Predatory Pricing in the Canadian Context

Kara Beitel

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ABSTRACT

Predatory pricing is one of the most debated aspects of antitrust legislation and theory. Economic scholars dispute its existence, and the methods for its detection are the subject of ongoing debate. Consequently, the regulation of this type of anticompetitive behaviour has developed significantly over the past thirty years. The cases and Guidelines reveal a careful approach taken to identifying behaviour as predation. The need to ensure that legitimate forms of competition are not penalized is integral to the success of the Competition Act and to the attainment of its enumerated purposes.

I. INTRODUCTION

Antitrust legislation requires the cooperation of economic theory and legal discourse. Nowhere is this more apparent than with respect to predatory pricing. Debate and discussion regarding the proper legal stance on this issue has gone on for decades, with academics and economists arguing amongst each other through their various publications. The underlying question is whether predatory pricing should be the subject of regulation. Opponents to its presence in antitrust legislation argue that, if it exists at all, it is so rare and difficult to detect that any attempts would be fruitless. Worse, they contend that an attempt to regulate would actually harm competition. Legitimate and desirable forms of competition would be identified as predatory behaviour and subsequently punished. Proponents of predatory pricing provisions ar-

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gue that, although rare, predation can and does occur in the market place. In order to protect healthy competition, rogue firms engaged in the practice must be identified and others dissuaded from attempting such a strategy.

Based on these economic debates, Canadian legislators have identified predation as a practice requiring regulation. The difficulty rests in finding a definition which captures predatory behaviour, while recognizing legitimate competition for what it is. The discussion that follows will focus on how antitrust regulators and the courts have defined predation, and how effective these Canadian regulations have been to date. A reflection of the caselaw and the Competition Bureau's Guidelines will reveal a reluctance to label price-cutting as predatory, except in the most obvious of cases. This caution shows a respect for the purposes underlying the *Competition Act*, and a desire to prevent government regulation from having the very opposite effects of those intended.

II. Purposes of the Competition Act

The purposes of the *Competition Act* are set out in s. 1 of the statute:

> The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.[1]

Of these four main purposes, the final one is often considered the most important. It is also the purpose which underlies the regulation of predatory pricing.

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[1] *Competition Act*, R.S.C. 1985, c. 19 (2nd Supp.), s. 1.

III. Definition of Classic and Strategic Predation

For the purposes of this discussion and the analysis contained herein, the definition of classic predation adopted by the Canadian Competition Bureau will be used as a starting point. The Predatory Pricing Guidelines define the practice as "a situation where a dominant firm charges low prices over a long enough period of time so as to drive a competitor from the market or deter others from entering and then raises prices to recoup its losses."[2] Central to this definition is firm dominance in the market and the potential for future recoupment of losses.[3]

The following analysis will deal almost exclusively with classic predation. Strategic predation has yet to find a prominent place in Canadian law and jurisprudence, and for those reasons is outside the parameters of this discussion. It should be remembered, however, that the adoption of amended Guidelines for Illegal Trade Practices, discussed in more detail below, may make strategic predation a relevant topic for future examination.

IV. Economic Theory Underlying Predatory Pricing

While there is insufficient space to do justice to the economic theories surrounding the phenomenon of predatory pricing, a brief overview will be useful to contextualize the later discussion. The two leading disciplines of economic theory, referred to as the Chicago and Harvard

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[2] J. A. VanDuzer and G. Paquet (Industry Canada-Competition Bureau), *Anticompetitive Pricing Practices and the Competition Act: Theory Law and Practice* (Ottawa: Minister of Public Works and Government Services, 1999) at 9 [VanDuzer & Paquet].

[3] Strategic predation, as defined in academic literature, is intended to deter potential entrants in a market, to discipline established rivals in the market, or perhaps simply to gain a reputation for the predator. If a dominant firm establishes a reputation of incurring significant losses in order to drive down the value or hurt its rivals, those rivals may become more timid in their future pricing strategies. In this scenario, future recoupment of losses through the imposition of monopoly-level prices is less important. The predator's goal is to ensure their continued dominance of the market, and to prevent to future erosion of profits. See Richard A. Posner, "The Chicago School of Antitrust Analysis" (1979) 127 U. Pa. L. Rev. 925 at 932 [Posner, "Chicago School"].

Schools, disagree on whether predatory pricing exists as a real practice in the market place.

