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Antitrust - Predatory Pricing - Sixth Circuit Incorrectly Uses of Post-Chicago Economics and Analysis of Non-Price Predation to Overturn Summary Judgment Granted to an Antitrust Defendant: *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*

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**ANTITRUST—PREDATORY PRICING—SIXTH CIRCUIT
INCORRECTLY USES POST-CHICAGO ECONOMICS
AND ANALYSIS OF NON-PRICE PREDATION TO
OVERTURN SUMMARY JUDGMENT GRANTED TO
AN ANTITRUST DEFENDANT: *SPIRIT AIRLINES, INC. V.
NORTHWEST AIRLINES, INC.***

CASEY BURTON*

SINCE 1993, the federal courts have not been friendly places for those businesses claiming to have suffered predatory pricing injuries under section 2 of the Sherman Antitrust Act.¹ Due to the Supreme Court's creation of an objective standard for price predation in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,² many lower courts, even in cases where common sense would seem to suggest that predatory pricing was occurring, held that there was no predation.³ However, with the action brought by Spirit Airlines against Northwest Airlines, the Sixth Circuit wrongly reopened the courts to hear potential predation actions by holding that, in addition to prices, non-price behavior can be taken into account under the *Brooke Group* test,⁴ thus signaling a shift away from Chicago economics and bring-

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¹ See Patrick Bolton et al., *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239, 2258-59 (2000) (stating that "[i]n the six years following *Brooke*, plaintiffs have not prevailed in a single case in the federal courts"); see also Jim Weiss et al., *Predatory Conduct Claims: Uncertain Future*, NAT'L L. J., June 26, 2006, at S2 (noting that "[b]usinesses troubled by their competitors' price cuts have had scant recourse to the antitrust courts.").

² *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222-224 (1993).

³ See, e.g., *United States v. AMR Corp.*, 335 F.3d 1109, 1120-21 (10th Cir. 2003) (applying the reasoning in *Brooke Group* to hold that because the tests proposed by the government were invalid, the government failed to establish pricing below an appropriate measure of cost).

⁴ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 953 (6th Cir. 2005).

ing subjectivity to the objective requirements previously used in price predation cases.⁵

The air transportation industry has grown tremendously since the 1990s, as, with rising affluence, there was a greater need for capacity in air travel; however, rather than following the lead of the major players in the business, many new companies decided to follow a low-cost model.⁶ One of these new players was Spirit Airlines, Inc. (Spirit), which was formed in 1992 with its base of operations in Detroit.⁷ Spirit initially scheduled flights to Atlantic City and Florida, then expanded its flight operations to Philadelphia and Boston in 1995 and 1996.⁸ In its efforts to expand, Spirit ran into Northwest Airlines, Inc. (Northwest), which was the dominant carrier using the Detroit-Metro airport.⁹

As a low-fare and no-frills airline, Spirit's management "expected to attract primarily the price conscious or leisure traveler."¹⁰ Throughout the period of the alleged predation, Spirit charged \$49 for the Detroit-Philadelphia route, and between \$69 and \$109 for its flight to Boston.¹¹ Prior to Spirit's entry, Northwest had a seventy-two percent market share for the Detroit-Philadelphia route, with an unrestricted fare of \$355 and a lowest restricted fare of \$125.¹² Further, Northwest had an eighty-nine percent market share on the Detroit-Boston route, with an unrestricted fare of \$411 and a lowest restricted fare of \$189.¹³ When Spirit finally achieved a measure of success and began flying full planes on these routes, Northwest responded by drastically cutting costs; reducing the price of the Detroit-Boston route to \$69 and the Detroit-Philadelphia route to \$49, both of which matched the price of Spirit.¹⁴ In addition, Northwest increased its output, adding two more flights to Boston and a

⁵ See Jonathan B. Baker, *Predatory Pricing After Brooke Group: An Economic Perspective*, 62 ANTITRUST L.J. 585, 586 (1994).

⁶ See Ruwantissa Abeyratne, *Competition in Air Transport—The Need for a Shift in Focus*, 33 TRANSP. L.J. 29, 62–63 (2005–2006).

⁷ *Spirit*, 431 F.3d at 921.

⁸ *Id.* at 922.

⁹ *Id.* at 922–23 (explaining that "Northwest controlled the majority of the gates at the Detroit airport either by lease or secondary rights from other airlines At the Detroit Metro airport, Northwest 'controlled' 64 of the airport's 86 gates and had 78 percent of all passenger travel from the Detroit-Metro airport.").

