Competition Snuffed Out: How Predatory Pricing Harms Competition, Consumers, and Innovation

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Tamar Katz:

Good morning. Welcome to the FTC's Workshop Competition Snuffed Out: How Predatory Pricing Harms Competition, Consumers, and Innovation. My name is Tamar Katz, and I'm an attorney advisor in the FTC's Office of Policy Planning. On behalf of the entire FTC workshop team, we are delighted that you're joining us today via our live webcast. Before we begin our program, I have a few housekeeping details to cover. First, we encourage viewers to participate in this event in real-time by joining us on Twitter. Our Twitter handle is @FTC. We'll be tweeting using the #pricingFTC. Second, shortly after the event, a video recording and transcript of this workshop will be available on our workshop webpage. Our intent is to create a lasting resource for everyone who's interested in this important topic. Finally, as with any virtual event, please bear with us if we experience any technical issues with the live stream. Now, I have the great pleasure of introducing our first speaker, Chair Khan, to kick off our workshop. Chair Khan?

Lina M. Khan:

Thanks so much, Tamar. Good morning, everybody. Thank you so much for joining us today. I'm so glad that we are able to gather virtually to discuss and learn about modern day predatory pricing. We have a terrific set of panelists today, and I just want to thank all of our speakers for taking the time to join us. I also want to thank the FTC's Office of Policy Planning and our Bureau of Economics for helping pull this event together.

Predatory pricing has been around for centuries. At the height of the Gilded Age, Standard Oil famously used anti-competitive pricing practices to secure its monopoly position in petroleum. One of those tactics included cutting prices aggressively below its own costs in a local market when rivals entered that market, ultimately driving out those rivals to maintain its dominance. Once the rivals had exited the

market and Standard Oil was no longer forced to compete, it would raise the prices back up with businesses and communities left paying the inflated costs.

The Supreme Court condemned Standard Oil's predatory pricing as a violation of the Antitrust Laws. In the years that followed, Congress recognized the threat posed by predatory pricing and enacted laws prohibiting a range of unfair pricing tactics. In 1914, Congress enacted the Clayton Act, which strengthened the earlier Sherman Act and included provisions prohibiting price discrimination. In 1936, the Robinson-Patman Act explicitly outlawed selling "goods at an unreasonably low prices for the purpose of destroying competition or eliminating a competitor," in addition to outlying other forms of price discrimination.

In the decades that followed, these laws and precedent were used to check predatory pricing abuses across the economy. Around mid-century, some economists began questioning the viability of predatory pricing as an anti-competitive tactic. The thinking was that predation was too high risk a gamble. Any firm attempting predation would guarantee itself major losses without any similar guarantee that it could make up those losses through raising prices later.

Even if the firm succeeded in driving rivals out of the market through bleeding losses, the strategy would only be profitable if the firm could sustain those higher prices and nothing would stop the competitors from returning and eating into those profits once the predator firm raised prices again. This thinking ultimately wound its way into the courts culminating in the 1993 group opinion from the Supreme Court. The court there announced a two-part doctrinal test requiring a plaintiff to show that the alleged predator set a price below cost and that it has a reasonable prospect or dangerous probability of recouping its investment in below-cost prices. Animating the court was the view that condemning predatory pricing risk condemning low prices as a whole, and that it was better to under-enforce through risking false negatives than risk false positives.

The court recognized that its new tests that a strikingly high bar for showing predation was comforted by the fact that "predatory pricing schemes are rarely tried and even more rarely successful." As scholars and commentators have noted, the court's analysis was not rooted in strong empirical evidence, and in the decades since, business literature and scholarly work have carefully detailed the ways that predatory pricing can be highly rational in some instances, even though our case law now says that it isn't.

Antitrust enforcement, of course, can only be effective if it is grounded in empirical and commercial realities. When jurisprudence becomes divorced from market realities, competition is undermined and the credibility of our antitrust regime suffers. This is why we are convening this discussion today. The FTC has long been on the front lines of ensuring that antitrust enforcement keeps pace with modern realities and its 6(b) authority to conduct market studies has long been a key driver of these efforts.

I routinely hear from market participants about their own experience with what seems to be predatory pricing. One common fact pattern is where a startup or founder will find itself in battle with a giant that can afford to sustain significant losses in one product stream using revenue from investors or other lines of business to stay afloat and driving out those smaller rivals that need all of their revenue streams to survive. This can be particularly salient in digital markets, where firms are incentivized to prioritize growth over profits in the short term to chase scale and cement dominance.

These strategies have been around for a long time and they will only get more advanced in the future as technology offers new ways for firms to engage in predation. Basic algorithms may allow firms to set prices using data and real-time information such as competitor prices and these types of algorithms are already common in industries such as travel and online retail. Algorithms can also enable firms to carry out targeted pricing charging different prices to different customers for the same good or services.

How should predation and predatory pricing doctrine account for these new commercial realities, especially when mechanisms for recoupment may look very different than they did decades ago? We've convened a terrific set of market participants today to help us wade through these tricky issues, including people who have a on-the-ground view of what predation could look like in the year 2024. Thank you so much again to everybody for joining us, and I will now turn it over to our panelists and back to Tamar. Thank you so much.

Tamar Katz:

Thank you, Chair Khan, for your thoughtful remarks. We are now going to turn to our first panel Predatory Pricing Today: Real World Tactics and Evidence. As the chair just discussed, predatory pricing is a form of anti-competitive conduct that is as old as antitrust law itself. However, in the 1970s, it was theorized that predatory pricing was irrational, because after a firm priced below its cost to drive out competitors, new entrants would emerge to police any price hikes by the incumbent. In a case called Brook Group, the Supreme Court adopted a test for predatory pricing predicated on this economic theory, and in the wake of that case, predatory pricing legal claims have been quite rare.

In this panel, we're going to focus on that underlying economic assumption and our contributors will discuss whether and when in our modern economy predatory pricing strategies might be economically rational for firms. They'll discuss both predatory pricing strategies in that canonical doctrinal sense pricing below one's costs, but they're also going to discuss pricing strategies that might be used to drive out other rivals. For this panel, we're going to focus on understanding firm's economic incentives in the modern economy. In our next panel, we'll turn to the question of whether and how the legal doctrine accords with those modern incentives. Our first panelist is Stacy Mitchell, co-executive director at the Institute for Local Self-Reliance. Over to you, Stacy.

Stacy Mitchell:

Thank you so much and thanks to the commission for hosting this important workshop and for the opportunity to speak here today. I'd like to briefly do three things, share an example of a monopoly that achieved its dominance in part through a long-term predatory pricing strategy, touch on one underappreciated consequence of allowing this tactic to go unchecked, and lastly, highlight how pricing algorithms have supercharged predatory pricing making this tactic more feasible and more effective.

The example I'd like to begin with is Amazon, which across its 30-year history has repeatedly sold products below cost to crush competitors and dominate markets. In its first six years, Amazon lost a staggering $3 billion selling books below cost, a strategy that wiped out countless bookstores. The investment paid off. First, Amazon captured the book market, today it controls half of print book sales and about three quarters of the e-books market. Second, Amazon leveraged that early dominance in books to move into e-commerce more broadly.

Then in the 2000s, Amazon targeted popular e-commerce rivals with similar tactics. After the shoe retailer, Zappos, doubled its sales between 2004 and 2007, Amazon attempted to buy the company, and when Zappos executives refused to sell, Amazon began selling shoes at a loss. Straining to keep its customers, Zappos matched the discounts and began losing money on every sale. All told, Amazon reportedly lost $150 million in the gambit and it worked. Zappos bleeding Red ink agreed to be acquired. Amazon used a similar strategy to topple Diapers.com losing perhaps as much as a hundred million dollars to force yet another competitor into a shotgun merger. Such tactics not only eliminated competitors, but likely discouraged future challengers from entering e-commerce altogether.

Today, there's good reason to believe that Amazon is continuing to sell particular products and services below cost with the losses financed not by external investors, but by profits from the fees that it charges

its third-party sellers. In 2023, third-party sellers on Amazon's marketplace paid Amazon about $170 billion in fees. Analysts believe that this revenue stream is highly profitable, that the cost Amazon incurs for fulfilling third-party orders are much lower than the fees it charges sellers resulting in substantial profits. Yet, if we look at Amazon's public financials, while it's become a much more profitable company in recent years, we don't see the scale of profits that analysts believe Amazon gets from seller fees showing up on its bottom line, and this raises the possibility that Amazon uses profits from seller fees to subsidize below-cost selling in other areas of its business. Selling particular products and services at a loss may be a way that Amazon holds competitors at bay and maintains its monopoly in e-commerce.

What's notable about this is that unlike the way courts have viewed predatory pricing, where a company sells below-cost at one point in time and then at a later point in time recoups its losses through inflated prices, in this scenario, the below-cost selling and the recoupment are occurring simultaneously in different parts of the company. Selling particular goods below-cost enables Amazon to maintain a monopoly while lucrative fees from captive sellers are the fruits of that monopoly, and there's no reason to think that this can't go on forever. Amazon founder, Jeff Bezos, in talking about Amazon's strategy, has used the metaphor of a flywheel, a perpetual motion machine, and that's exactly what this looks like.

Second, I wanted to highlight one of the underappreciated consequences of allowing predatory pricing to go unchecked. When large multi-product retailers or conglomerates can sell an entire category of products below-cost, it makes it difficult for businesses that specialize in that one product to survive. A specialty business has no other product lines to rely on. If you're a book retailer and a dominant multi-product firm decides to sell books at a loss, what do you do? You can't lose money on the one thing that you sell. Or say you make smart speakers and Amazon decides to sell its own smart speakers at a loss in order to make Alexa the dominant voice assistant.

As Patrick Spence, the CEO of Sonos, testified before a Congressional committee in 2020, these pricing tactics "hamstring those companies that have better products and cannot be sold at a loss." From the standpoint of competition, the problem here is that specialty firms provide distinct benefits to consumers and the markets in which they operate. Specializing often entails a deep level of expertise which pays off for consumers in multiple ways. Independent bookstores, for example, account for only about 10% of the market, but they play a wildly disproportionate role in product discovery. Staffed by voracious readers, independent bookstores discover new books and new authors that are worth reading and promote them to their customers. Many important books and authors owe their careers to discovery by an independent bookstore. Or as the Sonos example illustrates, in the case of specialty manufacturers, they often bring a deep expertise and commitment to a product that leads to innovation and quality improvements that we would not otherwise get if those specialty manufacturers did not exist.