The Chicago School approaches antitrust economic analysis according to its traditional "laissez-faire" stance, and argues that predatory pricing is not a viable or rational business strategy and for this reason will seldom, if ever, occur. To regulate and enforce prohibitions on the practice would have the negative effect of capturing price cuts which are pro-competitive and which generally benefit consumers. These conclusions are based largely on basic economic theories of supply and demand, and their relationship to price changes. Robert Bork is particularly apt at using this relationship to demonstrate that, should a dominant firm engage in predatory price-cutting, it will suffer from greater losses than its intended victim, and it will be unable to later recoup these losses.[4] Because firms are generally believed to be profit-maximizing, the inability to recoup losses will dissuade the rational firm from engaging in predation.[5]

The Harvard School is far more likely to see predation as a real threat to healthy competition. Their economic analysis, which has presented a direct challenge to that of Chicagoans, argues that despite its rare occurrence, predation should be a concern for antitrust regulators. The debate between advocates of the Harvard School, ignited by the seminal article by Areeda and Turner,[6] has centred largely on the proper method of identification. As will become clear throughout the discussion that follows, this is a debate which continues to this day. Areeda and Turner support a definition which identifies pricing as predatory when it falls below marginal cost. At this level, the firm is selling their product at a loss, and is wasting social resources, given that the cost of production exceeds the value of the finished product. Most importantly, however, pricing below marginal cost "greatly increases the possibility that rivalry will be extinguished or prevented for reasons unrelated to

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[4] Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself*, (New York: Basic Books, Inc., 1978) at 145-153 [Bork]; for a more complete analysis of the Chicagoan position on predatory pricing see Donald G. McFetridge, "Predatory and Discriminatory Pricing" in Frank Mathewson, Michael Trebilcock & Michael Walker eds., *The Law and Economics of Competition Policy* (Vancouver: The Fraser Institute 1990) 71 [McFetridge] and Frank H. Easterbrook, "Predatory Strategies and Counterstrategies" (1981) 48 U. Chi. L. Rev. 263.

[5] Posner, "Chicago School", *supra* note 3 at 928.

[6] Phillip Areeda & Donald F. Turner, "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act" (1975) 88 Harv. L. Rev. 697, [Areeda & Turner, "Predatory Pricing"].

the efficiency of the monopolist."[7] Another prominent economist has suggested that this definition is too narrow to capture all predatory behaviour. Douglas Greer advocates a more inclusive definition of predatory pricing.[8] According to this standard, any price below average total cost should be looked at with suspicion:

> If a firm's price falls below average total cost...the firm may continue to produce and sell in the short run if price is above its average variable cost, but in the long run, a price below average total cost will cause the firm to go out of business...a predator could succeed in driving equally efficient rivals from the field yet escape detection under the Areeda-Turner rule...[9]

An additional requisite element under Greer's approach is a predatory intent. This requirement distinguishes cases such as that described above from situations in which a firm may be selling below average total costs due to legitimate business considerations.[10] This requirement will be discussed in more detail throughout the discussion of predatory pricing regulation in Canada.

1. Summary of the Economic Rationale

Despite inspiring a plethora of debate and discussion on the issue, Areeda and Turner did not directly respond to the criticisms put forward by Bork and other Chicagoans. Is there any reason to create a workable definition of predatory pricing? Does it, or could it, exist in the market place? A recent paper commissioned by the Canadian Competition Bureau, provides a useful summary of the arguments supporting the existence of predatory pricing within the market place, thus justifying its prohibition. The paper noted that many economists and academics who support some sort of prohibition of predation base their arguments on:

> models which acknowledge that information and capital markets are not perfectly efficient. The predator and the victim will not have

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[7] *Ibid.* at 712.
[8] Douglas F. Greer, "A Critique of Areeda and Turner's Standard for Predatory Practices" (1979) 24 Antitrust Bull. 233 at 234-35 [Greer, "Critique"].
[9] *Ibid* at 240.
[10] Greer, "Critique", *supra* note 8 at 235.

> complete information regarding each other and the victim may not have access to sufficient capital to survive the period of predation.[11]

This implies that some of the assumptions which are central to the arguments presented by Chicagoans may be incorrect. The importance of these two factors, full access to information and financial markets, to a rational theory of predatory pricing is emphasized by McFetridge, who stated that "In the absence of financial asymmetries (deep pockets), full knowledge is fatal to classical predation."[12] In the absence of these assumptions about the market, the argument that predation is always an irrational strategy cannot be sustained.[13]

V. Application of Canadian Predatory Pricing Laws

1. The Predatory Pricing Trilogy

The Canadian jurisprudence concerning predatory pricing is limited to three cases which were brought under s. 33A(1)(c) of the *Combines Investigations Act* (later renumbered as s. 34(1)(c)). This provision is identical to that found today in paragraph 50(1)(c) of the *Competition Act*.[14] Each of these cases will be considered, especially with respect to the court's view of which practices constitute predatory behaviour versus those which are seen as healthy competition.

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[11] VanDuzer & Paquet, *supra* note 2 at 9 .