¹⁰ *Id.* at 922.

¹¹ *Id.*

¹² *Id.* at 923.

¹³ *Id.*

¹⁴ *Id.* at 923–24.

DC-10 aircraft, thereby increasing the number of flights from 8.5 per day to 10.5 per day.¹⁵

Given this behavior, Spirit filed suit claiming a violation of section 2 of the Sherman Act,¹⁶ alleging anti-competitive and exclusionary practices.¹⁷ Northwest moved for summary judgment on the grounds that at all times its revenue exceeded its average variable cost and that its low-price strategy was, in fact, pro-competitive.¹⁸ Based on the above facts and citing to *Brooke Group*, the trial court granted summary judgment for Northwest, ruling that Spirit failed to meet the requirements set out by the Supreme Court.¹⁹ An appeal to the Sixth Circuit followed.²⁰

On appeal, the Sixth Circuit reversed the grant of summary judgment to Northwest and held that a reasonable jury could have found in favor of Spirit.²¹ Prior to this decision, the Supreme Court held that, “[i]n certain situations—for example where the market is highly diffuse and competitive, or where new entry is easy, or the defendant lacks adequate excess capacity to absorb the market shares of its rivals and cannot quickly create or purchase new capacity—summary disposition of the case is appropriate.”²² The Sixth Circuit turned this logic around, and stated that where conditions were in direct contra-

¹⁵ *Id.*

¹⁶ 15 U.S.C.A. § 2 (West 1997 & Supp. 2007) (creating a felony for any “person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States”).

¹⁷ *Spirit*, 431 F.3d at 924.

¹⁸ *Id.* at 925.

¹⁹ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, No. 00-71535, 2003 U.S. Dist. LEXIS 26831, at *77 (E.D. Mich. Mar. 31, 2003), rev’d, 431 F.3d 917 (6th Cir. 2005). The court stated:

[t]he sole and objective benchmark is whether the alleged predator’s prices exceed its costs, by reference to the products it actually sells and the markets in which it actually competes with the alleged victim of predation. Under this standard, the record compels the conclusion that Northwest’s prices were not predatory, because the airline operated profitably on both the DTW-BOS and DTW-PHL routes during the entire period of alleged predation.

Id.

²⁰ *Spirit*, 431 F.3d at 921.

²¹ *Id.*

²² *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) (citing *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 119-120 n.15 (1986)).

diction, summary judgment would be inappropriate.²³ After stating this proposition, the Sixth Circuit held that the conditions were in direct opposition, as a reasonable trier of fact could find that Northwest "engaged in anti-competitive conduct aimed at driving Spirit out of the relevant markets" and that Northwest was able to recoup its lost investment in below-cost pricing.²⁴ This enabled the court to conclude that Spirit "presented sufficient evidence of predatory pricing to withstand summary judgment."²⁵

The major focus of the court was the two requirements of the *Brooke Group* test, the first of which states that, "a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs."²⁶ The court explained this reasoning, quoting the Supreme Court in noting that:

[W]e have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the anti-trust laws. "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition."²⁷

Given this Supreme Court precedent, in order for the Sixth Circuit to find a violation of the Sherman Antitrust Act, the court had to find that the price charged by Northwest was below Northwest's cost.²⁸ To evaluate cost, antitrust cases look to see

²³ *Spirit*, 431 F.3d at 931 (stating that "a corollary of this principle of *Brooke Group*, is that where the market is highly concentrated, the barriers to entry are high, the defendant has market power and excess capacity, and evidence of actual recoupment is present, summary judgment is inappropriate.").

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Brooke Group*, 509 U.S. at 222 (citations omitted).

²⁷ *Id.* at 223 (quoting *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990)).

²⁸ *Spirit*, 431 F.3d at 938 (stating that, "[a]lthough the courts have accepted the marginal or average variable cost standard as an indicator of intent [to monopolize], many allow for consideration of other factors indicative of predation" (quoting *D.E. Rogers Assocs., Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1436 (6th Cir. 1983))). The Tenth Circuit also noted that:

[f]or predatory pricing cases, especially those involving allegedly predatory production increases, the ideal measure of cost would be marginal cost . . . [h]owever, marginal cost, an economic abstraction, is notoriously difficult to measure . . . [e]conomists, therefore, must resort to proxies for marginal cost. A commonly accepted proxy for marginal cost in predatory pricing cases is Average Varia-

whether marginal cost is below price, and estimate marginal cost by looking to measures of average variable cost.²⁹ Finding an appropriate measure of average variable cost is what led the Tenth Circuit to uphold a grant of summary judgment in favor of American Airlines; the Tenth Circuit reasoned that all of the proxies for marginal cost offered by the government were fatally flawed for including or excluding certain measures.³⁰ The Sixth Circuit distinguished the methodology used by Spirit's experts from those used by the government in *AMR* because, whereas the government's numbers in *AMR* included both fixed costs and measures of reduced profitability, which made no economic sense, Spirit's numbers, on the other hand, did not include any fixed costs, and therefore a trier of fact could find the analysis accurate.³¹ After the court determined that a trier of fact could find that Northwest priced below cost, the court moved to the second prong.

The second prong of the *Brooke Group* test requires the plaintiff to prove that "the competitor recovered or had . . . a dangerous probability of recouping its investment in below-cost prices."³² The court concluded that a "trier of fact could reasonably find that Northwest recouped any losses from its predatory pricing quickly after Spirit left these routes."³³ The court came to this conclusion because, in addition to expert testimony that a fact finder could have believed, there was the empirical evidence that after the exit of Spirit, Northwest reduced capacity and increased prices, thus allowing it to receive monopoly profits.³⁴ Although the *Brooke Group* requirements were considered met by the Sixth Circuit, the court also looked to other factors to show that a jury could find predation.

In addition to analyzing the two requirements laid out in *Brooke Group*, the Sixth Circuit looked at three other factors in determining whether monopolization occurred—the relevant market, whether Northwest possessed market power, and

ble Cost ("AVC"), the average of those costs that vary with the level of output.

United States v. *AMR Corp.*, 335 F.3d 1109, 1115–16 (10th Cir. 2003).

²⁹ *Spirit*, 431 F.3d at 938.

³⁰ *AMR*, 335 F.3d at 1120–21.

³¹ *Spirit*, 431 F.3d at 945–46.

³² *Id.* at 947 (citing *Matsushita Elect. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986)).

³³ *Id.* at 950.

³⁴ *Id.* at 950–51.

whether there were significant barriers to entry.³⁵ The court briefly looked at these factors and held that a jury could have found in favor of Spirit on these questions.³⁶ The court held that a reasonable jury could find that the relevant market was composed of low-cost or price-sensitive travelers because either there was industry recognition of this submarket or the consumer response showed that there was a submarket.³⁷ The court also concluded that a trier of fact could find that Northwest possessed market power in this segment.³⁸ The court held that through the testimony of Spirit's experts regarding the market share and gate control, as well as Northwest's increase in prices after Spirit's exit from the market, a reasonable fact finder could conclude that Northwest was exercising monopoly power.³⁹ Similarly, the Sixth Circuit affirmatively answered the question of whether there were significant barriers to entry by stating that "the facts and the economics of this industry could reasonably be found to establish significant barriers to entry."⁴⁰ The Sixth Circuit found the existence of high entry barriers because of Northwest's control of a high percentage of the gates at the Detroit airport, as well as the fact that Spirit had to pay twenty-five percent higher landing fees due to its inability to acquire a long-term gate lease.⁴¹ In addition to looking at the two requirements of the *Brooke Group* test and the three other factors, the Sixth Circuit looked to non-price predation for evidence of violations of the Sherman Act.

Although the Sixth Circuit's reasoning described above would have alone been a radically different result from most antitrust litigation, the court's subsequent analysis of non-price predation

³⁵ *Id.* at 931–32 (citing *Conwood Co. v. U.S. Tobacco Co.*, 290 F.3d 768, 782 (6th Cir. 2003)).

³⁶ *Id.* at 931.

³⁷ *Id.* at 933–35 (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); *White & White, Inc. v. Am. Hosp. Supply Corp.*, 723 F.2d 495, 500 (6th Cir. 1983)).

³⁸ *Id.* at 937.

³⁹ *Id.* at 935–36 (stating that monopoly power is "the ability of a single seller to raise price and restrict output," and the "existence of such power ordinarily is inferred from the seller's possession of a predominant share of the market." (quoting *Eastman Kodak Co. v. Image Tech Servs., Inc.*, 504 U.S. 451, 464 (1992))).