Finally, I'd like to briefly note that the pricing algorithms companies deploy today can help to facilitate predatory pricing, making it more feasible and effective, less expensive and harder to detect. Algorithmic pricing enables companies to carry out predatory pricing strategies with extraordinary precision and finesse. Consider that Amazon's algorithms make millions of price adjustments every day, by drawing on Amazon's vast cache of real-time data about consumers and about rival retailers, Amazon's pricing algorithms can identify opportunities to selectively target competitors' customers. On the recruitment side, algorithms also determine which products show up in search results and which are chosen for the buy box suggesting opportunities to selectively steer customers to higher priced products. Algorithms make the current legal doctrine which views predatory pricing as implausible all the more out of step with the reality of today's markets. I'll close there. Thank you.

Tamar Katz:

Thank you so much for those remarks, Stacy. Our next panelist is Bill McGee, senior fellow for Aviation and Travel at the American Economic Liberties Project. Hey, Bill.

William J. McGee:

Good morning. Thanks very much, Tamar, and thank you to Chair Khan and the Federal Trade Commission for inviting me today. I'd like to speak to two issues related to the airline industry. One is the history of predatory pricing throughout the airline industry's history, and the other is this new paper that was just released yesterday by American Economic Liberties Project. It's called Predatory Pricing in Airlines, and we focus specifically on a real-time case that is going on right now in Hawaii with Southwest Airlines and Hawaiian Airlines. It was co-written by my colleague, Elaine Olin, and myself.

When we talk about the long history of predatory pricing in various industries, it's a little different with the airlines because for 40 years, from 1938 to 1978, pricing was regulated in the airlines by the government through the Civil Aeronautics Board, and in those years with the CAB, there was tremendous stability for one thing, and as we note in the paper, there was little incentive and few opportunities for predatory pricing. That is the pricing for the most part was based on cost, which these days is quite a revolutionary idea if you know anything about airline pricing. It also was based on a network algorithm, so that it was treated as a utility, and pricing was overseen by the CAB throughout the country.

What we saw in 1978, with the passage of the Airline Deregulation Act, was a tremendous amount of instability for one thing. In the next decade after 1978, there was a 74% decline in profits. In addition, for the first time, the airline industry started seeing a wave of mergers and bankruptcies. Prior to that, in the regulated age, mergers were very rare and bankruptcies were virtually non-existent. We also saw the influx of new carriers, mostly low-cost carriers, and that is exactly what deregulation was supposed to do. Unfortunately, in the long term, it has failed.

We now have the most concentrated industry we have ever had in the history of the airline industry since 1914. We have 12 soon to be 11 scheduled passenger airlines in the United States. For context, there were about 75 in the mid-1980s. We have a level of concentration at the top that we've never seen, American Delta, United and Southwest, the big four control 80%, and we've had a long, long period without new entrant airlines. When you look at the predatory pricing that kicked up in the 1980s and 1990s, it soon became a case of widespread abuse, mostly by large major carriers, there were many more of them then than there are now, against low cost carriers. Again, we saw this influx, particularly in the late 80s and early 90s, of low cost carriers and what the industry calls ultra-low cost carriers, and they became something that the major carriers wanted to eliminate, and in some cases, they were very successful in doing that.

They used a lot of different methods, including their fortress hubs, locking in loyalty through frequent flyer programs and credit cards, but they also used predatory pricing. There's a history here of Department of Transportation and the Department of Justice fighting back against this. In 1998, for example, there was a Senate hearing in which the small, then fairly new carrier Spirit testified that Northwest Airlines, a major carrier now part of Delta Airlines, lost $10 million by cutting its routes to $49 on one route, that is between Detroit and Philadelphia. That basically forced Spirit to have to exit the market. This was just one case, but it exemplifies everything that was going on then. After Spirit left that route, fares went up to $460 one way. It was a 500% increase.

In the 1990s, there started to be scholarly work and congressional work that pointed out that there were multiple cases of predatory pricing, American with Western Pacific, Vanguard, Sunjet. You'll notice, by the way, you don't recognize probably many of these names. That's because there was dozens and dozens of bankruptcies with the smaller carriers. Delta with Value jet, Northwest as mentioned was

Spirit and Sun Country, United with Frontier and Western Pacific. In 2002, the Department of Justice had sued AMR, the parent company of American Airlines, for its predatory pricing practices at its hub in Dallas. The federal judge ruled against the DOJ, because it couldn't prove that American was pricing below-cost. But then, in the late 1990s, the DOT, which had promised that it would offer departmental guidelines, started work on that, but in January 2001, they abandoned the guidelines and instead adopted a case by case approach. What we have had for more than 20 years now is both of these regulatory agencies, DOT and DOJ, have really dialed back their oversight of predatory pricing.

What we focused on in our paper that was just released yesterday is what has happened in Hawaii. Very briefly, Southwest Airlines entered that market, the Hawaiian market, with flights both from the mainland on the West Coast to Hawaii and within Hawaii on inter-island flights. They entered the market in 2019, more than five years ago, by offering $29 fares within the inter-islands. Now, introductory low fares are not at all uncommon in the airlines nor are they uncommon in other industries. The problem is it's been more than five years since then and Southwest, we have shown in our paper, is still pricing below-cost. The effect is that Hawaiian, which in 2018 had posted a profit of $233 billion, is now struggling for its life. Basically, in 2023, it posted a $261 million loss. Much of that was due to the fact that Southwest pricing was undercutting Hawaiian.

We prove in the paper that on at least three of the six routes in Hawaii, the inter-island routes, that Southwest was pricing at a loss based on the data that we were able to ascertain, which is not easy, by the way. That's another problem here with predatory pricing, it's a very opaque practice and it's hard to get your hands on the actual data that proves it, but we think we did it here. Because of that, as we phrase it, Hawaiian was left with a Hobson's choice, either bankruptcy or merger. As many know, Hawaiian recently agreed to be acquired by Alaska Airlines. In that sense, Southwest has won. The real question is, what's going to happen now when Alaska fully takes over Hawaiian and starts operating those inter-island routes? Inevitably, the fares are going to go up again. I'll be happy to talk more about this if there are questions, but I'll stop there.

Tamar Katz:

Thank you, Bill. Next, we have Matt Wansley, Professor of Law at Cardozo Law School. Professor Wansley?

Matthew Wansley:

Hi! Thanks, Tamar. Thanks, Chairman Khan, for hosting this workshop. I'm here to talk about predatory pricing in a place that it hasn't been much discussed, which is the venture capital market in Silicon Valley. I put together a short slide deck to explain why my co-author, Sam Weinstein and I, think that predatory pricing is happening in the venture capital market. We can go to the next slide.

First, I just want to start with some background about the financial model of venture capital and explain why it makes predatory pricing attractive. Venture capital is often called a home run or a grand slam industry. What that means is that venture capital and firms will invest their money in a portfolio that includes a large number of startups, say maybe 20 startups, and out of those 20 startups, the hope is not that all or even most of them will become profitable.

The hope is that a small number of those startups, often just one will become an outsized success, that they will see exponential growth. Imagine, if you're a VC, you invest in 20 startups, 18 of them fail, one of them generates modest returns, and that 20th one is Facebook. That's a super-successful venture capital portfolio. The data that's on the screen here comes from Horsley Bridge, which is a leading LP, and it shows that 6% of deals produce 60% of returns. There's really lopsided returns in a few deals.

What that means is that venture capitalists are always on the lookout to find companies that have the potential for exponential returns that can grow 10x or more. Let's go to the next slide.

The next slide points out that the VC funds that are the most successful actually have even more skewed returns. That is they have just as many or more failures as a typical VC firm, but when they win, they win big. They get 10x, 30x returns, and that's what generates the profits that they can return to their investors. This financial dynamic creates strong incentives for venture capitalists to find companies that can scale really quickly and can exit, that is have an IPO, or be acquired at a valuation that generates attractive returns for the VCs. Let's do the next slide. One such venture-backed company is Uber. Uber is a platform company, which means it connects a two-sided market, the riders pay fares to Uber, and then Uber pays out part of those fares to drivers in the form of driver pay. Let's go to the next slide. Like any platform company, Uber thrives on network externalities. That means the more riders that are on the network, the more the drivers are going to find that there's a ride waiting for them when they turn on the app. There's going to have less time where they're just deadheading around without a passenger generating revenue. Same thing with riders. The more drivers that are on the network, the easier that it is for riders to find a ride and the less likely time that they're going to spend just waiting to find an Uber.

Okay. Any company that thrives on network externalities has a strong incentive to subsidize both sides of the market. But we think what Uber did was go beyond just subsidizing both sides of the market, and they used subsidies in the market to push their competitors out of the market. To the next slide. What Uber did is it both subsidized driver pay and subsidized rider fares. That's why Uber fares were lower than taxi fares and why drivers were getting more pay from Uber than they were getting pay from just operating taxis. That made it more attractive for riders to get on the network, and it made it more attractive for drivers to get on the network and created a flywheel effect that made Uber a fast-growing company. Next slide.

Uber's low fares were always part of its selling point. What we're seeing on the screen right now is an ad that Uber ran in Los Angeles that was touted by Bill Gurley, who's on their board, it was a VC at Benchmark. Uber was saying, "Our prices are dramatically lower than cabs," and it was true. Uber's prices were dramatically lower than cabs in lots of metropolitan areas in the late-2010s in the United States of America. Why were Uber's fares so low? Well, it wasn't because Uber's innovation allowed them to make the service of transportation cheaper, it was because Uber was subsidizing the rides and subsidizing drivers on the networks, and it made it a more attractive product, and it helped to grow their market share. Next slide.