[12] McFetridge, *supra* note 4 at 77.

[13] This conclusion is based on the academic assessment of classic predation. The presence of strategic considerations, which are largely outside the scope of this paper, further support the conclusion that predation is a rational business strategy.

[14] Section 50 of the *Competition Act* (R.S.C. 1985, c. C-34, s. 50; 1999, c. 31, s. 50(F).) states:

> 50. (1) Every one engaged in a business who
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> (c) engages in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect, is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

i. R. v. The Producers Dairy Ltd.

The first case of predation was brought in the mid-1960s, and concerned the competition practices within the Ottawa dairy industry. *R. v. The Producers Dairy Ltd.*[15] was brought in response to a significant decrease in the wholesale price at which Producers sold their product to retail stores. The case considered what constituted a "policy" of selling pursuant to the *Combines Investigations Act*. The Court of Appeal described the meaning of the provision by stating that it required "something more than...the adoption of a temporary expedient to meet an aggressive, competitive move aimed directly at an important customer...."[16]

Prior to this prosecution, similar allegations against one of Producers' competitors had been dismissed after the Commission distinguished their actions from those of Producers as being "purely defensive and self-protecting."[17] The Court of Appeal ultimately dismissed the case against Producers for the same reasons. This is the first indication that the courts would consider whether the challenged price-cut was aggressive or defensive as relevant to finding the defendant guilty of predation.

ii. R. v. Hoffmann-La Roche Ltd.

The second case, *R. v. Hoffmann-La Roche Ltd.*,[18] was brought in response to Hoffman-La Roche offering free valium tablets to hospitals for two six-month periods when faced with a new entrant to the market. The case is significant as it is the first conviction under the predatory pricing provisions, and because it provides a full analysis of the elements of the offence.[19] The court identified these elements as: being engaged in a business; being engaged in a policy of selling articles; unreasonably low prices; and an anticompetitive effect of the policy or an anticompetitive *mens rea*.[20] Although there was contention regarding

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[15] (1966), 50 C.P.R. (2d) 265 (Ont. C.A.) [*Producers Dairy*].
[16] *Ibid.* at 271.
[17] Donald G. McFetridge & Stanley Wong, "Predatory Pricing In Canada: The Law and the Economics" (1985) 63 Can. Bar Rev. 685 at 689 [McFetridge & Wong, "Predatory Pricing"].
[18] (1980), 109 D.L.R. (3d) 5 (Ont. H.C.J.) [*Hoffman-La Roche*].
[19] McFetridge & Wong, "Predatory Pricing", *supra* note 17 at 690.
[20] *Hoffman-La Roche, supra* note 18 at 34-46.

whether Hoffman-La Roche was actually engaged in a policy of selling goods,[21] the resolution of the case ultimately rested on the definition of "unreasonably low" accepted by the court.

In adopting a definition, Linden J. noted that "economic theory cannot control the legal determination of reasonableness, but it is certainly relevant."[22] This view has support in the literature, where economists have noted that economic definitions are "not very helpful in describing predatory behaviour, and not easily translated into a legal rule...[An economic definition] would be of little value to judges, and would offer little guidance to dominant firms as to how to avoid prosecution."[23] What was required was an adaptation of economic theory into a workable, easily understood legal definition.

The legal definition resulting from the case is based in part on economic theory and in part on what the court believed to be the aims of Parliament in enacting the provision. A declaration of the illegality of all prices which fell below cost was explicitly rejected. In dismissing the definition supported by many economists, most notably Areeda and Turner, Linden J. stated that:

> If Parliament had intended that all sales below cost be considered unreasonable, it could have defined the term in that way. It did not. Parliament used the phrase "unreasonably low", a more flexible provision, in order to permit the Courts to assess all of the circumstances of sales before concluding whether the prices were unreasonably low.[24]

Context, therefore, is vital when determining if predation has occurred. Four factors were identified as being relevant to the court's analysis.

The first factor considered was the difference between production cost and selling price. The court stated that a price above cost can never be unreasonable, and therefore will not be considered predatory. When price falls below cost, the greater the disparity between the two will increase the likelihood that the price will be viewed as being unreason-

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[21] The defence argued that because Hoffman-La Roche was not selling valium, but was actually giving it away, their actions did not fall within the spectre of the statute. Linden J. rejected this view, stating "even when goods are given away totally free by a producer to a customer in a commercial context, this is still a "sale" in the sense that word is used in this section." (*Hoffman-La Roche, supra* note 18 at 37).

[22] *Hoffman-La Roche, supra* note 18 at 38.

[23] George A. Hay, "Economics of Predatory Pricing" (1982) 51 Antitrust L.J. 361 at 362.

