Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.

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Attorneys and Law Firms

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Justice KENNEDY delivered the opinion of the Court.

This case stems from a market struggle that erupted in the domestic cigarette industry in the mid–1980's. Petitioner Brooke Group, Ltd., [commonly known] as Liggett because of its former corporate name, charges that to counter its innovative development of generic cigarettes, respondent Brown & Williamson Tobacco Corporation introduced its own line of generic cigarettes in an unlawful effort to stifle price competition in the economy segment of the national cigarette market. Liggett contends that Brown & Williamson cut prices on generic cigarettes below cost and offered discriminatory volume rebates to wholesalers to force Liggett to raise its own generic cigarette prices and introduce oligopoly pricing in the economy segment. We hold that Brown & Williamson is entitled to judgment as a matter of law.

I

In 1980, Liggett pioneered the development of the economy segment of the national cigarette market by introducing a line of "black and white" generic cigarettes. The economy segment of the market, sometimes called the generic segment, is characterized by its bargain prices and comprises a variety of different products: black and whites, which are true generics sold in plain white packages with simple black lettering describing their contents; private label generics, which carry the trade dress of a specific purchaser, usually a retail chain; branded generics, which carry a brand name but which, like black and whites and private label generics, are sold at a deep discount and with little or no advertising; and "Value–25s," packages of 25 cigarettes that are sold to the consumer some 12.5% below the cost of a normal 20–cigarette pack. By 1984, when Brown & Williamson entered the generic segment and set in motion the series of events giving rise to this suit, Liggett's black and whites represented 97% of the generic segment, which in turn accounted for a little more than 4% of domestic cigarette sales. Prior to Liggett's introduction of black and whites in 1980, sales of generic cigarettes amounted to less than 1% of the domestic cigarette market.

. . . Cigarette manufacturing has long been one of America's most concentrated industries, . . . and for decades, production has been dominated by six firms: R.J. Reynolds, Philip Morris, American Brands, Lorillard, and the two litigants involved here, Liggett and Brown & Williamson. R.J. Reynolds and Philip Morris, the two industry leaders, enjoyed respective market shares of about 28% and 40% at the time of trial. Brown & Williamson ran a distant third, its market share never exceeding 12% at any time relevant to this dispute. Liggett's share of the market was even less, from a low of just over 2% in 1980 to a high of just over 5% in 1984.

The cigarette industry also has long been one of America's most profitable, in part because for many years there was no significant price competition among the rival firms. List prices for cigarettes increased in lockstep, twice a year, for a number of years, irrespective of the rate of inflation, changes in the costs of production, or shifts in consumer demand. Substantial evidence suggests that in recent decades, the industry reaped the benefits of prices above a competitive level, though not through unlawful conduct of the type that once characterized the industry.

By 1980, however, broad market trends were working against the industry. Overall demand for cigarettes in the United States was declining, and no immediate prospect of recovery existed. As industry volume shrank, all firms developed substantial excess capacity. This decline in demand, coupled with the effects of nonprice competition, had a severe negative impact on Liggett. Once a major force in the industry, with market shares in excess of 20%, Liggett's market share had declined by 1980 to a little over 2%. With this meager share of the market, Liggett was on the verge of going out of business.

At the urging of a distributor, Liggett took an unusual step to revive its prospects: It developed a line of black and white generic cigarettes. When introduced in 1980, black and whites were offered to consumers at a list price roughly 30% lower than the list price of full-priced, branded cigarettes. They were also promoted at the wholesale level by means of rebates that increased with the volume of cigarettes ordered. Black and white cigarettes thus represented a new marketing category. The category's principal competitive characteristic was low price. Liggett's black and whites were an immediate and considerable success, growing from a fraction of a percent of the market at their introduction to over 4% of the total cigarette market by early 1984.