The consequence is that they grew their market share quite quickly. As you can see in this graph, before 2016 and 2015, less than 20% of the market was Uber. This is data from the New York City Taxi and Limousine Commission. By 2019, Uber was getting close to 80%. It's now well over 80% in New York City, and it has remained that way despite the pandemic. Next slide. It's not just that the market has grown. You might think that Uber just grew the market. Uber did grow the market, but mostly what it did is just took market share away from taxis. When you look at taxis and where they were between 2010 and 2015, and look at, this is just the absolute numbers of trips that they're taking in New York City. The absolute number of taxi trips has declined considerably and ride handling apps, that's largely Uber and Lyft today have made up the difference. Next slide.

Uber initially faced some competition in the ride-hailing market. This is, again, New York City data, but they were able to crush the competition really quickly. Why? Because Uber had a lot more venture funding, like orders of magnitude more venture funding than their main competitors, Juno and Via, except for Lyft, which also was a venture-backed startup and also was heavily subsidizing its rides, and for a brief period in the late-2010s, actually had a venture-subsidized price war against Uber. Uber and

Lyft are now in most US metros in a stable duopoly where Lyft has about a third of the market, and Uber has about two-thirds of the market. Next slide.

How did Uber afford all these subsidies? Well, the short answer is that it lost a lot of money. These are net losses from Uber's financial statements. Note that those numbers in the column on the left are in the billions. Uber, which is a very asset-like business, it didn't have a sophisticated technology that it was trying to build, it still managed to lose billions of dollars in 2016, 2017, 2018, if you correct the financial statements to smooth out their operations, 2019 and 2020. This money was going to predatory pricing. This money was going to subsidize the rides. Next slide.

Now, of course, as other speakers have talked about, predatory pricing has two stages. There's the predation stage, where prices are really low, and then there is the recruitment stage where prices are really high. We are now in the recruitment stage for Uber. Uber prices have risen considerably in the post-pandemic world, and the few remaining taxes in New York City have also raised their fares now that they're not quite facing the same competition that they once faced from Uber. Next slide. The most important point in our paper is that regardless of whether Uber actually recoups, Uber's venture capitalists have made out like bandits. Benchmark, which was the VC firm that led Uber's series A round, invested $12 million in the company. At IPO, that stake was worth $6.75 billion. This is one of the best venture investments in the United States in the whole decade of the 2010s.

Uber, which only recently became a profitable company, and even today you can argue that its profit is largely a product of accounting gimmicks, for many years after its IPO was still losing money. But that didn't matter for Benchmark. Benchmark made its money not on Uber actually recouping but on Benchmark selling its shares in Uber to investors who believed that they would one day recoup. Benchmark, we think, created a model that other VCs might want to emulate. Invest in a startup, use your capital to let the startup engage in predatory pricing, have it clear the market, grow its market share, and then cash out to subsequent investors who anticipate later recruitment. Next slide. Oh, well, I guess that's the end. That's venture predation. That's our theory, and we're happy to take questions later.

Tamar Katz:

Thank you so much. Our final speaker is Doug Hoey, the Chief Executive Officer of the National Community Pharmacists Association, and we are delighted to welcome him to present right now.

Douglas Hoey:

Thank you, Tamara. Thank you for the invitation to be here. As Tamara said, I'm Doug Hoey. I'm the pharmacist and CEO of NCPA. We represent the 19,000 community pharmacies in the US. Our member pharmacies serve communities, both big and small, and half are located in communities with high numbers of socially vulnerable populations. We want to thank Chair Kahn and the FTC for holding this workshop and highlighting modern day predatory pricing that is exploiting consumers and undermining competition, certainly, in the pharmacy industry. Prescription drugs are a half a trillion dollar industry. Two thirds of adults take prescription drug.

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Douglas Hoey:

... billion-dollar industry. Two-thirds of adults take prescription drugs. But between 2010 and 2020, nearly 30% of all pharmacies closed. And just in the last seven years, the number of pharmacy choices

available to consumers has shrunk by nearly 15%. So there's a lot fewer pharmacy choices for consumers just over the last few years.

There was a time when it was the big mass merchandiser chains that were using predatory pricing to drive competition out of the marketplace. But modern-day predatory pricing is now vertically integrated PBMs, Pharmacy Benefit Managers, that are abusing their market power to eliminate competition. Most people assume that a prescription transaction works very simply that the retailer, in this case, the pharmacy buys a drug at wholesale, marks it up at a marketplace-based profit, and then the consumer buys it. And decades ago that was true, but today, only about 10% of prescriptions are sold that way. For the other 90% of prescriptions, the pharmacy benefit managers, the PBMs decide which drugs are covered, how much the consumer pays at the register, and how much the pharmacy will be paid.

Here's how a prescription transaction used to work. Next slide, please. So, very simple. The drug manufacturer created and sold its products to a wholesaler. The major wholesalers in our industry are companies like McKesson, Cardinal Health, and Cencora. The retailer, in this case the pharmacy, would buy the drug from the wholesaler, mark it up to cover their overhead costs, including all of the expertise, licensing, the regulatory and safety requirements associated with prescription drugs, and then make a small profit. That was then. Then came the PBMs. So originally the PBMs satisfied a need in the market in the late '80s and early '90s. The PBMs were prescription claims processors. That was unique for its day. So instead of patients paying cash for their prescription and then having to submit a paper bill for reimbursement, PBMs automated that transaction. So consumers could just pay their share of the prescription cost called the copay at the register. That was a good thing, but PBMs also blinded the consumer to the actual cost of their prescription. So whether a brand prescription costs $85 or $850, the patient still paid a $10 copay back then.

This blinding of the patient to the actual cost of their medication led prescription costs to skyrocket and PBMs made that all possible. As time has gone on, though, the PBMs got more greedy. Being a claims processor is basically like a utility. It's important, but not very sexy or profitable. There were a number of sizable PBMs in the market back then, but now the big three PBMs control prescription drug access and payment for 80% of all Americans. And the big six PBMs control prescription drug access for 95% of all Americans. But that level of market dominance didn't stop there. The PBMs then began to acquire or be acquired by major health insurers. Vertical integration has stifled competition in the pharmacy industry with the big health insurers as owners, the PBMs could now exert cradle-to-grave control over where patients not only got their prescriptions, but where they could get their healthcare.

Let's go to the next slide. So, that simple schematic now looks like this, and I'm not going to try to walk through every step in this process, but I wanted to show the schematic to illustrate just how much more complicated it is. PBMs now act as a platform to insert themselves into each stage of the drug distribution channels. And in doing so, they leverage their market power to extract dollars from the manufacturers, employers, pharmacies, and consumers. PBMs extract rebate dollars from manufacturers in exchange for formulary placement.

In other words, if you're a drug maker and you want your drug covered by insurance, you have to pay-to-play. PBMs entice employers to hire their PBMs by sharing some of the manufacturer rebates with some employers. However, as the saying goes, there's no such thing as a free lunch. The more the employer pays for drugs, the bigger the rebate, but they got to pay more for the drugs to get the bigger rebate. It'd be like Ford or Honda marking up the sticker price on one of their cars by $10,000 then offering an $8,000 rebate. And it winds up that the sickest patients, the sickest employees who need the most medicines, they get hurt the most in this scheme by paying off the highest list price. With the community pharmacies, there's no bona fide negotiations between pharmacies and PBMs. The prescription payment contracts that PBMs offer to the pharmacy are take it or leave it. Medicare Part D.

Those prescriptions make up one-third of the average independent pharmacies business. So one-third of prescriptions coming through the door are covered by Medicare Part D. In 75% of those transactions, those prescriptions covered by Medicare, the pharmacy is paid below its cost to acquire and operate the pharmacy.

By paying pharmacies less than what the pharmacy pays to acquire the drug, the PBM can accomplish two of its goals. First, it profiteers off of the spread between what it charges the employer and what it pays the pharmacy. And second, it eliminates its competition, further growing its market power. Lastly, and most importantly, the patient is harmed by PBMs. The patient's copays are based on the artificially higher prices from the PBM's pay-to-play rebate games. Patients also may have their doctor's prescriptions overridden by the PBMs in favor of a different drug the PBM prefers for the sole purpose of jacking up the rebate the PBM gets. Community pharmacy owners. Community independent pharmacies are resilient or hungry or very competitive. They have to be be able to survive, but PBMs stack the deck against them. Several states have looked at PBM practices in their state and found that PBMs are bilking that state for millions of dollars, and the PBMs are paying their affiliated pharmacies higher prices.

Next slide, please. So these are some highlights from the Mississippi Board of Pharmacy, which commissioned an audit of Optum commercial prescription claims for calendar year '22. The purpose of the audit was to assess compliance with Mississippi laws, and it found that PBMs paid their affiliated pharmacies. Remember, all these PBMs operate mail-order pharmacy and CVS Caremark owns CVS. PBMs paid their affiliated pharmacies nearly 150% more than they paid independent pharmacies. It found that PBM payments to independent pharmacies were 10 times more opaque. But why do you need payment transparency when you can exert almost total control over your competitor? And not only did Optum pay independent pharmacies less than pharmacies, a hundred percent of all the audits by Optum were of independent pharmacies.

In other words, in addition to pricing the competition out of business by setting the competition's price, PBMs also unilaterally assess penalties and bury their competition in mountains of paperwork. Predatory pricing, harming competition in pharmacy has evolved drastically since the days of the big mass merchandisers leveraging their market power to eliminate competition. PBMs have one-upped the mass merchandisers by not only using predatory pricing, but predatory patient control steering to eliminate their competition. Thank you for the opportunity to speak today, and I welcome questions if there are any. Thank you.

Tamar Katz:

Many thanks to you and all of our panelists for sharing your insights. We're going to briefly dive into a Q&A session. So I'll invite all of the panelists to turn back on their cameras. And the question I want to ask all of you, because you've all touched on this, but can we put in a real-world lens, what does predatory pricing mean for ordinary consumers and the American public? So, why do they care what happens to an independent bookstore or an independent pharmacy or if a low-cost airline goes out of the market? And why does it matter that venture capital investors are incentivized to engage in predation? Let's go in order of the order in which you presented. So, Stacy, we'll start with you.

