2004

To Trap the White Tiger and Unicorn, the Government Needs Better Traps: An Examination of the Viability of Predatory Pricing Claims in the Airline Industry

Dennis J. Keithly

Follow this and additional works at: https://scholar.smu.edu/jalc

Recommended Citation
https://scholar.smu.edu/jalc/vol69/iss4/8

This Comment is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Journal of Air Law and Commerce by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
TO TRAP THE WHITE TIGER AND UNICORN, THE
GOVERNMENT NEEDS BETTER TRAPS: AN
EXAMINATION OF THE VIABILITY OF PREDATORY
PRICING CLAIMS IN THE AIRLINE INDUSTRY

DENNIS J. KEITHLY

I. INTRODUCTION

THE VIABILITY OF a predatory pricing claim is an often de-
bated topic. Some experts in antitrust law argue that preda-
tory pricing is irrational, and unlikely to occur.\(^1\) Indeed, one
expert in the field noted that two FTC Commissioners analo-
gized predatory pricing to white tigers and unicorns in an effort
to demonstrate that many think the existence of an actual occu-
rence of predatory pricing is either rare or nonexistent.\(^2\) Others
argue that it can occur and does exist, but that current methods
for determining liability for predatory pricing fail to either de-
tect it or do not permit a successful prosecution of it.\(^3\) Despite
those that claim predatory pricing is but a myth, predatory pric-
ing remains a potential threat to competition in the airline
industry.

Under the current predatory pricing laws, an airline can hide
behind its own faulty or inadequate accounting procedures, or
in a worst case scenario, deliberately hide its predatory practices
in its accounting procedures. In such a scenario, the govern-
ment faces a nearly impossible task of showing the costs of the
airline to be predatory. In addition, the government enables
airlines to engage in behavior that is, at least on the surface,

---

\(^*\) Dennis J. Keithly, J.D., SMU Dedman School of Law. The author would like
to thank Nikki Renna for her advice and suggestions while writing this article,
Beverly Dureus, and the SMU Law faculty.


\(^2\) *Id.*

\(^3\) *Id.* (noting that the post-Chicago school of economics has set forth new theo-
ries of predatory pricing including “deep pocket” predatory pricers and “mul-
timarket recoupment” that have not yet been adopted).
predatory. This has been done through the enactment of such laws as the Wright Amendment and through assistance, in the form of bailouts, to airlines that are routinely unprofitable. As a result, competitors (specifically low-cost carriers), competition, and ultimately consumers are harmed. There are many possible solutions to these problems ranging from denying assistance to failing airlines, changing the method of measuring cost in a predatory pricing claim, relaxing the standards for measuring cost, and changing the elements the government needs to prove in order to successfully prosecute a predatory pricing claim. This article begins by briefly outlining the current law in predatory pricing by examining some recent cases and how they have been applied. Next, predatory pricing in the airline industry will be demonstrated by an example of a recent predatory pricing claim involving American Airlines. To further illustrate predatory pricing in the airline industry, the features and problems of low-cost carriers, including how they are preyed upon, will be briefly examined. Southwest Airlines will be used to illustrate how an effective low-cost carrier works. Finally, problems in measuring costs will be outlined, and some potential solutions will be proposed.

II. CURRENT STATE OF ANTI-TRUST LAW

A. OVERVIEW OF PREDATORY PRICING LAW

The preeminent case in predatory pricing law is *Brooke Group Ltd. v. Brown & Williamson Tobacco Corporation.* This case concerned predatory pricing as practiced in the cigarette industry with regards to generic brands of cigarettes. The Court applied Chicago school economics and determined that the firm of Brown & Williamson was not liable for predatory pricing. The most important aspect of this case was that it clarified the requirements needed to successfully prosecute a predatory pricing claim and resolved a conflict among the federal courts. Those

---

5 *Id.*
6 *Id.* at 243. The “Chicago school of economics” is a collection of literature written largely by scholars educated at the University of Chicago which holds that many types of behavior that the Supreme Court had previously determined to be unlawful could not possibly harm consumers, and furthermore, predatory pricing could never be implemented profitably. Richard J. Pierce, Jr., *Is Post-Chicago Economics Ready for the Courtroom? A Response to Professor Brennan*, 69 GEO. WASH. L. REV. 1103, 1105-06 (2001).
requirements, initially outlined in the Sherman Act,\textsuperscript{7} are setting prices below actual costs coupled with a reasonable prospect of recovering profits lost during the predatory period by increasing prices after the competition has folded, been driven out of the market, or acquiesced and raised prices.\textsuperscript{8} It is also important to note that competition must be harmed, and that it is insufficient for a competitor to simply suffer injury.\textsuperscript{9}

The Supreme Court acknowledged that there was no definitive method for determining the appropriate measure of cost.\textsuperscript{10} In its opinion, the Court accepted average variable cost, as defined by the parties, as an acceptable method, but did not adopt it.\textsuperscript{11} The Supreme Court acknowledged in another case, \textit{Cargill, Inc. v. Monfort of Colorado, Inc.},\textsuperscript{12} that the issue was still undecided concerning what the appropriate measure of cost was in a predatory pricing case. The Sixth Circuit had adopted a "standard for evaluating claims of predatory pricing" employed by the Ninth Circuit in which the plaintiff bore the burden of proof when the defendant's prices were set below total average prices but above average variable price. However, when the plaintiff set prices below average variable costs, the burden shifts to the defendant to prove that prices were justified.\textsuperscript{13} The Supreme Court also noted in \textit{Cargill} that the Ninth Circuit found predatory pricing when a company reduced prices to just over cost, finding that such a price reduction may be predatory pricing subject to showing a predatory intent.\textsuperscript{15} In their case, the

\begin{footnotesize}
\textsuperscript{8} Under the Robinson-Patman Act, which amended the Clayton Act, a reasonable prospect is required. Under the Sherman Act, a dangerous probability of recovering lost profits is required. \textit{Brooke Group Ltd.}, 509 U.S. at 209; see also Baker, \textit{supra} note 1, at 593-94 (explaining that a reasonable prospect is required under the Robinson-Patman Act standard for primary-line price discrimination, and a "dangerous probability" is required for a Sherman Act Section 2 attempted monopolization).
\textsuperscript{9} \textit{Brooke Group Ltd.}, 509 U.S. at 224.
\textsuperscript{10} \textit{Id.} at 223 n.1.
\textsuperscript{11} \textit{Id.}
\textsuperscript{12} \textit{Cargill, Inc. v. Monfort of Colo., Inc.}, 479 U.S. 104, 117 n.12 (1986). \textit{Cargill} concerned an action brought by a beef packer against two larger beef packers to keep them from merging. The Court ruled that the possible loss of profits by the plaintiff from price competition after the merger was insufficient to show predatory pricing. \textit{Id.} at 117.
\textsuperscript{13} Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050 (6th Cir. 1984).
\textsuperscript{14} See \textit{Transamerica Computer Co. v. IBM Corp.}, 698 F.2d 1377 (9th Cir. 1983). This case concerned manufacturers of "plug-compatible" peripherals.
\textsuperscript{15} \textit{Cargill}, 479 U.S. at 117 n.12.
\end{footnotesize}
Supreme Court refused to grant certiorari. However, the Ninth Circuit's decision has been effectively overruled by *Brooke* and related cases.