As the market for Liggett's generic cigarettes expanded, the other cigarette companies found themselves unable to ignore the economy segment. In general, the growth of generics came at the expense of the other firms' profitable sales of branded cigarettes. Brown & Williamson was hardest hit, because many of Brown & Williamson's brands were favored by consumers who were sensitive to changes in cigarette prices. Although Brown & Williamson sold only 11.4% of the market's branded cigarettes, 20% of the converts to Liggett's black and whites had switched from a Brown & Williamson brand. Losing volume and profits in its branded products, Brown & Williamson determined to enter the generic segment of the cigarette market. In July 1983, Brown & Williamson had begun selling Value–25s, and in the spring of 1984, it introduced its own black and white cigarette.

Brown & Williamson was neither the first nor the only cigarette company to recognize the threat posed by Liggett's black and whites and to respond in the economy segment. R.J. Reynolds had also introduced a Value–25 in 1983. And before Brown & Williamson introduced its own black and whites, R.J. Reynolds had repriced its "Doral" branded cigarette at generic levels. To compete with Liggett's black and whites, R.J. Reynolds dropped its list price on Doral about 30% and used volume rebates to wholesalers as an incentive to spur orders. Doral was the first competition at Liggett's price level.

Brown & Williamson's entry was an even graver threat to Liggett's dominance of the generic category. Unlike R.J. Reynolds' Doral, Brown & Williamson's product was also a black and white and so would be in direct competition with Liggett's product at the wholesale level and on the retail shelf. Because Liggett's and Brown & Williamson's black and whites were more or less fungible, wholesalers had little incentive to carry more than one line. And unlike R.J. Reynolds, Brown & Williamson not only matched Liggett's prices but beat them. At the retail level, the suggested list price of Brown & Williamson's black and whites was the same as Liggett's, but Brown & Williamson's volume discounts to wholesalers were larger. Brown & Williamson's rebate structure also encompassed a greater number of volume categories than Liggett's, with the highest categories carrying special rebates for orders of very substantial size. Brown & Williamson marketed its black and whites to Liggett's existing distributors as well as to its own full list of buyers, which included a thousand wholesalers who had not yet carried any generic products.

Liggett responded to Brown & Williamson's introduction of black and whites in two ways. First, Liggett increased its own wholesale rebates. This precipitated a price war at the wholesale level, in which Liggett five times attempted to beat the rebates offered by Brown & Williamson. At the end of each round, Brown & Williamson maintained a real advantage over Liggett's prices. Although it is undisputed that Brown & Williamson's original net price for its black and whites was above its costs, Liggett contends that by the end of the rebate war, Brown & Williamson was selling its black and whites at a loss. This rebate war occurred before Brown & Williamson had sold a single black and white cigarette.

Liggett's second response was to file a lawsuit. . . . Liggett alleged that Brown & Williamson's volume rebates to wholesalers amounted to price discrimination that had a reasonable possibility of injuring competition in violation of § 2(a) [of the Clayton Act]. Liggett claimed that Brown & Williamson's discriminatory volume rebates were integral to a scheme of predatory pricing, in which Brown & Williamson reduced its net prices for generic cigarettes below average variable costs. According to Liggett, these below-cost prices were not promotional but were intended to pressure it to raise its list prices on generic cigarettes, so that the percentage price difference between generic and branded cigarettes would narrow. . . .

The trial began in the fall of 1989. By that time, all six cigarette companies had entered the economy segment. The economy segment was the fastest growing segment of the cigarette market, having increased from about 4% of the market in 1984, when the rebate war in generics began, to about 15% in 1989. Black and white generics had declined as a force in the economy segment as consumer interest shifted toward branded generics, but Liggett's overall volume had increased steadily to 9 billion generic cigarettes sold. Overall, the 2.8 billion generic cigarettes sold in 1981 had become 80 billion by 1989.

The consumer price of generics had increased along with output. For a year, the list prices for generic cigarettes established at the end of the rebate war remained stable. But in June of 1985, Liggett raised its list price, and the other firms followed several months later. The precise effect of the list price increase is difficult to assess, because all of the cigarette firms offered a variety of discounts, coupons, and other promotions directly to consumers on both generic and branded cigarettes. Nonetheless, at least some portion of the list price increase was reflected in a higher net price to the consumer.