Stacy Mitchell:

Well, from consumer's perspective, this is eliminating competition. And we know that competition is the thing that safeguards consumers' interests in the long term. It is the thing that ensures the lowest prices, that ensures innovation, choice, and all the other things that consumers want in the marketplace. When you have a strategy that enables a company that either is backed by venture funds, or backed by

investors, or has another source of revenue, or is simply larger or multi-product or conglomerate, when you have a company like that that has a way to engage in a predatory pricing strategy, you're tipping the market in favor of those companies. Not based on this is not competition on the merits, right? It's not the best-winning, but simply the largest or the ones that are backed by these sources of funds. And in the long run, that's very bad for consumers.

Tamar Katz:

Bill, let's go to you next.

William J. McGee:

Sure. Well, I think the context that needs to be understood with predatory pricing in the airline industry is that, as I mentioned, we are in a more concentrated industry than we've ever had. We're down to just 11 carriers now. But what that means for the average passenger, when we were at American Economic Liberties Project, we were very vocal in opposing the Spirit-JetBlue merger earlier this year. I spoke to many people who said to me, "I never fly spirit. I really don't care if Spirit merges or it goes bankrupt. I have no desire to fly them." And what I said repeatedly was, "You should, because if you fly on a route, even if you're flying with American Delta, United, the largest carriers, a route that is served by Spirit, you are benefiting by Spirit's presence. When smaller carriers go away, whether it's through bankruptcy, whether it's through merger, or even they just decide to pull out of a market because of predatory pricing, everyone pays more."

And so, the challenge with predatory pricing is the first phase of it seems so good, those low fares, that it's a hard thing at times to convince people that long-term this is going to be very harmful. We went 14 years without a new entrant airline in the United States up until 2021 when Avelo and Breeze started up. In 2021, I lived in Connecticut and Avelo was flying out of New Haven to Fort Lauderdale for $19. And so, my girlfriend and I took advantage of it, right? We paid less for two round-trip tickets to Florida than one day's parking at LaGuardia or Kennedy if we had driven to New York, right? And so, afterwards, I had wrote about it for Condé Nast Traveler Magazine, and I spoke to the CEO at Avelo and he said, "How did you like it?" And I said, "Well, we really loved that $19 fare." And he laughed and said, "Enjoy it while you can. That doesn't pay the bills." Okay? So it's understood that for 30 days, here's the fare, they got media attention, they got people to fly in the airline, and then it stopped.

When this continues, as Southwest has done as we illustrate in our paper for five years, what you're doing is you're driving the other carrier in Hawaiian's case, as I mentioned, either to bankruptcy or to merger. And either is a bad scenario for consumers. The fewer carriers you have, I guarantee you the major carriers are thrilled that Hawaiian is merging with Alaska because the major carriers, this is one of the untold stories of the airline industry in the 21st century, American, Delta, and United stopped competing with each other on price about 20 years ago. It's very rarely spoken about, but the DOT's, quarterly airfare reports show this. So the fewer and fewer low-cost carriers and ultra-low-cost carriers we have, the worse it is for consumers. And while those introductory fares can be very tempting, when they're coupled with knocking someone out of the business and then jacking up the fares as we saw with Uber and so many other things, that's where the real problems kick in.

Tamar Katz:

That's really interesting. I think, Bill, what I hear you saying is that even if I don't fly a low-cost carrier, no matter what, the exit of that low-cost carrier is going to affect me because that competition is bringing down all prices, is that right?

William J. McGee:

Yes, absolutely. When I was at the trial in Boston for the first week with the Spirit-JetBlue case with the DOJ, JetBlue was trying to make the case that, "Well, we're small. Look at the national market share." The line that the CEO kept choosing was, "We're not Coke and Pepsi, meaning that JetBlue and Spirit combined don't have anywhere near the market share of one of the big four." But market share doesn't work on a national level in the airline industry. It works on the route that you care about, right?

For example, Spirit is the largest carrier in Fort Lauderdale. JetBlue is the largest in Boston. That's what you care about on the route that you're flying. And so, what we have seen is that even the smallest carriers, even the smallest carriers with the smallest, they might have 1% or 2% national market share. They bring down prices. It's demonstrated by the DOT. It's fact. They bring down prices from even the largest carriers. At first, they're sort of like a mosquito to the largest carriers and they're an annoyance. And then eventually, sometimes they get to the point where the major carriers do all they can to knock them out of business. And unfortunately, they have done that many times.

Tamar Katz:

That's really interesting. Thank you. Matt, let's go to you next.

Matthew Wansley:

Well, I think most consumers knew that in the mid-2010s, Uber prices were really cheap. And recently, they haven't been so cheap. Costs have gone up a lot. And that was even before the pandemic and the pandemic-related inflation kicked in. But I want to be clear, even if recruitment doesn't happen, predatory pricing can still cause harms. So say, for example, you were a driver trying to decide whether you should drive for a taxi company or you should drive for Uber in 2016 or 2017. I mean, you might've thought, "Look, the pay is a lot better for Uber. So instead of renting a taxi, what I'm going to do is just buy a car and start driving on my own for Uber.

Now, if those prices weren't real, if they were propped up by subsidies and driver pay declined, which is exactly what happened, you may have a branded asset, a car that you purchased on the basis of what you thought was a real market signal, but was actually predatory pricing. Or put it another way, let's say you're a local government that's trying to decide whether you want to invest in public transportation or not. And if Uber is providing a transportation service at a low price that's serving the same need that the public transportation line that you're considering would serve, you might not make that investment. So predatory pricing can distort the economy by introducing noise into the information that price signals would send in a competitive market.

Tamar Katz:

That's a really interesting point. Yeah, that's a really interesting point. And, Doug, let's finish off with you.

Douglas Hoey:

Yeah, thanks. I think for consumers, PBMs kind of offer the worst of both worlds for consumers because they don't necessarily get, at any time, the lower price, they get the higher prices. US citizens pay the highest prices, drug prices in the world, and they also get the aftermath of eliminating competition. So from a PBM standpoint, the patient is steered into a certain pharmacy. They don't even have to pretend to have lower prices. And because the PBM decides what they're going to pay their competition, they can systematically eliminate their competition. And what impact does that have overall on consumers? Well, it's kind of three categories of consumers.

If you're a sixty-year-old, healthy, take very few drugs, you may not notice it that much. But if you are taking prescription medications and you're having to go to one large chain because that's the only ones that are left, you have the inconveniences, the weight, the lack of personalization, you have that situation. If you're someone who needs prescription drugs and you need something for a child, you need something for a hospice patient, you need something different, you need something unique, and you don't have an independent pharmacy there to go to bat for you, you're going to struggle to find that, that patient's going to struggle.

And last but not least, socially vulnerable populations. That's where 57% of our 19,000 members are located in populations where there are socially vulnerable populations. At cities, rural areas. Those patients are going to not have a pharmacy available to them, not only for prescription drugs, but for healthcare advice. Pharmacists a lot of times are sort of that first line of healthcare advice. "Hey, I've got a rash. Can you take a look at this, pharmacist?"

" Hey, I got pain in my side. I've had this pain. I've got this headache for the last three days. Should I go to the doctor?" It's been a while since I've practiced, but there's a number of times where we sent patients directly to the emergency room based on their symptoms, and sometimes it helps prevent a heart attack, things like that. So consumers are already suffering at the hands of PBMs, and if they continue to eradicate pharmacies, their choices, it's going to harm patient care even further.

Tamar Katz:

Yes. What an impactful note to end on. I want to thank all of our panelists today for just an excellent discussion. The perspectives that you all brought to bear are invaluable. We're going to take a brief 10-minute break and when we return the Bureau of Competition, Deputy Director Laura Alexander, is going to moderate our second panel, which features experts who will discuss predatory pricing case law in light of these modern-day economic realities that we just discussed. See you in 10 minutes.

Lina M. Khan:

Hello everyone, and welcome back to Competition Snuffed Out: How Predatory Pricing Harms Competition, Consumers, and Innovation. I'm thrilled to moderate our second panel featuring a diverse group of experts from various backgrounds who have researched predatory pricing case law and economic models, and have litigation experience with predatory pricing cases. I am confident their combined expertise will bring valuable insights into our discussion. We'll first hear from Scott Hemphill, law professor at NYU Law School and author of Beyond Brooke Group, Bringing Reality to the Law of Predatory Pricing. Professor Hemphill.

Scott Hemphill:

Hey, good morning, everybody. Thanks for the opportunity to join you on what has already been a fascinating discussion. My job here is to kick off the discussion by introducing and discussing Brooke Group, which as folks on this call are probably aware as kind of our basic pattern for thinking about predatory pricing in the United States. I want to do three things; review the basics, identify maybe some less obvious elements of the case that I think ought to properly weaken its claim on the antitrust imagination, if you will. And then finally, identify some potential points of continuing flexibility. So first on the basics. As you already heard earlier from Chair Khan's remarks, Brooke Group sets the test for predatory pricing. We've got these two prongs that we'll be talking about in some detail.

First, price below some suitable measure of cost. There's a fight about what the right measure of costs should be. And second, some reasonable prospect of recoupment as evaluated ex-ante. Or if you have the facts as shown in fact to have occurred. The case has an explicit preoccupation with the

minimization of false positives, not wanting to chill, salutary price competition. There is a deep skepticism that predation can actually work in practice. There's a famous quotation that predatory pricing schemes are rarely tried and even more rarely successful. This comment in Brooke Group goes back to an earlier case in which there was a claimed consensus among commentators at that, so that is a claimed consensus among, let's say academics that predation can't happen.

Now, a quick preview of my own take before moving back to the case. This kind of skepticism that we see in Brooke Group I think is unwarranted given the economic theory that was available even at the time of Brooke Group, and certainly has been established since. I think we'll talk more about that in the course of our panel. The two elements of the test are in a lot of tension that is below cost pricing itself is pretty strong evidence that the firm thought it could recoup. And so, where the recoupment test turns out to be decisive in real-world cases, there's a strong risk of a false negative that is of exonerating conduct that is actually really troubling.

I favor seeing these two steps of the test as factors in an overall analysis rather than sharply distinct inquiries in the way that the Brooke Group court seemed to suggest of if we moreover observe strong evidence of profit sacrifice, that seems quite powerful as an economic matter and hence a fruitful place for law to take cognizance of. So, coming back to the case for a minute, a few sort of less...

