Submission on Draft Guidelines on Unreasonably Low Pricing

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association is a national association representing over 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved by the Executive Officers as a public statement by the National Competition Law Section of the Canadian Bar Association.

Submission on Draft Guidelines on Unreasonably Low Pricing

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (the Section) welcomes the opportunity to comment on the *Draft Enforcement Guidelines for Illegal Trade Practices: Unreasonably Low Pricing Policies under Paragraphs 50(1)(b) and (c) of the Competition Act* (the Guidelines) issued by the Competition Bureau. The Section strongly supports the Bureau's continuing efforts to clarify its enforcement policy by publishing enforcement guidelines, information bulletins, press releases and other interpretative aids to the business community in Canada.

The Section agrees with the Bureau's assessment that the 1992 Predatory Pricing Guidelines (the 1992 Guidelines) need revision. However, we question the appropriateness of the Bureau's timeline for such a revision in light of the pending *Air Canada* case before the Competition Tribunal and the recommendation of the House of Commons Standing Committee on Industry, Science and Technology that the predatory pricing provisions be repealed and dealt with as civil abuses of dominant position.

The Section is very concerned about the Bureau's recommendation to eliminate recoupment as an essential prerequisite to find that a firm has engaged in predatory conduct. We are not aware of any change in the law that would be a basis for this significant change in enforcement policy.

II. TIMING CONCERNS

We recognize that the Bureau's enforcement policies and interpretation of the *Competition Act* will change in response to developments in economic theory, market conditions, judicial pronouncements and legislative amendments. The utility of the Bureau's enforcement guidelines depends crucially on ensuring that they are regularly reviewed and updated to keep pace with such developments. As a result, we agree that it is appropriate to revise the 1992 Guidelines. However, we note that the Competition Tribunal's decision in the pending *Air Canada* case may have a significant impact on the interpretation and enforcement of the predatory pricing provisions – particularly as they may relate to the acceptance and clarification of an avoidable cost test.

Accordingly, in the Section's view, the Bureau should wait for the Competition Tribunal's decision in the *Air Canada* case prior to issuing the Guidelines in final form. That way, the Guidelines could reflect the Competition Tribunal's decision. Moreover, since the Guidelines were released, the House of Commons Standing Committee on Industry, Science and Technology has recommended that the criminal predatory pricing provisions be repealed and dealt with as civil abuses of dominant position. We believe that the Bureau should wait to see whether a consensus develops on eliminating or retaining the predatory pricing provision in its current form prior to issuing new guidelines on the enforcement of such a provision.

III. THREE PRINCIPAL CHANGES FROM THE 1992 GUIDELINES

The Guidelines reflect the following three principal changes to the Bureau's approach concerning allegations of unreasonably low pricing. First, the ability to recoup losses would no longer be considered the primary screening criterion. Second, in carrying out the cost-revenue analysis to determine whether a price is unreasonably low, the Bureau would use an "avoidable cost" standard as opposed to an "average variable cost" or "average total cost" standard. Third, the

Guidelines would include a new section dealing specifically with unreasonably low pricing resulting from market expansion.

The Section welcomes the statement that deals specifically with the application of the predatory pricing provisions where a new entrant into a market engages in low pricing. However, the Section is opposed to the Bureau's position that recoupment be eliminated as a pre-requisite to establish a violation under paragraphs 50(1)(b) and (c) of the *Act*. Further, it is difficult for the Section to comment meaningfully on the Bureau's recommendation to adopt the avoidable cost standard – as opposed to average variable cost – in the cost revenue analysis used to determine below-cost price selling. This is because the Guidelines provide very little guidance on the meaning of avoidable costs. The Section's concerns with these two principal changes from the 1992 Guidelines are discussed below.

A. Recoupment is an Essential Element of Predation

The essence of the economic theory of predatory pricing is best illustrated by the example of a dominant firm setting its prices so low over a sufficient period of time that the firm may drive one or more of its competitors from the market or deter other companies from entering the market. Once competitors exit the market or are successfully deterred from entering (thereby creating a less competitive market), the predator would be expected to raise prices significantly in an attempt to recover the costs incurred (i.e. losses or foregone profits) during the period of predation.