[24] *Hoffman-La Roche, supra* note 18 at 38.

ably low.[25] The length of time during which the goods were sold at the questionable price was the second relevant factor. The longer the period, the more likely that the prices were unreasonably low. Thirdly, the reason for the price reduction must be considered. Here, Linden J. followed the approach advocated in *Producers Dairy*: "defensive price-cutting is viewed differently than offensive price-cutting...Competition is a battle after all, and competitors must be allowed to engage in that battle, as long as they do so within reason."[26] A price which is set in response to a competitor's initial price reduction will be seen as a logical reaction in a competitive market, so long as the decrease is proportional and reasonable. The final factor identified was whether there are any long-term benefits to be gained by the price reduction. We must assume that the court is talking about only legitimate long-term market benefits, given that recoupment after the elimination of rivals is an important benefit to a predatory firm and central to a successful predatory pricing strategy.

The court's final area of analysis was with respect to the last element of the offence: that the policy of selling at the unreasonably low price had the effect or tendency of substantially lessening competition or eliminating a rival, or that it was designed to have that effect. The court referred to this section as the effect and *mens rea* analysis. Relying on company records to support its finding that the requisite *mens rea* was present in this case, the court nonetheless noted in *obiter* that the policy had not had the desired effect. Linden J. stated that, although the only competitor had been persuaded to temporarily exit the market by Hoffman-La Roche's actions, this did not necessarily mean that competition had been *substantially* lessened, or that the competitor had been permanently eliminated.[27] This notion is revisited in the Predatory Pricing Guidelines. The current thinking on what constitutes a substantial lessening of competition will be discussed in detail below.

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[25] *Hoffman-La Roche, supra* note 18 at 41-2.
[26] *Hoffman-La Roche, supra* note 18 at 42.
[27] *Hoffman-La Roche, supra* note 18 at 46.

iii. R. v. Consumers Glass Company Ltd. and Portion Packaging.

The final instalment in the trilogy of predatory pricing cases is *R. v. Consumers Glass Company Ltd. and Portion Packaging.*[28] The main issue, like in *Hoffman-La Roche*, was what constituted "unreasonably low" prices within the meaning of s. 34(1)(c) of the *Act*. In deciding on the appropriate pricing theory to adopt, O'Leary J. concentrated specifically on the Areeda-Turner test and the Greer test. After hearing the testimony of both Dr. Turner and Dr. Greer in defence of their respective theories, O'Leary J. articulated the appropriate considerations for the specific case before him. He found that, where a market was plagued with the chronic overcapacity that was demonstrated in this case, any price which was over average variable cost could not be considered predatory:

> *Dr. Greer assumes that...there is no predation while the alleged predator is loss minimizing in the short run. Dr. Turner is of course of the same view...the accused in this case never sold at predatory, that is to say unreasonably low, prices, because at all times they were selling so as to make the greatest contribution to...[the company's] fixed overhead.*[29]

While seeming to accept the Areeda-Turner standard as the default position in Canada, O'Leary J. declined to decide which test should be generally adopted. It was unnecessary for him to do so for the disposition of this case – under either test, Portion could not have been found to be engaged in predatory behaviour. His interest in Greer's alternative test and his extensive comment on the single American case that rejected the Areeda-Turner standard in favour of Greer's (*Transamerica Computer Co. v. IBM Corp.*)[30] suggests that he was perhaps leaning in that direction. Moreover, after stating that it was unnecessary to choose between the two tests, he stated that:

> if I were to adopt the view that any price below average cost is suspect, and look to the intent with which that price was adopted, I would still conclude that the accused did not adopt such a price in order to lessen competition or eliminate Amhil as a competitor but simply to minimize its losses and so the price charged was reasonable.[31]

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[28] (1981), 124 D.L.R. (3d) 274 (Ont. H.C.J.) [*Consumers Glass*].
[29] *Ibid.* at 297.
[30] (1979), 2 Trade Cases 79, 618.
[31] *Consumers Glass*, *supra* note 28 at 300.

While the Areeda-Turner standard had to this point been the *de facto* test applied in Canada, undoubtedly in part due to its wide adoption in other jurisdictions, the approach advocated by Greer emphasizing intent and market circumstances, was clearly gaining prominence.