PART 2 OF 4 ENDS [01:08:04]

Scott Hemphill:

...the case for a minute. A few sort of less obvious aspects of the case that I think bear emphasis. First, the elements of this famous test, price-cost comparison, and prospect of recoupment weren't really contested in the Brook Group case itself. So, as part of some research a few years ago, I took a look at the Blackmun papers, the papers of Justice Blackmun, who was part of the court when Brook Group was decided. And it seems pretty clear that the court was kind of lulled to sleep by the fact that the counsel for each side of the case, Phil Arida, and Bob Bork respectively appeared to agree on the major elements of the test. And so the court just went along with that. So, I think our current predicament is to some degree kind of a result of sleepwalking on the part of the court. Second, most of the opinion is much of the opinion is dicta.

The case itself was quite narrow, not even about a monopolist, but rather about Robinson-Patman Act oligopoly, and an oligopoly recoupment was thought at least by that court to be less likely. It says it really doesn't tell us much about predation by a monopolist. The Blackmun papers further revealed that the court thought that this was a pretty narrow fact-bound case about a specific strategy employed by cigarette manufacturers. They didn't understand it as a case that would decide predation more generally so far as appears, at least from the Blackmun papers. And then finally, it was a pretty narrow, and fact-bound focus. The court of appeals below had ruled for the defendants despite the plaintiffs winning at trial, mind you, on the ground that an oligopoly recoupment that is recoupment by multiple rivals was so implausible that it must fail as a matter of law. And at conference, that private discussion among the justices after oral argument, a majority of the court, including Justice Kennedy, was planning to reverse the court of appeals as having gone too far. Ultimately, Justice Kennedy switched his vote, and the result was an extremely deep dive into the details of a particular predation fact pattern. This was necessary given the court's ultimate disposition, which was to reject the verdict of a jury in the district court, and to conclude that the evidence that the jury considered was insufficient for any reasonable jury to find in favor of plaintiffs. But as a result, the expressed skepticism that we see in the case about predation ought to be understood in connection with the narrow theory placed at issue. Now, coming to kind of what is to be done, I think there are a few potential points of flexibility in Brooke Group. I don't count

myself a fan of the opinion, particularly, I'm trying to make the best of a bad situation. So, three brief things here. So, first on the recoupment prong of the test, we need to recognize that monopoly is different from oligopoly.

And so if a district court is evaluating a particular fact pattern, Brook Group's skepticism ought to be confined to oligopoly recoupment. Recoupment by a monopolist should not be met with the same skepticism. And we see in the American Airlines predation case from a few years ago that we may talk about later some comments consistent with recognizing that monopoly is different from oligopoly. Second, where recoupment is supported by some modern theory, modern economic theory of recoupment, for example, earning a reputation for predation, we ought to have some flexibility to ignore, or downplay the music, the negative music of the Brook Group opinion. And then third, when it comes to the price cost test, we often talk about average variable cost as a starting point, but the Supreme Court was not wedded to any particular measure of cost, and so we ought to recognize that various, perhaps fancier, measures of cost, of incremental costs are available. Why don't I stop there, with my, I don't know if there's a glass half full, a glass one third full slight note about space for bringing predation cases even despite the strictures of the Brook Group case.

Lina M. Khan:

Thanks so much, Professor Hemphill for that helpful background on predatory pricing case law. Next we have Dr. Liliane Karlinger from the chief economist team of the European Commission, or DGCOM, and she will discuss current economic literature suggesting that predatory pricing can be effective as a profit maximizing strategy to entrench, or gain market power. Dr. Karlinger, the floor is yours.

Liliane Karlinger:

Many thanks, Laura. Good morning, everyone, or good afternoon, or good evening as the case may be. So, what I would like to do is to explain a little bit what this famous, or infamous Chicago of predatory pricing is all about. Chair Khan, and Scott before mentioned that already briefly, just to make sure everybody is on the same page, what do we mean? What do we talk about when we speak about this supposed consensus of economists regarding how difficult it is to mount a predatory campaign? So, the critique is basically a result that is in itself perfectly sound, perfectly logical, but it builds on very strong assumptions, and it is therefore the product of these assumptions, and where a real life market does not meet those assumptions, or where they're not satisfied meet these criteria, the result no longer holds. So, if you found the result to be, let's say counterintuitive, even paradoxical, that is precisely because the world that it is built upon does not necessarily match the world in which most markets operate.

So, the result simply says, "Imagine you are in a perfect world", a so-called perfect market where everybody holds the same information about the kind of goods that are being sold, about the market participants costs. Where there are no barriers to entry, or exit, everybody can enter, or exit the market at any given point in time. Then the story goes, you cannot maintain a predatory strategy. Why is that so? Well, to begin with, imagine you did that, you are an incumbent, you charge prices below cost, you run losses. So does your competitor, imagine the competitor exits? Well, in order to recoup to make this at all a worthwhile strategy, you have to raise prices again, that will attract new entry into the market, and that will defeat the very purpose of your predatory strategy. So, either you keep predating forever, or else you might as well not do it at all.

That's one part of the story. The other part of the story is well, suppose you're trying to predate against your competitor, as I said, you're running losses. Then wouldn't the investors, the banks that financed you, and your competitor wouldn't they look through the scheme, and say, "Well, okay, we're going to support the competitor until we get to that point where you, the predator, will realize that your strategy

has failed, you will accommodate the entrant, and you will raise prices again. And both of you will live profitably in this industry." So, since you anticipate, you as a predator anticipate that this will happen, you will not see any reason why you would want to start predating in the first place. So, that's the implication of these conditions, these assumptions that I mentioned before about so-called perfect markets. Now, it is by no means a minority position among economists that markets are not perfect.

On the contrary, mainstream academic economists have devoted a long time, and great efforts to studying imperfect markets, meaning that for instance, there is so-called asymmetric information in the market. A very simple, straightforward example for that is that not everybody has the same costs in an industry. Some firms are more efficient than others, and it's always a bit of a secret what exactly your rivals costs are. You may know your own costs, but not necessarily those of your rivals. And this is where modern theories of predation come in. I would name two of them, which are to some extent a bit similar. One class of models that exploits this possibility of asymmetric information to rationalize predation is called reputation models. Another class is called signaling models. But in both of them, I think the intuition is quite straightforward. The modeling is perhaps a bit more complex, but the intuition is really straightforward.

So, suppose you are an incumbent in an industry, and future entrants, which may come in one by one. Again, I would say a feature that is very, very natural. These entrants may not necessarily know whether you are someone who tends to confront entry in a very aggressive way, if you will, or whether you are someone who accommodates easily. Both reactions can be potentially rational reactions. In particular, you may want to build a tough reputation for yourself as an incumbent by pricing very aggressively against early entrants in the market. The logic being, well, I incur those costs. Now the cost of building a tough reputation, but future entrants will see the dead body lying on the ground of earlier entrants who attempted to enter, and guess what? They will prefer to enter in industries where incumbents have a reputation of being accommodating, of being soft, not in those markets where you have a tough incumbent.

So, these models, reputation models, and also signaling models where the idea is you're signaling to your competitors to potential entrants that you have very low costs, you're very efficient, and so it's not convenient, or it's not profitable for them to enter into your market. These classes of models, if you will all build on this idea that costs, or competition types are not immediately known to everyone in the market. I think a very realistic feature, and there you can build predatory strategies that are perfectly rational, and perfectly profitable for the predator. There's another class of models that I would like to highlight, and talk a bit into, because I think they're very realistic, and help us understand what's going on in the real world, which are models of financial predation. So, remember the Chicago critique aspect that I had discussed before where the predator would be discouraged from predating, because financial markets will look through this strategy, and will support the entrant until it survived, or overcame the predatory campaign.

So, this, of course, builds on the assumption that financial markets have that kind of information to be able to judge what is going on in the industry. Now, as soon as we're willing to relax that assumption, as soon as we're willing to acknowledge that investors, banks, will not necessarily have that information, things change a lot. Imagine we are in a situation where you have an incumbent with deep pockets, someone who can afford if you will, to run losses for a certain amount of time, for instance, because you're a multi-product monopolist, or incumbent. So, you can use profits that you make on other products to cover your losses that you incur on that specific product where you run the predatory campaign. Assume also that your entrant is someone, a new kid on the block, if you will, someone that the investors, the banks do not know, have not had contact with before.

It is difficult for investors to distinguish unsuccessful entrants who just happened to be unsuccessful because their product was not good enough, because their cost structure was not competitive from those that were victims of a predatory campaign. So, what if those investors require some proof of success from the entrants, say they have to generate a certain level of cash flow within a certain amount of time for their credit lines to be extended. Then if you are the incumbent in this industry, you know that you just have to predate up to that threshold, so to speak, up to that cliff across which the entrant will fall if she does not manage to attract enough new financing, if she does not meet that hurdle that investors need to see to be convinced that this is a promising entrant, a promising competing product. So, in those situations, which I think are very realistic, it is perfectly rational, and perfectly profitable for an incumbent to stage a predatory campaign.

And as a final observation, let me also mention that we can tell a very simple story of sequential entry where it is really the scale of entry that determines the success of a predatory campaign. So, we can very simply think of a situation where the entrant has to enter sequentially into different products, or so these can be different markets that open one by one successively. So, in such a situation, if the incumbent knows that if I predate now I will monopolize not only today's market at a cost, but I will also monopolize tomorrow's market, because you, the entrant, will not be there, and it is not possible to jump into that future market directly without having been present in today's market. In such a situation, I can basically use all my future monopoly rents to finance my predatory campaign today. And so even in a market where there's no cost asymmetry, I can still successfully predate against an entrant. So, let me maybe stop here, and give the floor back to Laura.

Lina M. Khan:

Thank you so much, Dr. Karlinger. Our third panelist, Lewis LeClair is a principal with the law firm of McCool Smith. He will share his experiences litigating predatory pricing cases under the Brook Group standard. Mr. LeClair, please take it away.

Lewis LeClair:

Good morning. Thanks so much to the FTC for putting on this program. It's fascinating. I want to talk about the practicalities of pursuit of a private predatory pricing case. And let me start with the question of why is that important? I think it's important, because for the proper development of the law, you need private cases. The government has many priorities, and limited resources, and we need private cases to develop the contours of law, but in predatory pricing, that's difficult. Let's go to the next slide, please. I want to talk about five things. Why are predatory pricing cases so difficult? What are the changes in business, and economics that have impacted that? What are the challenges of price cost measures, recoupment, and then ways to combat those difficulties? Next slide, please.

