No. 22-2168

IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

NTE CAROLINAS II, LLC; NTE CAROLINAS II HOLDINGS, LLC; NTE ENERGY, LLC; NTE SOUTHEAST ELECTRIC COMPANY, LLC; NTE ENERGY SERVICES COMPANY, LLC; AND CASTILLO INVESTMENT HOLDINGS II, LLC,
Counterclaimants-Appellants,

v.

DUKE ENERGY CAROLINAS, LLC, DUKE ENERGY PROGRESS, LLC, AND DUKE ENERGY CORPORATION
Counterclaim Defendants-Appellees.

On Appeal from the United States District Court
for the Western District of North Carolina at Charlotte,
No. 3:19-cv-00515-KDB-DSC, Hon. Kenneth D. Bell

AMICI CURIAE BRIEF BY DR. BENJAMIN ZYCHER, GEOFFREY A. MANNE, PROFESSOR RICHARD A. EPSTEIN, AND PROFESSOR DONALD J. BOUDREAUX IN SUPPORT OF COUNTERCLAIM-DEFENDANTS APPELLEES

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DISCLOSURE STATEMENT UNDER APPELLATE RULE 26.1(A)

No *amicus* joining this brief is a corporation, organization, or association. *Amici* are all individuals: Benjamin Zycher, Geoffrey A. Manne, Richard A. Epstein, and Donald J. Boudreaux. Thus, they have no parent corporations, publicly held status, or publicly held entities with a financial interest to report.

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IDENTITY AND INTEREST OF AMICI[1]

Benjamin Zycher is an economist and senior fellow at the American Enterprise Institute. He has a PhD in economics from the University of California, Los Angeles, and a Master of Public Policy from the University of California, Berkeley. Among other positions, he previously served in the Office of Economic Analysis, Bureau of Intelligence and Research, U.S. Department of State; as a senior economist at the RAND Corporation; as a longtime adjunct economics professor at UCLA; and as a Senior Staff Economist for the President's Council of Economic Advisers. His scholarship focus includes energy policy.

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[1] No party or party's counsel authored this brief in whole or in part or contributed money that was intended to fund preparing or submitting this brief. No one other than amicus and its counsel contributed money that was intended to fund preparing or submitting this brief. Pursuant to Fed. R. App. P. 29(a)(2), all parties have consented to the filing of this brief.

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This brief supports appellee Duke Energy's contention on the appropriate price-cost standard for a claim of predatory pricing. *Amici* hope to assist the Court by bringing some economic principles to bear on the choice of an appropriate price-cost standard, since appellants are advocating a cost standard that seemingly would require (to avoid a finding of predation) firms to price their products no lower than average total production cost when confronting price competition.

SUMMARY OF ARGUMENT

Courts should approach predatory pricing claims with caution because price cutting is central to competition and because false positive errors can chill competition to the detriment of economic efficiency and consumer welfare.

Total average system cost is not an appropriate price floor for finding predation; the district court was right to reject a fixed-cost standard. This Court should reject claims based on the allegedly exclusionary effect of pricing not shown to be below short-run incremental cost. Moreover, a contention that Duke Energy's discount or rebate structure was "exclusionary" should not change the analysis, because the timing of price reductions should not be relevant.

ARGUMENT

I. Courts should approach predatory pricing claims with caution.

Price cutting is "often the essence of competition," which can enhance consumer welfare.[2] And so, "[a]ntitrust begins with the premise that all firms, even dominant firms, are permitted to compete aggressively and that hard competition is a desideratum rather than an evil."[3]

Because price cutting is central to competition and because of the potential adverse effects of judicial errors in this realm, pricing claims warrant judicial restraint.[4] The judicial choice of an appropriate standard has been described as a

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[2] *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986); *see Atl. Richfield Co. v. USA Petroleum, Co.*, 495 U.S. 328, 340 (1990) (noting "[l]ow prices benefit consumers"). Note that under certain conditions, in particular when consumers cannot determine the quality of the good easily before purchase, high prices yield benefits for consumers, *ceteris paribus*, by providing sellers with incentives to honor their commitments. *See generally* Benjamin Klein and Keith B. Leffler, *The Role of Market Forces In Assuring Contractual Performance*, 89 J. of Pol. Econ. 615–41 (Aug. 1981).

