholesale or retail firms, "marginal cost" is the addition to total cost incurred if and only if an additional unit of product is purchased and resold.

38. Note that a contractor who contracts to build a single home for a customer is one of the few types of producers in lay experience who calculate the marginal cost of the product and set a price in excess of it in a conventional home-building contract.

39. See *infra* notes 97-99 and accompanying text.

40. See *infra* notes 56-60 and accompanying text.

41. See *infra* notes 60-95 and accompanying text (discussing Ninth Circuit cases).

42. 509 U.S. 209 (1993).

43. *Brooke Group*, 509 U.S. at 222-23.

44. Areeda & Turner, *supra* note 36, at 727.

45. See *Janich Bros., Inc. v. American Distilling Co.*, 570 F.2d 848, 855 (9th Cir. 1977) (stating that "section 2 of the Sherman Act . . . and section 2(a) of the Clayton Act as amended by the Robinson Patman Act . . . are directed at the same economic evil and have the same substantive content"); see also *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1041 (9th Cir. 1981). In *Inglis*, the court stated that the cost test for section 2 of the Sherman Act violations was "equally applicable" to primary-line RPA cases, and reiterated that the court had "previously recognized that where 'a price differential threatens a primary line injury . . . [the two statutes] are directed at the same economic evil.'" *William Inglis & Sons Baking*, 668 F.2d at 1041 (quoting *Janich Bros.*, 570 F.2d at 855).

frequently, was an effective device for obtaining market monopolies, and could be prohibited without adversely affecting markets or price levels.⁴⁶ Areeda and Turner challenged all three assumptions,⁴⁷ and within a decade the United States Supreme Court adopted their views.⁴⁸

Areeda and Turner focused on the crucial importance of low prices and price cutting in free market competition.⁴⁹ To avoid needless over-deterrence of price cutting, Areeda and Turner advocated a cost-based test for detecting actionable predatory pricing that would eliminate what had proven to be the often futile search for "predatory intent."⁵⁰ The authors proposed that the seller's average variable cost⁵¹ for the goods sold in the suspect sale should be the test for predation.⁵² Applying that test, a price above average variable cost would be conclusively presumed to be non-predatory and a price below average variable cost would be conclusively presumed to be predatory.⁵³ The thinking of the authors was that fixed costs are irrelevant to a seller's pricing decision because the seller has no ability to avoid those costs. Thus, selling at any price above the total of the avoidable costs divided by the number of units produced (which is known as "average variable cost") was rational, meaning

46. See, e.g., *Forster Mfg. Co. v. FTC*, 335 F.2d 47, 52-53 (1st Cir. 1964); see also 16B JULIAN O. VON KALINOWSKI, *BUSINESS ORGANIZATIONS: ANTITRUST LAWS AND TRADE REGULATION* § 10.01[2], at 10-4 (1996) ("The traditional model of predatory pricing . . . which resulted in a number of verdicts against large businesses was that a dominant firm in a particular market could cut prices . . . while relying on 'deep pocket' resources . . . [and then] raise prices to a monopoly level."). Judge Robert H. Bork acknowledged the perceived view of predation by stating that "[t]here was a time not so long ago when everybody knew that the great American trusts had established and maintained monopoly positions by the ruthless extermination of smaller rivals." ROBERT BORK, *THE ANTITRUST PARADOX* 145 (1978). Julian von Kalinowski also acknowledged the "traditional formulation of the efficacy of predatory pricing as a tool for monopolization." VON KALINOWSKI, *supra*, at 10-4. The early case law showed the willingness of courts to find predation. See, e.g., *Standard Oil Co. v. United States*, 221 U.S. 1, 70-77 (1911); *Reynolds Metals Co. v. FTC*, 309 F.2d 223, 229-30 (D.C. Cir. 1962).

Areeda and Turner criticized the "exaggerated fears that large firms will be inclined to engage in [predatory pricing]." Areeda & Turner, *supra* note 36, at 698; see *infra* note 47. The efficacy of the practice was also questioned in Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 268 (1981) ("The predator must make a substantial investment with no assurance that it will pay off.").

47. See Areeda & Turner, *supra* note 36, at 699 (questioning the frequency of predatory pricing violations); *id.* at 698-99 (challenging the effectiveness of predatory pricing because satisfying the two prerequisites is unlikely); *id.* at 699 (cautioning that extreme care should be taken in formulating predatory pricing rules or else legitimate competitive pricing may be deterred).

48. See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) ("[P]redatory pricing schemes are rarely tried, and even more rarely successful."); see also *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 121 n.17 (1986). The Court's fear that prohibiting price cutting too broadly would produce the "perverse result" of inhibiting price competition is further expressed in *Cargill*, 479 U.S. at 116, and *Brooke Group*, 509 U.S. at 220-27.

49. Areeda & Turner, *supra* note 36, at 710-11.

50. The article was an attempt to formulate a clear test that courts could use to distinguish between predatory and competitive pricing because "[c]ourts in predatory pricing cases have generally turned to such empty formulae as . . . predatory intent in adjudicating liability . . . [which] provide little, if any, basis for analyzing the predatory pricing offense." *Id.* at 699.

51. See *supra* notes 34-35 and accompanying text (discussing the concept of average variable cost).

52. Areeda & Turner, *supra* note 36, at 716-18.

53. *Id.* at 711-12.

that the seller would gain added revenue in the short run. These low, but above average, variable cost prices would also benefit consumers,⁵⁴ as lower prices almost always do.

With its 1986 opinion in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,⁵⁵ the United States Supreme Court adopted the general premises and analysis of predatory pricing developed by Areeda and Turner.⁵⁶ The Court subsequently repeated those views in *Cargill, Inc. v. Monfort of Colorado, Inc.*⁵⁷ and *Brooke Group*.⁵⁸ However, the Court repeatedly has declined to adopt the average variable cost standard advocated by Areeda and Turner because it was unnecessary to do so to decide the cases at bar.⁵⁹

While the law of predatory pricing in the Ninth Circuit prior to the Areeda and Turner article was ambiguous,⁶⁰ that court readily adopted the views in that article shortly after its publication.⁶¹ On the crucial issue of the measurement of cost, the court's opinion, in *Hanson v. Shell Oil Co.*,⁶² went further than Areeda and Turner and adopted a cost-based test for predation that allowed greater freedom to sellers in pricing products for sale. The *Hanson* court held that, generally, there was a conclusive presumption that any price above average variable cost was nonpredatory, while there was only a rebuttable presumption that prices below average variable cost

54. *Id.* at 711. Of course, eventually the seller must realize enough revenues from its sales to pay the fixed costs as well. *Id.* at 700. The authors acknowledged that "marginal costs," which are discussed in notes 36-37, *supra*, would be a more accurate standard of costs to use for their test. *Id.* at 701-02. The difficulty of measuring marginal costs, however, led the authors to advocate average variable costs as an acceptable surrogate measure for determining if a price was predatory. *Id.* at 712 n.37.

55. 475 U.S. 574 (1986).

56. See *Matsushita Elec. Indus.*, 475 U.S. at 588-90.

57. 479 U.S. 104 (1986).

58. See *infra* notes 58-59, 77-78 and accompanying text (discussing *Brooke Group*).

59. In *Brooke Group*, the parties stipulated that average variable cost would be the applicable standard for determining predation. *Brooke Group*, 509 U.S. at 222 n.1. In *Matsushita*, the Court declined to resolve the cost-standard issue. The Court said that because *Matsushita* was a Sherman Act section 1 case, it was "enough to note" that an injury resulting from conspiracy occurred due to "pricing below some appropriate measure of cost." *Matsushita Elec. Indus.*, 475 U.S. at 584-85 n.8 & n.9. In *Cargill*, the Court said the general definition of predatory pricing as "pricing below cost" was "sufficient" for their purposes, since "only below-cost pricing would threaten to drive [the plaintiff] from the market . . . and because [the plaintiff] made no allegation that [the defendant] would act with predatory intent." *Cargill, Inc.*, 479 U.S. at 117-18 n.12.

60. See *Janich Bros.*, 570 F.2d at 856 ("[O]ur court has been less than clear in formulating a succinct, definitive test to determine predatory pricing."). It appears there were no previous Ninth Circuit opinions that dealt specifically with the predatory pricing standard.

61. See *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1358-59 (9th Cir. 1976) (explaining that there must be proof of Areeda and Turner's "below average variable cost" test in order to demonstrate predation); see also *id.* at 1358 n.5 (citing Areeda and Turner's view that it is questionable whether or not pricing below a profit maximizing point above marginal and average variable costs should be predatory).

62. See *id.* at 1358 (rejecting the plaintiff's allegation that Shell's pricing policy was part of an attempt to monopolize by affirming a judgment for Shell Oil).

were.⁶³ Thus, the *Hanson* court would always allow a defendant seller to rebut the presumption by proving it had a legitimate business motive for selling at a below average variable cost price.⁶⁴ A year after the *Hanson* opinion, the court specifically used the average variable cost standard to uphold a directed verdict in favor of the defendant when the plaintiff failed to produce adequate evidence establishing the average variable cost of the defendant.⁶⁵

Following its apparent adoption of the Areeda and Turner position, the Ninth Circuit retreated from this position to authorize the admission of evidence of predatory intent that was not based on a comparison of the defendant's price to its costs ("noncomparison evidence") in certain situations. The *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*⁶⁶ opinion held that a price above the defendant seller's average variable cost could be proven to be predatory on the basis of non-comparison evidence.⁶⁷ The court specifically limited this rule to situations in which the defendant's above average variable cost price was below its average total cost,⁶⁸ and the plaintiff was given the burden of persuading the jury that the defendant was motivated by predatory intent.⁶⁹ This burden could be discharged by "demonstrating that the anticipated benefits of defendant's pricing were dependent upon its tendency to discipline or eliminate competition and thereby enhance . . . the benefits of monopoly power,"⁷⁰ a practice commonly referred to as "limit pricing."