⁴⁰ *Id.* at 946–47 (stating that the "existence of high entry barriers is significant in determining the existence of predatory intent, inasmuch as only where such barriers exist will there be incentive to price predatorily." (quoting *Richter Concrete Corp. v. Hilltop Concrete Corp.*, 691 F.2d 818, 824 (6th Cir. 1982))).

⁴¹ *Id.* at 947.

was one of very few instances where a court evaluated anything other than a price-cost comparison.⁴² The District Court held that *Brooke Group* “deliberately eschews any qualitative judgments about the competitive desirability of one business practice versus another. The sole and objective benchmark is whether the alleged predator’s prices exceed its costs.”⁴³ In direct contrast, however, the Sixth Circuit held that:

[E]ven if the jury were to find that Northwest’s prices exceeded an appropriate measure of average variable costs, the jury must also consider the market structure in this controversy to determine if Northwest’s deep price discounts in response to Spirit’s entry and the accompanying expansion of its capacity on these routes injured competition.⁴⁴

Seemingly determined to utilize non-price factors, the Sixth Circuit reasoned that “even where theory suggests that predatory pricing is rare, . . . ‘when the realities of the market and the record facts indicate that [a predatory pricing scheme] has occurred and was likely to have succeeded, theory will not stand in the way of liability.’”⁴⁵ The court also cited to a Third Circuit opinion holding that sales above an appropriate measure of cost “does not end the section 2 analysis,” which, in the eyes of the court, allowed it to look to the addition of capacity as another factor in determining whether there was predatory pricing.⁴⁶ Purporting to apply this analysis, the Sixth Circuit looked to the reports of Spirit’s experts and held that a reasonable fact-finder could conclude that the expansion in output contributed markedly to the alleged price predation because the expansion would drive passengers from Spirit to Northwest, eliminating any competition in the market.⁴⁷

The Sixth Circuit’s conclusion in *Spirit Airlines, Inc. v. Northwest Airlines, Inc.* is an enormous departure from prior case law throughout the country. The Sixth Circuit both misinterpreted

⁴² *Id.* at 951 (discussing precedent where “a firm selling above average variable cost could be guilty of predation,” (citing *D.E. Rogers Assocs., Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1436 (6th Cir. 1983)) and also stating that “sales above its costs does not end the section 2 analysis.” (citing *LePage’s, Inc. v. 3M*, 324 F.3d 141, 151-52 (3d Cir. 2003))).

⁴³ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, No. 00-71535, 2003 U.S. Dist. LEXIS 26831, at *77 (E.D. Mich. Mar. 31, 2003), *rev’d*, 431 F.3d 917 (6th Cir. 2005).

⁴⁴ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 953 (6th Cir. 2005).

⁴⁵ *Id.* at 951 (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 229 (1993)).

⁴⁶ *Id.* at 951-52.

⁴⁷ *Id.* at 952-53.

and misapplied prior holdings of the Supreme Court, used economic theory that has not yet been embraced by other courts, and incorrectly used non-price factors to reverse summary judgment in favor of Spirit.

The Sixth Circuit, while devoting substantial time to the two requirements of the *Brooke Group* decision, incorrectly applied the standard set out by the Supreme Court. First, in determining whether prices are below an appropriate measure of costs, the court held, by looking to the only methodology proposed by Spirit, that a reasonable jury could find that price was below cost.⁴⁸ Yet, because the “mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition,”⁴⁹ courts should be extremely careful about relying on only one test.⁵⁰ Thus, Spirit’s reliance on a single test, full of debatable assumptions that allow for a finding of price below cost, misled the court to allow Spirit a trial on the merits. The court made a further mistake in determining that a jury could find that Northwest recovered the losses it sustained by pricing below cost. The court merely reiterated the findings of Spirit’s expert,⁵¹ with no analysis of whether the one opinion that was provided was economically rational. Spirit’s expert infused his analysis of recoupment with analysis both of expectations and of what actually happened, assuming that Northwest must have expected to drive Spirit from the market in two to four months, because the period of alleged predation was three months.⁵² This assumption is used solely for the purpose of providing an illustration to the court, but the Sixth Circuit incorrectly took the illustration as fact and used it to rule in favor of Spirit.⁵³

Further, the Sixth Circuit erred by using a theory of economics that has received little or no support from the courts, thus overturning the status quo and disrupting a half-century of anti-trust precedent. The current economic thought in antitrust cases is the Chicago School, used by the Supreme Court in most

⁴⁸ *Id.* at 945.

⁴⁹ *Brooke Group*, 509 U.S. at 226.