[3] Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 735 (updated Aug. 2022) (hereinafter "Areeda & Hovencamp, Antitrust Law").

[4] *See* Kenneth G. Elzinga & David E. Mills, *Predatory Pricing*, *The Oxford Handbook of Int'l Antitrust Economics* Vol. 2 (Roger Blair & D. Daniel Sokol eds.) (2014) (hereinafter "Elzinga & Mills, *Oxford Handbook*"), at 52 (opining that "the judicial modesty and restraint of the *Brooke Group* standard is warranted" based on "the inherent difficult of discerning in an adversarial proceeding the intent that animates a firm's conduct, and given the cost of deterring conduct that ultimately is procompetitive in an overly zealous attempt to protect vulnerable competitors and the status quo"); Geoffrey A. Manne & Joshua D. Wright, *If Search Neutrality is the Answer, What's the Question?*, 2012 Colum. Bus. L. Rev. 151, 184–85 ("The key challenge facing any proposed analytical framework for evaluating monopolization

choice between tolerating "false positive" and "false negative" outcomes.[5] A false negative error is a conclusion that predation has not occurred when it has. A false positive error is a conclusion that predation has occurred when in fact it has not; a defendant will be found liable even though it has not violated the law. With price competition, the Supreme Court has endorsed an error-avoidance approach that avoids false positives.[6] A contrary approach may lead dominant firms to keep prices

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claims is distinguishing pro-competitive from anticompetitive conduct. Antitrust errors are inevitable because much of what is potentially actionable conduct under the antitrust laws frequently actually benefits consumers, and generalist judges are called upon to identify anticompetitive conduct with imperfect information.").

[5] *See* Kenneth G. Elzinga & David H. Mills, *Trumping the Areeda-Turner Test: The Recoupment Standard in Brooke Group*, 62 Antitrust L. J. 559, 562 (1984) (contending "a court must weigh and compare the costs of false positives and false negatives," and "a test not disposed to false positives is superior to one equally indisposed to false negatives"; "[c]onsumers will be afforded more opportunities to secure the benefits of price competition"); Elzinga & Mills, *Oxford Handbook*, at 41 ("The search for a compelling antitrust test to evaluate predatory pricing claims is an exercise in balancing false positive against false negative judicial outcomes."); Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 2 (1984) ("If the court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of stare decisis, no matter the benefits. If the court errs by permitting a deleterious practice, though, the welfare loss decreases over time.").

[6] *See Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.*, 555 U.S. 438, 451 (2009) ("To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low."); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) ("the costs of an erroneous finding of liability are high"); *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 121 n.17 (1986) ("[B]ecause cutting prices in order to increase business often is the very essence of competition, mistaken inferences are especially costly, because they chill the very conduct the antitrust laws are designed to protect.") (cleaned up); *Matsushita*, 475 U.S. at 594 ("[W]e must be concerned lest a rule or precedent that authorizes a search

too high for too long, with "price umbrellas" that encourage inefficient rivals to enter or remain in the market.[7]

Moreover, commentators have observed that judicial skepticism is warranted about predatory pricing as a plausible monopolizing strategy,[8] and the Supreme Court has repeatedly observed that successful predation schemes are rare.[9] Predation can be costly and counterproductive. A would-be predator must weigh its short-term investment in low prices against its long-term prospect of future returns

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for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.") (internal quotation marks omitted); Elzinga & Mills, *Oxford Handbook*, at 41 ("[T]he caution built into the *Brooke Group* standards reflects the Court's concern with false positives and shows the Court's determination not to let antitrust get in the way of aggressive price competition.").

[7] *See* Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 708 (1975) ("[E]ven a temporary imposition of a price floor could encourage entry of inefficient firms.").

[8] *See* Robert H. Bork, *The Antitrust Paradox: A Policy At War With Itself* 145 (1978) (questioning "the probability of the occurrence of predation and the means available for detecting it"); Areeda & Turner, *Predatory Pricing*, 88 Harv. L. Rev. at 699; *see also* Joshua D. Wright & Judd E. Stone, *Still Rare Like a Unicorn? The Case of Behavioral Predatory Pricing*, 8 J. L. Econ. & Pol'y 859, 882 (2012) ("Empirical analyses, including laboratory experiments, suggest price predation is rare.").