2. The Predatory Pricing Guidelines

The purpose of the predatory pricing provisions is consistent with the purposes of the *Act*: to protect competition in Canada. In the case of predatory pricing, the danger rests in the effects of anticompetitive pricing. While low prices seem intuitively like a good thing, in certain circumstances they can have a negative impact on both the market and consumers. It is these situations where the predatory pricing provisions are aimed: "Although such pricing behaviour does confer some benefits to the purchasers in the market during the period of predation, those benefits will be transitory or short-term, and eventually outweighed by increased costs during the period of recoupment."[32]

Due largely to the limited case law and the lack of guidance which it provided to competitive firms, the Competition Bureau published Predatory Pricing Guidelines in 1992. The Guidelines are intended to provide the general approach taken to the investigation of predatory pricing complaints, but should not been viewed as binding on the Bureau, Attorney General, or the courts.[33] It is intended to provide some guidance so that firms may evaluate the risk that their behaviour will fall within the provisions of the *Competition Act* and thus be criminal. The Guidelines recognize that predatory pricing, as defined, will be a relatively rare occurrence. That said, the Competition Commissioner receives a disproportionately large number of complaints (few of which lead to official inquiries, and even less are subsequently referred to the Attorney General), and therefore requires a method of assessing complaints in order to "distinguish predatory pricing from otherwise vigorous and desirable price competition."[34] As will be seen more clearly

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[32] Competition Bureau, *Predatory Pricing Enforcement Guidelines* (Ottawa: Competition Bureau, 1992) at Preface [Competition Bureau, *Guidelines*].
[33] *Ibid.*
[34] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.1.

below, the ability to recoup losses after a period of predation has been central to the Canadian approach, and thus consistent with the economic rationale underlying the existence of predatory pricing. Absent the ability to recoup losses, predatory pricing is irrational behaviour which would not be encountered in the market.

Despite the minimal amount of case law available, the Bureau considered those cases that had been decided under the predatory pricing provision when drafting the Guidelines, particularly the *Hoffman-La Roche* and *Consumers Glass* cases. The four elements of the offence which the Crown must establish are that the predator is "engaged in a business"; the prices at issue are "unreasonably low"; those prices must be part of a "policy of selling"; and they must have the effect, or be designed to have the effect, of "substantially lessening competition or eliminating a competitor." That said, the Guidelines make it clear that the threshold issue is whether the prices are "unreasonably low."[35]

i. "Unreasonably Low" Pricing

The reasonableness of any price cannot be determined based solely on the cost formulas debated by Areeda and Turner, *et al.* Many of the variables recognized by the Bureau as being factors significant to this threshold issue are taken from the jurisprudence:

> was the alleged predator responding to price cuts of a rival firm, or did the alleged predator initiate them? How long were the prices in effect in the market? Was there excess chronic capacity in the industry resulting in firms offering prices which could fairly be described as loss-minimizing in an effort to remain viable and retain market share?[36]

With these contextual issues in mind, the analysis into whether the prices at issue are unreasonably low is done in two parts. The first step considers the market in which the alleged predator does business. At this stage of the analysis, market dominance is important. Theoretical analysis of predation demonstrates that the practice is only possible if the alleged predator enjoys market dominance. Chicagoans, while dismiss-

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[35] Competition Bureau, *Guidelines*, *supra* note 32 at Part 1.4.

[36] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.2.

ing that predatory pricing could or would occur frequently enough to warrant prohibitions, concede that if it were to occur only a dominant firm would be in a position to attempt it. As the Guidelines state, "By its very nature, price predation presumes that the alleged predator possesses sufficient market power to unilaterally impose price levels on the market long enough to harm its rivals financially, and to recoup any losses incurred in the process once its rivals have been forced to exit the market."[37] To determine market dominance, the Bureau considers the concentration of the market. This requires an initial definition of the market in which the alleged predator operates, followed by a determination of that market's concentration: "It is unlikely that an alleged predator with a market share of less than 35 percent would have the ability to unilaterally affect industry pricing."[38] With a market share of less than 35 percent, the alleged predator would be unable to force other competitors to lower their own prices. Moreover, without a rather significant difference in size between the alleged predator and alleged victim, the victim would be in a position to wait out the predation period.

The next factor under the market analysis is the conditions of entry. This is really an inquiry into whether the alleged predator will be able to recoup losses after driving competitors from the market. It is this precondition which Chicagoans believe will make predation an irrational strategy, as a firm's ability to recoup was doubted. Likewise, recent literature notes that "the recoupment requirement was used to screen out cases where predation appeared unprofitable and hence irrational."[39] The Bureau considers factors noted by the academics, including regulations affecting entry into the market and sunk costs, but neglects to consider the symmetry between entry and exit barriers. Barriers to entry will not only prevent new firms from entering the market, thereby allowing the alleged predator to recoup losses from the predation period, but will also act as barriers to exit which will dissuade the alleged victim from exiting the market in a timely fashion. The disregard for the effect of exit barriers may be due to the definition relied on by the Guideline with respect to this analysis:

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[37] Competition Bureau, *Guidelines, supra* note 32 at Part 2.2.1.1.

[38] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.2.1.1.

