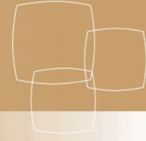
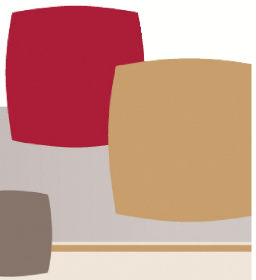
Competition Bureau Canada | Bureau de la concurrence Canada

Enforcement Guidelines



Predatory Pricing

Final version - July 2008



Canada

Preface

The Competition Bureau (the "Bureau") is a law enforcement agency responsible for the administration and application of the *Competition Act* (the "Act"). It contributes to the prosperity of Canadians by protecting and promoting competitive markets and enabling informed consumer choice.

The Bureau considers predatory pricing to be a firm deliberately setting prices to incur losses for a sufficiently long period of time to eliminate, discipline, or deter entry by a competitor, in the expectation that the firm will subsequently be able to recoup its losses by charging prices above the level that would have prevailed in the absence of the impugned conduct, with the effect that competition would be substantially lessened or prevented.

Competition delivers many economic benefits, including competitive prices and product choices. Low prices are usually a good indication of vigorous competition. While competitive prices are beneficial to consumers, certain anti-competitive pricing behaviour, such as predatory pricing, can harm the economy. Predatory pricing may have short-term benefits for consumers, but it can ultimately lead to higher prices or other anti-competitive effects in the long run. These guidelines address the Competition Bureau's approach to predatory pricing.

The Bureau first published its *Predatory Pricing Enforcement Guidelines* in 1992 to clarify its enforcement policy and to ensure that Canadian businesses and the public understood when below cost pricing might result in an investigation under the Act. Subsequently, the Bureau published *Enforcement Guidelines on the Abuse of Dominance Provisions,* the *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Retail Grocery Industry* and the *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Telecommunications Industry* which also address predatory conduct.

These updated guidelines describe the Bureau's enforcement approach on predatory conduct in light of recent jurisprudence and economic thinking. Three principal enforcement policy changes have been adopted in these guidelines, as described below.

First, complaints regarding predatory conduct will be initially examined under the abuse of dominance provisions. Examinations and inquiries of predatory conduct involve complex considerations of market structure and conduct, as well as an evaluation of how pricing practices may impact competition. Generally, these requirements are better suited to the non-criminal abuse of dominance provisions and adjudication by the Competition Tribunal. Preliminary examinations and inquiries under the criminal predatory pricing provisions are generally reserved for egregious conduct. In the past, criminal predatory pricing inquiries have been relatively few in number and only a handful of cases have been prosecuted before the courts.

Secondly, in carrying out the price-cost analysis, the Bureau will use average avoidable cost instead of average variable cost and average total cost, as used in the previous guidelines, to determine whether prices are "unreasonably low" under the criminal predatory pricing provisions. In the Bureau's view, applying an average avoidable cost standard is more

appropriate and will also ensure consistency with respect to the price-cost analysis in both civil and criminal examinations and inquiries of predatory conduct.

Finally, "price matching" has been added as a reasonable business justification for pricing below average avoidable costs.

In today's fast-paced, global economy, markets are constantly changing, demanding flexible and innovative responses to competitive challenges. Transparent and predictable enforcement policies are essential in this context. These guidelines explain how the Bureau enforces the provisions of the Act which address predatory conduct to deter anti-competitive behaviour and, at the same time, avoid chilling aggressive price competition.

Interpretation

These guidelines explain the general approach of the Commissioner of Competition (the Commissioner) to predation under the Act. They supersede all previous statements of the Commissioner or other officials of the Competition Bureau (the Bureau) addressing paragraph 50(1)(*c*) as well as the treatment of predation under section 79 of the Act.

These guidelines are not intended to restate the law or to constitute a binding statement on how the Commissioner will exercise discretion in a particular situation. Consequently, they do not replace the advice of legal counsel. The respective enforcement and prosecutorial decisions of the Commissioner and the Director of Public Prosecutions,* and the ultimate resolution of issues, depend on the circumstances of the matter. Guidance regarding future business conduct can be provided by requesting a Written Opinion from the Commissioner under section 124.1 of the Act. These guidelines do not bind or affect in any way the discretion of the Director of Public Prosecutions in the prosecution of matters under the Act. Final interpretation of the law is the responsibility of the Competition Tribunal and the courts.

* On December 12, 2006, the Office of the Director of Public Prosecutions was created as part of the *Federal Accountability Act*. This Act gives the Director of Public Prosecutions jurisdiction to conduct prosecutions for offences under federal jurisdiction. This office is independent of the Department of Justice and takes over the duties of the former Federal Prosecution Service.

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Executive Summary

Purpose and Scope of these Guidelines

As part of the Bureau's continuing efforts to ensure a transparent and predictable enforcement policy, these guidelines describe the Bureau's approach to the enforcement of the Act with respect to predatory pricing.

What Constitutes "Predatory Pricing"

The Bureau considers predatory pricing to be a firm deliberately setting prices to incur losses for a sufficiently long period of time to eliminate, discipline, or deter entry by a competitor, in the expectation that the firm will subsequently be able to recoup its losses by charging prices above the level that would have prevailed in the absence of the impugned conduct, with the effect that competition would be substantially lessened or prevented. The jurisprudence indicates that predatory pricing occurs where the prices charged by the firm are below an appropriate measure of costs and that there is no reasonable business justification for the low pricing policy or practice, such as selling off perishable products or matching the price of a competitor.

Enforcement Considerations

The Bureau has a screening process to determine whether alleged predatory pricing is likely to prevent or lessen competition substantially or eliminate a competitor.

First, the Bureau examines whether the firm engaging in the pricing conduct has, or is likely to have, market power - that is the ability to increase prices above competitive levels for a significant period of time or affect other significant non-price aspects of competition. Evidence of market power can be direct, such as high, uncompetitive prices or profits, or indirect. There are two primary indirect indicators of whether a firm is likely to have market power: i) a high market share and ii) effective barriers to entry and/or exit. Both are necessary conditions for a firm to exercise market power. Indirect indicators of market power are important because the Bureau usually receives predatory pricing complaints when the alleged predator has reduced prices.

A market share of less than 35 per cent will generally not give rise to concerns of market power. Similarly, if barriers to entry are low, attempts to exercise market power will be defeated by new entry or the expansion of existing firms in the relevant market. The Bureau will only pursue allegations of predatory conduct where it finds the alleged predator would likely have market power to the extent that it could likely recoup its losses following a period of predatory pricing. Otherwise, a Bureau investigation could chill legitimate price competition.

The second part of the screening process involves the Bureau examining whether or not the complainant's business in the relevant market is unprofitable over the time period that the price

reductions have been in force, and that this can be attributed to the alleged predatory conduct. In situations where the complainant is incurring losses, there is the prospect that a competitor may be eliminated or competitive rivalry may be diminished.

Predatory pricing complaints will be, at first instance, analyzed under the abuse of dominance provisions of the Act. Nonetheless, at any stage of the enforcement process, the Bureau may determine that the conduct merits being examined under the criminal predatory pricing provisions. This could include cases where the conduct is egregious, such as using predatory pricing in furtherance of actual or attempted cartel activity. Recourse to the criminal predatory pricing provisions may also be taken where the person or firm has a history of non-compliance with the Act, including past instances of predation.

Criminal Predatory Pricing

The criminal predatory pricing provision in paragraph 50(1)(*c*) of the Act contains three essential elements. There must be a "*policy of selling*" - that is, deliberate and repeated transactions over a sufficiently long period of time to constitute a practice, policy or strategy. Prices must be "*unreasonably low*" - which means that prices must be below average avoidable costs in the absence of a reasonable business justification. Finally, the offence requires the policy to have "*the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect.*"

In the context of predation, the Bureau interprets a substantial lessening of competition as increasing the ability of a firm to exercise market power to the extent that it could likely recoup its losses by charging prices above the level that would have prevailed in the absence of the impugned conduct. The competitive influence of the eliminated firm and its sunk cost assets are important factors in the Bureau's consideration of the elimination of a competitor.

The abuse of dominance provisions

The abuse of dominance provisions in sections 78 and 79 of the Act provide the Competition Tribunal with the power to issue a remedial order if the Commissioner can demonstrate, on the balance of probabilities, the following three elements:

(a) *one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,*

(b) *that person or those persons have engaged, or are engaging, in a practice of anti-competitive acts, and*

(c) *the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market.*

Allegations of predatory conduct under the abuse of dominance provisions require the dominant firm or group of firms to have a practice of selling at prices below average avoidable costs. Predatory conduct is only profitable for a dominant firm(s) if it maintains or enhances market power. In this context, the likely ability to recoup losses following a campaign of predatory pricing is an important indicator of market power.

Institutional framework for enforcement

The enforcement process is made up of several stages. After vetting the initial complaint, the Bureau conducts a preliminary examination. If there is reason to believe that the firm alleged to be engaged in predatory pricing is likely to have market power and the complainant is, or is about to become, unprofitable in the relevant market, the Commissioner may start a formal inquiry to determine the facts. This allows the Commissioner to apply to the courts for the use of investigatory powers, such as the power to search premises and seize evidence, or to compel testimony, the production of documents or written answers. If the inquiry results in sufficient evidence of a contravention, the Commissioner may seek to resolve the matter before the Competition Tribunal either by way of a consent agreement or by filing an application to commence contested proceedings. In the case of egregious conduct, the Commissioner may refer the matter to the Director of Public Prosecutions with a recommendation to prosecute.

How to contact the Competition Bureau

These guidelines and other Bureau publications are available on the Bureau's Web site. To obtain general information, make a complaint under the provisions of the legislation, or request a Written Opinion, please contact the Bureau by any one of the means listed below:

Information Centre
Competition Bureau
Industry Canada
50 Victoria Street
Gatineau, QC K1A 0C9

Tel.: (819) 997-4282
Toll-free: 1-800-348-5358
TDD (for the hearing impaired): 1-800-642-3844
Fax: (819) 997-0324
Fax-on-demand: (819) 997-2869

Web site: www.competitionbureau.gc.ca
E-mail: compbureau@cb-bc.gc.ca

Part 1: Introduction

The purpose of the Act is to maintain and encourage competition to achieve the objectives set out in section 1.1 of the Act. These include promoting the efficiency, adaptability and international competitiveness of the Canadian economy, ensuring that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy, and providing consumers with competitive prices and product choices.

Low prices are a hallmark of competition. However, when a person or a firm (hereinafter collectively referred to as a firm) deliberately sells at below cost prices, it can eliminate or deter competitive rivalry. While consumers may benefit from the resulting low prices for a brief period, they can be harmed in the long-run if diminished competition ultimately leads to higher prices or reduced levels of service, product quality or innovation.