[9] *See Brooke Group*, 509 U.S. at 226; *Matsushita*, 475 U.S. at 589–90 (describing "consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful," and are "inherently uncertain" as they depend "on successfully neutralizing the competition" to recoup losses and "harvest some additional gain"); *Cargill*, 479 U.S. at 121 n.17 ("[I]t is plain that the obstacles to the successful execution of a strategy of predation are manifold, and that the disincentives to engage in such a strategy are accordingly numerous.") (citing Bork, *The Antitrust Paradox*, at 144–59; John S. McGee, *Predatory Pricing Revisited*, 23 J.L. & Econ. 289, 291–300 (1980); Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. Pa. L. Rev. 925, 939–40 (1979)).

in the form of sustained prices that are high enough to pay off short-term losses and also compensate for the time value of money (a greater than dollar-for-dollar return).[10] A dominant firm with large market share can suffer disproportionate loss from below-cost prices vis-à-vis a smaller rival who may nonetheless eventually enter or reenter the market.

In addition to these justifications for a high standard when a rival claims a dominant firm's prices are too low, it is important to note the natural tendency of dominant firms to lose market power over time.[11] If a given firm dominates an industry, it is reasonable to assume that its prices (and the other characteristics of its services to customers) yield returns to investment higher than competitive levels. But if that is true, new competitors will be encouraged to enter the market, exerting downward price pressures, which means, again, that dominant firms tend to lose market power over time.[12]

The Supreme Court has avoided false positive errors. In *Matsushita*, *supra*, the Court rejected a claim by two U.S. television makers against several Japanese manufacturers of consumer electronic products. The claim alleged the defendants engaged in predatory pricing that would drive U.S. manufacturers from the market

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[10] *See Brooke Group*, 509 U.S. at 224.

[11] Elzinga & Mills, *Oxford Handbook*, at 57–58 ("A further reason for maintaining a high bar is that the market power of dominant firms, left alone, tends to erode.").

[12] Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. at 2 ("Monopoly is self-destructive. Monopoly prices eventually attract entry.").

and ultimately result in U.S. consumers facing unduly high prices from the Japanese manufacturers.[13] These predictions proved to be wrong. In the 12 years after the Court's decision, the Japanese defendants, combined, never managed to gain more than 40% of the U.S. market; no evidence developed that their tactics excluded the plaintiff firms; and the real price of TVs continued to decline.[14] Had the Court "ended or reduced price-cutting by the Japanese manufacturers, competition in the U.S. television market would have been injured, not improved."[15] That error was avoided.

Likewise, in *Brooke Group*, *supra*, the Supreme Court rejected a claim accusing Brown & Williamson (B&W) of predatory pricing of cigarettes to restrain the growth of the discount cigarette segment, and market developments confirmed that the Court was right to require a demanding standard.[16] In the years following B&W's Supreme Court victory, its market share declined, and its low pricing did not result in the plaintiff's exclusion from the market.[17] Nor did the price war have the effect that the plaintiff feared: curtailing the sale of discount cigarettes.[18]

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[13] *See* 475 U.S. at 577–78.
[14] Kenneth G. Elzinga & David E. Mills, *Predatory Pricing and Strategic Theory*, 89 Geo. L.J. 2475, 2490–91 (2000).
[15] *Id.* at 2490.
[16] *See id.* at 2492; Elzinga & Mills, *Trumping the Areeda-Turner Test*, 62 Antitrust L.J. at 581–82.
[17] Elzinga & Mills, *Predatory Pricing*, 89 Geo. L.J. at 2492.
[18] *Id.* at 2492–93.

II. Total average system cost is not an appropriate price floor for finding predation; the district court was right to reject a fixed-cost standard.

The court below was correct to reject total average system cost as the floor below which prices should be deemed predatory, a standard which inappropriately includes fixed costs (costs that do not change as a result of expanded output). An appropriate standard requires proof that the firm is charging below its short-run incremental cost, which is the same parameter as marginal cost. It is the cost to produce an additional unit of output. (An unbiased proxy for incremental cost is average variable cost ("AVC"), which is the average of all costs that vary with output.[19]) As explained below, by ascertaining whether prices are so low that they fail to cover incremental production costs, this standard aligns with economic theory on efficient pricing.

