The Dark Side of Fare Wars: The Sixth Circuit Takes a Fresh Look at Predatory Pricing Claims Under Section 2 of the Sherman Antitrust Act

*By J. Gregory Grisham**

It is a truism that public policy favors robust competition and that consumers generally benefit from lower prices as a result. Consequently, "predatory pricing claims present particularly difficult questions given that price cutting is one of the socially desirable forms of competition that the antitrust laws seek to promote."[1] For well over a century, federal law has prohibited the establishment of and attempts to establish monopolies in interstate trade and commerce.[2] Section 2 of the Sherman Antitrust Act ("Section 2") prohibits "Monopolization" and states:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.[3]

Given the favored status of competition, courts have taken a cautious approach when considering claims of predatory pricing.[4] One court has referred to a "predatory pricing scheme [as] 'the deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition.'"[5]

In a recent case involving the airline industry, the U.S. Court of Appeals for the Sixth Circuit considered claims of predatory pricing and other predatory tactics made by a so-called "low-cost carrier" against a "legacy" carrier.[6] In this case, the plaintiff, Spirit Airlines, filed a lawsuit against Northwest Airlines under Section 2, claiming monopolization and attempted monopolization based on alleged "predatory pricing and other predatory tactics in the leisure passenger airlines markets for the Detroit-Boston and Detroit-Philadelphia routes."[7] Spirit, a small Detroit-based airline, "targeted local leisure or price-sensitive passengers whose travel is generally discretionary… [by providing] a price incentive with unrestricted, but non-refundable fares."[8] Spirit had difficulty acquiring additional gates at Detroit's Metropolitan Airport ("Detroit Metro") when it attempted to expand its service because Northwest controlled the majority of the gates and was forced to pay higher landing fees.[9] In December, 1995, Spirit started offering a daily non-stop flight to Philadelphia at $49 and added a second daily non-stop flight in June 1996.[10] It also added a daily non-stop to Boston in April 1996 at fares of $69, $89 and $109.[11]

Northwest, by comparison, was in 1995 the fourth largest air passenger carrier in the United States.[12] At its Detroit Metro hub, Northwest controlled sixty-four of the airport's eighty-six gates and had 78 percent of all passenger travel at the airport.[13] Unlike Spirit, Northwest offered connecting service to passengers as well as "restricted and unrestricted tickets, airport clubs, frequent flyer benefits, advanced seat selection, first and other classes of service, and on-board meals."[14] Prior to Spirit's entry, Northwest offered non-stop service from Detroit to Philadelphia and Boston holding 72 percent and 89 percent market shares, respectively, for these routes and charged much higher fares.[15]

Northwest had developed an analytical model called "New Competitive Equilibrium Analysis" ("NCEA") as a tool to guide its response to a new competitor coming into an existing market it served.[16] In April 1996, Northwest took action in response to Spirit's entry into the Detroit-Boston market. Northwest cut its lowest fare to $69, offering it on all Detroit-to-Boston flights, increased the number of daily non-stops in the market from 8.5 to 10.5 and added a 289-seat DC-10 to the route.[17] Following the fare reduction, in July 1996, 74 percent of Northwest passengers flew at or below $69 on the Detroit-Boston route, which had declined to 67 percent by September 1996.[18] These actions by Northwest had a dramatic negative impact on Spirit. After the Northwest fare reduction and increase in capacity on the Detroit-Boston route, Spirit's monthly average passenger load fell to 18 percent in April, 1996, 21 percent in May, 24 percent in June, 31 percent in July, 29 percent in August and to 17 percent in September.[19] As a result, Spirit finally abandoned the route in the fourth quarter of 1996.[20]

In June 1996, Northwest responded on the Detroit-Philadelphia route, reducing its lowest fares to $49 on all Northwest flights. Within two months, Spirit suspended its second Detroit-Philadelphia daily non-stop flight and on September 30 it abandoned the Detroit-Philadelphia route.[21] Once Spirit dropped out of the market, Northwest again became the only carrier with non-stop service on the Detroit-Philadelphia route and initially raised its lowest unrestricted fare to $271, which later increased to $461.[22]

Spirit filed a lawsuit against Northwest in March 2000 in the Eastern District of Michigan at Detroit, asserting violations of Section 2 of the Sherman Antitrust Act, alleging "anti-competitive and exclusionary practices, including, but not limited to, predatory pricing."[23]

After discovery, Northwest filed a motion for summary judgment, arguing that (1) the relevant market was all passengers (local and connecting) on the Detroit-Boston and Detroit-Philadelphia routes, (2) Northwest's revenues exceeded its average variable costs on the two routes at all relevant times, (3) even if a leisure-traveler market was appropriate, Northwest's total revenues on the routes exceeded its relevant

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costs, and finally (4) Northwest, by reducing its fares in the two markets, was simply responding to Spirit's entry into the two markets.[24] Spirit, in opposition to the motion for summary judgment, argued, based on testimony from its expert and the facts adduced from the record, that a "price-sensitive or leisure fare traveler" on the Detroit-Boston and Detroit-Philadelphia routes was the relevant service or product market.[25] Spirit further argued that the appropriate measure of costs was "Northwest's incremental costs" in adding capacity on the two routes and that by using these standards, "Northwest's prices on these routes were below its average variable costs."[26] Spirit also argued that after it stopped service on the two routes in question, Northwest raised its fares and reduced capacity and successfully recouped its losses.[27] The district court, following discovery, granted Northwest's motion for summary judgment.[28] The district court rejected Spirit's expert's definition of the "relevant product or services market," but concluded that even if a "price-sensitive" market was appropriate, the evidence showed that Northwest "operated profitably on both the Detroit-Boston and Detroit-Philadelphia routes during the entire period of alleged predation."[29] Spirit appealed the district court's grant of summary judgment to the Court of Appeals for Sixth Circuit.