The *William Inglis & Sons Baking* court took no position on whether noncomparison evidence was admissible to prove predation if the defendant's price equaled or exceeded its average total costs.⁷¹ On another predation issue, the opinion contained

63. *Id.* A rebuttable presumption is implied by the court's language which states that "[t]here may be nonpredatory and acceptable business reasons for a firm engaging in such [below average variable cost] pricing." *Id.* at 1359 n.6.

64. *Id.* The court explained that pricing below average variable cost was not per se predatory, but rather a necessary element for a prima facie showing of an intent to monopolize. However, the court did not list any acceptable nonpredatory business reasons that could be used to defeat the claim.

65. *Janich Bros.*, 570 F.2d at 858-59. The opinion indicated a readiness to adopt the position that no price above average variable cost could be held to be predatory. *Id.*

66. 668 F.2d 1014 (9th Cir. 1981).

67. *William Inglis & Sons Baking*, 668 F.2d at 1035-36, 1038-39.

68. *Id.* at 1035-36.

69. *Id.* Note that Areeda and Turner had denigrated the concept of predatory intent, labeling it one of a number of "empty formulae." See Areeda & Turner, *supra* note 36, at 699.

70. *William Inglis & Sons Baking*, 668 F.2d at 1038-39; see *id.* (noting also that the noncomparison evidence must be examined as a whole and that the evidence of predatory intent introduced at the trial below was inconclusive). The noncomparison evidence offered by the plaintiff included: a report by a management consulting firm commissioned by defendant Continental that recommended competitive strategies, semi-annual sales reports prepared by Continental account executives, and documentary evidence that Continental personnel in northern California sought "market dominance." *Id.* at 1038-39. This evidence did not tend to prove predatory intent in the opinion of the *Inglis* court. *Id.*

71. *Id.* at 1035 n.30 ("We express no opinion on the permissibility of [a claim of predation in price above average total cost situations].").

dicta stating that proof that the defendant's price was below average variable cost would produce only a rebuttable presumption of price predation.⁷²

The subject of predation and above average total cost pricing was reconsidered by the Ninth Circuit two years later in *Transamerica Computer Corp. v. IBM Corp.*⁷³ There, the court squarely held that above average total cost pricing by a defendant could be predatory.⁷⁴ The court offered evidence of limit pricing as a general example of noncomparison evidence that would be admissible. A firm engaging in limit pricing charges a price lower than competition would force it to, thereby forgoing revenues in order to either restrict the sales of existing market competitors or send a false signal to potential market entrants indicating low profitability in the market.⁷⁵ The view of predatory pricing taken by the *Transamerica Computer* court was apparently premised on the traditional assumptions that predatory pricing was common, efficient, and could be broadly prohibited without harm to the competitive process. Three years after *Transamerica Computer*, the United States Supreme Court handed down *Matsushita Electric Industrial* which expressly rejected those assumptions.⁷⁶ At present, the run of United States Supreme Court opinions beginning with *Matsushita Electric Industrial* and ending with *Brooke Group* makes the *Transamerica Computer* position on predation and above average total cost pricing untenable.⁷⁷

As the law in the Ninth Circuit now stands, if the defendant seller's prices are above average total cost, no price predation can be found.⁷⁸ If the defendant's prices

72. *Id.* at 1036. However, the court stated that it is unlikely that pricing below average variable cost will be legitimate since the firm will be incurring out of pocket losses on each unit sold. *Id.* at 1035. Compare *id.* with *Areeda & Turner*, *supra* note 36, at 733 (asserting that proof of below average variable cost pricing establishes a conclusive presumption of unlawful predatory pricing).

73. 698 F.2d 1377, 1386 (9th Cir. 1983).

74. *Transamerica Computer*, 698 F.2d at 1386-88. The *Transamerica* court stated, "The logic of the *Inglis* approach applies with equal force in evaluating prices above average total cost." *Id.* at 1388. The opinion holds that the plaintiff's evidence of noncomparison evidence of predatory intent would have to be "clear and convincing" to support a jury finding of predation. *Id.*

75. The *Transamerica Computer* court presented three reasons for its hesitation to declare prices above average total cost as legal per se. First, limit pricing could occur at above average total cost. *Id.* at 1387. Second, it was "unwise" to base conclusions solely on a price/cost analysis, since "uncertainty and imprecision" are "inherent in determining 'costs.'" *Id.* Finally, a rule that prices above average total cost are presumed legal would create a "free zone" in which monopolists could "exploit their power without fear of scrutiny by the law." *Id.*

"Limit pricing" was defined as a situation "in which a monopolist sets prices above average total cost but below the short-term profit-maximizing level so as to discourage new entrants and thereby maximize profits over the long run." *Id.* at 1387 (citing 3 PHILLIP AREEDA & DONALD TURNER, ANTITRUST LAW ¶ 714b (1978)). The court cited *California Computer Products, Inc. v. IBM Corp.*, 613 F.2d 727, 743 (9th Cir. 1979), as support for the principle that limit pricing could be held predatory. *Transamerica Computer*, 698 F.2d at 1387, 1389 n.19.

76. See *supra* notes 56, 59 and accompanying text (discussing *Matsushita Electric Industrial*).

77. See *Brooke Group*, 509 U.S. at 223-24. The Court in *Brooke Group* clearly reaffirms the *Areeda* and *Turner* view. *Id.* The opinion states that only prices below some appropriate measure of cost can be held predatory. *Id.* at 224-26. Because the highest appropriate measure of costs is average total cost, no price over it could be considered predatory after *Brooke Group*.

78. Although the post-*Transamerica Computer* test for cost in the Ninth Circuit recognized a cause of action based on prices above average total cost, *Brooke Group* forecloses a predatory pricing claim based on prices above average total cost. Acknowledging that the *Matsushita Electric Industrial* and *Cargill* opinions "suggest that only

are between average variable cost and average total cost, price predation can be found if the plaintiff meets the burden of proving, through noncomparison evidence, that the defendant was motivated by predatory intent.⁷⁹ However, the concept of non-comparison evidence that proves predatory intent remains vague.⁸⁰ Finally, if the defendant's price is below average variable cost, the defendant will be held to have engaged in predatory pricing unless the defendant can persuade the jury that the defendant did not intend to eliminate competitors and obtain a monopoly.⁸¹

There are a number of subsequent Ninth Circuit opinions developing important points for the application of the above noted main principles. These opinions consider the proper calculation of average variable cost and what type of noncomparison evidence should be admitted to prove predation.

In three decisions handed down since *Transamerica*, the Ninth Circuit has set out an additional requirement for designating a cost as "variable" and includable in the calculation of a defendant seller's average variable cost. Starting with *Marsann Co. v. Brammall, Inc.*⁸² in 1986, the court stated that only "unique costs" incurred specifically in relation to the production and distribution of the identified added units of a defendant's output can be included in the defendant's total variable cost.⁸³ This restrictive concept is much narrower than the traditional definition of variable costs, which includes all costs incurred only because the seller chose to make and distribute more than one unit of the particular product involved in the sales at issue.⁸⁴

below-cost prices should suffice" as a basis for a predatory pricing cause of action, the Court in *Brooke Group* effectively overrules decisions holding above average total cost prices predatory. *See id.* at 233.

79. *See William Inglis & Sons Baking*, 668 F.2d at 1035-36.

80. *See supra* text notes 71-72 and accompanying text; *see also infra* notes 87-94 and accompanying text.

81. *See William Inglis & Sons Baking*, 668 F.2d at 1038-39.

82. 788 F.2d 611 (9th Cir. 1986).

83. *Marsann*, 788 F.2d at 612-14. In *Marsann*, the defendant sold the service of straightening large rolls of such materials as paper, steel, and tin steel so that the materials could be used in manufacturing processes. Processors hired the defendant to use its equipment and expertise to straighten malfunctioning rolls of these materials.

The majority of the *Marsann* court held that expenses incurred to generally increase defendant's output of services could not be included in the total variable costs of the defendant. The majority's rationale was that under applicable precedent, only the sales at issue constituted the "product." Thus, only costs specifically incurred to produce and distribute the specific services that had allegedly been sold below cost (*i.e.*, the "product") could be included in a computation of variable costs. *Id.* at 614-15. This requirement that all variable cost must be "unique" to, or "uniquely incurred" for, the sales at issue has been criticized. David L. Siddall, Comment, *Antitrust Law-Predatory Pricing: A Ninth Circuit Wrinkle: Marsann Co. v. Brammall, Inc.*, 12 J. CORP. L. 765, 776-80 (1987).

In an insightful concurring opinion, Judge Choy maintained that the majority's definition of product was incorrect. He pointed out that variable costs generally include any type of cost, the total of which varies with defendant's level of output of the service, not just the specific amount of costs uniquely incurred in making the sales at issue. *Marsann*, 788 F.2d at 615-16. According to Judge Choy, when a *prima facie* case of predation has been established, any argument for adjusting the average variable cost figure for sales made to a particular customer constitutes an affirmative defense. As such, it is the defendant's burden to prove which costs were unnecessary to the output of goods or services for that customer. Otherwise, Judge Choy asserts, an unreasonable burden is placed on a plaintiff attempting to prove predatory pricing since noncomparison evidence is "rarely available." *Id.* at 617.