B. PROBLEMS WITH CURRENT PREDATORY PRICING LAW

There are several problems with the current method for determining predatory pricing. First, cost is difficult, if not impossible, to measure. Although there has been no definitive method for measuring costs, the courts typically accept marginal or variable costs. These are often difficult to distinguish from fixed costs. Fixed costs are generally not accepted as a measurement of cost in predatory pricing cases in which changes in volume, production, or capacity are an issue. What makes a cost "fixed" is that it typically does not change when additional capacity is added or additional units are produced. Examples of fixed costs are typically things like management expenses, property taxes, and depreciation. Variable costs are the opposite: costs that change with the level of production. Airline-specific examples include things like fuel and salary expenses for the crews handling additional flights. Therefore, many courts reject any measure of fixed costs when the government, or another plaintiff, is trying to prove a case of predatory pricing.

Due to the difficulty of separating fixed costs and variable costs, it can be difficult to isolate the cost component of a predatory pricing claim. Without this component, the government or other plaintiffs usually find it difficult, if not impossible to prove their cases.

Furthermore, since no fixed costs can be used in a predatory pricing claim, defendants may try to disguise their marginal costs as fixed costs. An example of this is airline reservations. If only a few routes are added, or only a marginal amount of capacity is increased on a particular route, then the existing reservation offices of an airline are probably sufficient to handle reservation services for these routes. However, if the growth of

---

18 *United States v. AMR Corp.*, 335 F.3d 1109, 1115 (10th Cir. 2003).
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.* at 1109.
23 See *id.*
the airline is sufficient enough, eventually the airline will need
to hire additional employees and possibly open additional reserva-
tion offices. This makes a predatory pricing claim more
complex. Whether an item such as a "reservation" is a fixed or
variable cost will be debated by both parties, and whether it is a
matter of law or fact is uncertain. Additional problems with
measuring cost will be discussed in a later section of this article.

In addition, activities such as acquiring investment capital, re-
search and development, and advertising can make cost difficult
to measure. The costs associated with these types of activities
are not an appropriate basis for an antitrust violation. Seeking
investment capital and activities such as research and develop-
ment are just good business. Advertising is indicative of healthy
competition as one firm attempts to draw new customers by pro-
moting a better, more exciting, or new product rather than by
cutting prices to a level below the firm's cost of production.

C. DOUBTS ABOUT PREDATORY PRICING

Many courts and scholars have expressed disbelief in the via-
bility of a predatory pricing claim. Under the existing law that
surrounds the Sherman Act, a successful predatory pricing
scheme in the airline industry would typically require an airline
to reduce the price of airfare to a point that is below the actual
cost associated with providing flights on that route. The "dan-
gerous probability" that the airline will recover its losses through
monopoly profits once the competition is forced out of the
route must also exist. As some opinions point out, predatory
pricing schemes are inherently risky and irrational due to the
inherent risk in reducing prices, and the accompanying uncer-

24 Southwest is closing some reservation offices to save costs, which would indi-
cate that reservations are a variable cost. Trebor Banstetter, Low-cost Airlines Post
56485672. In AMR Corp., reservations would likely be considered a management
expense, which is another example of a fixed cost. AMR Corp., 335 F.3d at 1115.
25 Baker, supra note 1, at 588.
26 Id.
U.S. 574, 589 (1986) ("predatory pricing schemes are rarely tried, and even more
rarely successful.").
28 Id. at 223-24.
29 Id.
tainty of being able to recover lost profits by increasing prices once a competitor has been forced, if at all, from the market.\footnote{AMR Corp., 335 F.3d at 1114; see also Baker, \textit{supra} note 1, at 586.}

Several factors make future profits uncertain. Some of these factors include that the monopoly price obtained after the competitor is forced from the market must be high enough to recoup lost profits when prices were set low, that the product may become obsolete during the predatory pricing phase, and that the risk of a monopoly encourages new competition to enter the market.\footnote{The danger arises because a successful predatory pricing phase usually takes years to be successful, in which it is likely that a new product will be developed. In addition, a lack of competition is usually a factor that encourages new parties to enter a market, whereas an abundance of competition usually discourages it. \textit{See} Baker, \textit{supra} note 1, at 586.} However, in the airline industry, the likelihood of transportation via airplanes becoming obsolete is relatively remote.\footnote{Although events like the terrorist attacks on September 11, 2001 may reduce the willingness of the public to fly, such an event is not likely to discourage air transportation completely, and the reduced traffic is only temporary. Southwest Airlines has started to see an increase in some markets, such as business travel, in the last quarter of 2003. \textit{See} Banstetter, \textit{supra} note 24.}

The probability of new airlines entering the market is high, especially when there is a perceived lack of competition in a market; however, it is usually against the new and emerging low-cost carriers that one of the major airlines would engage in predatory pricing practices.\footnote{See Dawn Gilbertson, \textit{Airline Earnings Taking Flight; AmWest Posts Unexpected Profit; Southwest also in Black}, \textit{THE ARIZONA REPUBLIC}, Jan. 23, 2004, available at 2004 WL 57356733 (quoting America West's Chairman and CEO that competitors' fares were designed to drive America West out of markets in which they were in competition).}

For an airline, the danger in engaging in predatory pricing lies in the ability to recover lost profits during the predatory pricing phase. Unlike a tangible product, such as a car or cigarettes, a seat on a plane for a particular flight is an extremely perishable commodity. Once that flight has left the gate, that seat cannot be sold in the future. While some firms producing tangible products may be able to sell those items and recover lost profits on those items they were unable to sell during a price war, an airline does not have that advantage.
III. AN EXAMPLE OF PREDATORY PRICING IN THE AIRLINE INDUSTRY: UNITED STATES V. AMR CORPORATION

Predatory pricing claims have surfaced in the airline industry on several occasions. The scenario that would prompt a predatory pricing inquiry would occur when an airline lowers its prices in response to a new airline entering a market. Under the current method for determining predatory pricing, the court would want to distinguish between the airline’s fixed and variable costs. Once that determination has been made, the court would compare the airline’s prices to the variable costs. Things such as reservations, management salaries, and facility expenses would be regarded as fixed costs. Expense items such as fuel, salaries of the crew piloting the plane, and disposable amenities would be included as variable costs. If the variable costs exceed the prices set for the route, then the government has the potential to prove its case. The government would then need to demonstrate that the airline stood a dangerous probability of recovering any profits it lost after the new airline has left the market.

A recent example is the case of United States v. AMR Corporation. AMR was a review by the Tenth Circuit of a motion for summary judgment in which the District Court in Kansas dismissed a suit by the government against AMR Corp, the parent company of American Airlines, for predatory pricing. The government challenged the pricing strategies on various routes in which American competed with smaller, low-cost carriers. The government formulated four tests to show that American Airlines was engaged in predatory pricing that relied upon American’s own internal accounting procedures which assigned costs to each flight. Ultimately, the government lost its case on the summary judgment motion because each of the four tests included an allocation of fixed costs.

The facts of the case indicate that American responded to the entry of low-cost carriers into routes that it served by lowering prices and increasing capacity on those routes in some mar-

---

34 United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003).
36 Id.
37 AMR Corp., 335 F.3d at 1116-17.
38 Id. at 1117-20.
Once the low-cost carrier either moved its operations or ceased its operations, American resumed an earlier pricing strategy, frequently raising prices and reducing capacity to pre-competition levels. In addition, the government alleged that American was intentionally establishing a reputation as a predator that would vigorously defend its markets in an attempt to monopolize other markets. For example, before Vanguard Airlines started competing with American Airlines for the DFW-Wichita route, American charged an average fair of $99 to $108 on that route. When Vanguard entered the market, American Airline's average fare fell and varied from $52 to $58 at the low end to $61 to $75 at the high end. After Vanguard's exit from the route, American's average fare increased to $88 to $102, and then increased to $100 to $123. On the surface, this would appear to be cleverly disguised predatory pricing: American enjoyed a monopoly price before the entry of a low cost carrier; reduced prices until the low cost carrier, Vanguard in this case, was forced to leave the market; and then raised prices, although gradually, to a rate higher than when the competitor had entered the market, apparently to recoup lost profits during the period of time it was preying on the competition.