[39] Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, "Predatory Pricing: Strategic Theory and Legal Policy," (2000) 88 Geo. L.J. 2239 at 2263.

> the Director tries to determine whether or not attempted recoupment by the alleged predator, through price increases following the exit of a rival or rivals, would, within two years, invite entry into the industry on a sufficient scale to ensure that price increases could not be sustained.[40]

Thus, because the Commissioner will be looking at whether the predator will have more than two years in which to recoup losses incurred during the predation period, the effect of barriers to exit will indirectly be taken into account.

The second stage of analysis determines whether prices were unreasonably low and centres on the relationship between price and cost. The Bureau adopts the rationale hinted at in the *Consumers Glass* case, a combination of the Areeda-Turner and Greer rules. Areeda and Turner use average marginal cost (substituting average variable cost for the sake of convenience) as a litmus to identify prices which are predatory. Likewise, the Bureau will view a price which is below the average variable cost as unreasonably low, unless there is a justification for such a low price.[41] Greer, on the other hand, advocates a finding of predation where costs are below the firm's average total costs. The Guidelines state that no price *above* a firm's average total cost will be regarded as unreasonably low.[42] Thus, prices which are above average variable cost but below average total cost fall within a grey area in Canada. Whether prices within this grey range will be viewed as unreasonably low will depend on the circumstances. The Guidelines note that declining demand or substantial excess capacity in the market may justify prices within this range.[43]

An additional element is required under the Canadian test: the policy of selling at the unreasonably low price must have the effect or the tendency to substantially lessen competition or eliminate a competitor, or be designed to have that effect. Thus the Canadian test allows for defences even after a finding that prices are unreasonably low: that the pricing behaviour did not have the effect required, and that there was no predatory intent. Again, the Guidelines seem to favour the Greer approach as opposed to that of Areeda and Turner, who explicitly reject

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[40] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.2.1.2.
[41] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.2.2.
[42] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.2.2.
[43] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.2.2.

any defences once it is established that the price is below average variable cost.[44]

Once it has been established that the prices of an alleged predator are unreasonably low, and that there is a policy of selling goods at this unreasonably low price,[45] the analysis turns to their purpose and effect.

ii. Competitive Impact

Paragraph 50(1)(c) of the *Competition Act* makes it clear that either an anticompetitive effect or an anticompetitive purpose will lead to a finding that a firm has engaged in predatory behaviour, where the other elements of the offence have been satisfied. Accordingly, the statute is concerned with three scenarios, only one of which must be established for a conviction: "circumstances where the objectionable pricing behaviour has already brought about demonstrable and measurable harmful economic effects", circumstances "where the objectionable pricing behaviour has not been in place for a period of time sufficient to yet fully bring about these effects," and circumstances where "there is evidence available with respect to harmful design or intent of the alleged predator."[46]

There are actually five elements within the competitive impact analysis: whether a substantial lessening of competition has occurred; whether the elimination of a competitor has occurred; whether the behaviour would have a tendency to substantially lessen competition; whether the behaviour would have a tendency to eliminate a competitor; and whether there is evidence that, even if unsuccessful, the alleged predator cut prices with the intention of substantially lessening competition or eliminating a competitor.[47]

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[44] Although, Areeda and Turner only directly consider the defences of promotional pricing and meeting the competition. See Areeda & Turner, "Predatory Pricing", *supra* note 6 at 715.

[45] Factors relevant to the determination of whether there is a "policy of selling" include whether the prices were in place for a short period of time, whether they are defensive reactions to the pricing initiatives of competitor firms, and whether they are the response to various random market occurrences. See Competition Bureau, "Guidelines", *supra* note 32 at Part 2.3

[46] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.4.

[47] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.4.

The relevant inquiry to determine whether a substantial lessening of competition has occurred is whether the pricing policy had the effect or tendency to "preserve or add to market power and that there is little opportunity for competition in the future because entry barriers are maintained or raised."[48] It is significant that the preservation of market power is included in this definition. In *Hoffman-La Roche*, Linden J. indicated that it was unlikely that the Crown could prove a substantial lessening of competition, given that only one competitor was forced to stop competing in the relevant market. Although competition was lessened to a certain degree, he felt this did not necessarily equal a *substantial* lessening of competition.[49] The Guidelines indicate that this reasoning would not be upheld if that situation were to arise again. Hoffman-La Roche was clearly attempting to preserve its market share, consequently preventing any new entrants into that particular market. The effect of predatory behaviour in a situation such as this is to create a barrier to entry.