The economic literature provides a number of specific theories of predatory pricing by a dominant firm, demonstrating that in theory the practice can be rational. The theory of financial market predation, for example, provides a foundation for the argument that established firms have greater internal capital and access to capital markets than do potential "prey" and can therefore last out a

(below-cost) price war.[1] In such a situation, a dominant firm might price below cost to eliminate its rival through the depletion of internal capital, and then raise prices to monopoly levels.[2]

From a policy perspective, it is important to recognize that there may be instances where firms are removed from the market, or are prevented from entering, but where consumer prices remain the same or decline. Thus, while the interests of consumers and competitors may coincide in certain circumstances, it is not sufficient to state that consumers will necessarily be harmed simply because some firms are eliminated and the market thereby becomes more concentrated. The Bureau has therefore indicated that its enforcement approach will focus on the impact on competition when examining predation complaints.

In keeping with economic principles, the 1992 Guidelines indicated that predatory pricing would only be considered harmful if the preying firm raised or was expected to raise prices significantly to recover its losses or foregone profits after its low prices had caused a competitor to exit or had deterred the entry of new competitors. Accordingly, the Bureau would not take enforcement action against a low-pricing firm unless the firm had market power (i.e., the ability to maintain prices above competitive levels for a significant period of time).

While an ability to recoup losses will continue to be a factor to be considered, the Guidelines indicate that it is not a precondition to establish the offence of predation under the *Act*. This represents a fundamental change to the

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1 Patrick Bolton and David Scharfstein, "A Theory of Predation Based on Agency Problems in Financial Contracting" (1990) 80 *American Economic Review* 93.

2 In signaling theories of predation, a better-informed predator sells at low price to mislead its rival into believing that market conditions are unfavourable. For example, in cost-signaling models, a predator drastically reduces price to induce beliefs on the part of the prey that the predator has lower costs, when in fact the predator has no cost advantage. (Januscz A. Ordover and Garth Saloner, "Predation, Monopolization and Antitrust," in *Handbook of Industrial Organization* (Richard Schmalensee and Robert Willig, eds.) (New York: Elsevier Science Publishing, 1989) at 537. The beliefs of lower cost discourage entry or induce exit on the part of the prey.

interpretation and enforcement of Canada's criminal predatory pricing law for which there is no basis in the jurisprudence. The Section is strongly opposed to the Bureau's interpretation. It is also inconsistent with established economics – predatory pricing would result in a substantial lessening of competition only if there were some reasonable prospect for recoupment. Thus, recoupment is a necessary condition for determining that predatory actions are having the effect of or tending to substantially lessen competition.

In dealing with the meaning and significance of the recoupment concept, the language of the Guidelines is confusing. Recoupment may not be a necessary condition if the enforcement approach is geared to preventing pricing activity that is having the effect of or tending to *eliminate a competitor*. However, recoupment clearly is required if the enforcement approach is geared to preventing pricing activity that is having the effect of or tending to *substantially lessen competition*. As the Guidelines indicate that the Bureau's enforcement objective is to safeguard competition, then recoupment plays a larger role in the analysis than simply being another factor for consideration.

An example of this confusion is found at paragraph 64 where the Bureau articulates its rationale for abandoning recoupment as a primary screening criterion as follows:

> Low-pricing behaviour can also be motivated by reasons other than recoupment. For example, it may be rational for a firm to adopt a low-pricing policy and sacrifice present profits in order to preserve the long-term stability of an existing market structure. Additionally, a low-pricing policy could assist in establishing an industry standard to exclude others or maintain market control.[3]

The examples described above are in fact examples of recoupment. Preserving the long-term stability of an existing market structure presumably means preserving prices that are above competitive levels, thereby recouping the costs involved during the period of low pricing. Similarly, if the firm maintains market

3 Footnotes excluded.

control, this again indicates that it has achieved market power and has set prices above competitive levels – again allowing the firm to recoup any forgone revenues or losses incurred during the low-pricing period.

By providing such an explanation for why recoupment may not be necessary, the Guidelines appear to be adopting a narrow definition of recoupment. Recoupment should be defined in the Guidelines as the ability to recover forgone revenue or losses incurred during the low pricing period. This requires the alleged predator to have market power in the period when recoupment is occurring.