What the government apparently feared in the AMR case could be described as multimarket recoupment. Multimarket recoupment occurs when the alleged predatory pricer sets its prices on its product below cost in some markets, and recoups the loss from other markets while developing a reputation as a predator that will aggressively defend all of its markets. This theory of recoupment has not yet been addressed by the Supreme Court, and therefore remains a possible means by

---

39 AMR Corp., 140 F. Supp. 2d at 1145. The markets that were the subject of the suit included DFW (Dallas-Fort Worth) and one other city, including such cities as Kansas City, Wichita, Colorado Springs, Long Beach, Phoenix, Tampa, and Oakland.
40 Id. at 1144.
41 These markets included both small markets (such as Birmingham, Alabama; Springfield, Missouri; and Omaha, Nebraska) and larger markets (such as Cleveland, Philadelphia, and San Francisco). Id. at 1145-46.
42 Id. at 1169.
43 Id.
44 Id. at 1169-70.
45 Baker, supra note 1, 589-590.
46 Id.
47 Id. at 595-97 (noting that the Supreme Court did not reach the issue of multimarket recoupment because the plaintiff's theory of the case dealt with one market for cigarettes, not separate markets for generics and branded cigarettes).
which an airline could engage in predatory pricing practices and retain a dangerous probability of recouping its losses. This is a real possibility for major airlines because their business is split up amongst numerous markets and routes already. An airline that has a route with high capacity and high revenue could use the profit from that route to offset losses it sustains while attempting to drive out a competitor, likely a low-cost carrier, from another route.

Assume, arguendo, that American did intend to attempt to drive ValueJet out of markets in which the two airlines competed, and that it hoped to discourage other airlines from competing against them by setting an example. Current methods for calculating predatory pricing behavior would permit them to do this and allow them to get away with it. The airlines own internal accounting procedures allocate fixed costs and marginal costs to each flight, making it difficult to determine what the marginal cost was for each flight. American uses this system to make operating decisions for the airline.\textsuperscript{48} It seems illogical that these methods are apparently reliable enough for American to use in day-to-day operations, yet they are not adequate to allocate price for a predatory pricing complaint. In effect, if American wanted to drive out a new low-cost carrier, they could lower prices, increase capacity, wait for the competition to fold or move out of the market, and then either increase their prices to pre-competition levels or higher, or hope to recover the lost profits from other markets. In the meantime, the public has briefly enjoyed relatively low fares and additional alternatives in air travel. However, once the low-cost carrier is driven from the market, competition is harmed by the lack of alternatives and the return to pre-competition, or higher, prices.

Although \textit{AMR} may have been decided correctly under the current antitrust law, and American Airlines may not have been engaged in predatory pricing practices at all, the result offers little hope or reassurance to fledgling low-cost carriers and new airlines. Low-cost carriers lose their primary, if not their only advantage, when their ability to make a profit at the expense of low costs and few amenities is taken away. Instead of creating a

\textsuperscript{48} The two internal accounting systems used in the government's tests were AAIMSPAN and FAUDNAC. Each accounting system took some measure of variable and fixed costs in allocating total cost to a flight. Since each test used these systems, and each system relied in part on fixed costs, the court ruled that they were invalid for use in determining predatory pricing. \textit{AMR Corp.}, 335 F.3d at 1116-17.
more attractive product to the consumer, the major airline needs to only drive out the competition through predatory pricing. If they fear they might get caught, they just need to reallocate their expenses so that they appear to be fixed instead of variable, and the government will be unable to prove a case against them. Existing predatory pricing and antitrust laws, as demonstrated by this case, subject low-cost carriers to a predatory practice that is not only lawful, but also does not allow them to compete. To make matters worse, in some respects, this practice is subsidized by the government, as will be discussed later.

IV. LOW-COST CARRIERS

In order to understand some of the difficulties of current predatory pricing law in the airline industry, it is necessary to discuss exactly what a low-cost carrier is. A low-cost carrier "generally enjoy[s] the advantage of having lower costs than major carriers," and may be characterized as an airline that operates a "point-to-point network," and offers wages below the industry standard which allow them to offer lower fares. Typically, low-cost carriers can offer lower prices than the major airlines because they offer fewer amenities than larger airlines and their overall costs are less than their larger competitors. As mentioned earlier, Southwest, like many other airlines, does not offer reserved seating, but instead boards the majority of their passengers in the order they arrived at the terminal. Other low-cost carriers only operate on a limited number of routes, and most do not offer in-flight meals. However, in recent years, some low cost carriers have begun to experiment with adding additional amenities, such as satellite TV, internet connect-

49 United States v. AMR Corp., 335 F.3d 1109, 1112 (10th Cir. 2003) (noting that in 1994, the period immediately preceding the period of the alleged predatory pricing, American had calculated ValueJet's, another low-cost carrier stage-length adjusted cost per available seat mile to be 4.32 cents, and American's to be 8.54 cents).
52 Passengers are given a numbered boarding card as they arrive at the gate and are boarded on the plane in groups of thirty, with those arriving last usually getting the least "preferential" seats in the middle of the plane. Molly Ivins, From Texas, With Love and Peanuts, N.Y. TIMES, Mar. 14, 1999, available at http://www.dke.org/kelleher.html.
tions,\textsuperscript{53} and XM Satellite Radio\textsuperscript{54} in an attempt to attract additional customers.

Low-cost carriers hold two primary advantages over the larger major airlines. As discussed earlier, the first advantage is that they typically offer lower fares. These fares typically attract non-business customers.\textsuperscript{55} Another advantage enjoyed by low-cost carriers is that they usually offer more frequent flights. Low-cost carriers are also typically easier to book flights with because the fares for booking a last-minute flight on a low-cost carrier are not as steep as the price increase on a last-minute ticket with one of the major carriers. Another hallmark of the majority of low-cost carriers is that they typically operate fewer gates at the terminals they serve.\textsuperscript{56}

Since their inception, low-cost carriers have enjoyed growing popularity. Low-cost carriers "account for 25% of [airline] traffic, up from 10% as recently as 1999."\textsuperscript{57} The challenge at the inception of low-cost carriers was to get customers to accept second-rate air travel. As one commentator noted, the goal was to "[s]ell cheaper airline tickets to passengers who wouldn't pay for a full-fare, full-service ticket," with "one big caveat: It had to be made clear to these passengers that they were getting a second-class ride."\textsuperscript{58} Low-cost carriers have grown so much in popularity that today, a low-cost carrier, Southwest Airlines, has become the largest domestic airline.\textsuperscript{59}

\textsuperscript{53} Banstetter, \textit{supra} note 24 (stating that such amenities have "helped other low-fare carriers, particularly JetBlue Airways, draw passengers").

\textsuperscript{54} \textit{Id.} (noting that AirTran Airways plans to add XM Satellite Radio).


\textsuperscript{56} For example, low-cost carriers only accounted for 2.4% of the traffic at Dallas-Fort Worth International Airport in 2000 and used about that percentage of gates. By comparison, American accounted for 70.2% of all traffic, and an even higher percentage of gates. \textit{AMR Corp.}, 335 F.3d at 1112.