When demand conditions are sufficiently strong, the market price will allow a firm to cover its incremental costs of production and its average (per unit of output) fixed costs—the costs of capital equipment and the like that do not vary with output—that it previously "sunk" as investments made so that it could participate in the market. Which is to say, if demand conditions are sufficiently strong, price is expected to equal or exceed total average cost.[20]

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[19] *See* Areeda & Turner, 88 Harv. L. Rev. at 701–02, 716–17.

[20] If price is higher than average total cost, and expected to remain so, then the standard economic model of competitive behavior predicts that new firms would enter the market.

But matters change when demand conditions weaken. Demand conditions may weaken for any number of reasons. Perhaps the industry's particular output is less fashionable than before, or perhaps a new industry has emerged producing a product that is a good (but, say, not identical) substitute for the output of the original industry. Or perhaps a new seller emerges. When a new seller enters the market, a customer's incremental valuations for the output of the original seller will be lower because a new seller presents a new option for the customer to substitute away from the original seller.

That the perceived strength of competitive pressures, both current and prospective, affect pricing decisions should be self-evident. Other factors held constant, weak competitive pressures will yield prices relatively higher, while a perception of strengthening competitive pressures will lead the firm to charge relatively lower prices so as to reduce the incentives of customers to shift to an alternative supplier.[21]

And so, the emergence of a new competitor provides incentives for the existing firm to cut its prices, for exactly the same reason that the new competitor

[21] In economic jargon, the absence of strong competitive pressures, other factors held constant, means that demand conditions for the firm's output are relatively "inelastic," that is, not very responsive to increases in the prices charged by the firm. The emergence of a new competitor means that the firm now faces demand conditions that are more "elastic," that is, more responsive to increases in prices. This is for the obvious reason that the emergence of a new competitor allows customers to shift away from the original firm more easily.

will try to attract business away from the original firm by undercutting the latter's prices. There is nothing "predatory" about this response to the emergence of a competitor, as long as the new, lower price covers incremental costs. That price might be sufficient to cover the incremental costs of production and some part (but less than all) of the firm's average fixed costs. That the price does not cover all of the fixed costs is not suspicious. The firm is not better off losing a customer by forgoing a sale above incremental cost; the fixed costs would remain for a smaller customer base. The fixed costs cannot be avoided; they must be paid one way or another. So, an assertion that a price lower than average total cost demonstrates "predation" is not correct.

When a seller cuts the price for a specific customer without cutting the price for other customers it is economically rational because, as a general proposition, those willing to pay higher prices are charged accordingly, and those willing to pay only lower prices, perhaps because they have options not available to others, are charged those lower prices. Customers have differing demands—differing valuations for units of the good in question—because they have different needs, different preferences, and, indeed, differences in myriad parameters, including different options available to them. A seller confronting weakening demand may in effect "move down" the demand curve through differential pricing, charging each

customer the price reflecting their respective incremental values—each customer's willingness to pay—until the last customer pays a price equal to incremental cost.[22]

At that point output is efficient. Under standard economic theory, the efficient output level is that at which the maximum amount that consumers would be willing to pay to obtain one more unit of good *x* (the marginal value, or MV) equals marginal cost (MC). If marginal (or incremental) value is greater than marginal (or incremental) cost for *x* (MV > MC), this means that another unit of *x* is more valuable than a unit of alternative product (say, *y*) that the seller could produce with the resources (inputs) used to produce *x*. But if the marginal cost for *x* is greater than the marginal value of *x* (MC > MV), then shifting resources away from *x* and toward *y* would increase the value of what the economy can produce. The MC = MV efficiency condition should be intuitive. Under competitive conditions, consumers purchase additional units of good *x* until the incremental value (MV) falls to the point where it equals incremental cost (MC).[23] Economic analysis tells us nothing about the degree to which this outcome is "fair" or "just," because economics as a

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[22] *See* Hal R. Varian, *Intermediate Microeconomics: A Modern Approach* 425–35 (4th ed. W.W. Norton 1996).