84. After the first unit is made, the total amount of variable costs will vary with the level of the producer's output.

Under the "unique cost" concept, expenses generally incurred in supplying the product that cannot be specifically earmarked as incurred to make the particular sale are excluded from variable costs.⁸⁵ Thus, "heating, telephone, supervisors, display space, . . . and supplies" not shown to have been necessary solely for the production, as well as the distribution, of the specific output sold in the allegedly predatory price sale have been excluded from variable costs by the Ninth Circuit.⁸⁶ In all but a few cases the unique cost requirement for variable cost computation will reduce the average variable cost figure so low that the price of the sale at issue will exceed it. This means that in the Ninth Circuit few, if any, predatory price sales will be found on the basis of price-cost comparison evidence.

While the Ninth Circuit has addressed the subject of what noncomparison evidence will support a finding of predatory pricing when the defendant's price was above average variable cost,⁸⁷ noncomparison evidence proving predatory intent has never been admitted as evidence in a reported case. The discussion to follow assumes that there is still viability to the Ninth Circuit rule that pricing can be predatory even when the price at issue exceeds average variable cost. This is a weak assumption given the United States Supreme Court's views announced, most recently, in *Brooke Group*. However, the noncomparison evidence concept will continue to be important because in cases where the price of the sale at issue is below average variable cost, noncomparison evidence will be relevant on the issue of predatory intent.⁸⁸

Two Ninth Circuit opinions have discussed limit pricing as noncomparison evidence. In *Zoslaw v. MCA Distributing Corp.*,⁸⁹ the court restated the idea that if the proof showed defendant's price was above its average variable cost, predation could still be proven, but "it is the plaintiff's burden to prove that the defendant 'sacrificed greater profits or incurred greater losses than necessary in order to eliminate the plaintiff.'"⁹⁰ In *Airweld, Inc. v. Airco, Inc.*,⁹¹ the court followed *Zoslaw* and *William Inglis & Sons Baking*, quoting the same phrase to endorse the idea that a defendant's above average cost price could be proven to be predatory by proof that the defendant sacrificed revenues in order to destroy or deter a competitor.⁹² Other

85. *Id.* at 612.

86. See *William Inglis & Sons Baking Co. v. Continental Baking Co. Inc.*, 942 F.2d 1332, 1336 (9th Cir. 1991); see also *Scripto-Tokai Corp. v. Gillette Co.*, No. CV-91-2862-LGB(JRX), 1994 WL 746072, at *3-4 (C.D. Cal. Sept. 9, 1994) (discussing and applying the "uniquely incurred" concept).

87. It should be recalled that only prices below average total cost can be illegal. Therefore, the topic of noncomparison evidence to prove predatory intent is only relevant in cases in which the defendant has charged a price above average variable cost and below average total cost.

88. See *supra* notes 67-72 and accompanying text (discussing *William Inglis & Sons Baking*). Of course, as long as the unique cost concept remains part of the Ninth Circuit concept of average variable cost, there will be few cases in which the defendant's price is below its average variable cost.

89. 693 F.2d 870 (9th Cir. 1982).

90. *Zoslaw*, 693 F.2d at 888 (quoting *William Inglis & Sons Baking*, 668 F.2d at 1036).

91. 742 F.2d 1184 (9th Cir. 1984).

92. *Airweld*, 742 F.2d at 1193.

opinions have noted the possibility of self-incriminating memos as relevant evidence of predatory intent.⁹³

The uncertainty of the idea of "intent" in the predatory pricing context continues to be a central problem. Firms set prices to win sales from competitors, and the question of whether elimination of one or more of those competitors is an unforeseen result or a primary motive will always be difficult. Areeda and Turner argued against consideration of noncomparison evidence on the issue of predatory intent because of this uncertainty,⁹⁴ and many courts have expressed sympathy with their view.⁹⁵ The vague concept of noncomparison evidence, the uniquely incurred cost requirement, and the seeming incompatibility between Ninth Circuit opinions such as *William Inglis & Sons Baking* and *Transamerica Computer* and the strong dicta in *Brooke Group* make predatory pricing law in the Ninth Circuit problematic, at best.

C. The UPA Cost Concept

As stated at the beginning of this Article, the major difference between the federal predatory price concept and that contained in the UPA is the different measurements of cost under the statutes.⁹⁶ The UPA cost measure, which is clearly set forth in a comprehensive statute, employs a "fully allocated cost" measure to determine a seller's cost for the crucial price-cost comparison.⁹⁷ This measure is the same as the economist's term "average total cost," and it includes a reasonably allocated portion of fixed costs into the measurement of average costs. The UPA expressly includes either allocations of "overhead expense" or "cost of doing business" in the defendant's cost.⁹⁸ Those terms expressly include: "labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling costs, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance and advertising."⁹⁹

93. See *Transamerica Computer*, 698 F.2d at 1385 n.8 (citing Lawrence Sullivan, *Economics and More Humanistic Disciplines: What are the Sources of Wisdom for Antitrust?*, 127 U. PA. L. REV. 1214, 1229-30, 1232 (1977)); see also *Marsann*, 788 F.2d at 617 (Choy, J., concurring).

94. Areeda & Turner, *supra* note 36, at 699.

95. See, e.g., *Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc.*, 735 F.2d 884, 890-91 (5th Cir. 1984); *Northeastern Tel. Co. v. American Tel. & Tel. Co.*, 651 F.2d 76, 88 (2d Cir. 1981). In these opinions and in the many opinions cited in them, the courts' sympathy for the Areeda and Turner view does not compel the opinion to adopt the strict cost-price comparison standards of those authors.

96. See *supra* notes 4-10 and accompanying text.

97. CAL. BUS. & PROF. CODE § 17026 (West 1987). Section 17026 gives the following cost formulas: for production (manufacturers or producers), cost = raw material costs + labor costs + "all overhead expenses"; for distribution (wholesalers or retailers), cost = either invoice or replacement cost, whichever is lower + "cost of doing business," or a 6% markup if cost of doing business is indeterminable.

98. *Id.* § 17029 (West 1987). "Overhead expense" refers to allocated fixed costs of a manufacturer and "cost of doing business" refers to the allocated fixed costs of a distributor. See *id.*

99. *Id.*; see *id.* (including the terms quoted above in the text "without limitation").

The UPA does not set out a method for determining the allocation of overhead expense. To be legally acceptable, however, the allocation of overhead to a given product or distribution activity must be reasonably related to the burden that product or activity imposes on the overall cost of doing business.¹⁰⁰ A defendant may refute below cost pricing charges by demonstrating that its own reasonable cost methods show the prices were actually above cost.¹⁰¹ The fully allocated cost method will make the crucial cost figure significantly higher under the UPA than will the variable cost figure used under the federal statutes.¹⁰² The difference will be extreme in the Ninth Circuit which follows the "uniquely incurred" cost concept.¹⁰³ Therefore, low-price selling permitted under Ninth Circuit federal predatory price prohibitions may well be prohibited by the UPA.

In *Turnbull & Turnbull v. ARA Transportation, Inc.*,¹⁰⁴ the court held that the cost formula employed by the UPA does not conflict with the standard used in applying the federal antitrust laws and is not preempted by those laws.¹⁰⁵ The cost measure in the UPA simply sets a different standard than that used for federal statutes, and the fully allocated cost formula is reasonably related to legislative intent to prevent monopolies. Specifically, the UPA cost measure prevents multi-product companies from allocating all overhead expenses away from one product to others, charging very low prices for that product, and thereby forcing all smaller, single-product competitors out of the market.¹⁰⁶

In UPA litigation, a plaintiff has the benefit of several provisions of the Act that offer assistance in proving the defendant's costs. The most straightforward proof a plaintiff could produce would be testimony from a certified public accountant who had examined the defendant's books and calculated the overhead using the generally accepted accounting principles agreed upon by the profession.¹⁰⁷ If actual overhead cost information is unobtainable, California Business and Professions Code § 17072

100. *Turnbull & Turnbull v. ARA Transp., Inc.*, 219 Cal. App. 3d 811, 822, 268 Cal. Rptr. 856, 862 (1990). Allocation of out-of-state advertising expenses was an issue in *Western Union Fin. Svcs., Inc. v. First Data Corp.*, 20 Cal. App. 4th 1530, 25 Cal. Rptr. 2d 341 (1993). In that case, Western Union sued its competitor for UPA violations, alleging below-cost sales of money transfer services within California. The appellate court affirmed the trial court's cost analysis, which excluded advertising costs incurred outside California from the allocated overhead cost figure for California sales. *Id.* at 1539, 25 Cal. Rptr. 2d at 346.

101. *Turnbull & Turnbull*, 219 Cal. App. 3d at 823, 268 Cal. Rptr. at 863.

102. See *supra* notes 48-60, 99-101 and accompanying text.

103. See *supra* notes 82-88 and accompanying text.

104. *Turnbull & Turnbull*, 219 Cal. App. 3d at 822, 268 Cal. Rptr. at 862-63.

105. *Id.* at 823-26, 268 Cal. Rptr. at 862-65. The decision specifically involved the Sherman Act, but there is no difference between that statute and the RPA for the purpose of determining a state law/federal law conflict.

106. *Id.* at 822, 268 Cal. Rptr. at 862-63.