The court of appeals began its analysis of the summary judgment record by looking at the "Market Characteristics of the Passenger Airline Industry."[30] The court noted that the record included a U.S. Department of Transportation (DOT) study relied upon by an expert witness for Spirit, which stated, among other things, that the presence of low-fare carriers in a market results in lower fares and higher traffic levels.[31] The court also cited another study, which had found that the availability of low fares in a market resulted in an increase in passenger traffic and that airlines, in addition to pricing, use multiple competitive tools to attract passengers, such as:

> the number of flights a day and the timing of those flights; the characteristics of the flight itinerary such as whether the flight is nonstop, continuing single-plane service, or connecting service; rebates to the traveler in the form of frequent flier programs or corporate discounts; [and] in-flight amenities including food service and how closely the seats are spaced together; ground amenities including club lounges; and so forth.[32]

The study also found that "the presence of a low-fare carrier such as Southwest reduces an airline's ability to extract high fares from travelers" and that a low-fare carrier's entry into a market increases the number of tickets sold in the low fare category.[33] The court of appeals noted that access to gates at airports is a "substantial barrier to entry" for a new entrant into the market, and that such access is "not determined by open competition."[34] The Sixth Circuit also reviewed the testimony of another of Spirit's expert witnesses, Dr. Keith B. Leffler, who had analyzed the reports of Northwest's own experts in a prior lawsuit filed by Northwest against American Airlines, and concluded that Northwest's experts in the prior case had opined that:

> (a) air travel between city-pairs are relevant economic markets in the airline industry;
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> (b) predatory pricing can be a rational economic strategy in the airline industry;
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> (c) recoupment from predatory pricing is likely for an airline dominant in a relevant economic market in the airline industry;
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> (d) there are substantial barriers to entry into the airline industry;
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> (e) business travelers constitute a distinct market segment in the airline industry; [and]
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> (f) the measure of the average variable cost in the airline industry should include the cost of changing capacity.[35]

The court of appeals also reviewed the "market power" of Northwest, noting from the record that at the time Spirit entered the Detroit-Boston and Detroit-Philadelphia markets, Northwest had over two-thirds of the passenger traffic from Detroit Metro and over 80 percent of the gates at the airport.[36] The court also noted that Spirit's expert, Professor Elzinga, concluded based on his review of the market that "Northwest possessed sufficient market power on the Detroit-Boston and Detroit-Philadelphia routes 'to make predatory pricing plausible.'"[37] The Sixth Circuit then turned to a review of the "Relevant Market." The court found from the record that Northwest recognized a distinct and relevant "low price or price sensitive traveler" or "leisure traveler" market in the industry which had also been identified by two federal regulators who had studied the market.[38] In addition, Spirit's experts found a distinct "leisure traveler" market and concluded that this was the market in which Spirit and Northwest actually competed.[39] The court also reviewed the record evidence of "Northwest's Strategy" with respect to new market entrants. It noted statements made by Northwest's CEO that Detroit Metro was the company's "most unique strategic asset," which he said the company must protect "at almost all costs."[40] In addition, the court found that a Northwest study had concluded that competition with low-fare carriers would cost the company in the range of $250 to $375 million in annual revenue at its three hubs and that Spirit was identified as one of the low-fare carriers.[41] The court also noted an article published by Northwest's executive vice-president in 1987 setting forth a strategy to respond to the entry of low-fare carriers into the market, which included meeting or beating the new entrant's lowest unrestricted fare and then making sure Northwest had enough seats to handle the increased traffic.[42] The court also noted a DOT study of the airline industry that concluded, among other things, that "Northwest's response forced Spirit's exit from this market and was designed to do so."[43] Turning its review of the summary judgment record to the issue of "recoupment," the Sixth Circuit noted the opinion of another Spirit expert, Professor David Mills, who had explained that it is "the predator's view of below cost pricing as 'an investment strategy' that is the core of Elzinga-Mills recoupment test for predatory pricing."[44] Professor Mills testified that "Northwest had successfully recouped its lost revenue within months after Spirit's departure from these routes." The court further reviewed testimony regarding alleged "non-price predatory

practices," specifically the matching of Spirit's low fares in conjunction with the expansion of capacity on the Detroit-Boston and Detroit-Philadelphia routes which were deemed by Professor Elzinga to be the "keys to Northwest's successful predation against Spirit."[45]

After completing its review of the summary judgment record, the Sixth Circuit moved to a review of the legal sufficiency of Spirit's Section 2 claims.[46] The court began its analysis by reviewing the language of Section 2 and its purpose:

> Section 2 of the Sherman Act, in pertinent part, makes it unlawful to "monopolize, or attempt to monopolize… any part of the trade or commerce among the several States…." 15 U.S.C. § 2. "[Section] 2 addresses the actions of single firms that monopolize or attempt to monopolize… The purpose of the Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market." Spectrum Sports Inc. v. McQuillan, 506 U.S. 447, 454, 458, 113 S. Ct. 884, 122 L. Ed. 2d 247 (1993).[47]

The court continued its analysis by setting forth the required elements for Spirit's Section 2 claims of monopolization and attempted monopolization which are: "(1) the possession of monopoly power in a relevant market; and (2) the willful acquisition, maintenance, or use of that power by anti-competitive or exclusionary means as opposed to "growth or development resulting from a superior product, business acumen, or historic accident."[48]

After reviewing the language of Section 2 and the essential elements of the claims presented by Spirit, the Sixth Circuit turned to the first issue, namely the "relevant product and geographic markets in which [plaintiff] competes with the alleged monopolizer, and with respect to the monopolization claim, to show that the defendant, in fact, possesses monopoly power."[49] The court of appeals found that there was no dispute that the relevant geographic markets were "the Detroit-Boston and Detroit-Philadelphia route."[50] With respect to the related issue of the appropriate "product or service market," the district court had adopted Northwest's position that the relevant product or service market "includes 'local' passengers who travel from Detroit on these non-stop flights to either Philadelphia or Boston and "connecting" passengers from other Northwest flights who travel to these cities from the Detroit airport."[51] The Sixth Circuit reviewed U.S. Supreme Court precedent and revisited the summary judgment record in evaluating the district court's ruling on the issue. It noted that the Supreme Court had recognized that a product or service market may have "submarkets."[52]

The Sixth Circuit concluded that a reasonable trier of fact could conclude that both parties recognized the existence of "leisure" or "price-sensitive" passengers as a distinct market in the airline passenger market under Section 2.[53] Central to the court of appeals' finding was evidence that Northwest recognized the "leisure" traveler as a separate market, including Northwest's fare structure during the relevant period, the deposition testimony of a Northwest manager, the report of two Northwest experts in its predatory pricing lawsuit against American Airlines, and comments by a consultant retained by Northwest in connection with proposed enforcement by DOT.[54] In reaching this conclusion, the Sixth Circuit also relied on the opinion of Spirit's expert Professor Elzinga.[55]

The court next considered the issue of whether Northwest had monopoly power in the relevant markets, defined as the "the ability of a single seller to raise price and restrict output"[56] or "control prices or exclude competition."[57] It noted that monopoly power can usually be inferred where the alleged predator has a predominant market share.[58] Turning to the facts in the record, the court of appeals found that Northwest was the predominate carrier in each market, with an 89 percent share in the Detroit-Boston market and a share greater than 70 percent in the Detroit-Philadelphia market at the time of Spirit's entry.[59] In addition, Northwest controlled 78 percent of all passengers traveling from Detroit Metro and controlled sixty-four of the eighty-six gates at the airport under long term leases.[60] The court found that Northwest reduced the number of flights in the two markets and increased fares significantly after Spirit's departure, which "could reasonably be interpreted as a clear exercise of monopoly power."[61] It found that the opinion of Professor Elzinga that Northwest had sufficient market power to achieve success at predatory pricing, was a "reasonable economic conclusion based upon the proof."[62]

Next, the court turned to the issue of the appropriate measure of costs to determine whether Northwest's response was predatory. It began its inquiry by recognizing that a claim of predatory pricing under Section 2 requires that the plaintiff prove "that the prices complained of are below an appropriate measure of its rival's costs."[63] Noting that there was a split among the circuits (which the Supreme Court had declined to resolve in *Brooke Group*) over the appropriate measure of costs, the court set forth the test that had been earlier adopted in the Sixth Circuit in predatory pricing cases, which focused on average variable costs, but left open the possibility that a firm with above-average variable cost pricing might be guilty of predatory pricing.[64] The court also noted a later Sixth Circuit decision that held that if "the plaintiff proves that the defendant's prices were below average variable cost, the plaintiff has established a prima facie case of predatory pricing and the burden shifts to the defendant to prove that the prices were justified without regard to any anticipated destructive effect they may have on competitors."[65] The court of appeals then turned to a review of the opinions of Spirit's experts on this issue.[66] Spirit's experts had analyzed the incremental costs incurred by Northwest in response to Spirit's entry and compared these costs to the extra revenue that Northwest received from its response.[67] The court noted that the analysis employed "focuses on revenue from the additional flights (i.e., the extra capacity) that Northwest added (at discounted fares) because the alleged predation was executed through those additional flights."[68] Another Spirit expert, Dr. Daniel Kaplan, had used Northwest's own internal data to determine its average variable costs for price sensitive passengers on the Detroit-Boston and Detroit-Philadelphia routes.[69] Dr. Kaplan, in calculating average variable costs, included "flight costs, passenger costs, and gate and ticket-counter costs."[70] The court noted that Dr. Kaplan included as flight costs "fuel and labor" and the cost of the additional airplanes Northwest