The elements dealing with the elimination of a competitor are straightforward. The analysis will consider whether the competitor has left the market permanently. For this to be established, the Director must be satisfied that the firm has gone out of business, or is no longer in a position to prevent the alleged predator from raising prices to an anticompetitive level.[50] On this issue, the Guidelines are in agreement with the decision in *Hoffman-La Roche*. There, Linden J. stated that the Crown could not establish that the alleged predatory behaviour had actually eliminated the rival from the market permanently. The firm had continued to sell small amounts within the relevant market, and Hoffman-La Roche was not in a position to sell at monopoly-level prices.[51]

The final method of satisfying the competitive impact analysis is with respect to the intent, or *mens rea*, of the alleged predator. The Guidelines note that a number of factors are relevant to this determination, including the magnitude of the price cuts and the losses incurred, the lack of any justifying reason for the price cuts, and any documents or

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[48] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.4.
[49] *Hoffman-La Roche, supra* note 18 at 47.
[50] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.4.
[51] *Hoffman-La Roche, supra* note 18 at 47.

oral evidence establishing an anticompetitive intent.[52] As advocated by Greer, any extrinsic evidence will be relevant to the final determination.

iii. Proposed Amendments

In March of 2002, the Competition Bureau released a draft of the proposed Enforcement Guidelines on Illegal Trade Practices: Unreasonably Low Pricing Policies. These Guidelines, when adopted, will replace the Predatory Pricing Guidelines discussed above.[53] According to the draft Guidelines, their intention is to update the approach taken by the Bureau in accordance with changing economic perspectives. Underlying the proposed Guidelines is an increased awareness of strategic predation, and analysis on this issue has been added throughout the document. More specifically, there are three main changes from the existing Predatory Pricing Guidelines: the significance of the ability to recoup losses, the measure used in the price-cost analysis, and new guidelines dealing with unreasonably low pricing resulting from market expansion.[54] Only the first two are relevant to the current analysis.

The ability of an alleged predator to recoup losses has always been significant to the predatory pricing inquiry. Without this, the practice of predatory pricing is irrational, and would not be engaged in. Where recoupment was a threshold issue under the Predatory Pricing Guidelines, it is now considered only in relation to the competitive impacts analysis. The ability to recoup losses is seen as an indication of market share and barriers to entry and exit, but is "not a necessary element to be proven under paragraph...50(1)(c)."[55] The relegation of recoupment from a threshold issue to a position of one of many factors contradicts the theoretical arguments which consider it as central to the analysis of classic predation. The proposed Guidelines, however, note a number of situations in which predation could occur for reasons other than to ensure future recoupment:

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[52] Competition Bureau, *Guidelines*, *supra* note 32 at Part 2.4.

[53] Competition Bureau, News Release, "Information" (8 March, 2002) <http://strategis.ic.gc.ca/SSG/ct02341e.html>.

[54] Competition Bureau, *Illegal Trade Practices: Unreasonably Low Pricing Policies* (Draft), online: <http://strategis.ic.gc.ca/SSG/1/ct01139e.html> [Competition Bureau, *Illegal Trade Practices*].

[55] *Ibid.* at 14.

> ...it may be rational for a firm to adopt a low-pricing policy and sacrifice present profits in order to preserve the long-term stability of an existing market structure. Additionally, a low-pricing policy could assist in establishing an industry standard to exclude others or maintain market control.[56]

Implicit in this reasoning is the threat of strategic predation. A firm may engage in predatory pricing, not to ensure monopoly-level prices in the future, but to ensure that market share (and consequently profit) is not eroded in the future. They will not recoup their short-term losses *per se*, but future profits will be protected. In that sense, recoupment does actually occur, in that absent the predatory behaviour, the firm would likely have seen a future decline in profits.

The second significant change to the existing Guidelines is with respect to the measure used to determine which prices are "unreasonably low." In place of average variable cost and average total cost, the Bureau now recognizes avoidable cost as the appropriate measure. Avoidable costs are defined as "all costs that could have been avoided by a firm had it chosen not to sell the product(s) in question. In general, avoidable costs do not include sunk costs."[57] It would seem that avoidable costs include some fixed costs, such as the price and maintenance of machinery, which are not included in average variable cost. The difficulty with using this measure arises when courts are unable to obtain all the information necessary to calculate avoidable cost. This concern is especially relevant if the firm is engaged in the production of multiple products. If the courts face this difficulty, expedience will likely dictate that they use a proxy for avoidable costs, and revert back to using average variable cost and average total costs.

3. Abuse of Dominance Provisions

The above discussion concerns the criminal provisions dealing with predatory pricing. This type of anticompetitive behaviour can also be dealt with under the abuse of dominance provisions found in paragraph 79 of the *Act*. As a non-criminal provision, the Commissioner of

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[56] Competition Bureau, *Illegal Trade Practices*, *supra* note 54 at 14.
[57] Competition Bureau, *Illegal Trade Practices*, *supra* note 54 at 16.