107. The discovery sections of the UPA and the liberal general California discovery statutes provide for the discovery of defendant's books for this purpose. CAL. BUS. & PROF. CODE §§ 17083, 17084 (West 1987); CAL. CIV. PROC. CODE §§ 2016-2036.5 (West Supp. 1996); see, e.g., *Tri-Q, Inc. v. Sta-Hi Corp.*, 63 Cal. 2d 199, 204, 404 P.2d 486, 488, 45 Cal. Rptr. 878, 886 (1965) (appointing a certified public accountant to examine the defendant's books after a stipulation by the parties).

allows the use of cost surveys for the defendant's vicinity as evidence in proving cost.¹⁰⁸

Four methods for proving that the defendant's contract price for providing bus services for handicapped children were below cost were noted in *Turnbull & Turnbull*.¹⁰⁹ An economist, specializing in the transportation industry, testified for the plaintiff to establish that under each of the following computations the defendant's bid price was below its contract price: (1) A comparison of the defendant's net revenue in the location where the alleged below cost pricing took place with the defendant's net revenue from other locations, (2) a comparison of revenues per mile between defendant's contracts within the same county, (3) a comparison between a recomputation of defendant's costs based upon national surveys of bus operations cost data and the defendant's bid price, and (4) a comparison between a total expense figure for defendant's services based upon a reallocation of defendant's cost figures and its bid price. All four methods were apparently valid to the appellate court which said that in order for the allocation of overhead costs to a particular product or service to be "legally acceptable," the allocation "must be reasonably related to the burden such product or service imposes on the overall cost of doing business."¹¹⁰ A defendant is free to challenge the plaintiff's computation with its own overhead cost allocation by "using another reasonable allocation method."¹¹¹

The UPA also provides that discounts the defendant actually received for prompt payment of debts cannot be taken into account in computing the defendant's cost.¹¹² Volume purchase discounts, called "trade discounts," have been distinguished from prompt payment discounts by court interpretation.¹¹³ Volume discounts are considered reductions in the sales price, and must be reflected in any computation of the defendant seller's cost.¹¹⁴

Several other UPA provisions assist the plaintiff in proving the defendant's cost. California Business and Professions Code § 17074 provides that proof of transportation tariffs are presumptive evidence of delivery costs;¹¹⁵ § 17076 requires that the prevailing wage rate be used to compute the defendant seller's labor cost, even if the defendant pays its employees less than the prevailing wage,¹¹⁶ and § 17077 provides that if raw materials were obtained for nonmonetary consideration not easily valued,

108. See CAL. BUS. & PROF. CODE § 17072 (West 1987) (establishing that a "cost survey for the locality and vicinity" is competent evidence to prove defendant's costs). But see *Johnson v. Farmer*, 41 Cal. App. 2d 874, 878-79, 107 P.2d 959, 961-62 (1940) (rejecting a cost survey because it had no relevance to defendant's situation and costs); McCarthy, *supra* note 10, at 178 (discussing how cost is proven).

109. *Turnbull & Turnbull*, 219 Cal. App. 3d at 816, 268 Cal. Rptr. at 858.

110. *Id.* at 822, 268 Cal. Rptr. at 862-63.

111. *Id.* at 823, 268 Cal. Rptr. at 863.

112. CAL. BUS. & PROF. CODE § 17026 (West 1987). One interesting statutory exception is discounts given by cigarette manufacturers, if offered on a general basis. See CAL. BUS. & PROF. CODE § 17026.5 (West 1987).

113. See *United States v. California Portland Cement Co.*, 413 F.2d 161, 172-74 (9th Cir. 1969).

114. See *E & H Wholesale, Inc. v. Glaser Bros.*, 158 Cal. App. 3d 728, 734, 204 Cal. Rptr. 838, 843 (1984).

115. CAL. BUS. & PROF. CODE § 17074 (West 1987).

116. *Id.* § 17076 (West 1987).

the prevailing market rates for those raw materials can be used to calculate costs.¹¹⁷ These presumptions shift the burden of producing evidence in many cost issues, requiring a defendant to produce definitive costs to overcome the statutory presumptions.

D. Summary

In any litigation in which the plaintiff alleges that the defendant made a sale below cost, it is a very significant benefit for the plaintiff to have the applicable law require that the figure for the defendant's cost be high. This is the net effect of the UPA provisions when compared with the applicable cost concept developed by federal courts under section 2 of the Sherman Act or section 2(a) of the RPA.¹¹⁸ Because overhead expense is often a large component of average total cost, the UPA figure for defendant's cost will often be much higher than the comparable federal antitrust figure. In the Ninth Circuit the difference between the defendant's cost figure in a UPA cause of action and the comparable figure in a federal antitrust action is even greater because the circuit presently follows the "unique cost" concept in calculating the defendant's variable costs.¹¹⁹ The distinct advantage a plaintiff has in proving a high figure for the defendant's cost in a UPA action, as opposed to a plaintiff in a federal antitrust action, is further enhanced because of the various statutory presumptions contained in the UPA.¹²⁰

II. COMPARISON OF OTHER ASPECTS OF FEDERAL ANTITRUST LAWS WITH THE CALIFORNIA UNFAIR PRACTICES ACT

A. Federal Statutes

Section 2 of the Sherman Act makes it unlawful to "monopolize" any relevant market.¹²¹ To show a violation, the plaintiff must prove that the defendant engaged in strongly disfavored or "tainted" conduct in obtaining or maintaining its market share and that the defendant has a monopoly share of the relevant market or something approaching it.¹²² Courts have had a difficult time formulating appropriate terms for the "conduct element," and the test for this element has been described as a determination whether the defendant monopolist's conduct or business practices

117. *Id.* § 17077 (West 1987).

118. *See supra* notes 44-84 and accompanying text.

119. *See supra* notes 85-88 and accompanying text.

120. *See infra* notes 154-71 and accompanying text.

121. 15 U.S.C.A. § 2 (West Supp. 1996).

122. *See United States v. Aluminum Co. of America*, 148 F.2d 416, 432 (2d Cir. 1945). Note that the fact and amount of damage suffered by the plaintiff in a private enforcement action is not part of the proof of a violation. *See infra* Part II.B.4. (discussing proof of damages).

were “exclusionary;”¹²³ or were “something other than the exercise of skill, industry or foresight.”¹²⁴ or, in the latest formulation, were “not related to any apparent efficiency.”¹²⁵ While a lasting statement of the test for the element has yet to appear, courts have long held that proof of “predatory pricing” by a monopolist satisfies the conduct element.¹²⁶

The second element of the offense of monopolization requires proof that the defendant possesses monopoly power in the particular market in which it engaged in the particular conduct that is the subject of the plaintiff’s complaint. This “power element” often causes difficulty for the plaintiff seeking to privately enforce section 2 of the Sherman Act because proving or “defining” the relevant market is frequently a daunting task.¹²⁷ It can also be difficult to determine the exact amount of total sales in that market, so that the defendant’s share of those sales can be calculated. Under the UPA there is no power element, and the process of market definition is not a concern. While the UPA requires proof of conduct, that conduct, selling below cost, is well defined in the Act.¹²⁸

Under section 2(a) of the RPA, difficulties are caused by the precise demands of the statute. The plaintiff must prove (1) discrimination by the seller (requiring at least one sale at favorable terms and at least one sale at unfavorable terms), (2) in completed sales (as opposed to lease) transactions, (3) involving goods (as opposed to services, intangibles, or land), (4) in the course of interstate commerce (meaning one of the sales must involve shipment by the seller over a state line to the buyer), (5) that produced a certain type of anticompetitive effect.¹²⁹ The predatory price concept has been important under section 2 of the RPA only because federal courts have held that if predatory price selling occurs, the final anticompetitive effect element of a cause of action under section 2(a) may be established.¹³⁰ None of the first four

123. *United States v. United Shoe Machinery*, 110 F. Supp. 295, 342 (D. Mass. 1953), *aff’d per curiam*, 347 U.S. 521 (1954). Judge Wyzanski relied upon the opinion in *United States v. Griffith*, 334 U.S. 100 (1948), *overruled in part by Copperweld Corp. v. Independent Tube Corp.*, 467 U.S. 752 (1984), as support for the term. It is a fair extrapolation from Justice Douglas’s opinion in *Griffith*. However, that opinion does not use the precise adjective. *See Griffith*, 334 U.S. at 106-10.

124. *Aluminum Co. of America*, 148 F.2d at 430. The famous opinion by Judge Learned Hand discussed the conduct element at length. *Id.* at 429-32.

125. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608 n.39 (1985); *see infra* notes 126-93 and accompanying text (discussing the conduct element of the monopolization offense). The conduct element of the attempt to monopolize offense has proven to be even more elusive. *See Spectrum Sports v. McQuillan*, 506 U.S. 447, 454-59 (1993).

126. *See supra* Part I.B. (discussing the cost concept in the predatory pricing context of section 2 of the Sherman Act); *see also United States v. American Tobacco Co.*, 221 U.S. 106, 181-83 (1911) (discussing the concept of predatory pricing as an act of monopolization); *Standard Oil Co. v. United States*, 221 U.S. 1, 43 (1911) (discussing how predatory pricing can be an act of monopolization).

127. *See Aluminum Co. of America*, 148 F.2d at 423-27 (describing the importance and difficulty of a market definition under a monopolization charge).

128. *See supra* notes 97-100 and accompanying text.

129. 15 U.S.C.A. § 13(a) (West 1994).