1.1 Organization of these Guidelines

These guidelines are organized into five parts and two appendices:

Part 2 describes the institutional framework for enforcement with respect to predatory conduct.[1]

Part 3 describes the Bureau's market power and profitability criteria.

Part 4 describes how the Bureau conducts its price /cost comparison.

Part 5 describes how the Bureau analyzes the impact on competition stemming from predatory conduct.

Part 6 describes the remedies that could result from allegations of predatory pricing.

Appendix I applies the Guidelines to several hypothetical case examples. Appendix II summarizes the relevant Canadian case law.

1.2 Statutory Provisions

Subsection 79(1) of the Act states:

Where, on application by the Commissioner, the Tribunal finds that

> *(a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,*

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[1] Predation, predatory conduct and predatory pricing are used interchangeably in these Guidelines.

(b) *that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and*

(c) *the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,*

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

Several of the acts in the non-exhaustive list of anti-competitive acts in section 78 address predatory conduct. Paragraph 78(1)(*i*) refers to "*selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor.*" Paragraphs 78(1)(*c*) and 78(1)(*d*) refer to *"freight equalization"* and *"the introduction of fighting brands."* Contested proceedings under the abuse of dominance provisions require the Commissioner to file an application for the making of an order with the Competition Tribunal. The Bureau's general approach under the abuse of dominance provisions is set out in the *Enforcement Guidelines on the Abuse of Dominance Provisions*.[2]

In circumstances of egregious conduct, described in more detail in Part 2 below, the Bureau will examine the matter under the criminal predatory pricing provisions in accordance with these guidelines.

Paragraph 50(1)(*c*) of the Act states:

Every one engaged in a business[3] *who*

(c) *engages in a policy of selling products*[4] *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.

Criminal prosecutions under the Act are conducted by the Director of Public Prosecutions before

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[2] Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance Provisions* (Section 78 and 79 of the *Competition Act*) (Ottawa: Industry Canada, 2001) available online at: http://www.competitionbureau.gc.ca.

[3] Subsection 2(1) of the Act defines "business" as:

(*a*) manufacturing, producing, transporting, acquiring, supplying, storing and otherwise dealing in articles, and
(*b*) acquiring, supplying and otherwise dealing in services.
It also includes the raising of funds for charitable or other non-profit purposes.

[4] Under section 2 of the Act, a product is defined as either an article or a service.

a provincial court or the Federal Court of Canada. For a court to convict an accused, the Crown must prove the offence beyond a reasonable doubt.

Part 2: The Institutional Framework for Enforcement

The Act sets out a clear separation between the investigative role of the Bureau, the prosecutorial role of the Director of Public Prosecutions and the adjudicative role of the Competition Tribunal and the courts. The Commissioner is an advocate for competition, not for individual competitors.[5] The Commissioner has no power to regulate or compel a change in business conduct. Those powers are reserved for the Competition Tribunal and the courts. However, as described in Part 6 below, the Commissioner may, in appropriate circumstances, resolve a matter with a consent agreement or alternative case resolution without recourse to contested proceedings before the Competition Tribunal or the courts.

The investigative process consists of several stages: preliminary examination, formal inquiry and application to the Competition Tribunal or referral to the Director of Public Prosecutions.

2.1 Preliminary Examination

The Bureau has the power to examine any potential breach of the Act. In most cases, although not exclusively, the Bureau will commence a preliminary examination into alleged predatory conduct upon receiving a complaint. Most of the complaints the Bureau receives regarding predatory conduct are made by smaller competitors or new entrants in markets dominated by a well established firm. Typically, complainants allege that price reductions by a dominant firm threaten to drive them (and possibly others) from the market.

Initially, the Bureau will attempt to ascertain whether the price reductions are consistent with legitimate price competition or with anti-competitive conduct. For example, complaints about "one day sales" or selling at prices that are clearly above costs are not pursued. The courts have concluded that selling at prices which are above costs cannot constitute predatory pricing. Similarly, the jurisprudence is clear that short term, competitively expedient price cuts such as selling off perishable inventory are perfectly legitimate.[6]

After the initial complaint is analyzed and it is determined that the matter could raise an issue under the Act, the Bureau will start a preliminary examination. This involves obtaining and analyzing information from the complainant and other sources pertaining to the allegations of predatory conduct. The Bureau's analysis of market power begins with defining the relevant

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[5] Competition Bureau *Conformity Continuum Information Bulletin* (Ottawa: Industry Canada 2000) describes the general approach used by the Bureau in the administration and enforcement of the Act including options available to address instances of non-conformity.

[6] *R. v. Producers Dairy Ltd.* (1966), 50 C.P.R. (2d) 265 [*Producers Dairy Ltd.*]

product and geographic markets and then estimating the distribution of market shares as well as making an initial assessment of the likelihood that the exercise of market power would be constrained by the entry of new firms or the expansion of existing firms in the relevant market. The Bureau will also obtain information to determine whether the complainant's business in the relevant market is, or is likely to become, unprofitable as a result of the alleged predatory conduct. In order to verify the financial condition of the complainant, the Bureau will normally request its financial statements or tax returns. It is critical that complainants provide relevant information that support their claims of economic harm due to predatory conduct.

If the Bureau is satisfied that the market power and profitability criteria set out in Part 3 below are satisfied, it will obtain and analyze additional information on the behaviour of firms in the relevant market. This includes the duration, frequency, depth, and pattern of price reductions and responses by firms in the market. Normally, the more robust the price reductions, particularly if initiated by an incumbent, dominant firm, the more cause for concern under the Act.

2.2 Formal Inquiry

Section 10 of the Act provides the Commissioner with the power to commence a formal inquiry to determine the facts where there is reason to believe that (*a*) a Tribunal or court order has been violated, or (*b*) grounds exist for the Tribunal to make an order, or (*c*) a criminal offence has been, or is about to be committed.

Once an inquiry is underway, the Bureau can make use of court-authorized, investigatory powers to gather evidence. These powers can include orders for oral examination of witnesses under oath, written returns of information, the production of records, as well as orders for search-and-seizure.[7]

When the facts of the matter have been established, the Bureau will decide whether it believes there has been a contravention of the Act and, if necessary, the appropriate remedy to be sought. The potential remedies available once a contravention has been established are described in Part

[7] The existence of an inquiry is a legal requirement under section 11 of the Act to obtain a judicially authorized order to compel the production of documents, testimony or written answers under oath. While not legally required, the Commissioner usually commences a formal inquiry under section 10 of the Act before applying to the courts for a search warrant under section 15 of the Act.

6 of these guidelines.[8] In the event that the Bureau determines that a contravention of the Act did not occur, it will discontinue the inquiry.[9]

2.2.1 Criteria for Criminal Investigations

Predatory pricing complaints will be analyzed initially under the abuse of dominant position provisions of the Act. Nonetheless, at any stage of the enforcement process, the Bureau may determine that the conduct merits being examined under the criminal predatory pricing provisions. This could include cases where the conduct is not only likely to substantially lessen or prevent competition, but is also "egregious".

Egregious conduct could include, but is not limited to, using predatory pricing:

- to enforce or invite participation in a cartel agreement,[10] or
- on an ongoing or repetitive basis, or where the firm is subject to a Competition Tribunal or court order, or an undertaking forming part of an alternative case resolution.[11]

It is important to note that the conduct described immediately above could be the subject of additional criminal charges under the Act. Recourse to the criminal predatory pricing provisions may be taken where the person or firm that has engaged or is engaging in the predatory pricing practice or policy has a history of non-compliance with the Act.

Occasionally, the Bureau receives complaints that two or more firms are engaged in joint predatory conduct. In these circumstances, the Bureau could examine the complaint under the abuse of dominance or conspiracy provisions as they respectively address tacit and explicit anti-

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[8] Also see Part 5 of the *Enforcement Guidelines on the Abuse of Dominance Provisions*, *supra* note 2 at 26-27.

[9] Section 22 of the Act states that at any stage of an inquiry the Commissioner may discontinue the matter if the Commissioner is of the opinion it does not justify further inquiry. The Commissioner is required to write a report for the Minister of Industry indicating the information obtained and the reason for the discontinuance. The Minister may review the Commissioner's decision and order further inquiry. The Commissioner also notifies the target of the inquiry as well as the complainant(s) that the inquiry has been discontinued.

[10] Cartel agreements refer to the criminal offences of conspiracy, foreign directives and bid-rigging under sections 45, 46 and 47 of the Act.

[11] Part 6.1 provides a brief description of alternative case resolutions. Not all previous breaches of the Act are relevant in the context of recidivist behaviour. However, past instances of non-predatory anti-competitive conduct that involve the abuse of market power and have resulted in criminal convictions, Tribunal or court orders, or alternative case resolutions are relevant to current instances of predatory conduct if they demonstrate a repeated intent to eliminate, discipline, or predate competitors.

competitive agreements.[12]

2.3 *Proceedings under Section 79*

Subsection 79(1) authorizes the Commissioner to apply to the Competition Tribunal for an order to prohibit the practice of anti-competitive acts on the part of the dominant firm.[13] Additionally, or alternatively, where the Tribunal finds under subsection 79(2) that a prohibition order would not likely restore competition in the market, it may issue a remedial order, including the divestiture of assets or shares, as are reasonable and necessary to overcome the effect of the practice of anti-competitive acts. The application of sections 78 and 79 to predatory conduct is addressed in Part 4.3 of the *Bureau's Enforcement Guidelines on the Abuse of Dominance Provisions*,[14] Part 4.3 of the *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Telecommunications Industry*[15] and Part 5.2.2 of the *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Retail Grocery Industry*.[16]

2.4 *Referral to the Director of Public Prosecutions of Canada*

Under section 23 of the Act, the Commissioner may at any stage of any inquiry refer any information and evidence to the Director of Public Prosecutions "*for such action as the Attorney General of Canada (i.e. the Director of Public Prosecutions) may wish to take.*" The Director of Public Prosecutions will independently assess the sufficiency of the information and evidence and determine whether a prosecution is in the public interest. Prosecutions take place before the provincial courts or the Federal Court of Canada.

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[12] Part 3.2.1(e) of the *Enforcement Guidelines on the Abuse of Dominance Provisions*, *supra*, note 2, address joint dominance.

[13] Section 79 provides that the Tribunal may make behavioural and structural orders against a respondent firm(s) to cease a practice or take other steps to overcome the effects of the practice of anti-competitive acts. Under section 79, the Tribunal does not ordinarily have the power to impose administrative monetary penalties. Amendments to the Act which came into force on June 21, 2002, provide the Tribunal with the power to issue interim orders prior to litigation to prevent irreparable harm to a person as well as impose monetary penalties up to a maximum of $15 million against an airline carrier where the Tribunal has found that a dominant carrier has abused its dominant market position. In addition, section 66 provides for criminal penalties for failing to comply with a Tribunal order.