\textsuperscript{58} Bonné, \textit{supra} note 51.

\textsuperscript{59} Banstetter, \textit{supra} note 24 (stating that "Southwest Airlines remained the nation's most profitable airline in 2003").
Southwest Airlines is an example of a low-cost carrier based out of Texas. Southwest Airlines was founded in Dallas and operated out of Love Field offering service to Houston and San Antonio in 1971. In recent years, Southwest has been one of a handful of profitable airlines in the United States. In fact, it has been the most profitable airline in the United States in the last several years, and has posted profits for thirty-one consecutive years. While other airlines were posting losses for 2003, Southwest earned $442 million during the course of the year. Furthermore, while the major airlines were seeking government bail-outs and laying off employees in the wake of the events of September 11, 2001, Southwest continued its operations without any change in personnel. In addition to remaining profitable, Southwest routinely is rated the highest "in baggage handling and on-time performance, with the fewest customer complaints."

One reason it remains profitable is that it is able to keep its Revenue Passenger Miles close to its Average Seat Miles. In an internet article, Jon Bonné outlines how an airline like Southwest remains profitable, while other major airlines are not. Available Seat Miles (ASM) are defined as "the total of all the seats available on every airline route, multiplied by the length of the route." Revenue Passenger Miles (RPM) are the second half of the equation. They are defined as "the number of seat-miles for which the airline is actually filling a seat and making money." The closer RPM is to ASM, the more of the airline's

---


61 Id.

62 Id.


65 Torbenson, *supra* note 62. This represents an increase in profits over what was earned in 2002, when Southwest earned $241 million.


67 Ivins, *supra* note 52.

68 Id.

69 Id.
capacity is being used, and the more revenue the airline enjoys. This comparison is called revenue or yield, and shows how much an airline will make on each mile it flies. Southwest made 11.67 cents per mile, while United, a major carrier, made 11.1. While this is not a major difference, it does help demonstrate how Southwest is profitable while other major airlines are not.

Bonné also points out that "a recent Southwest breakeven was 59.3 percent . . . while United's breakeven was a staggering 90.3." As a low-cost carrier that offers few amenities, Southwest does not need to fill as many seats at a comparable price to that of a major airline, such as United, in order to turn a profit. Alternatively, Southwest can lower its fares on similar routes, fill more seats, and still turn a profit. For the same period that Southwest held a 59.3 percent breakeven point, their planes were filled to 69.8 percent capacity.

In January of 2003, it was reported that the average cost to fly a 1,000-mile route on a 737 was about $14,000 for a major carrier, which translates to about $120 for each paying passenger. In the meantime, the cost to Southwest for the same flight was about $10,000, or $102 per passenger. Bonné points out that at that time, the Air Transport Association was reporting the average fare for a 1,000 mile route was $118.46. It can be easily observed that any airline charging the average price was losing money per customer at the rate of about $1.54. In the meantime, a low-cost carrier, such as Southwest, is earning about $16.46 per customer, if they charged that price.

In addition to keeping its RSM to ASM ratio close, Southwest manages to keep its costs low in several other ways. As previously discussed, it does not offer many amenities, and has resisted adding amenities to its flights. There is no reserved seating, and Southwest does not provide in-flight meals. As some of their billboards proclaim, their in-flight meals are pea-
nuts, but so are their fares. Southwest also saves money and reduces cost through fuel hedging. Hedging is a practice used to lock in prices, and in this case, Southwest "was 87 percent hedged at oil prices equivalent to below $24 a barrel, well under the spot price today of about $35." Furthermore, Southwest maintains a "trademark 20-minute turnaround" for getting planes ready for flights and out of the gates, which is half the industry average. Southwest's fleet is limited to Boeing 737 aircraft, "which avoids the high costs of training pilots and maintenance crews for a variety of aircraft." More recently, in order to maintain low costs, Southwest has "eliminated commissions to travel agencies, consolidated its ticketing operation by closing three reservation centers and installed 'winglets' on a portion of its fleet to make airplanes more fuel efficient."

Although Southwest enjoys a price advantage over many of its major competitors, it does suffer from a few disadvantages. One of these disadvantages is that Southwest Airlines' operations are limited by the Wright Amendment at one of its major hubs. The amendment was enacted by Congress in an attempt to create a solution to a dispute between the two airports serving the Dallas-Fort Worth area. Under this amendment, Southwest is restricted as to which states it can fly to out of its Dallas hub. Specifically, the amendment limits the ability of any airline to establish a route that leaves from Love Field. Dallas-Fort Worth International Airport is not affected. Currently, a passenger flying out of Dallas on Southwest can only fly to other cities

---

79 Southwest does offer snack food, usually peanuts, but does not offer typical airline meals. Frey, supra note 55.
80 Torbenson, supra note 62.
81 Id.
82 This practice has been maintained despite heightened security measures following September 11, 2001. Frey, supra note 55.
83 Ivins, supra note 52.
85 Banstetter, supra note 24. The three reservation centers that closed were located in Dallas, Salt Lake City, and Little Rock.
87 The amendment was designed to protect the economic viability of DFW International Airport and encourage airlines to not use Love Field. Kansas v. United States, 16 F.3d 436, 438 (D.C. Cir. 1994).
88 More specifically, the amendment limits the ability of commuter airlines carrying more than fifty-six passengers, and restricts charter flights to flying beyond the states bordering Texas to ten per year. Id.
in Texas, or to an airport in one of the surrounding states under this amendment.\textsuperscript{89} Those passengers flying to destinations beyond the states bordering Texas may not check their baggage for their entire trip and must recheck their baggage at each terminal.\textsuperscript{90} There have been some unsuccessful legal challenges made against the constitutionality of the amendment.\textsuperscript{91} In the last several years, the Shelby Amendment was passed and has increased the area to which planes leaving from Love Field can fly non-stop to include Alabama, Mississippi, and Kansas.\textsuperscript{92}

A few airlines have attempted to challenge the amendment by establishing routes to cities and states outside of those permitted, and some of those plans have been successful. Legend Airlines began offering service from Love Field to Los Angeles and Washington, D.C. in April of 2000.\textsuperscript{93} The City of Fort Worth and several airlines attempted to block Legend from offering this service from Love Field.\textsuperscript{94} Eventually, the Fort Worth Court of Appeals ruled that the Wright Amendment and the Shelby Amendment did not restrict commuter planes with less than fifty-six passengers or a weight of less than 300,000 pounds.\textsuperscript{95} However, Legend Airlines folded and ceased to offer flights from Love Field in December of 2000.\textsuperscript{96} In response to Legend's service from Love Field, American Airlines offered service to New York, Los Angeles, and Chicago; Continental Airlines offered service to Cleveland; and Delta Air Lines offered service to Atlanta from Love Field.\textsuperscript{97} After the September 11, 2001 terrorist attacks, American stopped all flights from Love Field and Continental ceased its operations from Love Field to Cleve-