130. *See, e.g., Moore v. Mead’s Fine Bread Co.*, 348 U.S. 115, 118 (1954).

requirements of section 2(a) of the RPA are found in the UPA. The fifth requirement of anticompetitive effect, while an issue in many UPA cases, has been made rather easy for a plaintiff to satisfy because of court interpretations of the Act.¹³¹ Other facets of the law of section 2(a) of the RPA and of section 2 of the Sherman Act that can affect private enforcement actions are discussed in subpart II.B.¹³²

B. The UPA

1. Basic Prohibition and Procedural Concerns

California Business and Professions Code § 17043¹³³ prohibits “any person engaged in business within” the State of California from selling or giving away any article or product at less than cost¹³⁴ for the purpose of injuring competitors or

131. See *infra* notes 150-69 and accompanying text.

132. See *infra* Part II.B.2. (discussing injurious intent); see also *infra* Part II.B.3. (discussing affirmative defenses); *infra* Part II.B.4. (discussing damages).

133. CAL. BUS. & PROF. CODE § 17043 (West 1987).

134. There is presently a possible conflict over whether the sale below cost must occur within the state of California. Both present case law and present policy indicate that an in-state sale is required, but the issue is not foreclosed at this time.

In *Amarel v. Connell*, 202 Cal. App. 3d 137, 145, 248 Cal. Rptr. 276, 280 (1988), the court was concerned with whether California Business and Professions Code § 17043, of the UPA, was preempted by the Sherman Act in connection with a transaction that involved foreign commerce. *Id.* at 145-50, 248 Cal. Rptr. at 280-84. Although a sale to a government agency of the Republic of Korea was involved, the court did not address the issue of whether the allegedly below cost sale took place outside California. The opinion holds there was no preemption. *Id.* at 146, 248 Cal. Rptr. at 281. Since the delivery of rice, the product involved, would be outside the state, it could be argued that the opinion is consistent with the view that § 17043 is applicable to sales if the adverse effect of the sale is felt in California by competitors of the predatory price seller.

More recently, opinions in two federal court cases have held that § 17043 only applies to below cost sales made in California. Only one of the opinions was officially reported. In *Vollrath Co. v. Sammi Corp.*, 9 F.3d 1455, 1456-63 (9th Cir. 1993), the court specifically held that § 17043 prohibits only predatory sales made in California. The court thereby sustained the trial court's judgment notwithstanding the verdict based on this holding. *Id.* at 1464. Another district court opinion from the Central District of California has also held that the “engaged in business within this state” phrase requires that title in the sale at issue must pass within California. *California Egg Mktg. Ass'n v. Rose Acre Farms, Inc.*, No. CV 88-1736-RMT(EX), 1991 WL 263533, at *2 (C.D. Cal. Oct. 9, 1991).

Although there is no clearly ascertainable plain meaning of the language of the statute, the modern view of antitrust laws as “consumer protection” statutes would compel the position that the sale must take place in a market in the State of California. This requirement would ensure that only those sales would be protected by the statute and prevent the breakdown in competition that predatory price selling was thought to invariably produce when § 17043 was enacted. Of course, the UPA was enacted at a time when protection of small retailers and wholesalers was important to legislative bodies, this being accepted as one of the reasons for the passage of the RPA in 1936. See *FTC v. Morton Salt Co.*, 334 U.S. 37, 48-50 (1948). However, the announced purpose of the UPA is to protect competition. CAL. BUS. & PROF. CODE § 17001 (West 1987). This statutory purpose has been viewed traditionally as directly contrary to an intent to protect competitors. See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962) (“It is competition, not competitors, which the [Clayton] Act protects.”). But see *Harris v. Capitol Records Distrib. Corp.*, 64 Cal. 2d 454, 461, 413 P.2d 139, 144, 50 Cal. Rptr. 539, 644 (1966) (“Throughout the [UPA] the legislature has manifested its intent to discourage practices which injure the seller's competitors . . .”).

destroying competition.¹³⁵ The definitional sections of the UPA define “person” as an individual, partnership, firm, corporation, or any other business entity.¹³⁶ The term “sell” means an offer or advertising for sale,¹³⁷ and “give” means an offer or advertising with intent to give.¹³⁸ The term “article or product” means any “thing of value,” including “service or output of a service trade,” except for the output of publicly owned utilities or companies in industries subject to government price regulation.¹³⁹ One court has implied that an interest in real property should be considered a “thing of value” under the prohibitions of the Act.¹⁴⁰ Thus, § 17043 has much greater scope than section 2(a) of the RPA, which only applies to completed interstate sales of commodities.¹⁴¹ In addition, the Act contains a specific statutory provision commanding that the entire Act be construed liberally so that its beneficial effects can be achieved¹⁴² and a “catch-all” section that prohibits “any scheme . . . or any device of any nature whereby . . . [a] sale below cost is in substance or fact effected in violation of the spirit and intent of this [Act].”¹⁴³

Causes of action under § 17043 have been maintained in federal courts under the supplemental jurisdiction concept.¹⁴⁴ Furthermore, a meritorious supplemental state claim brought in federal court may be tried later in a state court after all the under-

135. See *infra* Part II.B.2. (discussing the intent to injure competition or destroy competitors requirement, which is easily presumed under California Business and Professions Code § 17071).

136. CAL. BUS. & PROF. CODE § 17021 (West 1987).

137. *Id.* § 17022 (West 1987).

138. *Id.* § 17023 (West 1987); see *id.* § 17046 (West 1987) (stating that it is unlawful to effectuate a violation of the UPA through any threat, intimidation, or boycott).

139. *Id.* § 17024 (West 1987); see *Garner v. Journeyman Barbers' Union*, 223 Cal. App. 2d 101, 107-08, 35 Cal. Rptr. 693, 697-98 (1963) (holding that barber services are covered under the UPA); *Paramount Gen. Hosp. Co. v. National Med. Enters., Inc.*, 42 Cal. App. 3d 496, 503, 117 Cal. Rptr. 42, 48 (1974) (holding that under the UPA lease-service package involving the operation of a hospital was an “article or product”).

140. See *Paramount Gen. Hosp.*, 42 Cal. App. 3d at 502 n.9, 117 Cal. Rptr. at 47 n.9 (stating that “there appears to be no historical reason why . . . interest[s] in real property of one kind or another are not ‘things of value’”); *id.* at 503 n.10, 117 Cal. Rptr. at 48 n.10 (reserving judgment on whether “pure” lease agreements, which do not involve services furnished by the lessor, are covered by the UPA).

141. See 15 U.S.C.A. § 13(a) (West 1994).

142. CAL. BUS. & PROF. CODE § 17002 (West 1987).

143. *Id.* § 17049 (West 1987); see *Paramount Gen. Hosp.*, 42 Cal. App. 3d at 501-02, 117 Cal. Rptr. at 46-47 (relying on the “catch-all” section in holding that the listing of specific types of business practices under prohibitions of the UPA was merely for illustrative purposes and not to be read to limit the application of the prohibition); *Independent Journal Newspapers v. United W. Newspapers, Inc.*, 15 Cal. App. 3d 583, 586, 93 Cal. Rptr. 299, 301 (1971) (interpreting this section to make the UPA applicable to sales below cost that were tied in with sales above cost).

144. See, e.g., *Royal Serv., Inc. v. Goody Prods., Inc.*, No. C88-2758 TEH, 1988 WL 126556, at *1 (N.D. Cal. Sept. 26, 1988); *Kirk-Mayer, Inc. v. Pac Ord, Inc.*, 626 F. Supp. 1168, 1172 (C.D. Cal. 1986); *USA Petroleum Co. v. Atlantic Richfield Co.*, 577 F. Supp. 1296, 1306 (C.D. Cal. 1983). In those cases, the § 17043 claim was maintained under the “pendent jurisdiction” power of the federal court involved. With the enactment of 28 U.S.C. § 1367 in 1990, the pendent jurisdiction concept was subsumed under the more general “supplemental jurisdiction” rubric of § 1367. Section 17043 actions will continue to be readily maintainable with federal court predatory price litigation as a matter of supplemental jurisdiction. See, e.g., *Pantazis v. Fior D'Italia, Inc.*, No. C 94-1094-FMS, 1994 WL 519469, at *2 (N.D. Cal. Sept. 20, 1994).

lying federal claims have been dismissed by the federal forum and the case has been remanded to a state court.¹⁴⁵

The usual rules of pleading and practice apply to UPA causes of action, including the requirement that complaints not be pleaded in vague or conclusory terms.¹⁴⁶ This requirement was taken to a seemingly illogical extreme in a 1971 court of appeal opinion holding that a complaint in a § 17043 action must state the defendant's sales price and the defendant's cost for the unit sold.¹⁴⁷ A later opinion relaxed this pleading requirement somewhat, holding that if it is difficult for a plaintiff to estimate the defendant's cost of doing business, and speculation on the figure is not useful, a general averment on information and belief in the complaint of defendant's will be sufficient.¹⁴⁸

2. Defendant's Injurious Intent

The concept of intent to injure competition in federal predatory price litigation has been minimized in importance over the last twenty years.¹⁴⁹ In the UPA, however, proof that the predatory pricing seller made the offending sales with the intent "of injuring competitors or destroying competition" continues to be specifically required.¹⁵⁰ The injurious intent requirement was apparently established to meet the demands of the United States Supreme Court opinion in *Fairmont Creamery Co. v.*

145. See *Kirk-Mayer*, 626 F. Supp. at 1172-73 (granting summary judgment for defendant on all federal law claims for violation of the Sherman Act, but dismissing without prejudice the related state claims for violation of the UPA); see also *Nishimoto v. Federman-Bachrach & Assocs.*, 903 F.2d 709, 715 (9th Cir. 1990) ("Dismissal of [a] federal claim does not deprive a federal court of the power to adjudicate the remaining pendent [now supplemental] state claims.") (citation omitted).