[14] *Supra* note 2

[15] Competition Bureau, *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Telecommunications Industry* (Ottawa: Industry Canada 2007) available online at: www.competitionbureau.gc.ca.

[16] Competition Bureau, *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Retail Grocery Industry* (Ottawa: Industry Canada 2002) available online at: www.competitionbureau.gc.ca.

Part 3: Stage One - Market Power and Profitability

In matters involving alleged predatory conduct, the Bureau applies the Act in a manner that maintains and encourages vigorous price competition, while deterring anti-competitive conduct. To achieve this objective, the Bureau applies a two stage analysis. First, market power and profitability criteria are examined and, if satisfied, a cost-revenue analysis is undertaken to determine whether prices are below average avoidable costs.[17]

The Commissioner will only proceed in respect of a predatory pricing matter where market conditions are conducive to the exercise of market power.[18] The profitability of the complainant in the relevant market will also be analyzed. If the complainant's operations in the relevant market have been, or could be reduced to the point of unprofitability as a result of the alleged predation, this may be an indicator that competition could be diminished.

3.1 Market Power Criterion

Market power refers to the ability to profitably increase or maintain prices[19] above competitive levels for a significant period of time. A significant period of time is deemed to be one year. The Bureau examines direct and indirect indicators of market power. In the context of predation, the likely ability to recoup losses following a period of predation is a good indicator of market power. Various decisions of the Competition Tribunal have also stated that evidence of high prices or high profits as well as the ability to price discriminate can mean that a firm has market power.[20]

Market shares and the conditions of entry and exit are the primary indirect indicators of market power examined. The typical first step in any analysis of market power is to define the relevant market. This allows for the estimation of the market shares of firms in the relevant market as well as an analysis of whether any barriers to entry and expansion would constrain the ability of a firm to exercise market power following a period of predatory pricing.

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[17] See section 4 for a discussion of avoidable costs.

[18] More information on market power can be found in the Bureau's *Merger Enforcement Guidelines* (Ottawa: Industry Canada 2004) and in various decisions of the Competition Tribunal for example, *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) [*Nutrasweet*] and *Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.) [*Laidlaw*].

[19] Unless otherwise indicated, price means price, output, quality, variety, service, innovation and other dimensions of competition. Therefore, raising price may also mean reducing these other non-monetary dimensions of competition. In predatory conduct matters, however, the emphasis is usually on prices.

[20] *Laidlaw, supra* note 18 at para. 327-330 and *Canada (Director of Investigation and Research) v. Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1 at 62-64, 102-105 [*Tele-Direct (Publications) Inc.*].

3.2 Market Definition

Defining the relevant product and geographic markets focuses on identifying products and the competitors that produce those products that are likely to constrain the ability of a firm to profitably raise price(s) or otherwise restrict competition. Competitors in the relevant market are identified by their provision of alternative products or geographic sources of supply to which buyers would be willing and able to substitute if the price for the product were to rise.

The boundaries of a market for competition analysis are delineated using the "hypothetical monopolist" framework to determine the smallest group of substitute products and the smallest region of production or supply that a firm must control such that a profit-maximizing firm (the hypothetical monopolist) would have an incentive to implement a small, but significant and non-transitory increase in price (referred to as a SSNIP)[21] above the price that would have prevailed in the absence of the alleged predatory conduct.[22]

Product market definition involves identifying whether there are close substitutes for the product in question such that buyers would switch to these substitutes in sufficient quantities in the event of a SSNIP, so as to render a price increase unprofitable. If there are, these substitute products will be included in the relevant product market. Direct evidence of switching behaviour in response to a SSNIP (i.e., price changes and concomitant quantity changes) would indicate

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[21] Generally, a five per cent real price increase above competitive levels lasting for one year is considered to be a SSNIP. With respect to the specific tests used under the SSNIP, it is recognized that market characteristics may sometimes necessitate using a different price increase or time period.

[22] In abuse of dominant position and predatory pricing cases, determining the relevant market may be difficult because price levels have been distorted as a result of the alleged predatory conduct. Therefore, defining the relevant market during the period of predation may lead to an overly narrow market definition as close substitutes (that would be included in the market at the price level that would prevail absent the predation) are excluded from the relevant market. The same analysis conducted during the period of recoupment may lead to an overly broad market definition as existing prices are above prices that would have prevailed in the absence of the predatory pricing and unjustified substitutes (that enter the market only at the price level higher than would prevail absent the predation) are included in the market definition. This is known as the "cellophane fallacy". Further information on the cellophane fallacy is contained in the *Enforcement Guidelines on the Abuse of Dominance Provisions supra* note 2 and in the *Information Bulletin on the Abuse of Dominance Provisions Applied to the Telecommunications Industry, supra* note 15 at section 2.2.

substitutability.[23] In the absence of direct evidence, a number of factors may assist in determining product substitutability. These include the views, strategies, behaviour and identity of buyers and sellers or other market participants; end-use or functional interchangeability of the products; physical and technical characteristics of the products; switching costs; and other impediments to trade.[24]

It is important to note that a product market definition consisting of a bundle of products can be an appropriate market definition in certain markets or industries characterised by multi-product firms. Bundling can stem from a technological relationship between products, point of sale service or convenience considerations for customers or other efficiency motivations.[25]

For the purpose of geographic market definition, the Bureau assesses the ability and willingness of consumers to switch purchases from suppliers at one location to suppliers at another location in sufficient quantities in response to a SSNIP to render a price increase unprofitable. A relevant geographic market consists of the smallest region within which a "hypothetical monopolist" of all sources of supply that are regarded as close substitutes by buyers, could impose a SSNIP above the price that would have prevailed in the absence of the alleged predatory conduct.[26] In the absence of direct evidence of switching behaviour in response to a SSNIP, a number of factors may assist in ascertaining consumers' willingness to switch between suppliers in different locations. These generally include the views, strategies, behaviour and identity of buyers; trade views, strategies and behaviour; switching costs; transportation costs; price relationships and relative price levels; shipment patterns; and foreign competition.[27]

3.3 Market Shares

The distribution of market shares held by individual firms is an important factor affecting the ability of a firm to exercise market power. Generally, the greater the market share of the firm engaging in price reductions relative to its competitors, the more likely that the firm will have

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[23] *Canada (Director of Investigation and Research) v. D&B Companies of Canada Ltd*. (1995), 64 C.P.R. (3d) 216 (Comp. Trib.).

[24] These factors are described in greater detail in the *Enforcement Guidelines on the Abuse of Dominance Provisions*, *supra* note 2.

[25] For more information on the treatment of bundling, see sections 5.1.1(a) and 5.2.2 of the *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Canadian Grocery Sector* and section 4.5 of the *Information Bulletin on the Abuse of Dominance Provisions as Applied to the Telecommunications Industry*.

[26] *Supra* note 22, the "cellophane fallacy" also applies to geographic market definition in abuse of dominant position and predatory pricing cases. When geographic price discrimination is present (and buyers and third parties are unable to arbitrage between low and high price areas), geographic markets are defined around the location of each targeted group of buyers.

[27] These factors are described in greater detail in the *Enforcement Guidelines on the Abuse of Dominance Provisions*, *supra* note 2 at 12-13.

market power. Evidence of persistently high market shares can be an indicator of market power because, over time, market dominance depends on the ability to prevent competitors and new entrants from increasing their market shares. This can be accomplished through legitimate means, such as greater efficiency or better products, or through improper means, such as anti-competitive behaviour.

Generally, the Bureau does not consider a firm with a market share of less than 35 percent to be capable of exercising market power.

3.4 Barriers to Entry[28]

High market share alone is insufficient to determine market power. Without barriers to entry, any attempt by a firm with high market share to exercise market power is likely to be met with entry or expansion such that it would not be profitable to raise prices above competitive levels. Barriers to entry can include: significant economies of scale; sunk costs; regulatory barriers; strategic behaviour; long-term contracts; market maturity; and the reputation of incumbents.[29]

Entry must be timely, likely and sufficient before it can constrain the exercise of market power. Timely means that entry will occur within two years; likely refers to the expectation that entry will be profitable; and sufficient means that entry would deter firms from raising prices by a significant amount. In assessing barriers to entry, the Bureau will consider new entry, expansion and the possibility of supply-side substitution by incumbent firms.

If entry is timely, likely and sufficient, then attempts to exercise market power by a firm will be unsuccessful. Consequently, the Bureau will not take enforcement action in respect of predatory conduct in markets where barriers to entry are low.

3.4.1 Types of Entry Barriers

Entry barriers typically fall into three general categories - structural (including barriers associated with incumbent reputation), regulatory, and strategic.

Structural barriers stem from the structural characteristics of the market and its participants, for example, economies of scale, absolute cost differences across incumbents and entrants, required sunk cost investments by entrants, and costs incurred by consumers from switching between the products or services of one firm to another's. In regard to the last of these, switching costs may include those associated with the value consumers place on the long-standing, good reputation of

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[28] Unless otherwise indicated, entry into or entering, a market refers to both entry by new firms and expansion by existing firms.

[29] More information on barriers to entry can be found in Part 6 of the Bureau's *Merger Enforcement Guidelines*, *supra* note 18.

a firm. Where there are such reputational barriers, consumers may be unwilling to switch to the products or services of a new firm absent compensation for the risk they associate with its use.

Other barriers that affect the timeliness, likelihood and sufficiency of entry are those created by the government. These regulatory barriers can include tariff and non-tariff barriers to trade, environmental regulations, and intellectual property rights.

Strategic barriers are typically structural barriers that have been influenced by market incumbents such that an entrant who would have otherwise found it profitable to enter no longer does.[30] In the case of predation, a particular type of strategic barrier can include an incumbent's reputation or incentive for aggressive, predatory post-entry behaviour. If the incumbent firm is successful at persuading the entrant that its continued presence or expansion in the market will be met with a strategy of below cost pricing, then the entrant will discontinue its expansion and possibly exit the market. This can deter the entry or expansion of other firms in that market or in other markets where the incumbent competes.

In evaluating whether a firm has a reputation for predation, or whether market conditions exist that make predatory behaviour more likely to be successful such that a potential entrant would be deterred, the Bureau considers whether one or more of the following non-exhaustive list of market conditions are present:

- the firm competes against smaller rivals in more than one geographic or product market or faces a succession of potential entrants over time;
- the firm has priced below cost in response to actual or potential entry in the past, and there is a rational belief on the part of actual or potential competitors that it is likely to repeat this action in response to future entry;
- the financing of an entrant is reliant on outside sources or is conditional on its ongoing profitability; and
- actual or potential entrants are aware of the exit or other adverse competitive effects experienced by other rival firms.

Ultimately, it is the combination of high market share and effective barriers to entry that support the presumption of the likely recoupment of losses (addressed in Part 5 below) following a predatory pricing campaign.