\textsuperscript{89} Id.
\textsuperscript{90} Id.
\textsuperscript{91} See id. at 436 (affirming the denial of a challenge to the constitutionality of the amendment for violating the port preference clause and the right to interstate travel or the First Amendment brought by airline travelers, the State of Kansas, and a travel agency); see also Cramer v. Skinner, 931 F.2d 1020, 1029 (5th Cir. 1991) (reversing a ruling dismissing a challenge to the constitutionality of the amendment for violating the First Amendment, port preference clause, or the right to interstate travel for lack of standing by an airline passenger).
\textsuperscript{93} Id.
\textsuperscript{94} See Legend Airlines, Inc. v. City of Fort Worth, 23 S.W.3d 83 (Tex. App.—Fort Worth 2000, pet. denied).
\textsuperscript{95} Id. at 97.
\textsuperscript{96} Southwest's History at Love Field, supra note 92.
\textsuperscript{97} Katie Fairbank, Delta to End Flights from Dallas Airport, DALLAS MORNING NEWS, Mar. 14, 2003, available at 2003 WL 17314871.
land.\textsuperscript{98} Delta ceased its flights from Love Field to Atlanta as of June 1, 2003, which effectively terminated all of its operations from Love Field.\textsuperscript{99} Currently, Southwest and Continental are the only airlines servicing Love Field, and Continental’s service is limited to regional service to Houston Intercontinental Airport.\textsuperscript{100}

The primary disadvantage of the Wright Amendment to any potential customer in Dallas wishing to take advantage of Southwest’s low fares, or any other airline operating out of Love Field for that matter, is that the customer will have to make at least one stop if they wish to travel anywhere beyond one of the states authorized by the Wright and Shelby Amendments. A solution to the inconvenience of customers having to change planes and recheck baggage has been proposed. “Through-ticketing” is a concept by which a customer would be able to buy a single ticket for destinations that would require at least one stop after leaving Love Field.\textsuperscript{101} The customers would still have to change planes, but they would be saved the inconvenience of buying more than one ticket, and this feature is projected to increase traffic for Southwest Airlines and Love Field.\textsuperscript{102} However, Southwest does not intend to pursue this option or make any challenges to the Wright Amendment in general.\textsuperscript{103} The role of the limitations imposed by the Wright Amendment upon Southwest in current predatory pricing schemes will be discussed below.

This description of Southwest Airlines was only to provide an example of a low-cost carrier. Southwest is arguably the most successful low-cost carrier of all time, making it a model for low-cost carriers entering the market,\textsuperscript{104} and perhaps for established airlines in the market today. Given its position as the largest domestic carrier,\textsuperscript{105} Southwest is an unlikely target for a successful predatory pricing scheme. However, a new airline just entering the market that does not have the benefit of thirty-one consecutive years of profit is far more susceptible to a predatory pricing attack.

\textsuperscript{98} Id.
\textsuperscript{99} Id.
\textsuperscript{100} Southwest’s History at Love Field, supra note 92.
\textsuperscript{101} Torbenson, supra note 60.
\textsuperscript{102} Id.
\textsuperscript{103} Id.
\textsuperscript{104} See Frey, supra note 55 (quoting David Stempler, president of the Air Travelers Association, “They have a very successful business model . . . they know what works and they don’t change it based on changing circumstances.”).
\textsuperscript{105} Banstetter, supra note 24.
VI. PROBLEMS IN MEASURING COST

There are several obstacles to accurately measuring costs. The first obstacle is the one most frequently cited by courts: it is difficult to measure and isolate variable costs from fixed costs. As illustrated in the discussion of the AMR case,\(^{106}\) it may be impossible for the firm, or airline, accused of predatory pricing to separate fixed costs from marginal costs. Therefore, even if a firm is engaged in predatory pricing, it may be impossible to prove. Outside of the difficulty of measuring or determining variable costs, several factors exist which either disguise cost, influence pricing legally, or change price in package discounts that have been found to be legal by the courts.

A. DECREASING PROFITS IN THE AIRLINE INDUSTRY

A fairly serious problem is that the airlines overall have suffered decreasing profits in recent years. After the terrorist attacks of September 11, 2001, the airlines overall have suffered decreasing fares and declining profits.\(^{107}\) Costs have not declined at a rate below that of revenues.\(^{108}\) In addition, there are not as many passengers paying full airfare.\(^{109}\) Therefore, revenue for the airlines is reduced. Ultimately, this should not matter in an investigation for predatory pricing because the government should be looking for prices set below costs, not revenues that exceed expenses. In addition, the government would most likely be looking for reductions in prices that occur after a new airline has entered the market. However, at some point the airlines must retrieve some of their costs. A couple of immediate solutions present themselves. First, airlines can reduce capacity. This would reduce cost, but it would only reduce variable costs for the flights or routes eliminated. The fixed costs would remain because, as stated earlier, fixed costs remain the same despite any changes in capacity.

Another solution to this problem is to reduce prices in an attempt to attract the public back to the airlines. If prices were set

\(^{106}\) See supra Part III.

\(^{107}\) See generally Gilbertson, supra note 33. See also Banstetter, supra note 24 (nothing that business fares for Southwest were beginning to rebound in the fourth quarter of 2003 after having fallen dramatically for three years).

\(^{108}\) Airline revenues per seat mile were falling before September 11 at the rate of 4.5% annually while costs were only decreasing at a rate of 0.7% annually. Paul Craig Roberts, Did Airline Regulation Fail?, WASH. TIMES, Sept. 10, 2003, available at 2003 WL 7718855.

\(^{109}\) Gilbertson, supra note 33.
below cost, this would automatically give the government one element of a predatory pricing claim. Of course the difference here is that the airline is not attempting to harm competition. In fact, it might be argued that by trying to save themselves, the airline is protecting competition. If an airline fails, then there is one less provider in the market, and competition ultimately suffers. Without competition, an airline is able to maintain monopoly prices. Even though the airline stands a chance of recovering lost profits in the future when and if the public’s confidence in air safety returns, there is not a high probability, nor is it dangerously likely,\(^\text{110}\) therefore, the second element of a predatory pricing claim would be difficult if not impossible to prove. If by some chance that could be proved, the government would still have to prove there was some sort of intent to harm competition, which was not the motivation for reducing prices in the first place.

An additional solution to declining revenues in the airline industry would be to invest in additional safety measures.\(^\text{111}\) The goal of investing in additional safety measures would be to restore consumer confidence in the airline industry by ensuring that they would be safe when traveling. The drawback to this solution is that additional costs would be incurred.\(^\text{112}\) Airlines would most likely be unable to increase prices in relation to these costs if they actually wanted to attract customers back to the airlines. As with a reduction in prices, the goal is not to harm competition, but to preserve revenue, and should defeat any claim of predatory pricing.

### B. Short-Term Discounts

Beyond declining profits and post-September 11 factors, another problem in measuring costs accurately is legitimate short-term discounts. There is nothing wrong with a short-term discount designed to attract business, or to fill more seats during

---


\(^{111}\) Additional safety measures have been mandated and authorized for the airlines since September 11. The cost has been exorbitant for some airlines, causing some airlines to request bailouts from Congress. *Id.*

\(^{112}\) Providing bailouts to airlines in order to reduce the impact of the costs for new safety measures has been a potential solution discussed by the government. *Id.*
off-peak seasons. Remember, the goal is to have RPM and ASM as close as possible in order to increase revenues. However, this raises a question as to whom or what defines a short-term discount. Usually, reasonableness will make clear what is and what is not a short-term discount. A discount offered for two weeks during off-peak seasons would in most cases be reasonable, while a "discount" that lasts two years is an established fare.