146. See *Chicago Title Ins. Co. v. Great W. Fin. Corp.*, 69 Cal. 2d 305, 323-24, 444 P.2d 481, 492-93, 70 Cal. Rptr. 849, 860-61 (1968).

147. *Independent Journal Newspapers*, 15 Cal. App. 3d at 586-87, 93 Cal. Rptr. at 302-03.

148. *G.H.I.I. v. MTS, Inc.*, 147 Cal. App. 3d 256, 275-76, 195 Cal. Rptr. 211, 223-24 (1983).

149. The characterization of "predatory intent" by Areeda and Turner as one of a number of "empty formulae" in predatory pricing law signaled a major change in the attitude toward intent as a viable concept in the area. See *Areeda & Turner*, *supra* note 36, at 699. They recommended eliminating intent as a matter of judicial concern because it provided "little, if any, basis for analyzing the predatory pricing offense." *Id.* A few years later the Federal Trade Commission proclaimed that "intent is a barren issue without consideration of the means" used by a low price seller to gain market share. *In re E.I. du Pont de Nemours & Co.*, 96 F.T.C. 653, 727 (1980). A few years after that, then Judge Stephen G. Breyer wrote, "But 'intent to harm' without more offers too vague a standard in a world where executives may think no further than 'Let's get more business,' and long-term effects on consumers depend in large measure on competitors' responses." *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983). The present status of the predatory intent concept is discussed in PHILLIP AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 714.2, at 493-500 (Supp. 1996); see *id.* ¶ 714.2h, at 500 ("[O]ne might still wonder whether the search for it is generally worth the effort, given that it would seldom be helpful.").

150. CAL. BUS. & PROF. CODE § 17043 (West 1987).

Minnesota,¹⁵¹ which was effectively overruled sixty years ago.¹⁵² Although the intent requirement remains in § 17043, it is unimportant as a practical matter.

The UPA assists plaintiffs in § 17043 actions by providing an “injurious intent” presumption in § 17071.¹⁵³ Under this section, proof of a sale below cost “together with proof of the injurious effect of such acts is presumptive evidence of the purpose or intent to injure competitors or destroy competition.”¹⁵⁴ This provision, which was held constitutional in 1944,¹⁵⁵ appears to establish a rebuttable presumption affecting the burden of proof in the terms of the modern California Evidence Code.¹⁵⁶ The effect of such a presumption can be very important because it would entitle a plaintiff in a § 17043 action to a jury instruction to the effect that the jury must find for the plaintiff on the intent issue unless the defendant proves by a preponderance of the evidence that it did not sell below cost with injurious intent.¹⁵⁷

The type of evidentiary proof of injurious effect that will support the presumption of injurious intent was addressed in *Sandler v. Gordon*¹⁵⁸ in 1949. That

151. 274 U.S. 1, 8 (1927), overruled by *Nebbia v. New York*, 291 U.S. 502 (1934); see *id.* (holding that because a Minnesota law prohibited locality discrimination by dairies in the prices the dairies paid for milk without regard to the dairies’ motives, the statute infringed upon a constitutional right to freely contract in a normally beneficial way). In *Wholesale Tobacco Dealers Bureau v. National Candy & Tobacco Co.*, 11 Cal. 2d 634, 658, 82 P.2d 3, 17 (1938), the California Supreme Court found that the UPA required proof of injurious intent, but noted: “It may be that an absolute prohibition regardless of intent would be unreasonable.” *Id.* at 658, 82 P.2d at 17 (citing *Fairmont Creamery Co. v. Minnesota*, 274 U.S. 1 (1927)).

152. *Nebbia v. New York*, 291 U.S. 502, 537-39 (1934). In *Nebbia* the Court upheld a state statute fixing wholesale milk prices, stating: “Price control, like any other form of regulation, is unconstitutional only if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt, and hence an unnecessary and unwarranted interference with individual liberty.” *Id.* at 539. The dissent mentioned and discussed *Fairmont Creamery* as one of a number of precedents the Court had, sub silentio, overruled. *Id.* at 547, 552-53 (McReynolds, J., dissenting); see McCarthy, *supra* note 10, at 187 (discussing *Fairmont Creamery*).

153. See CAL. BUS. & PROF. CODE § 17071 (West 1987). A second injurious intent presumption is established in California Business and Professions Code § 17071.5. *Id.* § 17071.5 (West 1987) That section applies to alleged loss leader sales and is discussed with that topic. See *infra* notes 197-200 and accompanying text.

154. CAL. BUS. & PROF. CODE § 17071 (West 1987).

155. *People v. Pay Less Drug Store*, 25 Cal. 2d 108, 113-14, 153 P.2d 9, 12-13 (1944).

156. See CAL. EVID. CODE §§ 605-06 (West 1987). The California Evidence Code became law in 1967, and no opinion has specifically addressed the question of whether § 17071 creates a presumption affecting the burden of proof or, the less significant, presumption affecting the burden of producing evidence. The test is whether the presumption at issue “implement[s] some public policy other than to facilitate the determination of the particular action.” *Id.* § 605 (West 1987). Section 17071 implements the strong public policy announced in § 17001 of the California Business and Professions Code to “safeguard the public against the creation or perpetuation of monopolies and to foster and encourage competition, by prohibiting . . . destructive . . . practices by which fair and honest competition is destroyed or prevented.” CAL. BUS. & PROF. CODE § 17001 (West 1987). It is thus like the presumptions held to affect the burden of proof in *Fisher v. City of Berkeley*, 37 Cal. 3d 644, 693-97, 693 P.2d 261, 300-03, 209 Cal. Rptr. 682, 721-24 (1984), *aff’d*, 475 U.S. 260 (1986), and *William Dal Porto & Sons, Inc. v. Agricultural Labor Relations Board*, 191 Cal. App. 3d 1195, 1207-12, 237 Cal. Rptr. 206, 212-17 (1987).

157. The text assumes that the plaintiff has offered evidence of the basic facts to establish the § 17071 presumption. Those basic facts are that the defendant made a sale below cost and that the sale diverted business from the plaintiff. If such evidence is introduced at trial, the judge must instruct the jury that if the jury finds it more probable than not that the basic facts are true, the jury must decide the intent issue under the instruction described in the text. CAL. EVID. CODE § 606 (West 1987).

158. 94 Cal. App. 2d 254, 210 P.2d 314 (1949).

opinion held that evidence proving that identified sales were diverted from the plaintiff to the defendant was proof of injurious effect and established the injurious intent presumption.¹⁵⁹ Later opinions have held that it is irrelevant whether such diversion is accomplished by personal solicitation,¹⁶⁰ offers of below cost services when regular priced items are purchased,¹⁶¹ secret rebates,¹⁶² or "low-ball" bidding to secure business at the expense of competitors.¹⁶³ If there is proof of a diversion of traceable sales, injurious effect is established and injurious intent is presumed.¹⁶⁴ A court has also found injurious effect without proof of diversion of traceable sales when the defendant engaged in pervasive below cost selling.¹⁶⁵ However, in cases of occasional below cost sales and in cases in which the plaintiff lost only minimal untraceable sales, no finding of injurious effect can be made.¹⁶⁶

A defendant can rebut the California Business and Professions Code § 17071 presumption of injurious intent by affirmative proof that the below cost pricing was due to good faith mistakes in the defendant's business operations.¹⁶⁷ A defendant who systematically destroyed accounting documents to make it impossible to calculate its costs would not appear to be acting in good faith.¹⁶⁸

159. *Sandler*, 94 Cal. App. 2d at 255-57, 210 P.2d at 315-17. The defendant took the plaintiff's customer list from the plaintiff's delivery truck, then diverted business by offering free (below cost) services to obtain these customers, to the injury of the plaintiff. Although these facts establish the § 17071 presumption, the plaintiff rebutted the presumption. *Id.* at 256-58, 210 P.2d at 315-17.

160. *See, e.g., E & H Wholesale, Inc. v. Glaser Bros.*, 158 Cal. App. 3d 728, 736-37, 204 Cal. Rptr. 838, 843-45 (1984) (discussing testimonial evidence that the defendant's representative personally asked potential customers what they were currently being charged, then beat that price, even though it was below cost).

161. *See Paramount Gen. Hosp. Co. v. National Med. Enters., Inc.*, 42 Cal. App. 3d 496, 499, 117 Cal. Rptr. 42, 45 (1974) (noting that doctors that would have rented space from the plaintiff accepted offers from the defendant because the defendant offered below cost services in connection with their leases).

162. *See G.H.I.I. v. MTS, Inc.*, 147 Cal. App. 3d 256, 267, 195 Cal. Rptr. 211, 218 (1983) (agreeing with the plaintiff's charge that secret rebates were a contributing cause in diverting business from, and thus injuring, the plaintiff).

163. *See Turnbull & Turnbull v. ARA Transp., Inc.*, 219 Cal. App. 3d 811, 815-16, 268 Cal. Rptr. 856, 857-58 (1990).

164. *Id.* Testimony of a buyer that it transferred business to the defendant due to below cost pricing is forceful direct evidence proving diversion and injurious effect. *Id.* A witness testified that the plaintiff's and defendant's services were of equal quality, but the contract was awarded to the defendant because it was the lowest bidder. *Id.*

165. *See Pay Less Drug Store*, 25 Cal. 2d at 111-14, 153 P.2d at 11-13 (holding that selling 400 items below cost for extended periods of time caused injury to competitors and destroyed competition without specifically finding a diversion of business).