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[30] The Competition Tribunal in *Laidlaw*, *supra* note 18 at 77-78 noted that while commencing a business may in some cases be easy, new entrants may find it difficult to survive for a variety of reasons, including the strategic behaviour of incumbents. For example in *The Commissioner of Competition v. Superior Propane Inc.* (August 30, 2000), CT1998/002, Reasons and Order (FINAL) at para. 147, 152-153 the Competition Tribunal describes how incumbents used a combination of contractual switching costs and price reductions to discourage entry. Appendix 1 of the *Merger Enforcement Guidelines*, *supra* note 18, provides a further discussion of strategic barriers.

3.5 Profitability Criterion

The Bureau will also attempt to determine whether the complainant's business in the relevant market is, or is likely to become unprofitable over the time period that the price reductions have been, or are likely to be in force, and that this can be attributed to the allegations of predatory conduct. When the complainant's profitability in the relevant market has been, or could be reduced to the point of unprofitability, there is a reasonable prospect that the complainant may be eliminated or that competition could be diminished were the complainant to increase prices after being disciplined.[31]

It is not necessary to demonstrate that the profitability of the complainant's business has been, or could be reduced to the point of unprofitability on a consolidated basis if the complainant operates in more than one geographic or product market. Nor is it necessary to establish that the pricing policy of its rival(s) is the sole reason why the profitability of the complainant's business in the relevant market has been, or could be reduced to the point of unprofitability. Generally, the Bureau will ask the complainants to provide information on earnings on operations segregated by the relevant market or markets in question during the previous time period as well as over the time period the alleged predatory pricing policy has been in effect.[32] In situations where a complainant alleges that it is deterred from entering a market because of the alleged predatory pricing policy of a rival firm, the Bureau will ask the complainant to prepare a *pro forma* projection of profitability over the time period the policy has been in effect. The *pro forma* statements must indicate that the profitability of the complainant's business would be reduced as a result of the predatory pricing over the relevant time period.[33]

Other profitability factors the Bureau will consider include:

i) whether the complainant relies upon outside, as opposed to internal, sources of financing;

ii) whether the complainant can compete during a period of price reductions with revenues from other markets;

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[31] While such an assessment of profitability is not a substitute for a full assessment of whether there is or is likely to be a substantial lessening of competition, it is a useful screen; if a firm's pricing policy is unlikely to eliminate or discipline competitors, it is unlikely to substantially lessen competition.

[32] A common accounting measure that the Bureau uses is Earnings before Interest, Taxes, Depreciation and Amortization. ("EBITDA").

[33] In the case of a firm that would be unprofitable even without the predation because, for example, it is a new entrant, the Bureau will examine whether the firm would have otherwise had significantly greater earnings.

iii) the investment required to become an effective competitor and the business decisions the complainant has taken to achieve that end;

iv) the financial strength of the firm initiating the price reductions relative to the complainant; and

v) whether the firm initiating the price reductions can support a campaign of price reductions with revenues from other markets.

Where a complainant is in a weaker financial position than the firm initiating the price reductions, a predatory pricing policy is more likely to have an anti-competitive effect.

Part 4: Stage Two - Price/Cost Comparison

Economic theory generally assumes that firms seek to maximize profits. This implies that, normally, firms set prices at or above marginal cost to achieve this objective. Often variable costs are used as a proxy for marginal costs as information on marginal costs is often not readily available. When unfavourable business conditions arise, a firm that is profit maximizing will continue in business, at least in the short run, as long as its revenues exceed its variable costs. If revenues were insufficient to cover variable costs, the firm's profit maximizing decision would be to cease production altogether as continuing production would only serve to exacerbate its losses. Consequently, sales below marginal costs, or an appropriate proxy thereof, in order to harm a competitor may be part of a strategy to engage in predatory pricing.

While variable costs can be a proxy for marginal costs, the Bureau's view is that average avoidable costs is the most appropriate cost standard to use when determining if prices are predatory, since average avoidable costs capture opportunity costs.[34] Avoidable costs refer to the costs that a firm could have avoided had it chosen not to sell the product(s) in question during the period of time the policy has been in place. By addressing certain incremental costs, including opportunity costs, associated with a practice or policy of predatory pricing, avoidable costs provide a closer proxy of marginal costs than variable costs alone. As well, most firms produce two or more products, and multi-product firms generally have fixed costs incurred in common on behalf of two or more of their products. Using average total costs as a standard for measuring cost in predatory pricing analysis is inappropriate, in part because of the difficulty of allocating common costs among two or more products. The avoidable costs test avoids the problem of having to allocate common costs to individual products.

The jurisprudence under both the criminal predatory pricing provision and the abuse of

[34] The concept of avoidable cost was first described as an appropriate measure of costs by Janusz A. Ordover and Robert D. Willig, in "An Economic Definition of Predation: Pricing And Product Innovation" (1981) 81 Yale Law Journal 8. See also William J. Baumol, "Predation and the Logic of the Average Variable Cost Test" (1996) 39 Journal of Law and Economics 49.

dominance provisions requires the Bureau to examine the underlying purpose of the price reductions in question. Paragraph 50(1)(*c*) requires the Crown to prove a *"policy of selling products at prices unreasonably low"* while the abuse of dominance provisions require the Commissioner to establish "*a practice of anti-competitive acts."* Both require an examination of all of the surrounding circumstances of the pricing behaviour of firms in the market. Moreover, the jurisprudence is clear that temporary or competitively expedient price reductions do not constitute a *"practice"* or *"policy."*[35]

4.1. Avoidable Costs

To determine whether a pricing policy or practice raises an issue under the Act, the Bureau determines whether the firm charging the price was able to cover the average avoidable costs of supplying the product(s) in question.[36] Avoidable costs refer to all costs that could have been avoided by a firm had it chosen not to sell the product(s) in question during the period of time the policy has been in place. Certain costs can be avoided by ceasing production or by redeploying production inputs to other uses.

For the purpose of calculating avoidable costs, a number of concepts are relevant: i) variable costs, that is all costs which vary with the level of output;[37] ii) fixed costs, that is costs that do not vary with the level of output such as the cost of land, buildings and machinery and; iii) sunk costs which cannot be recovered if a firm stops producing. The latter are equal to an asset's historic cost less its value redeployed into its next best alternative use or salvage value. Avoidable costs include variable costs and some fixed costs (which are product-specific) but do not include sunk costs.

Selling at prices that do not cover average avoidable costs will not usually be profit-maximizing for a firm unless there is an expectation to create or enhance market power. As such, where a firm engages in a policy of selling products at prices that are below average avoidable costs, in the absence of a reasonable business justification, the Bureau will assume that such pricing is engaged in for an anti-competitive purpose. Failing an anti-competitive objective, a firm would minimize its losses by ceasing production or raising its prices rather than continuing to sell at prices below average variable cost. The non-sunk portion of product-specific fixed costs (quasi-

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[35] *Nutrasweet*, *supra* note 18 and *R. v. Consumers Glass Co.* (1981), 33 O.R. (2d) 228 [*Consumers Glass Co.*]; *Producers Dairy Ltd.*, *supra* note 6; *R. v. Carnation Co.* (1969), 58 C.P.R. 112 (C.A.) [*Carnation Co.*], among others, address the interpretation of *practice* and *policy* (emphasis added).

[36] The Competition Tribunal defined avoidable costs as "[a]ll costs that can be avoided by not producing the good or service in question. In general, the avoidable cost of offering a service will consist of the variable costs and the product-specific fixed costs that are not sunk." *Canada (Commissioner of Competition) v. Air Canada* (2003), 26 C.P.R.(4th) 476 (Comp.Trib.) [*Air Canada*] at para. 76.

[37] Variable costs generally include, but are not limited to, ongoing expenses such as labour, materials, rent and utility costs, use-related plant depreciation, and promotional allowances.

fixed costs) are included because the firm either incurs the opportunity cost of not redeploying these input costs to an activity that would generate more revenues for the firm, or the firm would avoid these costs outright by not producing the product in question. Incremental fixed costs and sunk costs, such as expanding capacity or redeploying assets to a relevant market as part of a campaign of predatory pricing, also qualify as costs that can be avoided.

Generally, the Bureau will direct its price/cost analysis to the time period the predatory pricing policy is alleged. All variable costs, excluding common costs, are avoidable during the period the pricing policy is in place. Economic theory indicates that, over time, costs that are fixed in the short run can become variable in the long run. Therefore, the longer the pricing policy is in place, the more costs are likely to be considered avoidable. A second timing issue involves assessing the period over which incremental costs are to be considered avoidable. To do this, the Bureau will examine the standard amount of time taken by a firm's management to assess business performance and implement any required changes, such as redeployment, to increase revenues associated with these incremental costs.

In practice, assessing a firm's average avoidable cost can be complicated. Cost data at the firm level may be kept in many different forms depending on the industry, although for goods, for example, acquisition cost data is a common form. To calculate avoidable cost, the Bureau will begin with available data such as acquisition cost and add estimates of other avoidable costs (such as variable costs and product-specific fixed costs as listed above). It may also be necessary to subtract estimates of certain revenues, such as advertising allowances specific to the relevant product(s), to arrive at an estimate of total avoidable cost. This is then spread over the firm's total quantity produced in the relevant product market to arrive at an estimate of average avoidable cost per unit, which can then be compared to selling price.

The avoidable cost test does not require a firm to cover its total costs. Revenues and costs resulting from extraordinary items, such as asset sales, property and casualty losses, etc., do not enter into the analysis because they do not reflect the ongoing operations of the firm. As well, avoidable costs exclude common costs which cannot be directly attributed to a particular product.

Ordinarily, a multi-product firm incurs costs that are common for the production of all its products or for a particular group of products. When the Bureau conducts a price/cost analysis for only one of the firm's products, any common costs will ordinarily be excluded from the calculation of avoidable costs. This reflects the fact that the firm still needs to incur these costs in order to produce other products not subject to the predatory pricing allegation. In responding to allegations of predation where the relevant product market is defined as a bundle of products, the Bureau assesses whether the price for the bundle, as opposed to individual products within the bundle, is below its total average avoidable costs.

In the absence of a reasonable business justification (see Part 4.3 below), the Bureau will consider a price that is below average avoidable costs to be predatory, since in the normal course of business, a policy of selling at a price below avoidable costs would only be profit-maximizing because of its likely anti-competitive effects.