To the extent that the Bureau is actually abandoning recoupment as a necessary element of criminal predation, the approach contradicts economic evidence relating to predation and is in stark contrast to the United States law on predation. In the Section's view, abandonment of recoupment as an essential element of establishing the offence of predation will criminalize legitimate aggressive pricing behaviour and competitive rivalry to the detriment of consumers and the Canadian economy. It is simply not rational for a firm to engage in below-cost pricing unless the firm has a reasonable expectation of recouping its investment in below-cost prices. This concept was succinctly stated by the United States Supreme Court in *Brooke Group LDT v. Brown & Williamson Tobacco Corp.*:

> For the investment to be rational, the [predator] must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered." *Matsushita supra, at 588-589.* Recoupment is the ultimate object of an unlawful predatory pricing scheme. It is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution towards the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

> That below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: it is axiomatic that the antitrust laws were passed "for the protection of competition, not competitors"....Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws;...
>
> For recoupment to occur, below-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm's rivals, whether driving them from the market, or as was alleged to be the goal here, causing them to raise their prices to supracompetitive levels within a disciplined oligopoly. This requires an understanding of the extent and duration of the alleged predation, the relative financial strength of the predator and its intended victim, and their respective incentives and will... The inquiry is whether, given the aggregate losses caused by the below-cost pricing, the intended target would likely succumb. If circumstances indicate that below-cost pricing could likely produce its intended effect on the target, there is still the further question whether it would likely enter competition in the relevant market. The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, included the time value of money invested into it. As we have observed on a prior occasion, "in order to recoup their losses, [predators] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices". *Matsushita 475 U.S. at 590-591.*[4]

For the reasons discussed above, recoupment is critical to the success of any predatory pricing endeavour. The failure to prove recoupment is fatal to a predatory pricing claim.

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[4] 509 U.S. 209 at 224 (1993).

The significance of recoupment to a predatory pricing claim was recently commented on by William Kolasky, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice as follows:

> We view recoupment as an essential element of the test because, as the Supreme Court has said, "cutting prices in order to increase business often is the very essence of competition". There are many legitimate, procompetitive reasons for charging prices that are below cost, and there is no rational reason to deny consumers the benefits of lower prices in the absence of any realistic prospect for recouping short-term losses through later supracompetitive pricing.[5]

B. Clarification of the Avoidable-Cost Standard is Required

Under the 1992 Guidelines, a price above average total cost would not be considered unreasonably low. A price below average variable cost was likely to be regarded as unreasonably low unless there was a clear justification, such as the need to sell off perishable inventory. The Bureau's conclusion about the reasonableness of a price between average total cost and average variable cost would depend on the circumstances.

It is important that the Bureau's analysis of whether a price is unreasonably low consider "more than just the amounts of the prices or the relationship to costs". However, it is equally important that the Guidelines provide sufficient certainty to avoid deterring vigorous and aggressive price competition.

The Bureau now proposes to use an avoidable cost standard in determining whether a price is unreasonably low. The Guidelines define avoidable costs as "all costs that could have been avoided by a firm had it chosen not to sell the product(s) in question".

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5 William J. Kolasky, Deputy Assistant Attorney General Antitrust Division U.S. Department of Justice, *North Atlantic Competition Policy: Converging Toward What? Speech before the BIICL Second Annual International and Comparative Law Conference London*, England May 17, 2002 [footnotes excluded], available at http://www.usdoj.gov/atr/public/speeches/11153.htm.

Apart from indicating that avoidable costs may differ depending on the time period in question and generally do not include sunk costs (i.e. costs that have already been incurred and could not be recovered in a wind-up of a firm's operations), there is very little guidance on the meaning of avoidable costs. In contrast, section 2.2.2 of the 1992 Guidelines included specific examples of costs which would be considered variable and the *Draft Enforcement Guidelines on the Abuse of Dominance in the Airline Industry* contained a very detailed discussion of avoidable costs. If the Guidelines are to have an educational impact and be of practical utility, it is critical that the meaning of avoidable costs be clarified and, in particular, that the Guidelines include an explanation of how avoidable costs differ from variable costs. We suggest that predictability is uniquely important here, because pricing decisions typically have to be made quickly and companies should be encouraged to price aggressively and promptly. Relatively objective standards that can be applied upfront are not only essential for business decisions, they also facilitate summary disposition by regulators and adjudicators.

The Bureau indicates at paragraph 75 of the Guidelines that "the time period over which the cost based analysis is carried out and the time period over which the costs of the firm are avoidable may be different". The Section questions this. In our view, costs should only be considered avoidable if they are avoidable over the time period covered by the Bureau's examination.