C. INTERNET AIR RESERVATION SERVICES

An additional problem is presented in organizations such as Orbitz. This company is representative of a growing trend of internet businesses that have established themselves as discount providers of airfare, hotel rooms, and other travel expenses. In the United States, "internet sales represent about 15% of airline tickets sold." Low-cost carriers, including Southwest, Jet Blue, Air Tran, and ATA, have not participated in the Orbitz internet venture. Typically, these organizations are able to offer discounted rates because they purchase blocks of airfare from the airlines at a discount. In Brooke, the Supreme Court ruled that similar discounts offered in the cigarette industry were not in violation of the Robinson-Patman Act. The difference between discounts offered by an organization such as Orbitz and the discounts that were offered to retailers in the Brooke case is that Orbitz is owned by the airlines. Orbitz has been challenged by various travel agencies, airlines, and the government for various antitrust violations in stifling competi-

113 Bonné, supra note 51.
114 Other such providers include Travelocity, Priceline.com, Expedia.com and Hotels.com.
116 Id.
118 The "About Orbitz" section of the company's website states "How it All Started: Five airlines – American, Continental, Delta, Northwest and United – came together to fulfill a mission: Develop a website that would serve people better. Orbitz was designed for you – to make your travel planning experience easier and more affordable." Orbitz about Orbitz, at http://www.orbitz.com/App/about/about.jsp?c=3zsd&r=3g; see also, Orbitz Antitrust Inquiry Dropped, supra note 115.
119 The Justice Department closed its antitrust investigation of the Orbitz online service after finding no evidence that the company stifled competition. Orbitz Antitrust Inquiry Dropped, supra note 115.
D. Economic Theories of Predatory Pricing

A distinct problem exists when these types of cases reach the courtroom. A court attempting to determine what the current rule of law is in an antitrust case is faced with a dizzying array of precedents. The Supreme Court has been inconsistent in its handling of antitrust cases over the past century. In over 100 cases heard, originating from all over the country and interpreting antitrust laws in various ways, the Supreme Court has only overruled two cases. Not only does the government have to determine that the alleged predatory pricer has set price below cost, but they must convince the presiding judge that the case law that supports their position is the correct interpretation of statutory law from at least four schools of precedent in antitrust law. The government or other plaintiff has at least the opposing attorney and their expert, if not the judge's prior experience, working against them.

VII. Problem with Recouping Lost Profits

Measuring cost is not the only problem inherent in current predatory pricing law. In addition to measuring cost, the government must prove that the alleged predatory pricer had a dangerous probability, or a likely probability, depending on which act the predatory pricing claim was pursued under, of recouping lost profits.

---

120 See Class Action Sought in Orbitz Suit, Nov. 4, 2002, at www.siliconvalley.com/mld/siliconvalley/4442492.htm? (noting that travel agencies sued Orbitz and three of the airlines that own the site and sought lost commissions and the dissolution of Orbitz).

121 Forty travel agencies filed a lawsuit against Orbitz and its owner airlines, marking the third such lawsuit in three years. This suit alleged a conspiracy to cut and eliminate commissions and sought compensation for lost commissions. Tricia A. Holly, Agent Lawsuits Mount Against Airlines Over Alleged Antitrust Violations, TRAVEL AGENT, May 26, 2003, available at 2003 WL 11294163.

122 Southwest Airlines brought suit against Orbitz for providing "false and misleading" information regarding its fares and travel schedule, improper use of its trademark, and contests Orbitz's claim that they guarantee the lowest available airfares. Michael Mahoney, Orbitz Sued by Southwest Airlines, E-COMMERCE TIMES, May 4, 2001, available at www.ecommercetimes.com/perl/story/9518.html.

123 Pierce, supra note 6.


125 Pierce, supra note 6, at 1112; Thomas Morgan, Cases and Materials on Modern Antitrust Law and Its Origins (2d ed. 2001).
couping lost profits. In effect, this only punishes a firm engaging in predatory pricing if it profits from such activity. This element is not consistent with the goal of antitrust law. That goal is to protect competition, and ultimately, the consumer.

To illustrate this point, we can adopt the facts of the AMR case. Recall how American lowered its rates on flights from DFW airport to Wichita in relation to Vanguard offering service on that route, and subsequently raised its rates after Vanguard left. Assume that American was never able to recover the lost profits and other losses it incurred. Has competition been hurt any less because American did not recover its lost profits? The answer is undoubtedly “no.” While there were two airlines serving the route, customers had two airlines to choose from, and the airlines had an incentive to keep prices low. With the loss of Vanguard, American no longer has an incentive to offer more flights at a lower price because the competition is gone.

VIII. PROPOSED SOLUTIONS

There are a wide variety of solutions to the problems surrounding predatory pricing claims. Some of the solutions do not require predatory pricing law to change its elements at all. Other solutions are focused on amending, eliminating, or changing the elements of successful predatory pricing claims.

A. GOVERNMENT ACTION

There are two possible solutions to predatory pricing in the airline industry that require no modification to existing predatory pricing law. The first of these solutions is concerned with economic assistance provided to the airlines. In the aftermath of the terrorist attacks on September 11, 2001, the major airlines applied for and received $15 billion in bailouts from Congress. In the meantime, Southwest Airlines did not receive

---

126 Id.
127 See United States v. AMR Corp., 335 F.3d 1109, 1112-13 (10th Cir. 2003); United States v. AMR Corp., 140 F. Supp. 2d 1141, 1157-61 (D. Kans. 2001) (concerning the change in rates with regards to Vanguard).
129 Donnelly, supra note 110.
bailouts, and still managed to post a profit, albeit a smaller profit than usual.\textsuperscript{130} While America West used the assistance it received to reinvent itself as a profitable low-cost carrier, other airlines, such as US Airways, have squandered their assistance and remain inefficient.\textsuperscript{131} When the government provides these bailouts, it permits the airline receiving them to carry on with business as usual. An unprofitable airline that has priced its fares below cost can continue to do so because the shortfall will be subsidized by the government. However, simply denying airlines government assistance is not as easy of a solution as it sounds. United Airlines has continued to post losses since receiving its last bailout and is expected to ask the government for an additional $1.8 billion in aid.\textsuperscript{132} While it might be tempting to deny United Airlines the aid, there are 62,174 jobs on the line.\textsuperscript{133} Failing to provide some sort of assistance could have political and economic repercussions.\textsuperscript{134} In addition, the United States traveling public has become increasingly reliant on air travel.\textsuperscript{135} Allowing an airline to fail is likely to cause severe disruption to travel and the economy. The argument for not providing bailouts would be that it would force airlines to control their costs, set prices effectively, or go out of business and allow another established airline to fill the void.\textsuperscript{136} In fact, some experts predict that consolidation inside the airline industry is inevitable.\textsuperscript{137}

The second solution is more specific to the Dallas-Fort Worth area, and Texas in general. This solution calls for the repeal of

\textsuperscript{130} Ramstack, \textit{supra} note 84.

\textsuperscript{131} America West received $380 million in assistance from the government and has transformed itself into an industry leader. In the meantime, it is suspected that US Airways will file for bankruptcy if they do not receive additional government assistance after having received $1 billion after September 11. Donnelly, \textit{supra} note 110.

\textsuperscript{132} Id.

\textsuperscript{133} Id.

\textsuperscript{134} Id.

\textsuperscript{135} Through September of 2003, the domestic carriers combined for a total of 439,842,373 passengers. http://www.twa-employees-at-aa.com/employees_passengers.htm.

\textsuperscript{136} Donnelly, \textit{supra} note 110 (quoting the head of Delta Airlines that the Air Transportation Stabilization Board, which is in charge of the bail outs, should quit providing assistance to the airlines, and "[l]et the marketplace work").