[23] It is axiomatic that as the acquisition of a given good rises, its incremental value falls. This is direct implication of the fact that, all else being equal, as price falls, the quantity demanded rises, that is, that demand curves are "downward sloping." This is the First Law of Demand: "Less is demanded at a higher price." Armen A. Alchian & William R. Allen, *Universal Economics* 62 (Jerry L. Jordan ed., Liberty Fund 2018).

discipline or social science does not provide such definitions. But economics does tell us that this outcome is efficient.

It would be inconsistent with the consumer-welfare standard to contend that a seller (including an electrical utility) should effectively be forced to stand down from competitor pressure by keeping prices no lower than average system cost. Naturally, price competition can result in the exclusion of less efficient rivals.[24] Nonetheless, this exclusion of less efficient producers enhances consumer welfare for two reasons. First, survival of less efficient rivals means that total industry output consumes more resources than otherwise would be the case. Greater resource use—greater costs—for a given total industry output means prices higher than otherwise would be observed. It is also the case that because prices will be driven up, the quantity demanded—total industry output—will be driven down. Second, the additional resource use by the given industry means that fewer resources are available for all other sectors taken as a whole, which means that all other output will be reduced and those prices taken as a whole will be higher than otherwise would be the case.[25]

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[24] *See* Kenneth G. Elzinga & David E. Mills, *Antitrust Predation and* The Antitrust Paradox, 57 J.L. & Econ. (Supp.) 181, 186 (2014); *see Brooke Group*, 509 U.S. at 223 (requiring proof of below-cost pricing because "the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting").

[25] *See* Armen A. Alchian and William R. Allen, *Exchange and Production: Competition, Coordination, and Control* 2–4 (Belmont: Wadsworth 3d ed. 1983);

Whether for the industry in question or for the economy as a whole, policies that shield inefficient producers are inconsistent with the consumer welfare standard.

A contention that Duke Energy's discount or rebate structure was "exclusionary" should not change the analysis, because the timing of price reductions should not be relevant. In response to competitive pressure from a new firm, the original firm might cut prices on existing contracts for the subject product, on future contracts for that product, or some combination of the two. From the perspective of economic and antitrust analysis, only the present value of the revenue stream for that product matters, which is a function of contractual prices and sales over time (across contracts) and the discount rate applied to the overall revenue stream. Such price cutting in the face of competitive pressures is consistent with economic efficiency as long as the per-unit price is not below short-run incremental cost.[26] If indeed NTE were a more efficient competitor, then there was no reason in principle that NTE could not offer a new contract yielding a payment stream for the

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see also Hal R. Varian, *Intermediate Microeconomics: A Modern Approach* 531–33 (W.W. Norton 4th ed. 1996). It is possible that output in the given industry will be driven down so much that over time more resources would be available for use in other sectors. But this possibility does not detract from the central point here: The policy-driven survival of less efficient rivals in an industry means that those prices are higher than necessary and that total economic output is less valuable, making consumers worse off.

[26] *See* Areeda & Hovencamp, Antitrust Law at ¶ 749e (discussing how even with a retroactive rebate "the ordinary predatory pricing rule [*Brooke Group*] should apply" by attributing "the entire value of the discount to the goods that are still in competitive play at the time the discount is offered").

delivery of electricity supplies with a present value lower than that offered by Duke for the services combined in the existing and new contracts.

CONCLUSION

The Court should reject claims based on the allegedly exclusionary effect of pricing not shown to be below short-term incremental cost.

Respectfully submitted,

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May 19, 2023

CERTIFICATE OF COMPLIANCE

1. This brief complies with type-volume limits because, excluding the parts of the document exempted by Fed. R. App. P. 32(f) (cover page, disclosure statement, table of contents, table of citations, statement regarding oral argument, signature block, certificates of counsel, addendum, attachments):

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Dated: May 19, 2023

/s/ Sean E. Andrussier
Counsel for Amici Curiae

CERTIFICATE OF SERVICE

I hereby certify that on May 19, 2023, I electronically filed the foregoing Amici Brief in Support of Counterclaim-Defendants Appellees with the Clerk of the Court for the United States Court of Appeals for the Fourth Circuit using the appellate CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

/s/ Sean Andrussier
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