What are the key difficulties if you're a plaintiff in a predatory pricing case? Number one, judicial skepticism. It's written in Brook Group, and it is all over the judiciary that predatory pricing is rarely tried, less rarely successful. There's a great fear of false positives, so that makes it difficult when you face a skeptical judge going in. Also, the economic analysis is very intensive, and expensive, and so it's not easy to put that together to get the data, analyze the data, and put it together in the right way. Finally, showing a dangerous probability of recoupment is very tough, because you're talking about the world that will be, and not the world that exists today. And that is often, again, particularly with a skeptical judge, hard to get the right analysis. You have to have an economist that can talk about what the market will look like in the future, and that can be quite difficult to put together. Next slide, please.

All right, what are the changes that have made these cases even more difficult? Most importantly, the relatively simple pricing models illustrated by Brook Group, and a 9th Circuit Case, Rebel Oil, which

involved gasoline, and gasoline stations. Those are not the modern world where predatory pricing is often seen. In the age of platforms, and web marketing, you have extremely sophisticated, and complex pricing, and bundling decisions being made. So, it is difficult. It's not only difficult to get the information, the output, you also have to understand how you got there, and what's going on, which may require enormous effort. Might even require a source code expert to learn how an algorithm, for example, is putting together the pricing choices. What are the factors that are being used? How are they being used? Also, accounting records are now expansive, and multifaceted. All large companies that you're likely to be accusing of predatory pricing have massive accounting departments.

They're running very sophisticated software. Some of the records that may be used may even be transitory, may be difficult to find, and difficult to use. And most of the records that you need may be completely separate from the pure historical gap accounting records of the defendant. So, it's very difficult to put that together, and to deal with it. Cost analysis is equally challenging. We've heard on this program a suggestion that there ought to be a lot of flexibility with respect to the cost analysis, but the reality is the Chicago School has reigned supreme, and you have to show that it's below typically average variable cost, which in, and of itself is extremely challenging to determine, and present. Deciding whether a cost is fixed, or variable can be in, and of itself extremely challenging.

Next slide, please. When pricing isn't uniform across the market that you're dealing with, what do you actually measure? If you've got various different products, and combinations of products, how do you decide what's most important, and how widespread the below cost pricing needs to be? Sometimes there are transitory pricing adjustments, and it's difficult to know whether that, for example, is a true competitive promotional pricing versus a targeted attack on a competitor. On the revenue side, you often have to decide are there impacts of customer migration across products? If a particular product is priced at a lower level, are you attracting customers that you lose from another higher priced product combination? And can you use that? Can you measure that, in terms of factoring in whether, or not the pricing is predatory? Fixed, and variable costs are not immutable, the timeframe matters. I mean, I've heard an economist say, "All costs are variable over a long enough period of time", and that's probably true.

So, you have to decide. And if you're talking about huge buckets of costs, many, many inputs, you may have to do an analysis over all of that in order to determine exactly where you are. Promotional pricing can be particularly challenging. You can sometimes have a large dominant competitor in one market who portrays itself as a new entrant in another market, but it has all of the attributes of a dominant competitor, so that in, and of itself can also make the presentation difficult. Next slide, please. Recoupment. Recoupment is, I think, the most difficult, and I've talked a little bit about that, how hard it can be. In the Uber case, for example, we did allege that recoupment was a dangerous probability, and likely to occur, but it was extremely challenging. The presence of another competitor is always really challenging. In the case of Uber, of course, you had the competitor Lyft, and much of the argument at motion to dismiss was about whether, or not Lyft would serve as a check, and would increase its output in the event that Uber tried to raise prices.

So, that was extremely difficult. Rebel Oil in the 9th Circuit is a difficult case in terms of recoupment, and how you show it. So, it is overall you have to do your best to present why in the true economic market of the future, the dominant competitor will be able to raise prices, and will not be checked. And we were able to get by motion to dismiss, but it was in part, I think, by virtue of allegations about the status of Lyft. And I do recall the skepticism of Judge Spiro who at one point said, "I wonder what the executives of Lyft would say about this." So, you see the skepticism not only in cost, and pricing, and market, you see it with respect to recoupment. Price discrimination, how significant is that, and should that matter? I think it is extremely significant, and I will talk about that in just a minute. Let's go to the next slide.

Last thing I want to address, what can be done? I've laid out many of the difficulties that someone faces, and when you're a private plaintiff, and largely represented by a contingent law firm who's putting up real money, millions of dollars for economic analysis, you want to have some expectation that you have a reasonable chance for success. I think if these cases are going to flourish, inevitably we're going to need to take into account the significant impact of what Chairman Kahn called targeted pricing, and what I may be more pejoratively referred to as price discrimination, which is the ability to use high prices in various segments of the market to fund targeted below cost pricing in another segment of the market. And my own view is, and had we reached summary judgment without resolution in the Uber case, which we didn't, we did resolve it before then.

But had we gone there, I think you would've seen a significant amount of back, and forth, and argument about the impact of dynamic pricing, targeted pricing, and how significant that is. And my own view is that if a plaintiff can show the ability to raise prices to a segment of the market, it will. That alone ought to be sufficient to show a dangerous probability of recoupment if it already exists by virtue of the ability to target your prices, lower them where the competitor is most prevalent, keep them high, where competition is less prevalent. If you could show that, in my view, the courts ought to treat that as sufficient showing of dangerous probability of recoupment. Finally, with respect to cost pricing analysis, I think the flexibility that is discussed in the article from the panelists that spoke earlier, extremely important to be able to deal with the complexities of cost, and pricing, and have the most flexibility in showing how you achieve the below cost pricing, how it was targeted, and what it meant for the market.

So, I think those are the ways that we can make predatory pricing case law meaningful, and have these cases properly developed. I was fascinated, I'll end with this, I heard earlier they had done an actual empirical analysis of recoupment by Uber in the New York market after the time period of our case. So, in the real world it happened. At least that's what the economic analysis showed. We were on the front end. Much harder to say, "It will happen", easier on the back end to look at it, and say, "It actually did happen." So, these cases are real, they matter, and they matter to the development of the law. Thanks very much.

Lina M. Khan:

Thanks so much, Lew. Our last speaker, Sam Weinstein, is a law professor at Cardozo Law School, and author of The Venture Predation. Professor Weinstein?

Sam Weinstein:

Thanks so much, Laura, thanks to the FTC for putting on this great workshop. So, I'm going to be talking about some updated predatory pricing strategies that I think give the law eye to the idea that predatory pricing is rarely tried. Next slide, please. So, we've heard quite a bit today about predatory pricing skepticism. So, this is the Chicago School idea that it's an irrational strategy, and that you'll never see it in the wild, or rarely see it in the wild, because firms are reluctant to try it because won't work out for them for a variety of reasons. Next slide, please.

So, Brook Group has decided in 1993 based predominantly on the Chicago school theory. And since then, as we've heard, the economics has advanced, and we have a variety of post Chicago School theories, often game theoretical models to show that in certain settings, price predation is a rational strategy. I think what ties together a lot of these theories as Dr. Karlinger discussed, is the idea of asymmetric information. So, the idea that the predator has some information that the prey, or the prey's lender doesn't have. And the predator knows that it's using below cost pricing, predatory pricing, to chase out the rival, but the rival might think that the predators found some new efficiency, or the rival's lenders might think that, and drop out of the market thinking they've been outcompeted on the

merits, when in fact they've just been outcompeted because of predatory pricing. The problem has been trying to find these examples in the wild, trying to see this happen in real life. As my co-author, and I, Matt Wansley argued in this paper Venture Predation.

Next slide, please. We think you can find this example in Silicon Valley. So, let me just talk briefly. Matt talked about it earlier, but just to introduce this theory again. So, if you think about classic predation, you take a firm that is going to self-fund, or use bank funding for a price war. Its hope is to chase out the rival, or discipline the rival, and then raise prices above the competitive level. And it really is dedicated to making back all that money because it's on its own account. A venture predation is different, right? So, here the money comes from the venture capitalists. What the venture capitalists is hoping to do is to create a company with a huge amount of scale, and do it very quickly. So, it's going to fund a price war probably to a platform company, allow the platform company to solve the chicken, and egg problem, and get users on both sides of the platform, hoping that company scales very quickly. And then within the tenure timeframe of the venture fund, the venture capitalists are going to cash out either through an IPO, or through an acquisition. And probably some of the founders are going to cash out, too. Okay, next slide please. So, there are a couple differences that are really critical about venture predation as opposed to classic predation. So, the big one I think Matt talked about earlier is that, as opposed to a firm that's doing this on its own account, venture capitalists don't care about recoupment. They don't care if the company ultimately makes back all the money that was lost during the price war. All they care about is convincing the next investor at the IPO, or at the acquisition stage, that this company has enough scale that's going to be able to charge monopoly, or oligopoly prices, and make a good profit for the later investors.

Okay, next slide, please. The second difference that we think is key between venture predation, and classic predation goes to this asymmetric information setting that the post-Chicago School economists talked about. So, if you think about a public company. Now, a public company can try to hide predation through accounting measures. Eventually, probably people are going to ask questions. In a private company of a VC-backed startup, for instance, it's easier to hide predation, it's easier to take advantage of the asymmetric information. The venture capitalists often sit, or almost always sit on the board of the startup. They can work with the founders to get the strategy going. And it's very difficult for the rivals, say the taxicab companies with Uber to understand what's going on.

They might think rationally that Uber has some new efficiency, and that's why they're able to charge below what the taxicabs have been charging for years. But in fact, what's going on is this is venture-backed predation. Okay, next slide, please. Okay, so what are the costs of venture predation, or predation generally? And in the paper we talk about three states of the world with venture predation that we think we've seen. So, one would be successful recoupment. This is, let's say Uber is able to, with Lyft, raise their prices above the competitive level for long enough that they make back every last dollar they spent during the price...