used on each route; and as passenger costs the costs associated with processing tickets and boarding, the cost of flight food and beverages, liability insurance costs, and the incremental cost of fuel to carry each passenger.[71] Additional costs used to determine average variable costs were costs for pilots, flight attendants, gates and counter space.[72] The court noted that Dr. Kaplan calculated the monthly average variable costs for the Detroit-Boston route for the April-September 1996 period as ranging from $65.87 to $85.24 and the monthly average variable cost range for the Detroit-Philadelphia route for the July-September period to be from $53.47 to $60.17.[73] The Sixth Circuit considered Dr. Kaplan's findings that on all passenger service on the two routes during the relevant time period (1) net passenger revenue on the Detroit-Boston route was $10.75 below Northwest's average variable cost; and (2) net passenger revenue on the Detroit-Philadelphia route was $11.86 below Northwest's average variable cost.[74] In addition, Dr. Kaplan had concluded that for the "price-sensitive traveler" Northwest's net passenger revenue was $8.07 below average variable costs on the Detroit-Boston route and $6.53 below average variable costs on the Detroit-Philadelphia route.[75] The court of appeals noted that Northwest's expert had reached different conclusions, although he also relied on the same internal Northwest data as the Spirit experts.[76] Northwest's expert Professor Janusz A. Ordover, in his analysis, "considered total revenue from all passengers, leisure travelers as well as connecting passengers, earned from these routes and compared those revenues to Northwest's variable costs for those flights."[77] Professor Ordover used several of the same cost elements as Dr. Kaplan to determine average variable cost.[78] The Sixth Circuit noted Professor Ordover's conclusion that after deducting average variable costs from passenger revenue, Northwest's "average fares on the routes exceeded its average variable costs" and that "Northwest's pricing response to Spirit's entry would have been profitable even if Spirit had continued to serve the markets."[79] The court also noted the rebuttal reports of Spirit's experts that criticized Dr. Ordover for including all passenger revenue on each route, since in their opinion local passengers (i.e., the leisure traveler market) were the passengers that Northwest was attempting to divert from Spirit.[80]

After reviewing the record, including the opinions of all experts, the Sixth Circuit concluded that a reasonable trier of fact could accept the Spirit expert's "definition and calculation of Northwest's incremental costs to attract the leisure travel passengers on these routes as the appropriate measure of Northwest's average variable costs for deciding Spirit's Section 2 claim against Northwest."[81] The court held that summary judgment was inappropriate, since the "intellectual disagreement" created material factual disputes on the issues of the "relevant market" and the "appropriate measure of costs."[82]

The Sixth Circuit also concluded based on the record that a reasonable trier of fact could conclude that significant barriers to entry existed based on Northwest's control of sixty-four of the eighty-six gates at Detroit Metro under long term leases and the fact that Spirit had to pay $100,000 to access a gate and 25 percent higher landing fees than airlines with long term leases, such as Northwest.[83]

The court then moved to consider whether the essential element of recoupment was met in the case before it.[84] The Sixth Circuit reviewed the Supreme Court's decision in *Brooke Group*,[85] and summarized the relevant inquiries as follows:

> The inquiry is whether, given the aggregate losses caused by the below-cost pricing, the intended target would likely succumb. 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 pricing 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....
>
> Likewise, we have required proof of an injury to competition by a firm's predatory pricing, to sustain a Section 2 claim of monopolization....
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> In Conwood, we deemed a predator's conduct causing 'higher prices and reduced consumer choice... harmful to competition.'[86]

After setting forth the applicable legal standard, the court of appeals examined the testimony offered by Spirit's expert on the issue, Professor Mills, who had concluded that Northwest was able to recoup its losses from predatory pricing within a few months of Spirit's exit from the markets.[87] The Sixth Circuit found that a trier of fact could reasonably find that Northwest was able to recoup any losses within a short time of Spirit's exit from the two markets, noting that Northwest increased its fares seven times above the level existing during Spirit's presence in the markets.[88] The court also found that a trier of fact could reasonably conclude that competitive injury occurred as a result of Northwest's actions, citing higher fares paid by travelers on the two routes.[89]

The Sixth Circuit also examined Spirit's assertion that a key aspect of Northwest's policy of monopolization and its predatory strategy was expansion of capacity on the two routes, a claim that was not considered by the district court, which had ruled that proof that revenue exceeded average variable cost ended the inquiry.[90] The court of appeals disagreed with this analysis, and found that the opinion of Spirit's experts that the increase in capacity was essential for Northwest to succeed in its predatory pricing scheme was a "reasonable economic explanation of the anticompetitive effects of Northwest's two-prong response to Spirit's entry on these routes, that included a rapid expansion of Northwest's capacity on these routes."[91] The court stated that a party could violate Section 2 even where its prices are not below its average variable costs.[92]

The court of appeals, in reversing and remanding the case to the district court, concluded that "even if the jury were to find that Northwest's prices exceeded an appropriate measure of average variable costs, the jury must also consider the market structure in this controversy to determine if Northwest's deep price discounts in response to Spirit's entry and the accompanying expansion of its capacity on these routes injured competition by causing Spirit's departure from

this market and allowing Northwest to recoup its losses and to enjoy monopoly power as a result."[93]

The Sixth Circuit's decision in Spirit may represent a new judicial willingness to move away from the rigid application of economic theory to a more realistic market-based approach where "facts demonstrating economic effect trump theory."[94]

Endnotes

1 M. Denger, et al., *Predatory Pricing and Practices*, 1583 PLI/Corp. 293, 300 (Jan.-Feb. 2007) (*hereinafter* Predatory Pricing). *See also* D. Crane, *The Paradox of Predatory Pricing*, 91 Cornell L. Rev. 1 (2005) ("The paradox of predatory pricing law is that even an analytically perfect specification of the line between predatory and innocent price cuts would result in deviations from optimal pricing because the very recognition of a predatory pricing offense will induce some firms to forgo innocent price cuts.").