In December 1985, Brown & Williamson attempted to increase its list prices, but retracted the announced increase when the other firms adhered to their existing prices. Thus, after Liggett's June 1985 increase, list prices on generics did not change again until the summer of 1986, when a pattern of twice yearly increases in tandem with the full-priced branded cigarettes was established. The dollar amount of these increases was the same for generic and full-priced cigarettes, which resulted in a greater percentage price increase in the less expensive generic cigarettes and a narrowing of the percentage gap between the list price of branded and black and white cigarettes, from approximately 38% at the time Brown & Williamson entered the segment to approximately 27% at the time of trial. Also by the time of trial, five of the six manufacturers, including Liggett, had introduced so-called "subgenerics," a category of branded generic cigarette that sold at a discount of 50% or more off the list price of full-priced branded cigarettes.

After a 115–day trial involving almost 3,000 exhibits and over a score of witnesses, the jury returned a verdict in favor of Liggett, finding . . . that Brown & Williamson had engaged in price discrimination that had a reasonable possibility of injuring competition in the domestic cigarette market as a whole. The jury awarded Liggett $49.6 million in damages, which the District Court trebled to $148.8 million.

After reviewing the record, however, the District Court held that Brown & Williamson was entitled to judgment as a matter of law on [ground of] lack of injury to competition. . . . The District Court found that no slowing of the growth rate of generics, and thus no injury to competition, was possible unless there had been tacit coordination of prices in the economy segment of the cigarette market by the various manufacturers.

The District Court held that a reasonable jury could come to but one conclusion about the existence of such coordination among the firms contending for shares of the economy segment: it did not exist. . . .

The United States Court of Appeals for the Fourth Circuit affirmed, [holding] that the dynamic of conscious parallelism among oligopolists could not produce competitive injury in a predatory pricing setting, which necessarily involves a price cut by one of the oligopolists. In the Court of Appeals' view, "[t]o rely on the characteristics of an oligopoly to assure recoupment of losses from a predatory pricing scheme after one oligopolist has made a competitive move is ... economically irrational."

We granted certiorari, and now affirm.

II

A

Although we have reiterated that a price discrimination within the meaning of [Section 2(a) of the Clayton Act] is merely a price difference, . . . the statute as a practical matter could not, and does not, ban all price differences charged to different purchasers of commodities of like grade and quality. Instead, the statute contains a number of important limitations, one of which is central to evaluating Liggett's claim: By its terms, the Robinson–Patman Act condemns price discrimination only to the extent that it threatens to injure competition. . . . Congress did not intend to outlaw price differences that result from or further the forces of competition. Thus, the Robinson–Patman Act should be construed consistently with broader policies of the antitrust laws.

Liggett contends that Brown & Williamson's discriminatory volume rebates to wholesalers threatened substantial competitive injury by furthering a predatory pricing scheme designed to purge competition from the economy segment of the cigarette market. This type of injury, which harms direct competitors of the discriminating seller, is known as primary-line injury.

We last addressed primary-line injury over 25 years ago, in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). In *Utah Pie*, we reviewed the sufficiency of the evidence supporting jury verdicts against three national pie companies that had engaged in a variety of predatory practices in the market for frozen pies in Salt Lake City, with the intent to drive a local pie manufacturer out of business. We reversed the Court of Appeals and held that the evidence presented was adequate to permit a jury to find a likelihood of injury to competition.

Utah Pie has often been interpreted to permit liability for primary-line price discrimination on a mere showing that the defendant intended to harm competition or produced a declining price structure. The case has been criticized on the grounds that such low standards of competitive injury are at odds with the antitrust laws' traditional concern for consumer welfare and price competition. . . . We do not regard the *Utah Pie* case itself as having the full significance attributed to it by its detractors. *Utah Pie* was an early judicial inquiry in this area and did not purport to set forth explicit, general standards for establishing a violation of the Robinson–Patman Act. As the law has been explored since *Utah Pie*, it has become evident that primary-line competitive injury under the Robinson–Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act. . . .

Accordingly, whether the claim alleges predatory pricing under § 2 of the Sherman Act or primary-line price discrimination under the Robinson–Patman Act, two prerequisites to recovery remain the same.[*] First, 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.