\textsuperscript{137} Roberts, \textit{supra} note 108. Roberts also points out that consolidation would eventually lead to only two, and in many cases, one, airline serving most routes, which would lead to monopoly prices and re-regulation along with the problems inherent therein.
the Wright Amendment. The Wright Amendment, as discussed earlier, prevents Southwest from competing with American, which is the dominant carrier operating out of DFW,\textsuperscript{138} on routes that extend beyond the surrounding states. Without this competition, American has been able to sustain high fares.\textsuperscript{139} If Southwest were not shackled by the Wright Amendment and permitted to offer service out of Dallas to cities such as Wichita, American would be forced to price its airfares at reasonable levels. This has been referred to as the "Southwest effect:" when the airline moves into a market, the other airlines are forced to lower their fares to compete.\textsuperscript{140} If the Wright Amendment had been repealed then the AMR case likely never would have occurred.\textsuperscript{141} American would not have been able to reduce prices in response to a new competitor because they would have already been forced to price their fares reasonably in comparison to Southwest's. It is the absence of competition that encourages airlines like Vanguard to attempt to enter the Dallas-Fort Worth market.\textsuperscript{142} While Southwest may have grown past the point where it is vulnerable to predatory pricing attacks, new low-cost carriers are vulnerable to such tactics. On the surface, this does not appear to benefit competition because it denies an additional participant to the market. However, competition would be benefited because there would be two major airlines keeping prices in check.

B. Altering the Elements of Predatory Pricing

If predatory pricing as a cause of action is to survive, then the manner in which it is determined must change. As stated earlier, the goal of predatory pricing laws and regulations, as with all antitrust law, is to protect competition. That goal is nearly impossible under current economic standards of measuring predatory pricing. Much of predatory pricing litigation has

\textsuperscript{138} See AMR Corp., 335 F.3d at 1112 (finding that in 2000, American's share of passengers at DFW was 70.2%).


\textsuperscript{140} Ramstack, supra note 84. Recently this effect was felt at the Baltimore-Washington International Airport after Southwest Airlines began operations there in 2002, and increased traffic at the airport from approximately nine million passengers in the 1993 to nineteen million passengers in 2002.

\textsuperscript{141} Irving, supra note 139.

\textsuperscript{142} Id.
been molded by the "Chicago school of economics," and more recently influenced and reshaped by the "post-Chicago school."\textsuperscript{143} The Chicago school largely believes that predatory pricing is impossible,\textsuperscript{144} while the post-Chicago school believes that predatory pricing can exist under the right circumstances.\textsuperscript{145}

Some scholars have proposed moving beyond Chicago school economics completely and embracing post-Chicago economic models to determine antitrust violations.\textsuperscript{146} Those attempts have been criticized as being inconsistent and unpersuasive.\textsuperscript{147} In addition, inappropriate education of the judge and jury in post-Chicago theories, biased experts in the trial setting, and the confusion caused by lawyers questioning those experts have been cited as reasons why post-Chicago theories are not yet ready for the court room.\textsuperscript{148} Another problem with relying on post-Chicago models is that if utilized correctly, motive is irrelevant.\textsuperscript{149} Rather than relying solely on economic models, perhaps it is time to amend current tests for predatory pricing, or to establish whole new methods of determining predatory pricing.

There are several possible solutions to the problem of measuring predatory pricing. These solutions are based on current economic models, including Chicago and post-Chicago versions, for determining liability. These solutions include shifting the focus of a predatory pricing inquiry to intent and results, al-

\textsuperscript{143} The "Chicago school of economics" is a body of scholarly literature produced by economists either educated at the University of Chicago, or by professors that taught there. These scholars created economic models that attempted to demonstrate how acts that the government described as predatory could never harm competition. The "post-Chicago school" is comprised of scholars that have created economic models that attempt to demonstrate how predatory pricing could exist under the right circumstances, such as multimarket recoupment. Pierce, \textit{supra} note 6, at 1105-06 (noting that the judge ruled for the government after inconsistent evidence was given using the post-Chicago models).

\textsuperscript{144} \textit{Id.} at 1103.

\textsuperscript{145} \textit{Id.} at 1105-06.


\textsuperscript{147} Pierce, \textit{supra} note 6, at 1103.

\textsuperscript{148} \textit{Id.} at 1109-10.

\textsuperscript{149} \textit{Id.} at 1114. Pierce argues that motive should not be considered because of the unreliability of evidence (such as internal memos that rely on war-like language), and that motive to harm a competitor while helping oneself is healthy for competition. \textit{Id.} at 1113. However, this would make predatory pricing a strict liability offense, which it is not meant to be.
lowing the prosecution to use the airline’s method of accounting to determine cost, or to use an industry standard to determine cost.

1. Shifting Focus of Predatory Pricing to Intent and Results

One possible solution to the problems created by the current method of measuring predatory pricing would be to simplify what determines predatory pricing. This method could be described as more focused on intent and results. Instead of making the formula prices below cost plus the dangerous probability of recapturing lost profits by increasing prices at a later date after the competitor has been forced from the market, a test that alters the measure of cost could be employed. Instead of looking for prices set below cost, the court could look for prices set at cost or just above cost. This by itself would not be enough. The government would also need to prove that prices were set at this level in order to harm not just a competitor, but competition overall. Any measure of likelihood of recovery of lost profits at a later time is unnecessary. This test would give more focus to intent, action, and result. In order to prove a predatory pricing claim under this test, the government or plaintiff would need to demonstrate prices were set below, at, or near cost, a predatory intent, and that competition was harmed. A strict measure of cost is not as important, and if necessary, could become an issue of fact to be determined by the trier of the case. Predatory intent could be proven through extrinsic evidence, such as internal memos or statements by the officers of the airline.\(^\text{150}\)

An example of such a test from outside the airline industry can be found in *Transamerica Computer Company v. IBM*.\(^\text{151}\) In this case, the Ninth Circuit held that prices could not be considered per se legal if the prices exceeded the marginal cost of the alleged predatory pricer.\(^\text{152}\) The court recognized that presuming costs that were over price to be presumptively legal foreclosed the consideration of other factors such as intent, market power, and long-run behavior.\(^\text{153}\)

\(^{150}\) Id. at 1115.

\(^{151}\) Transamerica Comp. Co., Inc. v. IBM Corp., 698 F.2d 1377 (9th Cir. 1983).

\(^{152}\) Id. at 1386.

\(^{153}\) Id. at 1387. This result is also supported by "post-Chicago" economics, which suggests that a firm that sets its price just above cost can deter aggressive competition and harm competition. Baker, *supra* note 1, at 591.
If this test were applied in the AMR case, it is likely that the government would have survived the summary judgment motion, and had an opportunity to present their case to the jury. At that point, the government would have had a far more manageable task of demonstrating to the jury how American Airlines reduced its fares and increased capacity on those routes in which they were threatened by a low-cost carrier, and then resumed prices from the pre-predatory pricing era once the competitor was forced from the market. This is not to say that American would have been found liable for predatory pricing, but it would at least have made them explain the rationale behind drastically lowering their prices to apparently unprofitable levels in the face of competition from a low-cost carrier, and then raising those prices once the competition left.

2. Acceptance of the Airline’s Internal Measure of Cost

An alternative solution would be to allow the government or a plaintiff to use the airline’s own accounting procedures against them. If it is good enough for the boardroom, it should be good enough for the courtroom. Stated differently, if an airline can rely on an accounting system that allocates portions of fixed costs to a route in order to make operating decisions based on that route, then why should the government not be allowed to use the same information to prosecute that airline for predatory pricing? The traditional answer is that this information includes fixed costs, which do not change regardless of the addition or subtraction of routes and flights. This argument misses a key point by completely ignoring intent.