2 *See* 15 U.S.C. §2. The Sherman Antitrust Act was originally enacted in 1890 with later amendments in 1955, 1974, 1990 and 2004. *Id*.

3 *Id*. Section 1 of the Sherman Antitrust Act, 15 U.S.C. §1 prohibits "contract[s], combinations in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations…" Section 1 further provides that "[e]very person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $ 100,000,000 if a corporation, or, if any other person, $ 1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court." Sections 1 and 2 are independent from each other, although objects of conspiracies may overlap to some degree. *See* American Tobacco Co. v United States, 328 US 781, 90 L Ed 1575, 66 S Ct 1125 (1946). A monopoly under Section 2 is a species of restraint of trade under Section 1. *Id*.

4 ILC Peripherals Leasing Corp. v. Int'l Bus. Machines Corp., 458 F Supp 423, 1978-2 CCH Trade Cases P 62177, 26 FR Serv. 2d 1048, (N.D. Cal. 1978), aff'd, (9th Cir. 1980)(holding that the defendant should not be found guilty of predatory pricing, regardless of its cost, when it reduces prices to meet lower prices already being charged by its competitors, since to force the defendant to maintain noncompetitive prices would create the kind of market position that the prohibition of predatory pricing was meant to preclude).

5 Predatory Pricing, at 299 (quoting AD/SAT v. Associated Press, 920 F. Supp. 1287, 1301 (S.D.N.Y. 1996), aff'd, 181 F. 3d 216 (2d Cir. 1999)).

6 Spirit Airlines, Inc. v. Northwest Airlines, Inc., 431 F. 3d 917 (6th Cir. 2005), rehearing and rehearing en banc denied, 2006 U.S. App. LEXIS 10603 (6th Cir. 2006), motion to direct the Clerk to file a petition for writ of certiorari out of time denied, 127 S. Ct. 340, 166 L. Ed. 2d 12 (2006).

7 *Id*. at 921.

8 *Id*. at 922. The so-called "local leisure" or "price-sensitive" passengers are individuals whose travel plans are generally discretionary "such as passengers visiting friends and relatives, and tourists or vacationers who might not otherwise fly." *Id*. These passengers may decide to travel by air, as opposed to driving, based on the availability of lower fares. The "local leisure" or "price sensitive" passengers can be distinguished from business travelers who are often required to fly on short notice without regard to the availability of low fares. Spirit did not offer passengers "first-class" seating, a frequent flyer program or connecting service. *Id*. Spirit started out in 1992 serving four cities and expanded service in 1993 to cities in Florida. *Id*.

9 *Id*. Spirit was unable to secure a permanent gate arrangement, but was permitted to use gates formerly used by "Trump Shuttle and Charter," and obtained short term leases from two other legacy carriers serving Detroit Metro. *Id*.

10 Spirit experienced a "load-factor" of nearly 75% in December 1995, which increased to 88.5% in June 1996 when the second daily non-stop to Philadelphia was added. *Id*. The term "load factor" in the aviation context refers to the ratio of "revenue passenger miles" to "available seat miles" of a particular flight. *See* http://www.reference.com/browse/wiki/Load_factor.

11 *Id*.

12 *Id*. at 923. Northwest has "hubs" in Minneapolis, Detroit and Memphis. Spirit by comparison had annual revenues of $62.9 million as of June 1996. Id.

13 *Id*.

14 *Id*. Northwest policy seeks "to maximize the revenue that [Northwest] earn[s] for [its] domestic network… and… [to] try to sell every seat at its highest possible fare." *Id*.

15 *Id*. Northwest's only competitor in the Detroit-to-Philadelphia market was U.S. Airways. Northwest offered six daily non-stops from Detroit to Philadelphia while U.S. Airways offered four. *Id*. When Spirit entered the Detroit-Philadelphia market, Northwest's lowest unrestricted fare was $355 and its lowest restricted fare was $125 one-way. Before Spirit entered the Detroit-to-Boston market, Northwest provided non-stop passenger service with 8.5 daily round trips; its lowest unrestricted fare was $411 and its lowest restricted fare was $189. *Id*. U.S. Airways had fares comparable to Northwest on the Detroit-Philadelphia route. *Id*. At the time of Spirit's initial entry into the Detroit to Philadelphia market, neither Northwest nor U.S. Airways reduced its fares to match Spirit's lower fares or increased capacity on the route. *Id*. Northwest was planning to reduce capacity on the Detroit-Boston route in the summer of 1996 before Spirit entered the market. *Id*.

16 *Id*. This two-step model involved considering "the impact of the new entrant's service on Northwest's revenue" and deciding "whether to add capacity on the route." *Id*.

17 *Id*. at 924. The DC-10 had more than three-times as many seats as Spirit's entire daily capacity on the route. *Id*.

18 *Id*. After the reduction, Northwest passengers flying the Detroit-Boston route paid less for fares than Spirit passengers on the same route on 93.9 percent of the days on which Spirit flew the route. *Id*.

19 *Id*. Northwest averaged over 30,000 passengers per month on the route, in the April to September 1996 time period, while Spirit's monthly high was 17,000. *Id*.