The Section agrees that in some circumstances common costs incurred in the production of more than one product would not be considered avoidable. However, the Guidelines should clarify whether this would still be the Bureau's position if a firm is not covering the variable costs of producing any of its products. Moreover, the Guidelines give no indication of the complexity and variety of issues that would arise in applying an avoidable cost concept in relation to various production and distribution scenarios. For example, the utility or appropriateness of "avoidable cost" is questionable in manufacturing and distribution scenarios where multiple products are derived from a common raw

material. The economic effects of applying the test to this scenario differ in many ways from the effects of the test as applied to a transportation network. As the Guidelines would have general application to all industries and trades, the Bureau should understand and articulate how the avoidable cost test would apply in all foreseeable situations. The use of multiple examples would be helpful.

IV. GENERAL COMMENTS

The preface to the Guidelines indicates that transparency and certainty of enforcement process is essential in the context of today's fast-paced, global economy. To enhance certainty, the Guidelines should clearly indicate that they will inform and reflect the Bureau's enforcement policy until they are amended following a period of public consultation or unless the court or the Competition Tribunal directs otherwise. Similarly, transparency and certainty would be enhanced if the Bureau refrains from challenging conduct which adheres to the 1992 Guidelines until the new Guidelines are finalized.

As recognized in the introduction to the Guidelines, low pricing is generally not anti-competitive. In fact, it is one of the principal objectives of maintaining competitive markets. While section 50 of the *Act* contains the phrase "unreasonably low pricing", in some cases the Guidelines refer to "low pricing" in a negative way. To avoid any suggestion that "low pricing" is presumptively or likely anti-competitive, this language should be avoided throughout the text.

On page 3, the Guidelines indicate that the courts have concluded that selling prices which are above costs can never be unreasonable. However the Guidelines do not sufficiently emphasize this point. The "avoidable cost" test introduced in the preface is not discussed or referred to in the body of the Guidelines until page 16. In our view, the below-cost test is central to an analysis of predatory or unreasonably low pricing and warrants greater emphasis. Perhaps the phrase "below-cost pricing" could be used instead of "low pricing".

In various places, the Guidelines refer to a practice of strategically low pricing in order to deter entry. In our view, there is nothing improper or unlawful about such a practice. In establishing a price which is expected to maximize its profits, an incumbent firm is entitled to consider the likely response to that price by actual and potential competitors. Such behaviour is lawful, economically rational and, to the extent it results in lower prices, beneficial to consumers. While an incumbent which reduces its prices below cost in response to a specific threat of entry may be engaged in predation, the Guidelines should not discourage incumbent firms from considering potential entrants in establishing above-cost prices. The key is whether the pricing activity results in competitive harm. Accordingly, all references to "strategic pricing behaviour" should be changed. All pricing decisions are strategic, and strategic pricing behaviour is not *per se* (or even presumptively) unlawful.

V. SPECIFIC COMMENTS

The Section's comments on specific sections of the Guidelines are set out below. For ease of reference, we have assigned paragraph numbers to the text in the body of the Guidelines (see attached Appendix "A") and refer to those paragraph numbers in these comments.

A. Interpretation

The statement that the Guidelines "supersede all previous statements of the Commissioner or other officials of the Bureau" should be narrowed to refer only to statements on the interpretation and enforcement of section 50(1) of the *Act*, including the 1992 Guidelines.

B. Introduction (Part 1)

The Introduction recognizes the benefits of low prices stemming from legitimate competitive rivalry and the difficulty of distinguishing them from low prices resulting from anti-competitive behaviour. This is an important point and should be further emphasized. The Bureau should make it clear that it will err on the side

of caution and pursue low pricing investigations only in the clearest of circumstances. Overzealous intervention may discourage the vigorous price competition which is a hallmark of competitive markets. If firms start to face competitor complaints and detailed information requests from the Bureau every time they cut prices, these firms may be discouraged from reducing prices. This will result in greater price stickiness and increased conscious parallelism (when the unilateral actions of firms coincide without there have been any form of communication among them). Inappropriate intervention in the marketplace by the Bureau may have the unintended and perverse effect of encouraging higher prices and less price volatility.

The Introduction states that "unreasonably low pricing…means involvement in a policy of selling below cost in order to deter entry into a market, or to force competitors out of a market". This is different from the way the illegal trade practices are defined in section 50(1). The Bureau should clarify that it is taking the position that intent is a prerequisite to enforcement activity. The jurisprudence indicates that intent to lessen competition or eliminate a competitor is an essential element of the crime. This results from the meaning that is given to the word "policy" in paragraph 50(1)(c) of the *Act*.