166. *See Ellis v. Dallas*, 113 Cal. App. 2d 234, 242, 248 P.2d 63, 68 (1952) (holding that selling three grocery items as loss leaders did not have the effect of diverting trade or injuring any competitors); *see also Dooley's Hardware Mart v. Food Giant Mkts., Inc.*, 21 Cal. App. 3d 513, 517, 98 Cal. Rptr. 543, 545 (1971) (finding no evidence that use of three loss leaders diverted sales or injured competition in general, or as relates to the plaintiff in particular).

167. *See, e.g., Tri-Q, Inc. v. Sta-Hi Corp.*, 63 Cal. 2d 199, 207-08, 424 P.2d 486, 490-91, 45 Cal. Rptr. 878, 882-83 (1965). The defendant's below cost price was due to an error in following the usual procedures when there was no competent cost accounting system for a new product, rather than an intentional act. *Id.*

168. *See id.* at 207, 424 P.2d at 490, 45 Cal. Rptr. at 882; *Turnbull & Turnbull*, 219 Cal. App. 3d at 816-19, 268 Cal. Rptr. at 858.

The opinion in *E & H Wholesale, Inc. v. Glaser Bros.*¹⁶⁹ discusses the types of evidence typically introduced on the issue of injurious intent in a § 17043 action. The president of the defendant corporation attempted to rebut the intent presumption by testimony that it never acted to injure competition. However, the record also contained a deposition of a corporate officer who stated that prices were set regardless of cost, in order to beat competitors' prices by a nominal amount. Due to the conflicting testimony, the court held that the defendant was not entitled to a directed verdict on the issue of intent.¹⁷⁰

3. Affirmative Defenses

Given the current state of Ninth Circuit predatory pricing law under section (2) of the Sherman Act, there would appear to be very little room for any affirmative defenses for a company with a market share in the monopoly range that engages in below average variable cost pricing.¹⁷¹ In a predatory price action under section (2)(a) of the RPA, only the "meeting competition" defense could possibly be statutorily invoked by the defendant.¹⁷² This defense, which applies when a discriminating seller lowers its price to meet the equally low price of a competitor, would apply even to a sale to the favored buyer at a price below cost. Under section 2(b) of the RPA, the defendant would bear the burden of proving the elements of the defense.¹⁷³

California Business and Professions Code § 17050 describes five specific situations in which a seller's below cost selling will not violate § 17043.¹⁷⁴ Each

169. 158 Cal. App. 3d 728, 204 Cal. Rptr. 838 (1984).

170. *E & H Wholesale*, 158 Cal. App. 3d at 736-38, 204 Cal. Rptr. at 844-45.

171. See *supra* notes 79-95 and accompanying text. The Ninth Circuit concept of average variable cost, which is restricted to unique costs, ensures that only in rare, extremely low price sale situations will a plaintiff be able to make a prima facie case. It is inconceivable that the type of extremely low prices needed for a prima facie case in the Ninth Circuit could be defended on the basis that the defendant was meeting the competition from another competitor. It is, in any event, somewhat doubtful that a "meeting competition" defense is available in an action to enforce section 2 of the Sherman Act. See *Union Leader Corp. v. Newspapers of New Eng., Inc.*, 180 F.Supp. 125, 142-43 (D. Mass. 1959), *aff'd in part and amended in part*, 284 F.2d 582 (1st Cir. 1960).

172. There are three statutory defenses theoretically available to a defendant in a predatory price discrimination case under section 2(a) of the RPA. The "changing conditions" defense is always unavailable in any serious charge of predatory pricing. See 15 U.S.C.A. § 13(a) (West 1973). The "cost justification" defense is unavailable today because the United States Supreme Court requires proof that the defendant's price was below its average variable costs. Hence there can be no cost savings on a particular sale that would justify the depth of such price cuts. In any event, the defense has long been rendered a virtual dead letter due to traditional requirements of accounting accuracy the defendant must meet in order to prove the exact amount of its savings. See *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543, 561 n.18 (1990). This leaves only the "meeting competition" defense as a practical possibility in a predatory price action under section 2(a) of the RPA. See *infra* notes 177-83 and accompanying text.

173. See 15 U.S.C.A. § 13(b) (West 1973) (requiring the defendant to prove that the price charged was established to meet the equally low price of a competitor). Under present law, the defendant is still protected by the defense when it undercuts the low price offered by a competitor as long as it acted in a reasonable good faith effort to match the competitor's price. See, e.g., *Great Atl. & Pac. Tea Co. v. FTC*, 440 U.S. 69, 82 (1979); *United States v. United States Gypsum Co.*, 438 U.S. 422, 453 (1978).

174. CAL. BUS. & PROF. CODE § 17050 (West 1987).

establishes a separate affirmative defense, and the defendant seller must plead and prove that the specified fact situation existed at the time it made the challenged sales. The affirmative defense situations described in § 17050 are when a seller is: selling goods in connection with discontinuing its business, selling seasonal or perishable goods after the optimal time for their sale, selling damaged goods, selling goods pursuant to a court order, and selling goods at a low price in a good faith effort to meet a competitor's legal price.¹⁷⁵

Of these affirmative defenses, only the meeting competition defense has been significant in reported cases. The defense is obviously available in situations in which the defendant proves it was pricing below cost to meet the low prices of an identified competitor.¹⁷⁶ Less obviously, the defense is available to a defendant seller who responds to general competition that has driven prices low in the market by pricing its product below cost to meet the market price.¹⁷⁷

The defense requires that the defendant act in good faith to meet the legal prices of a competitor.¹⁷⁸ The good faith requirement is not met if the defendant continues its below cost selling for an unreasonable time after competitors raise their prices.¹⁷⁹ The requirement also does not permit a defendant to lower its price below cost after its competitors have raised their low prices back to normal, higher market levels.¹⁸⁰ Finally, the "legal price" requirement negates the meeting competition defense for a defendant that lowers its prices below cost to meet prices of a competitor when the defendant knows the competitor is violating the UPA by pricing below cost.¹⁸¹ Rather than sanction competitive lawbreaking, the court stated that "[e]ach side must obey

175. *Id.* § 17050 (a)-(e) (West 1987). The meeting competition defense set forth in subsection (d) applies to wholesalers and retailers, and the terms of the defense set forth in subsection (e) apply to manufacturers.

176. *See Sandler v. Gordon*, 94 Cal. App. 2d 254, 255-58, 210 P.2d 314, 315-17 (1949) (awarding judgment against the defendant for violating § 17043 and allowing the plaintiff to use the § 17050 "meeting legal prices" defense for a cross-complaint filed by the defendant). The plaintiff and defendant, both diaper laundry operators, filed complaints alleging various unfair and discriminatory business practices prohibited by the Unfair Practices Act.

177. *See William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 461 F. Supp. 410, 423 (N.D. Cal. 1978), *aff'd in part and rev'd in part*, 82 F.3d 424 (9th Cir. 1996) and 668 F.2d 1014 (9th Cir. 1981). The bakery industry was heavily competitive at the time of the controversy. Prices were dropping industry-wide, and defendant's price decreases were a good faith response to the competition. The court of appeals reaffirmed the district court's decision on this matter. *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1050 (9th Cir. 1981).

178. CAL. BUS. & PROF. CODE § 17050(d), (e) (West 1987).

179. *See People v. Pay Less Drug Store*, 25 Cal. 2d 108, 112, 153 P.2d 9, 12 (1944) (holding that even though the defendant's price decreases were in response to competition, the defendant had kept prices below cost for "periods of weeks or months" after competitors raised prices).

180. *See id.* (stating that "in some cases defendant's sales below cost were not begun until 'weeks or months' after similar advertised prices of competitors had been discontinued").

181. *See Page v. Bakersfield Uniform & Towel Co.*, 239 Cal. App. 2d 762, 764, 49 Cal. Rptr. 46, 48 (1966) (issuing a permanent injunction order requiring both competitors in a "bitter-end laundry war" who repeatedly violated various sections of the UPA to abstain from further breaches).

the law; the fact that one competing party disregards the statute does not give the other party a legal excuse to do so."¹⁸²

4. Damages

The basic rules governing damages recoverable under the federal acts and the UPA are the same.¹⁸³ After the jury determines the amount of "actual damages" suffered by the plaintiff, that figure must be trebled by the trial court judge, who has no discretion in the matter.¹⁸⁴ Because treble damages are punitive, a plaintiff cannot recover additional punitive damages.¹⁸⁵ Finally, a court must include an award of "reasonable attorney's fees" to a successful plaintiff.¹⁸⁶ No award of attorneys fees against an unsuccessful plaintiff is authorized under the statutes.

The basic measure of actual damages suffered by the plaintiff in a predatory pricing action will be the profits lost by the plaintiff attributed to sales diverted to the defendant by the below cost selling of the defendant. While this measure of damages should be applied in private predatory price actions under either section 2 of the Sherman Act or section 2(a) of the RPA, possible confusion could arise under either statute because of the uncertain contours of the "antitrust injury" concept.¹⁸⁷ Under the straightforward pattern for damage recovery under the UPA, there is no possibility for confusion. If the defendant's selling below cost directly caused the plaintiff to lose an identifiable contract, damages are calculated by determining the amount of profit the plaintiff lost because the contract was diverted to the defendant.¹⁸⁸ The same diversion test applies if ascertainable customers, but not necessarily

182. *Id.* at 770, 49 Cal. Rptr. at 51.