4.2 Practice or Policy

In addressing this requirement, the Bureau considers whether the selling activity of the firm in question is a legitimate short-term competitive tactic, or whether it is sufficiently long term or repetitive to be considered a pricing strategy. In *R. v. The Producers Dairy Limited*, the Ontario Court of Appeal interpreted *"policy"* as meaning more than the adoption of a temporary measure to counteract an aggressive, competitive move aimed directly at an important customer of the low pricing firm.[38] In *R. v. Hoffmann-La Roche,* the Ontario Court of Appeal stated that sales made on a one-time basis are unlikely to constitute a policy. Rather, sales need to be ongoing or repeated.[39] In markets where the bulk of purchasing is done over a short period of time, such as seasonal markets or markets where infrequent large tender calls constitute a significant portion of market transactions, the Bureau may well conclude that prices applied over a short period reflect a "*practice*" or "*policy*" as envisaged by the legislation. The Competition Tribunal in the *NutraSweet* abuse of dominant position case stated that different individual anti-competitive acts taken together may constitute a *"practice."*[40]

4.3 Business Justification for Pricing Below Avoidable Costs

Jurisprudence requires that the Bureau take into consideration legitimate business objectives for pricing below cost.[41] For example, it may be reasonable for a firm to sell excess, obsolete or perishable products at below-cost prices. Similarly, companies may use below-cost promotional pricing to induce customers to try a new product.

There may be other business justifications for pricing below average avoidable costs. The "meeting competition" defence refers to a firm that reduces its prices to match a competitor's price reduction even if the price is below the firm's average avoidable costs. For example, if a firm enters a market with a low price to establish sales and market recognition, an incumbent

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[38] *Producers Dairy Ltd.,supra* note 6. The Court found that the low pricing in question, which lasted two days, did not constitute a policy. See also *Carnation Co. supra* note 36.

[39] *R. v. Hoffmann La Roche Ltd.* (1980), 28 O.R. (2d) 164 (H.C.J.) affirmed 33 O.R. (2d) 694 (C.A.). The Court found that products "given away" at no charge for a six-month period constituted a policy of selling. The Court also concluded that for any course of pricing action to constitute a "policy of selling," it must be established that it was planned and deliberate conduct by responsible employees of the company. The Court added that repeated sales of products at unreasonably low prices by sales persons, without the official authorization of the Board of Directors of senior officers of the company, may be sufficient to constitute a "policy of selling."

[40] *Nutrasweet, supra* note 18 at para. 23.

[41] *Consumers Glass Co.*, *supra* note 35. Also see *Boehringer Ingelheim (Canada) Inc. v. Bristol-Myers Squibb Canada Inc.* (1998), 83 C.P.R. (3d) 51 [*Boehringer Ingelheim*], a private action brought under section 36 of the Act.

firm may respond to this action in the short run by matching those prices.[42] Generally, this response would not be considered to be anti-competitive by the Bureau. In assessing price matching, the Bureau will examine each situation on a case-by-case basis to determine all facts and circumstances relevant to establishing whether the below cost pricing is, or is likely to be, anti-competitive.

One factor which the Bureau will consider is whether there is a qualitative difference between the products being offered by the rival companies. Where one product is superior to another in terms of quality or service, matching prices would, in effect, be "undercutting." Similarly, adding production capacity, introducing related product "giveaways," or the provision of additional services along with price matching could, in effect, constitute "undercutting." If in the case of product giveaways or the provision of additional services the pricing results in the matching firm selling at prices below its average avoidable cost, the Bureau may take enforcement action.[43]

The jurisprudence under the abuse of dominant position provisions also addresses the concept of a business justification, albeit not in the context of alleged predatory pricing. Paragraph 79(1)(*b*) states *"that person or those persons have engaged in or are engaging in a practice of anti-competitive acts."* The jurisprudence under paragraph 79(1)(*b*) requires that an anti-competitive act have as its purpose an intended predatory, exclusionary or disciplinary effect on a competitor.[44] The argument that an anti-competitive act was in the interest of a dominant firm(s) is not sufficient to raise a valid business justification defence.[45] In order to support a defence of a valid business justification, there must be a credible efficiency or pro-competitive explanation, unrelated to an anti-competitive purpose, as to why the dominant firm engaged in the alleged anti-competitive conduct.[46]

Part 5: Competition Test

The abuse of dominant position provisions require the alleged anti-competitive pricing to have an actual or likely anti-competitive effect. Paragraph 79(1)(*c*) requires that "*the practice [of anti-competitive acts] has had, is having, or is likely to have the effect of preventing or lessening competition substantially in a market*." The impact on competition, not competitors, is the

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[42] *Boehringer Ingelheim*, *ibid*.

[43] The issue of "undercutting" was alleged in the Commissioner's application in *Canada (Commissioner of Competition) v. Air Canada* at para. 4(c) and at para. 104-107 and para. 121-125 CT 2001/002 available online at www.ct-tc.gc.ca. This issue, however, was not addressed in the Competition Tribunal's decision in *Air Canada*, supra note 35, which only addressed avoidable costs. (See Appendix II for more details).

[44] *Nutrasweet*, *supra* note 18. Also see *Commissioner of Competition v. Canada Pipe Company Ltd./Tuyauteries Canada Ltée*, 2006 FCA 233 at para. 64-73 [*Canada Pipe Company Ltd.*].

[45] *Laidlaw*, *supra* note 18 at 334-335.

[46] *Canada Pipe Company Ltd., supra* note 44 at para. 84-91.

ultimate focus of inquiry under the abuse of dominance provisions. Therefore, a practice of anti-competitive acts which actually or likely lead to the elimination of a competitor but do not have the effect or likely effect of substantially lessening or preventing competition in the relevant market, would not constitute a contravention of the abuse of dominant position provisions.[47]

Under the criminal predatory pricing provisions set out in paragraph 50(1)(*c*), the Crown must prove that the pricing policy has one of the following anti-competitive elements:

(a) the effect or tendency of substantially lessening competition,

(b) the effect or tendency of eliminating a competitor, or

(c) be designed to substantially lessen competition or eliminate a competitor.

The Bureau is of the view that the word "*tendency*" implies more than the mere possibility that the policy will result in an anti-competitive effect. To avoid characterizing potentially pro-competitive price reductions as anti-competitive, the Bureau interprets "*tendency*" as requiring evidence that the pricing policy, if continued, will *likely* have an anti-competitive effect.

In addition, it is an offence under paragraph 50(1)(*c*) for a firm to engage in a predatory pricing policy with the *design* to substantially lessen competition or eliminate a competitor. Simply adopting an aggressive pricing policy or a defensive pricing posture in light of new competition is not enough to trigger concern under the Act. The design of the policy must indicate a purpose of eliminating, disciplining, or predating a competitor. Evidence of anti-competitive intent is important in this context. The Bureau examines a number of factors, which may include, for example, the magnitude of the price cuts and the losses incurred, the absence of any other rationale for the price cuts (such as excess capacity in the market or the need to dispose of perishable goods), and documentary and oral evidence of the intent of the senior executives of the firm. The design of the policy can be inferred on the basis of these and other factors surrounding the introduction of the pricing policy.

5.1 Prevent or Lessen Competition Substantially

Generally, a substantial lessening of competition occurs when an anti-competitive practice or policy maintains or enhances market power. In conducting its analysis, the Bureau typically examines whether the relevant market would have been more competitive in the absence of the

[47] *Ibid.* at para. 69.

predatory conduct.[48] In the context of predatory conduct, the Bureau interprets preventing or lessening competition substantially as increasing the ability of a firm to exercise market power[49] to the extent that the firm can likely recoup its losses. As with assessing market power in the first instance, high barriers to entry and a lack of remaining competition are generally sufficient to establish that a firm has or will likely have the market power necessary to engage in recoupment.

Recoupment usually takes place when the firm that initiated the predatory campaign increases prices[50] in the relevant market following the elimination or disciplining of its competitors. Disciplining may result in a rival increasing its prices, or becoming less aggressive or otherwise restraining its competitive activities. Other forms of recoupment are also possible. Raising barriers to entry, for example, by acquiring a "reputation for predation" can make it easier for a firm to recoup losses (or preserve existing market power in other markets) following a period of predation such that actual or potential new entrants perceive a higher risk that entry will be unprofitable. As well, predation may be a rational strategy in order to preserve the long-term stability of an existing market structure, coerce participation in an illegal conspiracy or to establish an industry standard to exclude others or maintain market control.[51]

The Bureau will evaluate whether there are factors which reduce the probability of recoupment.[52] Generally, customers understand that it is not in their long term interest to have uncompetitive markets even if it means foregoing price reductions in the short run. Where there are large, sophisticated customers that are able to exploit supply alternatives in the market, the Bureau will examine whether there are strategies available to effectively counter recoupment such as stock piling of inventory or entering into supply contracts or alliances with the alleged target of the predatory campaign. In evaluating the viability of these counter-strategies, the Bureau will assess whether these actions would be profitable for customers or if they would be undermined by a "free rider" problem.[53]

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[48] This approach was endorsed by the Federal Court of Appeal in *Canada Pipe Company Ltd.*, *ibid*. at para. 38.

[49] Obiter comments in two decisions of the Competition Tribunal, *Tele-Direct Publications Inc, supra* note 20 at 199 and *NutraSweet*, *supra* note 18 at 43-45 support recoupment as an essential element of predation under the abuse of dominance provisions of the Act.

[50] *Supra* note 19. Recoupment can take non-price forms such as negatively affecting levels of service provided to consumers, product choice and/or product quality or innovation.

[51] See Patrick Boulton, Joseph F. Brodley & Michael H. Riordan, "Predatory Pricing, Strategic Theory and Legal Policy" (2000) 88 Geo.L.J. 2239 at 2267-2271.

[52] See for example, Frank H. Easterbrook, "Predatory Strategies and Counter Strategies" (1981) 48 University of Chicago Law Review 263.

[53] The latter can occur where each customer wishes to maximize their interests by buying from the predator at the low price while at the same time assuming that other customers will support the target firm to maintain the long-term competitiveness of the market. The ensuing lack of support for the target firm will render it unable to survive the period of below cost prices.

5.2 Eliminating a Competitor

The criminal predatory pricing provisions contemplate the elimination of a competitor as a basis for criminal liability. To conclude that a competitor has been eliminated, the Bureau must be satisfied that a competing firm has, in fact, gone out of business, been deterred from entering the relevant market, or is otherwise no longer in a position to be an effective competitor in a particular market. In general, however, the mere elimination of a competitor is not a sufficient basis for the Bureau to pursue predatory pricing under the criminal provisions, unless it is likely to substantially lessen or prevent competition and also meets the definition of "egregious" conduct outlined in Section 2.2.1 above.

In cases where it is alleged that below cost pricing would tend to eliminate a competitor, the Bureau examines evidence from the competitor showing its financial status and projections for its future viability in the market to determine whether elimination is a *likely* outcome. Whether the sunk cost assets of the eliminated competitor will likely remain in the relevant market either to be sold to a viable competitor or to be re-activated when pricing recovers are important considerations. Other factors such as the loss of brand name recognition and reputation as a viable competitor can also have a negative impact on competition in the relevant market. The Bureau is more likely to pursue a case when the assets of the eliminated firm are removed from the market or otherwise rendered unviable.