PART 3 OF 4 ENDS [01:42:04]

Sam Weinstein:

... for long enough that they make back every last dollar they spent during the price war. This fits just within Brooke Group as a case law matter, it would be unlawful under Brooke Group if you could show it, but as Lew was saying, it'd be very difficult to show. The harm is obvious, super competitive prices paid by consumers. There are fewer firms to choose from, less product innovation.

Okay. Another scenario that we've seen with say WeWork, which looked like a venture predator to us, is failing to dominate. So WeWork burned billions of dollars offering below cost leases to try to gain scale

and destroy co-working competitors. And what happened at the end of the day was when WeWork tried to IPO, its cost structure became clear to everyone and everyone understood they couldn't make money, so the IPO collapsed. So what happens there is you have a transfer of wealth from investors, VCs to consumers. So some folks got below cost office space for a while and VCs, SoftBank, in this case, lost some money. I don't think that's maybe the best use of funds, but we're not so worried about that.

The tricky scenario is domination with uncertain recoupment. We think this is probably Uber. So this is Uber and Lyft have, we think a stable duopoly now in ride-sharing. And it appears to us that some folks at least are paying super competitive prices for ride-sharing through Uber. There have been some other harms, fewer choices, less product innovation. Is it clear to us that Uber is going to recoup every last dollar lost during the price war? No, we don't know. It's too difficult to say, as Lew was saying. But there are other costs.

So first, some people are paying above the competitive price, we think, and that's bad. As Matt was saying before, the market's distorted, so the price signal is distorted. Maybe an Uber driver makes the wrong decision based on a subsidized fare or maybe a municipality makes the wrong decision on public works due to what it thinks Uber's costs are going to be, prices are going to be going forward. Or generally we just think this is a gross misallocation of capital. We don't like or we think it's bad for society that venture capitalists spend money on price predation when they could be spending on something better like a vaccine. Okay, next slide please.

So litigation challenges, Lew just talked about these. In venture predation, we think there are three. One is it's going to be difficult in a nascent market like let's say ride-sharing to show defendant's dominance. The second is, and I think Lew touched on this too, is how do you distinguish venture predation from lawful below-cost pricing? So any platform company is going to need to burn some cash to get started. To solve the chicken and the egg problem it's going to need to lose some money to get folks on the platform on both sides. Where do you draw the line? How long do you have to charge below cost to say it's unlawful? We think Uber crossed that line. They essentially did this for years and years, maybe a decade they lost money. It's not clear they ever really made money. So we think they've passed that line, but where is that line that's difficult? And then finally satisfying recoupment as everyone has talked about is quite challenging. Next slide please.

So what can we do with a recoupment product that would be better than what's happening right now? We think at least with venture predation, a judge or a jury should be able to infer a likelihood of recoupment from the way that investors act. So either the early investors who think they're willing to sustain losses for a long time with the idea that this company might eventually recoup, but certainly the later investors who are buying into a company that they think is going to be able to charge above the super competitive level, we think that ought to be enough to show recoupment. At least if you don't like that, how about investors' belief plus some proof of super competitive pricing, we think Uber's doing that now and not this impossible hill to climb of, you have to show that every last dollar would be recouped. Okay, next slide please.

And I just want to mention one other updated strategy, other folks have mentioned this too that I think calls for a re-examination of Brooke Group. This is using predatory pricing algorithms, so Christopher Leslie has a great paper called Predatory Pricing Algorithms where he talks about targeted predation, you could target your customers, your rival's customers for below-cost pricing while charging the competitive price or the super competitive price to your own customers. And these dynamic pricing algorithms can commit to the strategy in a way that humans can't making it much more dangerous and the law should react. So I'll stop there.

Lina M. Khan:

All right, that was terrific. Thank you. So that concludes our presentations and now hopefully we can get all these folks to engage in a productive question and answer period. And I want to start off by noting that I sent some agreement among the panelists that Brooke Group's court's skepticism about whether predatory pricing occurs and is profitable was not warranted and that there is predatory pricing going on in markets that is not being enforced against. And Sam talked some about the cost of that predatory pricing that is not being subjected to enforcement. And I just wanted to ask the other panelists if there are costs that Sam did not mention to this unenforced predatory pricing. Scott, you want to start us off?

Scott Hemphill:

Yeah, sure. I'd be happy to jump in. And I should say for avoidance of doubt, we are definitely in a realm of under enforcement to the extent that the set of cases that are brought as basically zero. And given that we know that as a matter of theory there are opportunities for this to be profitable and we see tantalizing examples even as outsiders to the facts where it might well be arising and given moreover that I think there's a shared understanding that if a firm is pricing below cost, there's a good chance that it thinks it's able to recoup. Sam just touched on some of this, and when they do it we believe them, that is the price-cost test should tell us something about recoupment.

But getting more narrowly into your question, what are the costs? We've talked about a lot of different distortions. We talked about a post-predation period of recoupment. I think it's worth noticing also the lost innovation that we might expect, that to the extent that we have one firm rather than several, the firms that are being squeezed out might well be sources of quality competition, might well have provided opportunities for innovation that we just never see. And I'm going to use the word innovation loosely to include elements of simply differentiation, respect for privacy, let's imagine being a point of differentiation, that it's hard to think of as innovation in the sense of a better mousetrap, but just a different mousetrap that might command custom from customers had they not been squeezed out.

Lina M. Khan:

Terrific. Others? Lew, did you want to jump in here?

Lewis LeClair:

Sure. I think the greatest cost is the competitors that just don't compete because of these challenges. That's the single greatest cost. The American innovation is driven by small competitors who do better, have great ideas and come forward. And predatory pricing is a tremendous way, a tool in the monopolist toolkit to kill that. And it costs American consumers enormously when those competitors don't come in, improve and make the market better. That's the single greatest cost in my mind.

Lina M. Khan:

Yeah. And I think another cost that I don't think anyone has mentioned, but it came up during our prep sessions is that this can also distort public spending. To take the Uber example, someone mentioned that it could under incentivize municipalities to invest in public transportation and things, so that's a dimension that I think is worth noting as well.

So federal enforcers have not brought a predatory pricing case in more than a decade. I'd be curious for the views of this group on whether you think the courts now, given the evolution in the economic science and in the thinking about the legal tests, might be open to a narrower reading of Brooke Group than in the past. And if not, why not?

Lewis LeClair:

Well, I'll jump in on this. I think they will be, and I think that the place where this will be helped is, the emergence of AI and algorithms I think will ultimately convince the courts that some of the rigid standards of Brooke Group cannot go forward in the same way, there has to be some ability to pursue these cases on the basis of the data and you simply can't. You've got to give flexibility. And I do, maybe I'm just an optimist, but I actually think the courts will recognize that for these cases to have any opportunity to succeed, there has to be flexibility in the analysis both on the recruitment side and on the price cost side. And I'm very hopeful that will happen.

Lina M. Khan:

And Scott, I think your article points the way to some of the ways that could happen. I'm curious whether you have seen any evidence in the courts that they are actually embracing some of your very wise insights.

Scott Hemphill:

Yeah, so I guess I am a little bit of pessimism and a little bit of optimism. So I think I have a little bit of pessimism about the idea that, and I don't understand anybody to be claiming that, 'We've seen this groundswell of interest in adventurous and I trust on the part of the mind run of district court judges." Maybe with the changing composition of the judiciary we might get more openness to that.

I think what we ought to be thinking of is two things, both of which have been sort of said. One is you don't need every judge to be open to this, you need some judges to be open to this in order to start chipping away at the mistakes of broad interpretations of Brooke Group. A confident judge who understands the economics and who sees the narrowness of Brooke Group in certain ways we might be able to make some headway.

I don't want to be so optimistic, we haven't talked about the fact that later Supreme Court cases seem to understand Brooke Group and that they've basically taken the music and run with it in later cases like Weyerhaeuser let's say, or LinkLine. So I don't want to overstate Brooke Group as this tiny little thing, I'm just trying to encourage us to see it less of a brooding omnipresence. I think even if you look at American Airlines, the distance between the District Court and the Court of Appeals is important. The district court got a lot of things wrong, extremely skeptical. The Court of Appeals, affirmed the DOJ did not win that case, but there's a lot of material I think in the American Airlines case that suggests that to some degree they saw the issue clearly though they were limited by the fact that a lot of work had already been done by the district court that would've been pretty hard to undo.

The other thing I just want to emphasize, which Lewis mentioned just a minute ago, I think is totally right, is the importance of new facts. If you're trying to give, let's say a competent district judge a reason to understand Brooke Group in a way that makes possible the continued viability of predatory pricing cases, having facts that are different from oligopoly recoupment by cigarette manufacturers is really helpful. And I think the targeting point, whether seen in the algorithm mode of Christopher Leslie's article, or this point that was just made about recoupment being enabled by targeting of the inelastic customers, I think is really important. And if it can be established on particular facts, that I think gives substantial space to move away from the negative music of that opinion.

Lina M. Khan:

Yeah. So if we were to move away from at least the broad reading of Brooke Group or more radically to a standard that's different than the one that Brooke Group articulated, I mean Scott, you have in your article some thoughts about what that standard should be, but Liliane, I wanted to turn to you because

you has a different standard and I would love for you to sort of give a sense of what that standard is and how successful it is and whether you think that would make sense as a standard in US cases as well.

Liliane Karlinger:

Yeah, I'm happy to speak about that a bit. So basically putting on my enforces hat, which I also have as a member of the Chief Economist team here at DG COMP, I can tell you about the legal standard that we have here in Europe that differs from the US standard in two fundamental ways, and I think both of these give us here more leeway, more discretion to run predation cases. And that is why we have a non-zero number of predation cases, not many, but at least a handful to point to.

So one key difference is the legal standard for the price cost test. So in Europe we have one test that is very similar to the one that you have in the US. So [inaudible 01:56:15] principle, if you will, that pricing below average variable cost is considered presumptively illegal in the EU, but it does not end there. So in the EU you can also run cases where prices are above ABC. There is a whole range of prices, even all the way up to average total cost that could potentially be considered unlawful, predatory if, and that's a big if of course, as an authority you can provide evidence of intent to exclude competitors. So that in practice means you need documentary evidence, some internal documents, deliberations of management showing beyond a simple email, an angry email, but really showing that there was a strategy behind this pricing that had as its goal the exclusion of an entrant.