20 *Id*. at 925.

21 *Id*.

22 *Id*. After the Northwest fare reductions on the Detroit-Philadelphia route in June 1996, Spirit's monthly passenger load dropped to 43 percent in July, 1996, 36 percent in August, and 31 percent in September. *Id*. Northwest implemented its $279 (lowest) unrestricted fare on the Detroit-Philadelphia route on October 28, 1996, which later rose to $416 on April 20, 1998. *Id*.

23 *Id*. at 924-25.

24 *Id*. at 925.

25 *Id*.

26 *Id*.

27 *Id*. In addition to its arguments regarding the appropriate product or service market, the appropriate cost model, and recoupment, Spirit argued that Northwest's control of gates at Detroit Metro created a significant barrier to competition which assisted Northwest in its predatory pricing scheme. *Id*.

28 *Id*. at 925-26.

29 *Id*. The district court, in granting the defendant's motion for summary judgment, cited the Supreme Court's decision in *Brooke Group Ltd. v. Brown and Williamson Tobacco Group* as the controlling authority for its decision. 509 U.S. 209, 113 S.Ct 2578, 125 L.Ed. 2d 168 (1993).

30 *Spirit*, 431 F. 3d at 926.

31 *Id*. The report cited by the court of appeals was DOT's study "The Low Cost Airline Service Revolution" (April 1996), *at* http://ostpxweb.dot.gov/aviation/domav/lcs.pdf.

32 *Spirit*, 431 F. 3d at 926-27 (quoting C. Oster & J. Strong, *Predatory Pricing in the U.S. Airline Industry*) (*hereinafter* Oster-Strong Study). The Oster-Strong study cited Northwest's third quarter 1996 response to Spirit in the Detroit-Philadelphia market as an example of an airline making more seats available in the lower fare category. *Id*.

33 *Id*. at 927.

34 *Id*. at 928. The testimony of Spirit's expert, Professor Kenneth Elzinga, noted that local governments control access to gates and runways and that access is allocated "without a formal market mechanism." *Id*. (quoting Gautam Gowrisankaran, *Competition and Regulation in the Airline Industry*, Federal Reserve Board of San Francisco Economic Letter, Number 2002-01, at 1). Professor Elzinga further noted that most airport gates "are controlled by long-term exclusive-use leases with the local airport authority." *Id*. at 928. The court of appeals also noted that a Northwest expert witness, in the company's prior lawsuit against American Airlines for predatory pricing, recognized that new entrants in a market face a "higher cost of entry" since existing airlines "obtained their initial awareness and facilities base pursuant to governmental regulations that protect them from competition." *Id*. at 928.

35 *Id*.

36 *Id*.

37 *Id*. at 929.

38 *Id*.

39 *Id*.

40 *Id*.

41 *Id*.

42 *Id*. (quoting Levine, *Airline Competition In Deregulated Markets*, 4 Yale J. On Reg. 393, 476-78 (1987)). The strategy mapped out in the article was called "new competitive equilibrium analysis." *Id*.

43 *Id*. at 929.

44 *Id*. at 930. The "Elzinga-Mills" test looks at the profit that the alleged predator would earn if the "target" of the predatory pricing remained in the market as a fair benchmark of the alleged predator's "reasonably expected gains and losses." *Id*. In applying the "Elzinga-Mills" test to the facts before the court, Professor Mills opined that three factors needed to be considered:

> [T]he first task is to compare Northwest's average fares during the months when Spirit operated its flights on the [Detroit-Boston] route to the average fares that would have prevailed on the route, but for Northwest's alleged predation. This factor measures the monthly financial sacrifice the airline shouldered by charging prices below the otherwise prevailing level. The second task… compares the average fares Northwest would expect to charge, during the months immediately after Spirit exited the market, to the average fares that otherwise would have prevailed in the market. This second factor measures the monthly financial return Northwest could achieve by driving Spirit from the market with its predatory pricing. The third factor compares the anticipated monthly sacrifice during predation with the anticipated monthly return during recoupment to understand whether predatory pricing plausibly would have been a profitable option for Northwest to exercise.

45 *Id*. The court of appeals also noted the opinion of another Spirit expert, Dr. Daniel Kaplan, who opined that Northwest analysts deviated from the company's "price-out model forecast" in justifying the addition of a DC-10 on the Detroit-Boston route. *Id*.

46 *Id*. at 930-31. The court of appeals discussed the proper standard for summary judgment in an antitrust lawsuit. The court cited the U.S. Supreme Court's decision in *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, which stated that summary judgment should be granted where the alleged antitrust violation "simply makes no economic sense." 504 U.S. 451, 467, 112 S. Ct 2072, 119 L. Ed. 2d 265 (1992). The court of appeals then reviewed a subsequent Supreme Court decision, *Brooke Group Ltd. v. Brown and Williamson Tobacco Group*, and concluded, based on the holding in *Brooke Group*, that "where the market is highly concentrated, the barriers to entry are high, the defendant has market power and excess capacity, and evidence of actual recoupment is present, summary judgment is inappropriate." 509 U.S. 209, 226, 113 S. Ct. 2578, 125 L.Ed.2d 168 (1993). *Spirit*, 431 F. 3d at 931.

47 *Id*. at 931-32.