Part 6: Remedies and Written Opinions

There is a range of potential remedies available under the abuse of dominance provisions and the predatory pricing provisions. These, as well as Written Opinions under section 124.1 of the Act, are briefly described below.

6.1 Alternative Case Resolutions[54]

If the Commissioner, having investigated a complaint of abuse of dominance, is satisfied that the evidence supports an application to the Tribunal for a remedy, the Commissioner will normally communicate to the parties any preliminary concerns regarding the alleged contravention of the Act. The parties would then be afforded the opportunity to respond to the Commissioner's concerns and propose alternative means of addressing those concerns, and thereby avoid contested proceedings before the Tribunal.

Resolution of these matters is dealt with on a case-by-case basis. In most circumstances, the Commissioner's preference would be to have a remedy agreed upon by the parties set out in a consent agreement pursuant to sections 105 and 106 of the Act. In instances where an alternative (i.e. non-contested) course of action has been adopted to resolve competition issues, the

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[54] For further information see the Bureau's *Conformity Continuum Information Bulletin, supra* note 5.

Commissioner will issue a press release or an announcement on the Bureau's Web site to ensure that all interested parties are informed that the matter has been resolved.

6.2 Orders of the Competition Tribunal

Where, on application by the Commissioner, the Tribunal finds that the elements of subsection 79(1) are met, it may make an order prohibiting a respondent firm or firms from engaging in the practice of anti-competitive acts. In the case of predatory pricing, for example, while the Tribunal does not function as a price regulator, it could make an order prohibiting a firm from continuing to price below average avoidable cost. In addition, or alternatively, if the Tribunal finds that an order prohibiting the continuance of the practice is not likely to restore competition in the affected market, the Tribunal may, pursuant to subsection 79(2), make an order directing any such actions, including the divestiture of assets or shares, as are reasonable and necessary to overcome the effects of the practice of anti-competitive acts.[55]

Section 104 of the Act provides that where an application under Part VIII, which includes section 79, has been made, the Competition Tribunal may, on application by the Commissioner, issue an interim order as it considers appropriate.[56]

Section 66 of the Act sets out the penalties associated with failing to comply with an order of the Competition Tribunal. Any person who contravenes or fails to comply with such an order is guilty of an indictable offence and liable on conviction to a fine at the discretion of the court, or to imprisonment for a term not exceeding five years, or both. On summary conviction, an accused person is liable to a fine not exceeding $25,000 or to imprisonment for a term not exceeding one year.

6.3 Prosecution

If the Commissioner concludes that an egregious offence has been committed, evidence may be referred to the Director of Public Prosecutions with a recommendation that criminal charges be brought. The Director of Public Prosecutions will then decide whether or not a prosecution is in the public interest in accordance with the criteria set out in the *Federal Prosecution Service Deskbook*.[57] A person found guilty of an offence under paragraph 50(1)(*c*) may be imprisoned for a maximum of two years. A fine may be imposed in addition to, or in lieu of, a prison term.

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[55] To date, the Commissioner has not sought the divestiture of assets or shares in an application under section 79 of the Act. However, such remedy remains possible under the appropriate circumstances.

[56] The section provides that the Competition Tribunal is to consider the principles ordinarily considered by superior courts when granting interlocutory or injunctive relief, that the interim order will have such terms and shall have effect for such a period of time that the Competition Tribunal considers necessary and sufficient to meet the circumstances of the case, and once issued the Commissioner is to proceed as expeditiously as possible to complete the proceedings under Part VIII.

[57] See *Federal Prosecution Service Deskbook*, Chapter 20, available online at: www.justice.gc.ca.

6.4 Other Remedies

The remedies for allegations of criminal conduct are not limited to those resulting from a prosecution before the courts. Under section 34 of the Act, the Director of Public Prosecutions may apply to the court for a prohibition order for a period of up to ten years, to stop behaviour that constitutes, or is directed toward, the commission of an offence. In urgent circumstances, the Director of Public Prosecutions may apply for an interim injunction under section 33 to temporarily halt such behaviour pending a prosecution or the completion of proceedings under subsection 34(2).

6.5 Recovery of Damages

Section 36 of the Act provides a right of private action for the recovery of damages. This remedy is available if there has been a violation of the criminal provisions of the Act, or a failure to comply with an order of the Competition Tribunal or a prohibition order issued by a court. Recovery can be equal to the loss or damage suffered by the plaintiff.

6.6 Binding Written Opinions

The Bureau facilitates compliance with the law by providing various types of written opinions subject to fees. Company officials, lawyers and others are encouraged to request an opinion under section 124.1 of the Act on whether the implementation of a proposed business plan or practice would raise an issue under the legislation. Written opinions are based on information provided by the applicant and take into account previous case law, prior opinions and the stated policies of the Bureau. They are binding on the Commissioner when all the material facts have been submitted by, or on behalf of the applicant, and when these facts are accurate.[58]

[58] For more information on Written Opinions see *Competition Bureau Fees and Service Standards Policy* (Ottawa: Industry Canada March 2003) available online at: www.competitionbureau.gc.ca.

APPENDIX I - Hypothetical Case Examples

The following hypothetical case examples illustrate how the Bureau would apply the Act to various allegations of predatory conduct. By focussing on the key elements outlined earlier, it is hoped that the reader will derive a better understanding of when and why the Bureau is likely to take enforcement action in specific cases.

Case 1

Fact Set:

A competitor of Company A, a national wholesale distributor of a major brand of consumer products, has alleged that Company A is engaging in selling at below cost prices. While there is no dominant distributor in the market, there are several well-entrenched firms similar to Company A, one of whom has more than a 35 per cent share of the market. Company A, the third largest distributor, has 17 per cent of the market at present, which has declined about three per cent over the past two years.

Typically, each distributor supplies a wide range of products to retailers. As well, the manufacturers of the products have not established exclusive territories or other types of restrictions in their distribution networks.

Each distributor maintains warehouses and delivery facilities in several Canadian cities, and employs commissioned sales agents operating in the field. An American based distributor established a Canadian operation over the past year.

The customers in the market are retail outlets ranging in size from small independent stores to large national chains. The various competing brands of the products are somewhat differentiated in terms of both styling and operating features, but the major determining factor on the demand side of the market is price; that is, historically, the retailer's purchasing decisions about competing brands offering more or less the same quality features have been price-driven.

Company A, being aware of the complaint made to the Bureau by its competitor, has provided the Bureau with information which confirms that it recently lowered its prices considerably with respect to the products in question. Company A provided the Bureau with information which indicates that the reduced prices have at all times been greater than its average avoidable costs in respect to the products. Furthermore, it provided evidence showing that the short-run effect of the price reduction has been to secure additional market share at the expense of several of its competitors, some of whom have held firm in respect of their own pricing policies. The complainant submits that it would be unprofitable to match Company A's price reductions.

Discussion:

The Bureau's preliminary examination finds that conditions of entry into this type of distribution business are relatively easy. There are no institutional barriers present and sunk costs are not a

major factor in the start-up cost considerations of potential entrants because warehouse facilities can easily be converted to other uses.

There is no dominant firm in the market, and little brand loyalty on the part of buyers, all of whom are price-driven in their purchasing decisions and willing and able to switch from one supplier to another on reasonably short notice.

On the basis of favourable entry conditions and Company A's market share of 17 per cent, the Bureau would conclude that Company A does not have market power and is not likely to attain market power through predatory conduct, and would not pursue the complaint further. While the price reductions may well lead to reduced sales volumes and profits for some of Company A's competitors, the conduct is not anti-competitive. Moreover, Company A's prices are not below its average avoidable costs.

On its face, the pricing behaviour of Company A looks like an attempt to recapture lost market share through price competition in a highly fluid and dynamic market. Therefore, its price reductions do not contravene the Act.

Case 2

Fact Set:

Company A is a manufacturer of a product which is sold directly to large wholesalers serving the home construction industry. Five years ago, there were several manufacturers of the product but, currently, the market is served by only three firms. Companies B and C both allege that Company A has begun using a low-pricing strategy to drive one or both of them from the market.

With a share of about 40 per cent of sales of the product, Company A is the largest manufacturer. Companies B and C each have about 30 per cent of product sales.

All of the firms are operating at well below their respective production capacities, as a result of declining demand brought on by the growth in market acceptance of several close substitute products. These substitute products are made of different materials and are about 10 per cent lower-priced than those offered by Companies A, B and C. All three companies are currently unprofitable.

The conditions of entry into the industry are relatively easy. The raw materials used in the industry are in abundant supply at competitive prices. Sunk costs do not represent a significant barrier to entry since the capital equipment used in the production process can, for the most part, be put to alternative uses. There is little product differentiation and no evidence of strategic behaviour on the part of incumbents.

Prices have been declining in the industry for more than one year but, in the face of continuing sales volumes lost to the close substitute products, Company A has now lowered its price to a

level just above its average avoidable cost, but less than its average total costs. One of the complainants has provided the Bureau with a document from Company A purporting to demonstrate that Company A intends to eliminate its competitors from the industry. In a memorandum to its sales staff and announcement to its customers, Company A explained that it was lowering its price to make the product "more competitive within the construction industry."

Discussion:

In these circumstances, the Bureau likely would define the relevant market to include the close substitute products. It is clear that the close substitute products have a constraining effect on pricing of the product supplied by Companies A, B and C. Additionally, ease of entry would constrain Company A's ability to increase prices above competitive levels. On the facts, the reason for the price change by Company A appears to be to protect its business from being eroded by suppliers of close substitute products. In this case, the Bureau would not start a formal inquiry because Company A does not likely have market power, and its prices are above its average avoidable costs. In effect, Company A was engaging in rational loss-minimizing behaviour in the face of excess capacity and competition from low-priced substitute products. Therefore, the matter would not warrant further investigation.

Case 3

Fact Set:

Company A is the largest of several vertically-integrated firms supplying an intermediate product. The company has a market share in excess of 50 per cent. Its largest rival's share is about 12 per cent, with the remaining firms accounting for less than 10 per cent each.

There has been steady market growth each year and demand is projected to increase considerably over the next 10 years in the industry. With no close substitutes in the market for their products, most firms are known to be considering investing in the expansion or modernization of their production facilities over the next two years.

The vertically-integrated firms control, for the most part, the sources of raw materials used in their production processes. In effect, their manufacturing units are seen as captive customers for the raw materials which they control, and little third party trade takes place in respect of these raw materials. The equipment used in their production process is highly specialized and accounts for a large proportion of start-up costs. As a result, sunk costs are a significant barrier to entry. In addition, economies of scale play an important role on the product side. Most, but not all of the market participants enjoy significant scale economies in the operation of their regional plants. The customer side of the market is characterized by numerous buyers, both large and small, all engaged in the manufacture of finished goods. The products supplied by Company A and its competitors represent input costs to the buyers, and they are extremely price-conscious in their purchasing behaviour. Quality being equal, they will switch from one supplier to another when provided with even a small price incentive to do so. Price cutting by one firm in the industry has tended, in the past, to be matched quickly by other suppliers. For the most part, prices and

market shares have tended to be fairly stable in recent times.

