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# Why aren't there more California below-cost pricing cases?

By Dylan Ballard

The most common response I hear after I tell someone about the elements of a below-cost pricing claim under California's Unfair Practices Act is, "I'm going to go talk to someone else now."

But the *second* most common response I hear is, "Why isn't every California company bringing one of these claims?"

It's not a crazy question. The UPA's below-cost pricing statute is perhaps the broadest such statute in the nation, and far broader than comparable federal laws, which have been narrowed in recent decades almost to the vanishing point. Indeed, the statute — which dates back to the Great Depression and the era of New Deal economics — could be interpreted as a bright-line prohibition against pricing just about anything below cost to take business from a competitor. *See* Bus. & Prof. Code Section 17043. And yet, at least by the hyperactive standards of contemporary commercial litigation, the statute has not been heavily employed or even spoken about, mainly collecting cobwebs in the dim corners of law libraries.

California's businesses should be paying more attention to this law, and to its peculiar risks and rewards. These are the elements of a UPA below- cost pricing violation:

1. Defendant offered to sell or sold something at prices that were below its costs;
2. Defendant's purpose was to injure competitors or destroy competition;
3. Plaintiff was harmed; and
4. Defendant's conduct was a substantial factor in causing plaintiff's harm.

That's it. (*See* CACI No. 3301). If those elements do not already strike you as expansive on their face, please consider the following:

**The Statute Covers Nearly All Products and Services**

Unlike certain federal below-cost pricing laws that are limited to sales of tangible goods, the UPA applies to any transaction (or proposed transaction) involving a "thing of value," including services and intellectual property

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rights. *See* Bus. & Prof. Code Section 17024. The only exception is for products or services for which rates are set by the California Public Utilities Commission.

**"Below Cost" Means "Below Fully Allocated Cost"**

In calculating whether a particular price is below cost, the UPA requires the use of "fully allocated" cost (also described as "average total cost"), a measure that incorporates all of a company's fixed and variable costs divided by the number of "units" produced. This includes not only costs directly associated with the particular product or service, but also every conceivable form of overhead, including things like "labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance and advertising." Bus. & Prof. Code Section 17029.

By contrast, most courts agree that federal laws only prohibit pricing below "average variable cost," a more limited measure that focuses solely on a company's variable costs (costs like materials that change as production increases or decreases) divided by the number of units produced. This calculation will nearly always yield a much smaller cost figure than the UPA's "fully allocated" standard, making below-cost pricing significantly more challenging to plead and prove under federal law.

None of this is to say that the ultimate cost calculation in a UPA case is free from controversy; cost accounting and allocation issues remain hotly contested in many cases. But the UPA defines the parameters of that dispute as broadly as possible by making virtually any form of cost fair game.

**There Is No "Price Averaging" Defense**

Under federal law, courts generally have allowed defendants to justify below-cost pricing of particular sales with evidence that their *overall* sales (e.g., along an entire product line) are, on average, above cost. California courts have clearly rejected the existence of any such "price averaging safe harbor" under the UPA, instead applying the statute literally to prohibit any individual sale below cost, without reference to other sales. *See Fisherman's Wharf Bay Cruise Corp. v. Superior Court*, 114 Cal. App. 4th 309 (2003).

**It Is Unsettled Whether There Is a "Bundling" Defense**

The "bundled discount" — a discounted price on the condition that the customer purchases more than one kind of product or service — is a common breeding ground for allegations of below-cost pricing. In these contexts, defendants have argued that a below-cost price for one item in the "bundle" should not be unlawful so long as the *total* price of all products in the bundle is above the bundle's *total* cost. Under federal law, courts generally have rejected such arguments, instead independently analyzing whether the relevant item in the bundle was sold below that item's cost. *See Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008).

While the case law applying the UPA is not as developed, it is likewise questionable whether such a "bundling" defense has any traction under the statute. The logic of the UPA cases rejecting the "price averaging" defense — under which courts must "focus literally on whether the defendant sold 'any article or product' at less than cost" — can be understood to imply the rejection of the bundling defense as well. *See Fisherman's Wharf*, 114 Cal. App. 4th at 309. This is the logic that has lead

one court, for example, to hold that a provider of medical lab services violated the UPA by pricing certain of its services below cost, even though those services were sold along with other services under a single contract, and the total price of all of the services provided under the contract was above cost. *Rheumatology Diagnostics Lab., Inc v. Aetna, Inc.*, 2015 WL 1744330 (N.D. Cal. Apr. 15, 2015).

**There Is a Presumption of Unlawful Purpose**

Among the more challenging elements of a UPA claim may be the statute's requirement of a "purpose to injure competitors or destroy competition." As in other areas of the law, direct evidence of the defendant's state of mind may be hard to come by. The statute greases the wheels in this regard by issuing a rebuttable presumption of unlawful purpose once the plaintiff establishes below- cost pricing and resulting harm to its business. Once the presumption issues, the defendant assumes the burden of coming forward with evidence that it acted with a lawful purpose.