Competition can make an application for a remedial order from the Competition Tribunal. Upon receiving an application and being satisfied that the elements of the offence have been established, the Tribunal is empowered to impose a variety of remedies. In most cases, the Commissioner will decide at the outset which provision is the most appropriate venue given the circumstances of the particular case.

Behaviour reviewable under paragraph 79 is very similar to that which is criminal under paragraph 50. The Abuse of Dominance Guidelines state that:

> an abuse occurs when a dominant firm or group of firms engages in conduct that constitutes exclusionary, disciplinary or predatory behaviour towards competitors or potential competitors, with the result that competition is prevented or lessened substantially.[58]

The elements to be established under this provision are closely related to those examined with respect to paragraph 50(1)(c). Likewise, the stated purpose of the Abuse of Dominance provisions is to ensure that effective competition is allowed to flourish, and not be impeded by anticompetitive acts of a dominant firm.[59]

There are three elements contained within paragraph 79. These will not be examined in detail, except to the extent that they parallel those found in paragraph 50. As its name suggests, central to the Abuse of Dominance provisions is an examination of the market power – that is, the dominance – of the firm within the particular market. As is the case with respect to a predatory pricing analysis, this entails an examination into existing barriers to entry and the market share enjoyed by a firm. The market share should be greater than thirty-five percent in order for the Bureau to continue its investigation; market shares below that level are not considered "dominant."[60]

The anticompetitive acts complained of must be the "practice" of the dominant firm. This is similar to the "policy" of selling at an unreasonably low cost analysis that is undertaken pursuant to paragraph 50(1)(c). The Guidelines indicate that the definition of "practice" is broader than that of "policy": "while a practice is normally more than an isolated act,

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[58] Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance Provisions* (Ottawa: Competition Bureau, 2001) at 6 [Competition Bureau, *Enforcement Guidelines*].
[59] *Ibid.* at 6.
[60] Competition Bureau, *Enforcement Guidelines*, *supra* note 58 at 15.

it may also constitute one occurrence that is sustained and systemic or that has had a lasting impact on the state of competition."[61] Given the wide variety of acts covered by this provision, it is foreseeable that a single act may have long term effects on competition, unlike predatory pricing where unreasonably low price levels would have no significant impact on competition where they were not prolonged.

The final element under paragraph 79 is the effect of preventing or lessening competition substantially in a market. As under paragraph 50, the substantial lessening of competition occurs when a dominant firm "preserve[s] or add[s] to…[their] market power."[62]

Paragraph 79, therefore, provides an alternative avenue. Which the Commissioner chooses will depend on circumstances specific to the case and may include whether the firm has engaged in other anticompetitive activities or if a more effective remedy may be available under paragraph 79.[63] A remedy to correct the anticompetitive behaviour in an expedient manner may be preferable to a criminal action which would undoubtedly take longer to resolve. An especially important consideration is the strength of the Commissioner's evidence that predation has occurred. Because paragraph 50 is a criminal provision, its elements must be proven beyond a reasonable doubt – a burden that has been difficult to meet in many past antitrust prosecutions.

VI. Conclusion

Predatory pricing is perhaps one of the most debated issues in antitrust economics. Its very existence has been disputed, and there is currently no universal agreement on how to recognize it. That said, the past thirty years have been witness to significant advances in its understanding. Courts and tribunals have begun to utilize current economic thinking to develop a legal standard that is inclusive enough to catch predatory behaviour, but cautious enough to not impede effective competition. Chicagoans objected to the regulation of predatory pricing because they

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[61] Competition Bureau, *Enforcement Guidelines*, *supra* note 58 at 17.
[62] Competition Bureau, *Enforcement Guidelines*, *supra* note 58 at 18.
[63] Competition Bureau, *Guidelines*, *supra* note 32 at Part 1.2.

believed the process for identifying it would lead to the misidentification of legitimate forms of competition. Time has shown that, not only can predatory behaviour happen in an ever more concentrated marketplace, it can be distinguished from beneficial competition. Canadian experience provides ample evidence of this. From the hundreds of allegations of predatory pricing, only three cases have progressed to the courts, and of those only *one* has resulted in a conviction. This is likely due in part to the alternate civil avenue made available through paragraph 79 of the *Act*. But much credit must be given to the Bureau and to the courts. The ultimate purpose behind prohibiting predation – to ensure fair competition among all firms – has not been lost.

Given the results arising from an inquiry into the Canadian experience, it is safe to conclude that the prohibition of predatory pricing is warranted. Antitrust legislation which purports to protect the competitive process and consumer welfare cannot ignore a practice that has proven to be a threat to these ideals.