So I think that second leg of the test or that second type of test that we have in Europe strikes a nice balance for those who are worried about false positives. Of course, as soon as you allow prices to go above ABC and still find an instance of predation, that gets you closer and closer to false positives because prices above ABC are compatible with a number of pro-competitive strategies, so no doubt. So what really eliminates that risk again is the evidence on intent. Because if that pricing strategy was pro-competitive, if it was a matter of what we just discussed, overcoming chicken and egg problems, promotional pricing at the beginning, a pro-competitive reaction in one way or another to entry, this would be reflected in the strategy documents of the firm. Where instead it becomes clear that they were consciously sacrificing profit or consciously slashing prices with the sole objective of excluding a competitor, contemplating as an intended result of those actions the exclusion of a competitor that reduces the ambiguity as to what it is exactly that you're seeing in those prices.

So that's one leg. And the other, I think, main difference that we have in Europe is that we do not have to show recoupment. So this is simply not part of the required standard of evidence, which from my own experience in the [inaudible 01:59:12] case, and I'm happy to speak into that later if useful, is it's hugely helpful because it is just very difficult to argue successful recoupment, not necessarily because it doesn't happen, but because it may happen in a different way on a different market. It is just a lot more complex than what in the US case law judges seem to expect of just observing increasing prices on the very same market post exit or post end of the predatory campaign. So since recoupment is not articulated, spelled out in this straightforward way in most predation cases that I've seen, that requirement would not be met in a number of cases that instead were successfully brought in Europe.

Lina M. Khan:

Yes. Yes, Scott, go ahead please.

Scott Hemphill:

I just wanted to add one thing that came to mind after hearing about this wonderful alternative world in which we don't have a recoupment requirement, and I think we've heard repeatedly desires to water that down or to inform it with, for example, evidence of price below cost, that being a pretty powerful

signal that they were up to something. It's a sacrifice analysis which we're familiar with from other parts of antitrust.

And just coming back to some of Sam's work with respect to venture predation that I think sometimes we imagine what's needed for a recoupment test is that recoupment was more likely than not, and that just seems totally wrong to me when we think about these sort of long shot strategies.

So one way, I don't think this is necessarily... I don't know whether Sam would agree with the following or not, I'm not sure it's a point of major emphasis there, but you could imagine that let's say a one in 10 shot of a huge amount of recoupment over the course of decades is enough to justify a big expenditure in the moment, that is that recoupment and expected value, even if the probability of achieving that is pretty low to be ought to be enough and so that even if we have a recoupment requirement, we ought to understand that with that in mind, especially in environments where we know that the investors are taking a flyer on a low probability jackpot that the prospect of recoupment could be much dimmer as long as the magnitude is high enough.

Lina M. Khan:

Well, Sam, we're almost out of time, but since your work was invoked by Scott, I want to give you a chance to have the last word.

Sam Weinstein:

Yeah, I just want to completely endorse everything he just said, which is to say one way you might criticize our theory is, well, why would the late stage investors ever take on this company if they look at the documents and say, "Well, they're not really making money." But it's just the reason that Scott said, they think, well, they have a lot of scale, so they're trying to hit a grand slam and they think there's a chance here with a company like Uber that we will hit that grand slam. So it's not irrational for the late stage investors to take the company off the VC's hands. So it's a great point and I completely agree with it.

Lina M. Khan:

Well, unfortunately, that does conclude our panel because we are out of time, but this has been such a terrific discussion and thank you so much to our panelists for sharing your thoughts and insights. I would now like to welcome Commissioner Bedoya to give some closing remarks. Commissioner Bedoya.

Tamar Katz:

Thank you, Laura, so much for having me here today. I learned a lot from reading some of the scholarship that was highlighted today, and I hope everyone who has been watching and listening has as well.

As a first matter, I think it's really important to remember that predatory pricing or local price cutting as it was once called, hurts businesses and the public alike. Cutting your prices below the cost of production to push out your rivals, of course hurts competition, it makes it impossible to compete on the merits. So in a world of predatory pricing, the best man does not win. The richest man wins, the one with the biggest war chest wins. And so of course the public loses too. Those low prices from the predator feel pretty good for a little while until all of the predator's rivals are gone and prices goes up, go up and quality falls through the floor. As one of the architects of this commission, Louis Brandeis put it, "Far-seeing organized capital secured by this means the cooperation of the short-sighted, unorganized consumer to his own undoing. That consumer yields to the temptation of trifling immediate gain and selling his birthright for a mess of potage becomes himself an instrument of monopoly." Under

predatory pricing, everyone except the predator loses. Today I want to do two things in brief. First, I want to challenge one idea at the heart of Brooke Group, or rather, I want to add my voice to the chorus of people challenging this idea, and that's the idea that predatory pricing is rare. That's the first thing I want to do. The second thing I want to do is highlight what I think is an underappreciated symptom of the recoupment that follows a predatory pricing strategy. We all know that the second prong of predatory pricing under Brooke Group is recruitment through super competitive prices. It's clear to me that often recruitment also manifests as infra-competitive wages, infra-competitive working conditions and infra-competitive product quality.

So taking a step back, since Brooke Group, scholars and economists have done a great job undercutting this idea that predatory pricing is irrational. So there's a whole lot of reasons why someone, a business might want to engage in the strategy. Maybe other firms won't know your pricing below costs. Maybe they'll assume you've just built a far cheaper and better mousetrap so they exit. Maybe all you need is to establish a reputation for being a predator, and that will help you push out your rivals without actually incurring the cost of pricing below costs. So there's any number of ways in which this can be "rational", at least from an economic sense.

But I think for far too long, people have assumed that predatory pricing is in fact rare when it very obviously it's not. And of the scholarship that was highlighted today, I'm especially grateful to Professor Weinstein and Professor Wansley for their article Venture Predation, which highlights how venture capital-backed startups very clearly appear to engage in predatory pricing. So with these massive VC war chests startups price their products and services well below cost. The VCs don't mind if they fail because all they need is just one or two of their bets to pay off. Rivals certainly don't know that startups are pricing below cost because privately held companies don't have the same obligations to disclose their financials as publicly traded companies and so those infracompetitive prices push their rivals out of the market. Once they've established that market share, founders and VCs can make highly profitable exits, not by actually recouping, but by convincing other investors who buy their shares that recoupment is in fact possible. And once the firm actually starts recouping the public and workers suffer.

I'll say that as I was reading Venture Predation, it reminded me of a different cycle that was outlined by author and friend of the FTC, Cory Doctorow, he calls it the let's just say, enblankification of the internet. And all of us have seen that cycle. It goes like this, a platform could be a rideshare platform, a social media site, an online marketplace starts out with low prices and high quality. It builds market share and locks consumers, workers and businesses into the platform. And then when it's time to recoup those losses, prices go up and quality goes through the floor. In 2024, I think people have a very hard time describing that cycle as rare. And while Doctorow's enblankification of the internet is not a one-to-one match to the requirements of the predatory pricing cycle, I think it's close enough that it is very, very hard to call predatory pricing rare. That's my first point on the rarity or rather the commonness of this strategy.

This is my second point, and it ties into something that came up in Professor Wansley and Weinstein's article. They highlight the fact that recruitment might not come in the form just of super competitive prices to consumers that would of course be recognized by the consumer welfare standards, it might also come in the form of infracompetitive wages and working conditions to the working people who supply the labor to the alleged predator. Specifically, they highlight the experiences of taxi drivers who might see that a rideshare company is paying better than a taxi company who might leave their jobs at taxi companies to go drive for that rideshare company, even purchasing vehicles to do that only to see their wages plummet when the rideshare company allegedly enters a recoupment phase.

Now here's the thing is that when I read this, this isn't some hypothetical set of allegations. These are the exact allegations being made right now today by rideshare drivers across the country. So just two

months ago, I went up to New York City and sat down with a room full of rideshare drivers to hear about their problems and they alleged exactly this, they had been lured in to drive for the companies that purchased vehicles for these companies with promises of high pay and also control over their working hours only for the companies to subsequently degrade that pay and degrade that control that they had over their working conditions. And that's one thing that's really clear, it was not just about wages for them, they also alleged that their working conditions were degraded as well.

I'll always remember the first speaker at that workshop was a gentleman named Mohammed Mohammed. He had started a drive for the apps in 2016 after he saw the collapse of the taxi industry. Like a lot of drivers, he loved this idea of being in control. He talked a lot about how the companies called him a partner. They said, "You're a partner to us," he told me. And he was a good partner. He, over nine years, logged 21,000 rides and maintained a hundred percent acceptance rating and a five-star rating as well. But over the past few months, not just the pay had degraded, but the flexibility and control had evaporated as well because when he got up in the morning to drive, he would sometimes find that he was locked inexplicably out of both of the apps.

Bloomberg just did a terrific expose or investigation on this, and they found that in just one day over the five hours that he was on the road, he was locked out entirely out of both of the rideshare apps for two of those hours. And he told me it was luck. He had no idea how it works. And frankly, this echoed, and I know the experiences in New York City are partly specific to a regulatory issue that has arisen there in the way the drivers allege that the platforms have used that to their advantage. But this kind of account is extremely common. I refer to Professor Dubal's article on algorithmic wage discrimination in which you hear echoes of that same argument that it comes down to luck. We can't explain how this works. You have a lot of drivers comparing driving for rideshare companies as something akin to playing their odds at a casino. And so when we think about recoupment, we cannot just think about super competitive prices. We have to think about infracompetitive pay and working conditions and the quality of those jobs.

And in closing, I think that of course, Brooke Group is law and of course, as long as Brooke Group is law, the recruitment requirement is law as well. But I think Professor Hemphill's article was very helpful in underlining that Brooke Group was born out of a very specific set of factual requirements. And so I would hope that the recruitment standard under Brooke Group could be met via evidence, not just of the super competitive prices, but also in terms of infracompetitive pay and working conditions as well as infracompetitive quality in terms of the products being offered to consumers.

So with that, it is my pleasure to adjourn this workshop and I want to say thank you to everyone on staff who helped organize it. I want to say thank you to all of our speakers today, the scholars and practicing attorneys who joined. And with that, I will declare this workshop adjourned. Thank you so much for coming and watching.

PART 4 OF 4 ENDS [02:12:13]