As a practical matter, it is unlikely that this presumption could ever be enough to carry the UPA's purpose requirement all by itself. Proving below- cost pricing and resulting injury are no small tasks, and the defendant's burden in rebutting the presumption is not especially heavy. But the mere existence of the presumption may sometimes prove helpful to plaintiffs at summary judgment, and as an atmospheric at trial, where it must be articulated in the jury instructions.

**Courts Disagree on the "Unlawful Purpose" Needed to Establish Liability**

Perhaps the most unsettled issue under the UPA is just what mental state the defendant must have to be found liable. The statute speaks disjunctively of a "purpose of injuring competitors or destroying competition." Bus. & Prof. Code Section 17043. The jury instructions for the UPA's closely related provisions prohibiting "loss leaders" seem to make clear that "injuring competitors" just means to take sales or customers from them. *See* CACI No. 3302 (requiring that the defendant "took business away from or *otherwise injured* competitors") (emphasis added).

Some courts have applied the statute literally in this regard, finding the purpose element satisfied by evidence that the defendant wanted to use below-cost pricing to take business from at least one competitor. Others have seemed to interpret the element as requiring a desire to drive at least one competitor out of business entirely. Still others have seemed to require a desire to destroy all competition in a market (though this approach seems to ignore the plain, disjunctive language of the statute).

The statute's distinct reference to "injuring" competitors (rather than eliminating or destroying them) arguably seems to support a liberal reading of the unlawful purpose requirement, such that the defendant need only wish to harm a competitor through lost sales or customers. If that is right, then the UPA's purpose requirement becomes significantly less daunting. Indeed, a UPA defendant could argue that this literal interpretation improperly punishes companies merely for competing to the ultimate benefit of consumers, which the antitrust laws are supposed to encourage.

**There Is No "Market Power" or "Recoupment" Requirement**

Below-cost pricing is only actionable under federal law if the defendant has "market power," or the ability to manipulate prices in a particular market (usually reflected in a high level of market share). This requires federal antitrust plaintiffs to define and prove a "relevant market" — an often challenging endeavor steeped in economics.

In addition, federal laws require plaintiffs to prove "recoupment" — i.e., that the defendant, through the challenged below-cost pricing, will be able to drive its competitors out of business and then raise its prices high enough for long enough to make the entire below-cost pricing scheme profitable. This recoupment requirement in particular has severely reduced the filing of below-cost pricing cases under federal law.

The UPA does not impose any of these relevant market, market power, and recoupment requirements, reducing the need for assistance from expert economists, and greatly expanding the scope of liability. Of all of the statute's departures from federal law, these may be the most practically significant.

**The UPA's Remedies Are Powerful**

In addition to creating broad liability, the UPA contains a menu of broad remedies. Damages are automatically trebled. Bus. & Prof. Code Section 17082. And a plaintiff may obtain preliminary or final injunctive relief — a serious risk to defendants given that the terms of any such injunction would be expected to constrain the pricing of their products — without posting a bond, and without proving any injury at all, actual or threatened. *Id.*, Sections 17081, 17082. The statute also instructs courts that any injunction (e.g. prohibiting below-cost pricing) must apply to all of a defendant's products or services "and not merely the article or product involved in the action. *Id.*, Section 17080.

So let's return to my original question — why, given the statute's potential application to business conduct occurring in markets across this state every single day, do we not see more UPA below-cost pricing cases? For one thing, it is important not to give the impression that UPA cases are *easy*, because even under the permissive standards outlined above, the evidentiary hurdles inherent in persuasively establishing things like cost allocation, or the defendant's state of mind, or causal injury to the plaintiff's business, can be daunting, and perhaps even prohibitive in some cases.

But I believe there is also another mindset contributing to the relative lack of cases, a feeling that, despite what this statute is telling us, *this can't be right*. In particular, competition lawyers who spend much of their time in federal courts crafting arguments under federal laws may find it difficult, even if only subconsciously, to fully embrace a law that rejects so many of the principles on which federal competition laws are based. And likewise, the notion that this statute really ought to be more consistent with federal law has seemed to bubble up in the minds of judges — most of whom are far more familiar with the areas of California competition law that do jibe closely with federal law — in some recent UPA decisions. It's an understandable impulse, and one UPA defendants would be wise to employ to their advantage whenever possible.

For the most part, though, California courts have so far taken the position that the UPA really is, and was intended to be, just as expansive and unusual as its plain language would indicate. There is no debating that the UPA was born of an unprecedented economic crisis, during an era when the legislature found it imperative to take a strong hand in regulating what it viewed as overly-aggressive competitive behavior. It is not obvious where these lines should be drawn in the California economy of today, but if they are to be re-drawn, the bulk of that project seems likely to fall to the Legislature, rather than the courts. Until then, the UPA sits, gathering dust, waiting.

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