. . . Even in an oligopolistic market, when a firm drops its prices to a competitive level to demonstrate to a maverick the unprofitability of straying from the group, it would be illogical to condemn the price cut: The antitrust laws then would be an obstacle to the chain of events most conducive to a breakdown of oligopoly pricing and the onset of competition. Even if the ultimate effect of the cut is to induce or reestablish supracompetitive pricing, discouraging a price cut and forcing firms to maintain supracompetitive prices, thus depriving consumers of the benefits of lower prices in the interim, does not constitute sound antitrust policy. . . .

The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices. "For the investment to be rational, the [predator] must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered." *Matsushita Electric*

[*] [Courts have identified differences between the two statutes. Specifically, Section 2 of the Sherman Act condemns predatory pricing when it poses a "dangerous probability of actual monopolization," whereas the Robinson–Patman Act requires only that there be "a reasonable possibility" of substantial injury to competition before its protections are triggered.]

Industrial Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 588–589 (1986). Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for "the protection of competition, not competitors." *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or "purport to afford remedies for all torts committed by or against persons engaged in interstate commerce." *Hunt v. Crumboch*, 325 U.S. 821, 826 (1945).

For recoupment to occur, below-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm's rivals, whether driving them from the market, or, as was alleged to be the goal here, causing them to raise their prices to supracompetitive levels within a disciplined oligopoly. . . .

If circumstances indicate that below-cost pricing could likely produce its intended effect on the target, there is still the further question whether it would likely injure competition in the relevant market. The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it. . . .

These prerequisites to recovery are not easy to establish, but they are not artificial obstacles to recovery; rather, they are essential components of real market injury. As we have said in the Sherman Act context, "predatory pricing schemes are rarely tried, and even more rarely successful," *Matsushita*, 475 U.S. at 589, and the costs of an erroneous finding of liability are high. The mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition; because cutting prices in order to increase business often is the very essence of competition, [while] mistaken inferences are especially costly, because they chill the very conduct the antitrust laws are designed to protect. It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high.

B

Liggett does not allege that Brown & Williamson sought to drive it from the market but that Brown & Williamson sought to preserve supracompetitive profits on branded cigarettes by pressuring Liggett to raise its generic cigarette prices through a process of tacit collusion with the other cigarette companies. Tacit collusion, sometimes called oligopolistic price coordination or conscious parallelism, describes the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.

In *Matsushita*, we remarked upon the general implausibility of predatory pricing. *Matsushita* observed that such schemes are even more improbable when they require coordinated action among several firms. *Matsushita* involved an allegation of an express conspiracy to engage in predatory pricing. The Court noted that in addition to the usual difficulties that face a single firm attempting to recoup predatory losses, other problems render a conspiracy "incalculably more difficult to execute." In order to succeed, the conspirators must agree on how to allocate present losses and future gains among the firms involved, and each firm must resist powerful incentives to cheat on whatever agreement is reached.

However unlikely predatory pricing by multiple firms may be when they conspire, it is even less likely when, as here, there is no express coordination. Firms that seek to recoup predatory losses through the conscious parallelism of oligopoly must rely on uncertain and ambiguous signals to achieve concerted action. The signals are subject to misinterpretation and are a blunt and imprecise means of ensuring smooth cooperation, especially in the context of changing or unprecedented market circumstances. This anticompetitive minuet is most difficult to compose and to perform, even for a disciplined oligopoly. . . .

[The interdependent pricing of an oligopoly is unlikely to but nonetheless is possible]. A predatory pricing scheme designed to preserve or create a stable oligopoly, if successful, can injure consumers in the same way, and to the same extent, as one designed to bring about a monopoly. However unlikely that possibility may be as a general matter, when the realities of the market and the record facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability. . . .

In this case, the price and output data do not support a reasonable inference that Brown & Williamson and the other cigarette companies elevated prices above a competitive level for generic cigarettes. . . .

The judgment of the Court of Appeals is *Affirmed.*

Justice STEVENS, with whom Justice WHITE and Justice BLACKMUN join, dissenting.

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