48 *Spirit*, 431 F. 3d at 932 (quoting Conwood Co., L.P. v. U.S. Tobacco Co., 290 F.3d 768, 782 (6th Cir. 2002)).

49 *Id*. at 932.

50 *Id*. at 933.

51 *Id*.

52 *Spirit*, 431 F. 3d at 933.

53 *Id*.

54 *Id*. at 933-34. Internal Northwest documents showed that the company made a distinction between business and leisure travel. *Id*. at 933. The Northwest manager for domestic pricing testified that the company viewed the business and leisure markets as separate markets. *Id*. at 934. One Northwest expert in the American Airlines lawsuit opined that "there were at least two relevant product market segments in which airlines compete: business and discretionary and leisure travel." *Id*.

55 *Id*. at 935. Professor Elzinga, in his analysis of the cost-revenue comparison, used the leisure traveler as the relevant market. *Id*. The court of appeals noted the impressive credentials of Professor Elzinga, including his prior government service as an economist in the United States Department of Justice and as a consultant to the Federal Trade Commission and his writings on predatory pricing which have been cited by the U.S. Supreme Court in antitrust cases. *Id*. at 934.

56 *Id*. at 935 (quoting *Eastman Kodak*, 504 U.S. at 464)(in turn quoting Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 503, 89 S. Ct. 1252, 22 L. Ed. 2d 495 (1969)).

57 *Spirit*, 431 F. 3d at 935 (quoting United States v. E.I. du Pont Nemours & Co., 351 U.S. 377, 391, 76 S. Ct. 994, 100 L. Ed. 1264 (1956)).

58 *Spirit*, 431 F. 3d at 935. *See Eastman Kodak*, 504 U.S. at 464, 481 ("possession of over two-thirds of the market is a monopoly," citing American Tobacco Co. v. United States, 328 U.S. 781, 797 (1946)).

59 *Spirit*, 431 F. 3d at 935.

60 *Id*.

61 *Id*. at 935-36.

62 *Id*. at 936. The court of appeals, in finding that Northwest possessed the requisite market power to engage in predatory conduct, also cited an article by Professor Paul Stephen Dempsey, that the court found touched on the issues in the case and that, among other things, quoted Northwest's Michael Levine as stating "I believe predation is possible and that it occurs… [I]t is possible for an incumbent to impose on prospective entrants nonrecoverable costs by pricing in a way that seeks to ensure that they do not attract a significant share of passengers regardless of the incumbent's own costs." *Id*. at 936 (quoting *Predation, Competition & Antitrust Law: Turbulence In The Airline Industry*, 67 J. Air L. & Com. 685, 708 (2002)). *Id*.

63 *Id*. at 937 (quoting *Brooke Group*, 509 U.S. at 222). In *Brooke Group*, the Supreme Court used "the average variable cost standard" in the case before it because the parties had stipulated it was the appropriate measure. *Id*. at 223.

64 *Id*. at 937-38. The Sixth Circuit had earlier, in *D.E. Rogers Associates, Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1436-37 (6th Cir. 1983), adopted a modified version of the Ninth Circuit's test in *William Inglis v. ITT Continental Baking Co.*, 668 F.2d 1014, 1035-36 (9th Cir. 1981)("[w]e hold that to establish predatory pricing a plaintiff must prove that the anticipated benefits of defendant's price depended on its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power. If the defendant's prices were below average total cost but above average variable cost, the plaintiff bears the burden of showing defendant's pricing was predatory. If, however, the plaintiff proves

that the defendant's prices were below average variable cost, the plaintiff has established a prima facie case of predatory pricing and the burden shifts to the defendant to prove that the prices were justified without regard to any anticipated destructive effect they might have on competitors.").

65 *Spirit*, 431 F. 3d at 938 (quoting Arthur S. Langenderfer Inc., v. S.E. Johnson Co., 729 F.2d 1050, 1056 (6th Cir. 1984) (in turn quoting Inglis, 668 F.2d at 1035-36). *See also* Directory Sales Mgmt Corp. v. Ohio Bell Tel. Co., 833 F. 2d 606, 613 n. 13 (6th Cir. 1987).

66 The court noted that Spirit's experts, Professors Elzinga and Mills used the same tests for predation and recoupment in the case before it that were cited by the Supreme Court in *Brooke Group*. *Spirit*, 431 F. 3d at 939.

67 *Id*.

68 *Id*.

69 *Id*. Dr. Kaplan used Northwest's "Flight Profitability System" ("FPS") which, among other things, analyzes the costs and revenues of each Northwest flight. *Id*. Dr. Kaplan also studied the Northwest fare structure for the Detroit-Boston and Detroit-Philadelphia routes for 1996 to determine the appropriate dividing line between price-sensitive travelers and other travelers on these routes, which he determined was a fare of $225. *Id*. at 940.

70 *Id*. Dr. Kaplan opined that gate and ticket counter costs would be reflected in depreciation and amortization expenses. *Id*.

71 *Id*.

72 *Id*.

73 *Id*. Dr. Kaplan divided the sum of the cost factors identified as variable by Northwest's FPS and the aircraft market value by "the total number of passengers traveling on that segment during the relevant time periods." *Id*.

74 *Id*. at 940-41.

75 *Id*. at 941.

76 *Id*. at 941-46.

77 *Id*. at 942.