If an airline deems it important to allocate some fixed costs to a new route, or the addition of a flight to that route, who is the court to say that this information is not important in making this operating decision? How an airline runs its business, as long as it is done legally, is up to the managers and executives of the airline. If it is important to the airline that fixed costs be represented in their calculations when determining whether to add or subtract a flight or route, then the court should accept this method of accounting.

There are several advantages to using this type of test. First, it alleviates the need of the government, or plaintiff, and the defendant of attempting to measure cost, because it will have already been done by the defendant. Every publicly traded company is required to report to the Security Exchange Commission on a quarterly basis. Therefore, they should have an
accurate record of costs nearly four times per year. Second, this encourages airlines to keep better records, and to employ more accurate accounting procedures. This not only benefits the government in the area of predatory pricing, it allows better monitoring for violations of the Sarbanes-Oxley Act\(^\text{154}\) and permits the investing public to make more informed decisions on their investments. Third, it encourages the more efficient use of resources.

Once the method of accounting is accepted by the court, the burden of the government is lessened. One of the three elements of a predatory pricing allegation is easy to determine: price set below cost. Neither the government nor the defendant is required to determine what average variable cost or marginal cost is for the airline, or the industry in question. There are no disputes as to what should be classified as a fixed cost and what is properly classified as a variable cost. The time it takes to bring a predatory pricing claim to trial will have been reduced dramatically.\(^\text{155}\) The most difficult hurdle in successfully prosecuting a claim of predatory pricing\(^\text{156}\) has been overcome.

If this type of test had been used in AMR, the government would have survived the summary judgment motion. The government had prepared four different tests to measure cost using American’s own accounting systems.\(^\text{157}\) In addition, American admittedly “overrode its own internal capacity-planning models for [pricing for each contested] route, which had previously indicated that such increases would be unprofitable.”\(^\text{158}\) As mentioned earlier, each test was rejected because each included some measure of fixed costs, which lead to the motion for summary judgment being granted.\(^\text{159}\) Under this method, American’s admission of pricing its fares at a level they knew to be unprofitable would have been enough to survive the summary


\(^{155}\) Many predatory pricing claims never reach the trial stage because of the time needed to successfully determine what the costs of the alleged infringer are. Pierce, supra note 6, at 1110-11 (noting that an antitrust case against IBM that was started in 1969 was eventually dismissed thirteen years later, years short of a resolution, after IBM was no longer a dominant player in the computer market, and noting that a similar, current case against Microsoft was three years old at no closer to a resolution).

\(^{156}\) See Transamerica Computer Co., 698 F.2d at 1377; United States v. AMR Corp., 335 F.3d 1109, 1109 (10th Cir. 2003).

\(^{157}\) AMR Corp., 335 F.3d at 1116-19.

\(^{158}\) Id. at 1112.

\(^{159}\) Id. at 1121.
judgment motion, and the government could have presented its case to a jury that would determine whether the prices complained of were in fact low enough to be predatory.

3. An Industry Standard for Measure of Cost (or Southwest Airlines as a measure of cost)

A third solution would be to adopt an industry standard for cost. The disadvantage of this method is that it puts the burden on the defense to justify why their prices fall below cost. Intuitively, the burden should fall on the government or the plaintiff in showing that there is a cause of action. However, the goal is to simply allow the government to make a prima facie case. If the defendant company is not engaging in predatory pricing, it could always move for summary judgment and submit an affidavit outlining its actual cost, and demonstrate how their prices are actually set above cost. The burden would then shift back to the government/plaintiff to prove either that the figures submitted by the defendant were inaccurate, or that there was still an intent to lower prices to drive out the competition.

Another potential disadvantage of this method would be determining who gets to set the industry standard. One possible solution to this problem would be to use the cost information of an existing airline. Southwest Airlines comes to mind because of its history of profitability and low prices. The disadvantage of using this method is that a low-cost carrier is going to have a different set of costs than one of the other major airlines. Southwest does not offer reserved seating, in flight meals, or first class. An airline like American or United offers all these amenities plus some others. All three items would change the cost for the airline. If Southwest were used as a measure of cost in the AMR case, then American, and any other airline the government decided to allege predatory pricing against, would have had a large burden of showing why their costs were set as high as they were. Furthermore, Southwest may not be inclined to share all of its corporate secrets for success with its competition.

160 Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050 (6th Cir. 1984) (stating that requiring a “[firm’s] bids be above competitors’ costs would deprive [that firm] (and others similarly situated) of reward from greater efficiency. This would serve only to stifle the incentive to compete”).
4. A Standard of Cost Set by an Independent Party

A preferable solution would be to allow an independent third party to establish these standard costs. Of course, on the surface, the disadvantage of this method would be the need to establish an agency to keep track of these types of costs. Ideally, existing cost information could be used to determine these types of costs. If Jon Bonné can create a four page article that is indicative of what an airline's general costs are, then it should not be too difficult to adopt a standard index.

The other advantage of this solution is that by establishing a standard index of costs for the airline industry, it can be better policed. The government only need compare listed prices for any airline against the index to be able to determine if there is some sort of an antitrust violation. On the flip side, an airline would know in advance when they are likely looking at litigation for a potential predatory pricing violation. Armed with this information, the airline could be prepared to demonstrate how its costs differ from the index, and why its prices are in line with its costs. This would allow both the government and the airlines to avoid costly litigation.

One of the greatest advantages to all of these methods is that airlines would no longer be able to hide behind their own suspect accounting procedures. Under current predatory pricing law, a major airline can weed out smaller competitors using predatory pricing practices and get away with it. The requirement of a demonstration of prices below cost allows them to do so. As discussed earlier, AMR demonstrates a possible scenario. For the sake of discussion, assume that American was trying to force out its competition. It already had a huge advantage in resources, an example of which is its established fleet. Increasing capacity on a route for them is simply a matter of moving a few more flights to that route. A smaller, low-cost carrier does not have that luxury. American can overwhelm a smaller competitor by adding flights to a contested route, reducing prices on that route below their actual costs, and then wait for the competitor to either abandon the route or go out of business. Due to its size, American could attempt to engage in multimarket recoupment, and should theoretically be able to absorb the losses on the route until the competitor leaves, at which point it can reduce capacity and increase prices in an attempt to recover

161 Bonné, supra note 51.
lost profits. If the competitor or the government complains, it is up to them to prove that American’s prices were in fact below cost. As AMR demonstrates, that is nearly impossible to do, so American, or another large airline, would get away with it.

IX. CONCLUSION

Predatory pricing has evolved over the course of the past century through the influence of economic models. As defined, predatory pricing is akin to the mythical unicorn: no firm, or airline, would engage in such behavior because of the extreme unlikelihood of recovering lost profits after the competition has been forced from the market. Furthermore, even if a rare case of predatory pricing did exist as defined under current law, the government, or other plaintiff, would have an extremely difficult time in capturing this white tiger because of the impossible standards set by the courts. Therefore, it is time for Congress to step in and arm the government with better traps, and it is time for the Supreme Court to stop paying attention to the conflicting economic models of the Chicago and post-Chicago schools. If the elements of predatory pricing are not going to be changed, then the government can help prevent predatory pricing by refusing to subsidize and grant bailouts to airlines that do not show a record of profitability and by repealing laws, such as the Wright Amendment, that prevent competition instead of encouraging it. This can be accomplished by relaxing or altering the standards for measuring cost and placing more focus on intent to harm competition and the resulting harm to competition. While the airline industry is essential to the nation’s economy, it is time for the government to stop subsidizing predatory behavior and allow the airline industry to establish more realistic models of operation.