Company A has disrupted this stability by reducing its prices across the board by over 25 per cent. Two of its smallest competitors have independently claimed to the Bureau that the purpose of Company A's price-cutting behaviour is to drive them from the market, whereupon they expect that prices would rise to levels higher than those prevailing before the price reductions. Each of the complainants had been seriously contemplating expansion of production facilities to bring them closer to realizing the scale economies enjoyed by the larger firms in the industry. However, with the recent deep decline in prices, these plans have been put "on hold" as the companies financial projections indicate that expansion would be unprofitable at the prevailing low prices.

According to the complainants, current market prices are very close to, if not below, their average avoidable cost of production.

Discussion:

The industry is characterized by relatively difficult conditions of entry. Company A occupies a large part of the market given its 50 per cent market share, whereas not one of its competitors has a share of more than 12 per cent. Company A's market share coupled with high barriers to entry suggest that Company A may have the market power to influence industry output and prices. As well, the complainants' expansion plans have been suspended as a result of Company A's price reductions. The price-cutting by Company A is contrary to what one would expect in the face of increasing market demand with no external impetus for the behaviour.

The fact that market prices are close to, if not below the complainants' average avoidable costs is not sufficient to establish predation but it is interesting nonetheless. In light of all of the available information at the preliminary stage, the Bureau would be concerned enough to examine whether Company A's prices are below its average avoidable costs. Some of the market effects of the pricing behaviour are already evident, in that two competitors have forestalled their expansion plans in the face of below cost market prices. Should prices remain at their present levels for a significant period of time, one or more competitors could be eliminated and competition harmed.

Even if a competitor is not forced to exit the market, the Bureau would want to know if the purpose of Company A's price cutting was to demonstrate the extent of its market power. Through this form of strategic behaviour, the company may have conditioned its competitors to accept its role as undisputed price leader and may have deterred them from expanding their facilities in a way that would have them compete more vigorously in the future.

In any event, with little chance of quick, effective entry to the market, Company A will likely be able to exercise market power, which was possibly enhanced by its behaviour. With the ability to raise its prices back to previous levels, or even higher, the company would be able to recoup its losses and ultimately profit from its strategy to the detriment of consumers.

For these reasons, the Commissioner would have reasonable grounds to initiate an inquiry under the abuse of dominance provisions. This would involve a careful scrutiny of all of the relevant circumstances surrounding Company A's pricing behaviour. In all likelihood the latter would necessitate the use of formal investigative powers available to the Commissioner to determine whether Company A's prices are below its avoidable costs as well as whether the continuation of the practice would likely prevent or lessen competition substantially. If the results of the inquiry indicate that the *Competition Act* has been violated, the Bureau would likely make an application to the Competition Tribunal for a remedial order if the Bureau and Company A could not resolve the matter on consent.

Case 4

Fact Set:

Company A is the largest provider of transportation services to residential and commercial/institutional customers in a large Canadian city. Specialized trucks are used to provide service for each category of customers. Traditionally, Company A has secured at least one third of the residential business available in the city by bidding against a large number of potential competitors for contracts tendered by the municipal tendering authority. Last year, Company A acquired its largest competitor and assumed service for an additional residential contract as well as other commercial/institutional customers. Over the years, Company A has acquired a number of small start-up competitors before they became large enough to bid for municipal contracts or some of the larger accounts in the commercial/institutional market. Consequently, Company A has almost 70 per cent of the residential market in the city and about 60 per cent of the commercial/institutional market. There are two other major competitors in the city: Company B and Company C.

Commercial/institutional customers often have complex needs based on the number of weekly service requirements and the nature of the goods being transported. Customers usually enter into standard fixed term contracts with a supplier or put out tenders for this type of service. Commercial/institutional customers range from small restaurants up to very large accounts such as shopping malls, hospitals and universities.

Recently, a new competitor based in a commuter community north of the city has attempted to break into the commercial/institutional market in the city by bidding on public tenders issued by the university and several of the hospitals in the downtown core, as well as by soliciting commercial/institutional accounts in the northern fringe of the city. After winning a major contract with one of the hospitals, the General Manager of Company A arranged a dinner meeting with the President of the new competitor. Over drinks, the General Manager of Company A suggested that the two companies should work together indicating that the tender for the university will be coming out in a month and Company A intends to keep the business. In return for submitting an inflated bid, he said that Company A would not enter into the new competitor's community and would possibly subcontract some work to the new competitor. The President of the new competitor refused to go along, stating that bid-rigging is illegal.

Over the next two months, Company A submitted a very low bid for the university tender and slashed prices dramatically for new accounts in the northern fringe of the city where the new competitor was starting to make inroads. As well, sales representatives for Company A approached the new competitor's commercial/institutional customers in the city offering to service contracts at a 50 per cent price reduction, and cover any legal costs if the new competitor started lawsuits for breach of contract. The new competitor had to match Company A's price cuts to stay competitive in the market even though it was not profitable to do so.

After a few months, the President of the new competitor contacted the Bureau and recounted the events above.

Discussion:

The extent of competition in the industry varies according to each industry segment. Generally, the residential market appears to be competitive. While Company A has a large market share, the very large value of the municipal contracts available likely attract a sufficient number of actual and potential bidders so that it is unlikely that Company A has market power in this market. Below cost pricing in this market would likely be an indicator of vigorous competition as recoupment of losses would appear to be unlikely following a period of below cost pricing.

Competitive conditions in the commercial/institutional market are not favourable. Barriers to entry are high, new entrants need to invest in market specific assets and most customers have fixed term contracts with the incumbent suppliers that are difficult to terminate. This provides Company A with a secure revenue base and the ability to price discriminate. Company A has dominant market share and it is possible that the two remaining competitors tacitly or explicitly coordinate their activities in an anti-competitive fashion with Company A. Finally, Company A's price reductions have rendered the new competitor's business in the City unprofitable.

The Bureau would be concerned that Company A's price reductions are below its average avoidable costs. Since truck operating costs are the major variable cost item in the industry and are relatively fixed across competitors, there is a strong probability that Company A's price reductions are below its avoidable costs. Company A's dominant market position along with the suggestion that incumbent competitors coordinate prices suggest there is a strong possibility of recoupment of losses in the event that the new competitor's competitive activity is inhibited or if it exits the market.

Given that Company A made overtures to the new competitor to participate in an illegal bid-rigging scheme and insinuated that there is an on-going conspiracy among the three major competitors in the market, there is evidence that the conduct of Company A is egregious. Company A appears to be motivated by a desire to bring the new competitor into a cartel arrangement with the other firms in the market.

In these circumstances, the Bureau would commence an inquiry under the criminal predatory pricing provision under paragraph 50(1)(*c*). As well, the Bureau would pursue any information pertaining to a possible conspiracy and/or bid-rigging offence.

APPENDIX II: Summary of Case Law

Case: ***R. v. Producers Dairy Ltd.*** **(1966), 50 C.P.R. (2d) 265**

Key facts

Product market:	Dairy (milk)
Geographic market:	Ottawa area (Ontario)
Market share of accused:	First or second in the market
Venue:	Ontario Court of Justice
Charges laid:	Under s. 34(1)(*c*) of the *Combines Investigation Act** now s. 50(1)(*c*) of the *Competition Act*.
Indictment period:	November 16, 1961 - November 18, 1961
Trial outcome:	Charges dismissed
Appeals:	Appeal dismissed June 8, 1966 (Ontario Court of Appeal)

Pricing strategy/policy

- Clark Dairy alleged that its competitor Producers Dairy Ltd. sold homogenized milk and two per cent milk at prices unreasonably low with the effect of substantially lessening competition in the dairy market.
- For a two day period, Producers Dairy Ltd. gave away one free quart of homogenized milk to each customer with the purchase of either a quart of milk for 23 cents or a half gallon of milk for 45 cents.

Key elements of the decision

- The adoption of a temporary measure to counteract a competitive move does not constitute a "policy"within the meaning of s.34(1)*8*).
- The reduction in price was established to match or meet Clark Dairy's low prices.
- The response of Producers Dairy Ltd. was appropriate under the circumstances.

Other issues

- The Crown's argument that Producers Dairy Ltd. intended to keep its low prices in effect

and reduce retail prices further was rejected.

* The *Combines Investigation Act*, R.S.C. 1970, c. C-23 was repealed and replaced by the *Competition Act*, R.S. 1985, c. C-34, in June 1986.

Case: **_R. v. Carnation Co._ (1969), 58 C.P.R. 112 (C.A.)**

Key facts

Product market:	Evaporated milk
Geographic markets:	Alberta, British Columbia and Ontario
Market share of accused:	Alberta: 20 per cent; B.C.: 10-11 per cent
Venue:	Alberta Supreme Court
Charges laid:	October 11, 1966 under s. 34(1)(*b*) of the *Criminal Code* (now s. 50(1)(*b*) of the *Competition Act*).
Indictment period:	December 10, 1959 - August 1, 1960
Trial outcome:	Accused acquitted December 15, 1966
Appeals:	Appeal dismissed March 7, 1969 (Alberta Supreme Court, Appeal Division)

Pricing strategy/policy

- In 1959, a company doing business under the name Alpha commenced supplying evaporated milk in Alberta and British Columbia at prices lower than Carnation's. In response, Carnation offered a $1.96 reduction off each case of milk it sold in British Columbia to match Alpha's prices.

- The Crown alleged that Carnation adopted a policy of selling evaporated milk in Alberta and British Columbia at prices lower than it charged in Ontario.

Key elements of the decision

- Carnation resorted to a "temporary expedient" to meet an aggressive competitor.

- The fact that Carnation may have sought to eliminate its competitors' aggressive behaviour was an incident in a price war and not an indication of Carnation's intent to lessen competition.

Other issues

- Canadian competition law does not prevent a competitor "within legal limits" from reacting to an aggressive competitor.
- The court rejected the argument that Carnation was depriving its competitors of the various practices which contributed to their progress.

Case:	***R. v. Hoffman La Roche Ltd.* (1980), 28 O.R. (2d) 164 (H.C.J.) affirmed 33 O.R. (2d) 694 (C.A.)**

Key facts

Product market:	Prescription drugs (librium and valium)
Geographic market:	Canadian hospital market
Market share of the accused:	95 per cent of valium sales to hospitals
Venue:	Ontario Court of Justice
Charges laid:	Under s.34(1)(*c*) of the *Combines Investigation Act* (now paragraph 50(1)(*c*) of the *Competition Act*).
Indictment period:	January 1, 1968 - November 30, 1974
Trial outcome:	Accused found guilty February 5, 1980, on the charge of having engaged in a policy of giving away free valium to hospitals over a six month period.
Appeals:	Decision upheld October 6, 1981 (Ontario Court of Appeal)

Pricing strategy/policy

- In 1970, a new competitor, Frank Horner Ltd. (Horner), entered the valium market supplying a generic brand of valium and offering discounts and free tablets.