78 *Id*. In his average variable cost analysis, Dr. Ordover declined to use the commercial lease rates for the aircraft used by Northwest on the routes in question, instead choosing "the opportunity costs of the aircraft and its least attractive alternative deployment within the airline's system." *Id*.

79 *Id*. at 943.

80 *Id*. The court noted that Northwest's FPS and its "Price Out Model" did not consider differences between leisure travelers and other classes of travelers to be meaningful for purposes of calculating average variable costs. *Id*. at 946.

81 *Id*. at 945.

82 *Id*. The court of appeals rejected the district court's finding that the opinion of Spirit's expert made "no economic sense" and found that a reasonable trier of fact could find the opinion reasonable based on the facts in the record and economic principles. *Id*. The court of appeals also distinguished the cases cited by Northwest. *Id*. at 946-47. Unlike in *United States v. AMR Corp.*, 335 F. 3d 1109 (10th Cir 2003) (a predatory pricing case against American Airlines), where the Tenth Circuit found that none of the tests that the government utilized was a true measure of the incremental cost of adding extra passengers on the route in question, Northwest did not contend that Spirit's price-cost test was flawed; in addition, Spirit's price-cost analysis was based on Northwest's FPS system which Northwest admitted calculated a reasonable approximation of average variable costs for a route. *Spirit*, 431 F. 3d at 946. The court of appeals also noted that other courts have accepted average variable costs as the proper measure of costs in predatory pricing cases. *Id*.

83 *Id*. at 947. The court of appeals noted that the presence of high barriers to entry is a factor to consider because high barriers make it more likely that an incumbent will be able to price "predatorily." *Id*. at 946 (citing Richter Concrete Corp. v. Hilltop Concrete Corp., 691 F. 2d 818, 824 (6th Cir. 1982)).

84 *Spirit*, 431 F. 3d at 947-48. "The second perquisite under § 2 of the Sherman Act, is proof that the competitor recovered or had a reasonable prospect or a dangerous probability of recouping its investment in below-cost prices." *Id*. (quoting Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 589 (1986)).

85 509 U.S. at 224-26.

86 *Spirit*, 431 F. 3d at 948-49 (quoting *Conwood*, 290 F. 3d at 789).

87 *Spirit*, 431 F. 3d at 949-50. For example, Professor Mills looked at Northwest's monthly sacrifice during predation and its monthly returns after predation in the Detroit-Philadelphia market and determined under different scenarios whether recoupment was plausible and, if so, the time necessary for recoupment. *Id*. He concluded that recoupment was plausible and that the time necessary for recoupment would vary between one and seven months based on factors such as prevailing prices and the anticipated period for predation. *Id*.

88 *Id*. at 951.

89 *Id*.

90 *Id*.

91 *Id*. at 952. Professor Elzinga opined that a fare decrease by Northwest was not sufficient to run Spirit out of the markets, since capacity was presumably optimized before Spirit entered the market so that Northwest "could not add a large number of additional passengers even at lower prices unless it also increased capacity." *Id*.

92 *Id*. The Sixth Circuit stated that a finding that revenue exceeds average variable costs is not sufficient to end the inquiry where the record and "market realities" reflect the existence of a predatory pricing scheme:

> *Brooke Group* emphasized that even where theory suggests that predatory pricing is rare, "however unlikely that possibility may be as a general matter, when the realities of the market and the record facts indicate that [a predatory pricing scheme] has occurred and was likely to have succeeded, theory will not stand in the way of liability." 509 U.S. at 229 (citing *Eastman Kodak*, 504 U.S. at 466, 467). In *Conwood*, we explained "'anticompetitive conduct' can come in too many different forms, and is too dependent upon context, for any court or commentator ever to have enumerated all the varieties." 290 F.3d at 784 (quoting Carribean Broad. Sys. Ltd. v. Cable & Wireless PLC, 331 U.S. App. D.C. 226, 148 F.3d 1080, 1087 (D.C. Cir. 1998)). Moreover, in *D.E. Rogers*, we adopted the Inglis rule that "acknowledges that in certain situations, a firm selling above average variable cost could be guilty of predation." 718 F.2d at 1436 (citing *Inglis* 668 F.2d at 1035).

Spirit, 431 F. 3d at 952.

93 *Id*. at 953. Circuit Judge Karen Nelson Moore wrote a concurring opinion. *Id*. at 953-59. To date, at least two district courts have cited the Sixth Circuit's analysis in *Spirit* with respect to claims under Section 2. *See, e.g.,* Ky. Speedway, LLC v. NASCAR, 410 F. Supp. 2d 592, 596 (E.D. Ky 2006) (noting that the relevant market may be narrowly defined); Invacare Corp. v. Respironics, Inc., 2006 U.S. Dist. LEXIS 77312 at *25 (N.D. Ohio 2006) ("Spirit Airlines does not hold that a party could show predatory pricing without any type of below-cost pricing.") *See also* D. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 Emory L.J. 423, 477 n. 229 (2006) (citing *Spirit* in discussion of differing approaches for determining the appropriate measure of costs in predatory pricing cases).

94 *Cf.* W. Michael, *Holmes and the Bald Man: Why Rule of Reason Should Be the Standard in Sherman Act Section 2 Cases*, 4 Pierce L. Rev. 359, 370-71, n. 75 (2006).