183. *See* 15 U.S.C.A. § 15(a) (West 1994) (providing for the recovery of damages by anyone injured "by reason of" a violation of the Sherman and Clayton Acts). Violations of section 2 of the RPA are included, because that section replaced and became section 2 of the Clayton Act. 15 U.S.C.A. § 15(a) (West 1994); *see id.* § 17070 (West 1987) (authorizing civil suits to enforce the UPA's provisions); *see also* CAL. BUS. & PROF. CODE § 17082 (West 1987) (providing for mandatory trebling of the plaintiff's "actual damages").

184. *See* *Pollock & Riley, Inc. v. Pearl Brewing Co.*, 498 F.2d 1240, 1243 (5th Cir. 1974) (holding that "Congress's authorization in 15 U.S.C.A. § 15 to triple the award of damages is a matter of law to be applied by the district court without interference from the jury"); *Unedus v. California Shoppers, Inc.*, 86 Cal. App. 3d 932, 942, 150 Cal. Rptr. 596, 601-02 (1978) (holding that trebling of damages under California Business & Professional Code § 17082 is mandatory).

185. *Turnbull & Turnbull v. ARA Transp., Inc.*, 219 Cal. App. 3d 811, 826-27, 268 Cal. Rptr. 856, 865-66 (1990).

186. *See* 15 U.S.C.A. § 15(a) (West Supp. 1996); CAL. BUS. & PROF. CODE § 17082 (West 1987).

187. The antitrust injury requirement in federal private treble damage actions was first announced in *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487-89 (1977). *See generally* James R. McCall, *The Disaggregation of Damages Requirement in Private Monopolization Actions*, 62 NOTRE DAME L. REV. 643, 655-58 (1987).

188. *See* *Paramount Gen. Hosp. Co. v. National Med. Enters., Inc.*, 42 Cal. App. 3d 496, 499, 117 Cal. Rptr. 42, 45 (1974). In *Paramount General Hospital*, the plaintiffs pleaded damages in the amount lost due to diversion of lease packages for medical space from the plaintiff to the defendant: \$11,000 in lost rentals and \$796,000 in lost income from patients of two types. The first type of lost income was the loss of profits from diverted medical office leases that the plaintiffs would have made with identifiable doctors. The second type of damage was for lost profits

ascertainable contracts, were lost due to the defendant's below cost selling.¹⁸⁹ Damages are equal to the profits that would have been made on the reasonably estimated sales by the plaintiff to the diverted customers.¹⁹⁰

California courts have indicated that in cases in which the plaintiff could prove that neither specific contracts nor specific customers had been diverted, an award of damages would be proper under the UPA.¹⁹¹ If the plaintiff and the predatory pricing defendant were competing in a retail consumer market characterized by high volume cash sales, § 17043 could not be enforced unless the plaintiff could recover damages on the basis of reasonable estimates of plaintiff's lost sales volume resulting from defendant's predatory pricing.¹⁹²

III. LOSS LEADER PRICING UNDER THE FEDERAL LAW AND THE UPA

Case law under section 2 of the Sherman Act and section 2(a) of the RPA has not focused upon loss leader pricing. Absent the development of special rules for detecting the practice by courts, those statutes will continue to be inadequate vehicles for damage recovery by plaintiffs injured by the practice. The UPA specifically condemns and defines loss leader pricing and is easily invoked by such plaintiffs.

California Business and Professions Code § 17044, a companion provision to § 17043, prohibits the use of "loss leaders" in the pricing of products.¹⁹³ A loss leader is defined in California Business and Professions Code § 17030 as an item sold at less than cost where: (a) the purpose of the seller is to induce the purchase of other merchandise, or (b) the effect is a tendency to deceive purchasers, or (c) the effect is to divert trade from or injure competitors.¹⁹⁴ Although § 17030 uses the term "merchandise," the section has been held to apply to services.¹⁹⁵ Neither § 17044 nor § 17030 require proof of a defendant seller's intent to injure competition or competitors. Nonetheless, California courts have held that a plaintiff must prove that the

that plaintiffs would have made in selling various medical services (pharmaceutical, radiological) to the patients the identified doctors would have brought to the plaintiffs' building. The court held "that plaintiffs have stated a cause of action for damages . . . based on a violation of section 17043." *Id.* at 504, 117 Cal. Rptr. at 48-49.

189. *Id.* at 499, 117 Cal. Rptr. at 45.

190. *See Sandler v. Gordon*, 94 Cal. App. 2d 254, 258-59, 210 P.2d 314, 316-17 (1949). In *Sandler*, the plaintiff showed 34 customers were temporarily lost and 39 customers were permanently lost to the defendant because of below cost pricing. A certified public accountant calculated the lost revenue that the plaintiff would have received from those customers and deducted the various expenses to compute the plaintiff's actual damages.

191. *See Paramount Gen. Hosp.*, 42 Cal. App. 3d at 499, 117 Cal. Rptr. at 45; *G.H.I.I. v. MTS, Inc.*, 147 Cal. App. 3d 256, 275, 195 Cal. Rptr. 211, 223 (1983). The plaintiff and defendant sold records at retail to unascertainable customers. The court held that the plaintiff could maintain a cause of action for damages for "lost customers and profits" under § 17043. *G.H.I.I.*, 147 Cal. App. 3d at 264, 195 Cal. Rptr. at 216.

192. *See supra* note 149 and accompanying text. Both the *Paramount General Hospital* and *G.H.I.I.* opinions involved retail, high volume, cash sales.

193. CAL. BUS. & PROF. CODE § 17044 (West 1987).

194. *Id.* § 17030 (West 1987).

195. *See Garner v. Journeymen Barbers' Union*, 223 Cal. App. 2d 101, 107, 35 Cal. Rptr. 693, 697 (1963) (holding that barber services are covered under definition of "loss leader").

defendant acted with the intent to injure competitors to sustain a § 17044 cause of action.¹⁹⁶ The UPA section establishing a presumption of intent to injure competitors in alleged predatory pricing situations¹⁹⁷ is applicable to the court-declared intent requirement of § 17044.¹⁹⁸ There is also a special "injurious intent" presumption section in the UPA that applies in certain loss leader situations.¹⁹⁹

California Business and Professions Code § 17071.5 creates a presumption of the defendant's injurious intent if the seller prices a product below cost and limits the quantity of that product that can be purchased by a buyer.²⁰⁰ The section only applies to sales by retailers who purchase commodities from others and resell them to consumers.²⁰¹ The section has been held constitutional,²⁰² and the presumption is considered to be one that shifts the burden of proof under California Evidence Code § 605.²⁰³

As discussed previously,²⁰⁴ a number of affirmative defenses are available to defendants in predatory price cases.²⁰⁵ The same defenses are available in loss leader actions, and the meeting competition defense has been successfully invoked in one reported opinion.²⁰⁶

IV. CONCLUSION

The UPA was written in specific terms at a time when predatory pricing was viewed as a frequently used and highly effective method of stamping out competitors to the great loss of consumers. The federal statutes were written in much broader terms and have been interpreted in broad or narrow fashion depending upon changes in the prevailing economic thought among antitrust judges. In large part due to the fact that the prohibitions in the UPA were "frozen" by precise statutory drafting in a previous era, plaintiffs complaining of lost profits because of below cost selling are well advised to consider the California UPA as a vehicle for recovery.

196. See, e.g., *Ellis v. Dallas*, 113 Cal. App. 2d 234, 238-39, 248 P.2d 63, 65-66 (1952). But see *McCarthy*, *supra* note 10, at 181 (criticizing this position).

197. See *supra* Part II.B.2.

198. See *Hladek v. City of Merced*, 69 Cal. App. 3d 585, 591 n.3, 138 Cal. Rptr. 194, 198 n.3 (1977); *Dooley's Hardware Mart v. Food Giant Mkts., Inc.*, 21 Cal. App. 3d 513, 516, 98 Cal. Rptr. 543, 544 (1971).

199. CAL. BUS. & PROF. CODE § 17071.5 (West 1987).

200. *Id.*

201. *Id.*

202. *Dooley's Hardware Mart v. Food Giant Mkts., Inc.*, 1 Cal. App. 3d 105, 107-08, 81 Cal. Rptr. 451, 452-53 (1969).

203. *Dooley's Hardware Mart*, 21 Cal. App. 3d at 517-18, 98 Cal. Rptr. at 545-46; see *supra* notes 154-58 and accompanying text (discussing California Evidence Code § 605 and § 606 in connection with California Business and Professions Code § 17071).

204. See *supra* Part II.B.3.

205. See CAL. BUS. & PROF. CODE § 17050 (West 1987).

206. See *Dooley's Hardware Mart*, 21 Cal. App. 3d at 518-19, 98 Cal. Rptr. at 546 (holding that the defendant's use of three grocery items as loss leaders was part of an effort to meet competition, not done with intent to injure).

Specifically, the difference in the crucial measure of the relevant cost of the seller is enough to recommend the California statute for competitors injured within the state. The other differences between the possibly applicable federal acts and the UPA all point in the same direction, indicating the UPA as a far easier statutory cause of action to establish. Those differences include the lack of any requirement to prove any facts other than the existence of a predatory sale in § 17043, the direct nature of damage recovery under the UPA, and the ease of proving necessary intent under that Act. All firms selling in the California market and all attorneys who advise them on commercial and trade regulation matters should be aware of the facility the UPA offers to competitors injured by predatory pricing.