In response to Homer's actions, Hoffman - LaRoche engaged in four separate policies:

- Selling valium to hospitals at a zero price during a six month period.
- A one year free supply of librium was offered to hospitals with the purchase of 15mg and 25mg tablets at regular prices.

- $1 sales of librium to governments purchasing authorities.
- One free unit was offered to customers with the purchase of one or more units of librium or valium.

Key elements of the decision

- Policy of selling at prices unreasonably low includes giving away articles.
- Hoffman - La roche's reaction to the competition was unreasonable in the circumstances.
- Circumstantial evidence was sufficient to determine predatory intent.

Other issues

- Response to competitor's actions must be reasonable as to price in all circumstances.
- Cost/price comparison is not determinative of whether or not a price is "unreasonably low" unless the price is clearly above cost (i.e. above cost prices cannot be unreasonable).
- Other factors to consider: duration of price reductions, competitive circumstances, existence of legitimate long-term economic benefits and whether accused acted in "self-defence."

Fines and other remedies

Hoffman - La Roche was fined $50,000. The Crown's appeal of the sentence was dismissed.

Case: ***R. v. Consumers Glass Co.*** **(1981), 33 O.R. (2d) 228**

Key facts

Product market:	Small plastic cup lids
Geographic market:	Canada
Market share of accused:	62 per cent
Venue:	Ontario Court of Justice
Charges laid:	December 1976 under s. 34 (1)(*c*) of the *Combines Investigation Act* (now paragraph 50(1)(*c*) of the *Competition Act*).
Indictment period:	October 16, 1975 - March 31, 1978

Trial outcome: Accused acquitted June 17, 1981

Appeals: n/a

Pricing strategy/policy

- Amhil Enterprises Ltd. (Amhil) alleged that its competitor Consumers Glass Co. Ltd. (Consumers Glass) engaged in a policy of selling plastic lids at unreasonably low prices with the design of eliminating a competitor from the market.
- In response to Amhil's entry into the market, Consumers Glass offered discounts of up to 21 per cent for customers who bought all their cup lids from it in an attempt to retain its market share.

Key elements of the decision

- Where chronic excess capacity exists in a market, an accused cannot be said to have sold at unreasonably low prices regardless of its intent if, at all times, it sold at prices above its average marginal cost.
- Selling at prices above average variable cost of production does not constitute selling at unreasonably low prices.
- Predatory pricing does not exist where the accused is only minimizing its losses.

Other issues

- In deciding whether a price is unreasonably low, the court must bear in mind that the purpose of the Act is to protect the public interest in free competition.
- The context within which prices are being applied is to be considered in determining price reasonableness.
- The Crown's argument that Consumers Glass should simply have shared the market with its competitor by keeping its price above average costs was rejected by the Court.
- The Crown's argument that Consumers Glass "passed up" opportunities to raise prices and thereby reduce losses was also rejected.

Case: ***947101 Ontario Ltd. (Throop Drug Mart) v. Barrhaven Town Centre Inc.*** **(1995), 121 D.L.R. (4th) 748 (Ont. Gen. Div.)**

Key facts

Product market: Dispensing of prescription drugs

Geographic market: Ottawa-Carleton area (Ontario)

Market share of accused: n/a

Venue: Ontario Court of Justice

Allegation: 947101 Ontario Ltd. filed a statement of claim under s. 36(1) of the *Competition Act* alleging, *inter alia*, a violation of paragraph 50(1)(*c*) the Act.

Relevant period: n/a

Trial outcome: Allegation dismissed January 9, 1995

Appeals: Application for leave to appeal to the Ontario Court of Appeal was dismissed March 24, 1995

Pricing strategy/policy

- Lease dispute between Barrhaven Town Centre Inc. (Barrhaven) and 947101 Ontario Ltd. led to several accusations including that a pharmacy operated by Loblaws located in Barrhaven was charging a dispensing fee below cost.

Key elements of the decision

- No injunction may be obtained by a plaintiff against predatory pricing unless the person seeking the injunction can establish that the conduct in question would give rise to a cause of action in favour of the plaintiff.

Other issues

- The term “unreasonably low” means something like “unreasonably low having regard to the purpose of the *Competition Act* to foster competition and to inhibit anti-competitive practices.”

- The court concluded that there was no evidence that the pricing policy of the accused had been established to harm its competitor’s business.

Case: ***R. v. Perreault*** **[1996] R.J.Q. 2565 (C.S.*)***

Key facts

Product market: Driving Schools

Geographic market:	Sherbrooke area (Quebec)
Market share of accused:	32 per cent
Venue:	Québec Superior Court
Charges laid:	Under paragraphs 45(1)(*c*), 50(1)(*b*), 50(1)(*c*), and 61(1)(*a*) of the *Competition Act*
Indictment period:	1987-1995
Trial outcome:	Accused convicted by jury on all counts June 15, 1996
Appeals:	n/a

Pricing strategy/policy

- Mr. J. Perreault, the owner of a driving school with operations in Magog and Sherbrooke, was accused of the following violations of the *Competition Act*: conspiracy with other driving schools to reduce prices of driving courses, predatory pricing practices and price maintenance.
- Perreault engaged in a policy of deliberately charging $31 to $51 less than the prices of competitors over a two year period in order to drive them out of the market.

Key elements of the decision

- Perreault intentionally maintained a low pricing policy designed to eliminate competitors.
- Planned, repetitive, and intentional acts of Perreault had very damaging effects on competitors and consumers.

Other issues

- Perreault was also convicted of conspiracy under s. 45 and price maintenance under s. 61.
- Conduct of accused continued even after a criminal investigation had begun.
- Accused attempted to maintain prices by threatening competitors.

Fines and other remedies

Mr. J. Perreault was sentenced to a one year term of imprisonment.

Case:	***Boehringer Ingelheim (Canada) Inc. v. Bristol-Myers Squibb Canada Inc.* (1998), 83 C.P.R. (3d) 51**

Key facts

Product market	Anti-cancer Drug (TAXOL)
Geographic market:	Canada
Market share of defendant:	94 per cent
Venue:	Ontario Court of Justice
Allegation:	The plaintiff filed a statement of claim under s. 36(1) of the *Competition Act* alleging a predatory pricing violation the Act.
Relevant period:	n/a
Trial outcome:	Summary judgement dismissing the predatory pricing claim rendered October 9, 1998.
Appeals:	n/a

Pricing strategy/policy

- Bristol-Myers Squibb had a patent conferred monopoly on the drug TAXOL until Boehringer Ingelheim entered the market in July 1995 and began selling a generic product at prices lower than those of its competitor. In response, Bristol-Myers Squibb matched, and in some instances, undercut, Boehringer Ingelheim's prices.

- Based on allegations that Bristol-Myers Squibb engaged in predatory pricing, Boehringer Ingelheim sought an injunction to prevent its competitor from selling the drug TAXOL at prices lower than its average total cost.

Key elements of the decision

- A price cannot be predatory when the price reduction is made to meet a competitor's lower prices.

- Price matching is not an unfair practice, even if below average cost.

Other issues

- Competitors must be allowed to meet prices as long as they do so within reason.

- Selling below cost can be justified in order to meet the low prices of a competitor.
- The phrase "unreasonably low" is not defined by economic theory - rather, it is a flexible provision used by the courts to assess all the circumstances of sales.

Case: ***Canada (Commissioner of Competition) v. Air Canada,*** **(2003), 26 C.P.R. (4th) 476(Comp. Trib.)**
Key facts

Product market:	Air Passenger Services
Geographic market:	Seven City Destination Pairs (i.e. routes) in Atlantic and Central Canada
Market share of respondent:	80 per cent to 100 per cent depending on the route*
Venue:	Competition Tribunal
Application filed:	March 5, 2001
Relevant period:	April 1, 2000 to March 5, 2001
Tribunal decision:	July 22, 2003, on the Phase I portion of the matter
Appeals:	Further to a settlement of the matter, Air Canada agreed not to appeal the Competition Tribunal's decision

Pricing strategy/policy

- The Commissioner alleged that Air Canada responded to the entry of WestJet Airlines Ltd. and Can Jet Airlines in the routes in question by increasing its capacity and/or decreasing its fares, in a manner that did not cover the avoidable costs of operating the flights.

Key elements of the decision

- In the summer of 2000, airline specific amendments and related regulations came into force which effectively made operating or increasing capacity on a route at fares that do not cover the avoidable cost of the service an anti-competitive act under section 78 of the Act. The Phase I decision addressed:

  i) the categories of costs that were avoidable;

ii) the relevant time period;

iii) the relevant unit of capacity; and

iv) the treatment of "beyond revenues" in applying the avoidable cost test.

The Tribunal generally adopted the approach advocated by the Bureau on how to apply the avoidable cost test.

- As the avoidable cost test was stipulated by the legislation, the issue of whether avoidable cost is an appropriate or superior measure of cost for determining predation did not arise. The Tribunal noted that failing the avoidable cost test does not lead to a conclusion that Air Canada engaged in a *practice* of anti-competitive acts that constitute an abuse of dominant position.

Other issues

- In May 2001, the Tribunal ordered that the matter be heard in two phases. Phase I addressed the application of the avoidable cost test in two sample routes while Phase II was to address the balance of the application. The Phase I hearing was adjourned twice following the events of September 11, 2001.

- In April 2003, Air Canada filed for protection under the *Companies' Creditors Protection Act*, and the Phase II hearing was accordingly adjourned. In October 2004, the Commissioner withdrew the section 79 application on the basis that Air Canada had determined that it would not appeal the Phase I decision of the Competition Tribunal as well as on the basis that significant changes had taken place in the Canadian airline industry since the litigation began in 2001.

Orders and other remedies

Not applicable.

*The Commissioner's application alleged that Air Canada *substantially or completely controlled* the seven routes at issue, that Air Canada's market share exceeded 80 per cent on the top 200 routes in Canada which account for more than 90 per cent of air passenger revenue in Canada, and that Air Canada's market share on the routes between Toronto and Saint John, Moncton and Charlottetown approached 100 per cent. In its response to the Commissioner's application filed on April 5, 2001, Air Canada, *inter alia*, denied the allegation that it *substantially or completely controlled* the routes in question citing new entry and network effects among other factors. As the Phase II hearing did not take place as a result of the settlement mentioned above, the Competition Tribunal never addressed the alleged dominance of Air Canada.

Canada