⁵⁰ When the government sued American Airlines for predatory pricing, they prepared four tests, noting that “a range of tests are necessary to rule out false positives and assure confidence in the results.” *United States v. AMR Corp.*, 335 F.3d 1109, 1117 (10th Cir. 2003).

⁵¹ *See Spirit*, 431 F.3d at 949–50.

⁵² *Id.*

⁵³ *See id.*

of its recent jurisprudence.⁵⁴ The influence of the Chicago School is seen in the attitude of the Supreme Court when it held that successful predatory pricing is “inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition.”⁵⁵ This skepticism regarding predatory pricing continues, as seen by the lack of success of predatory pricing claims since *Brooke Group*.⁵⁶ However, the Sixth Circuit cited to Jonathan Baker, whose article clearly shows a bias toward the post-Chicago School, in which predatory pricing is seen as possible by establishing a reputation of predation.⁵⁷ Other post-Chicago writers have commented that “predatory pricing can be a successful and fully rational business strategy”⁵⁸ by taking into account imperfect information, multi-market recoupment, game theory, and other forms of strategic behavior.⁵⁹ These views have never been endorsed by the Supreme Court, and many of the most respected jurists involved in the study of law and economics subscribe to the opposite view.⁶⁰ The Sixth Circuit, in embracing and using this new theory of economics, has upset the relative stability in the antitrust field and has produced a decision contrary to the preference of the Supreme Court for the Chicago School of economics.

Finally, the Sixth Circuit incorrectly used non-price factors to determine if predatory pricing took place. While non-price factors can be used in predatory pricing cases, such as those involving bundling, Spirit’s allegation of non-price predation through increasing capacity is duplicative of its price predation claim. Universally accepted economic theory informs this principle, as there is no difference between a decrease in price and an increase in output—a decrease in price leads to an increase in quantity demanded and an increase in output leads to lower

⁵⁴ See Baker, *supra* note 5, at 586. See, e.g., *Brooke Group*, 509 U.S. at 209; *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588–90 (1986).

⁵⁵ *Matsushita*, 475 U.S. at 589. See also *Brooke Group*, 509 U.S. at 226 (stating that “[a]s we have said in the Sherman Act context, predatory pricing schemes are rarely tried, and even more rarely successful”) (citation and internal quotations omitted).

⁵⁶ Bolton et al., *supra* note 1, at 2258–59.

⁵⁷ Baker, *supra* note 5, at 591.

⁵⁸ Bolton et al., *supra* note 1, at 2241.

⁵⁹ *Id.* at 2247.

⁶⁰ See, e.g., Frank H. Easterbrook, *Predatory Strategies & Counterstrategies*, 48 U. CHI. L. REV. 263, 264 (1981) (stating that “there is no sufficient reason for antitrust law or the courts to take predation seriously”). See generally ROBERT BORK, *THE ANTITRUST PARADOX* (1978).

prices. Further, any independent examination of non-price predation is unnecessary, because any increase in capacity was already taken into account through Spirit's calculation of average variable cost. Spirit's calculation of average variable cost included the "economic cost of using an airplane . . . based on the market lease rate for the airplane,"⁶¹ and thus any other consideration of the increase in capacity would be double counting that factor. If Spirit wanted to make a claim for non-price predation, it should not have been able to include the opportunity cost of the increase in capacity as reflected in the market lease rate; however, without the large addition to average variable cost due to the addition of a DC-10, the price charged by Northwest would almost certainly have been above cost, and thus Spirit would have no claim. Thus, the court was incorrect in considering the addition of capacity in conjunction with other price factors.

The Sixth Circuit's holding should concern many of the major air carriers and should give new life to the crop of low fare airlines that survived the initial "predation" efforts of major airlines. This decision goes against all precedent and prior courts' use of economic thought, and establishes new antitrust worries for many large companies. Specifically, airlines should be worried that this is more an indictment of the hub-and-spoke system in general than of Northwest in particular, because if this decision is upheld by the Supreme Court, all of the major airlines may be found guilty of anti-trust violations, because they have all engaged in this practice at some time or another to "defend" their hub. Finally, this decision moves the decision from one of an objective comparison of prices and costs to one where all manner of non-price behavior can become fodder for a plaintiff who failed to carry out its business in a profitable manner when faced with an entrenched defendant.

⁶¹ Spirit Airlines, Inc. v. Nw. Airlines, Inc., 431 F.3d 917, 940 (6th Cir. 2005).