C. Enforcement Considerations (Part 3)

Paragraphs 11 and 12 suggest that the Bureau's low-pricing enforcement activities are complaint driven. The Guidelines should provide some perspective on the extent to which a "low price" complaint is likely to result in a finding that the price is "unreasonably low". It would assist to include updated statistics on the number of complaints received by the Bureau and the number which have resulted in enforcement activity.[6] If the Bureau engages in significant independent monitoring of pricing activity, this should also be described. Information on the factors considered by the Bureau in prioritizing its cases would also be helpful.

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[6] This might also help to discourage unmeritorious complaints.

Paragraph 16 indicates that as a "threshold" matter, the Bureau assesses the likelihood that the behaviour "will harm competition, and therefore consumers and businesses". It would certainly be inappropriate to continue an investigation into behaviour that will not likely harm competition. At the same time, it should be noted that not all lessening of competition is unlawful. The prohibition in the *Act* involves substantially lessening competition or eliminating a competitor. Also, the Guidelines should clarify that "consumer harm" must be established and that the term consumer includes business customers.

The safe harbours for firms with market shares of less than 35% and industries with low barriers to entry are relatively clear and will provide some certainty to certain businesses. However, the exception for a firm whose market share is less than 35% but "considerably greater than its rivals" is less clear. The Guidelines should set out what is meant by "considerably greater" (e.g. a 10% gap, double the next highest share) and whether a *de minimis* threshold will be applied (e.g. less than a 10% share). The Bureau should also consider whether there should be a similar four-firm concentration threshold (60% or 65%). In addition, the last sentence states that "the Bureau usually will pursue cases where the low-pricing incumbent firm has a market share of more than 35%". The policy should be stated in the negative – i.e. "the Bureau will generally not pursue cases where the low-pricing incumbent firm has a market share of 35% or less".

The section on "preliminary examination" (paragraph 17) states that the Bureau considers the "duration, frequency, depth and pattern of the low-pricing behaviour". The Bureau should clarify whether price reductions of longer duration, greater frequency and greater magnitude are more or less likely to be considered anti-competitive. Also, it is important for the Bureau to recognize and take into account that it only has information provided by the complainant. This information may not be credible. The Bureau should be cautious and alert to strategic behaviour by complainants which may chill competitive rivalry.

D. Elements of Unreasonably Low Pricing (Part 4)

Part 4 of the Guidelines explains how the Bureau interprets the specific elements that must be proved to establish a violation of paragraphs 50(1)(b) and 50(1)(c) of the *Act*. For the reasons discussed above, the Section strongly disagrees with the change in the Bureau's enforcement approach that recoupment is not a necessary element. In addition, as previously discussed, the Section believes that the meaning of avoidable cost needs to be clarified.

Following are the Section's specific comments on Part 4 of the Guidelines. For ease of reference, we have used the headings and sub-headings used in Part 4 of the Guidelines.

(i) Policy of Selling Products

Paragraph 36 refers to markets "where infrequent large tender calls constitute a significant portion of market transactions". The Guidelines should expressly indicate that in such markets customers are likely to have significant countervailing power and that it is therefore unlikely that a low-pricing policy will have anti-competitive effects. Some jurisdictions, notably Europe, have found "bid markets" to be competitive given countervailing power even though the winning bidder may obtain a 100% market share.

Paragraph 37 seems misplaced and more appropriately related to the section on "effect or tendency of substantially lessening competition". The paragraph states that "the Bureau is of the view that it should not have to wait to take action until an unreasonably low pricing policy has had a noticeably anti-competitive impact". This statement should be amended to clarify that if the policy has not had an anti-competitive "effect", the Bureau will not take action unless the policy has or is likely to have an anti-competitive "tendency" or "design".

(ii) Competitive Impact

The discussion of paragraph 50(1)(b) in paragraph 39 refers to "geographic markets". Although the *Act* refers to selling "in any area of Canada", we believe that the effects of any such policy should be evaluated with reference to relevant geographic antitrust markets. Eliminating a competitor in one "area" of a geographic market will have no impact on competition if there are no barriers to the expansion of competitors in other areas. The Guidelines should clarify that this will be the Bureau's policy.

(iii) Effect or Tendency of Substantially Lessening Competition

Paragraph 44 suggests that the effect of a low-pricing policy will be evaluated based on whether it prevents or lessens competition substantially – i.e. whether it creates, preserves or enhances market power. Paragraph 46 then states that "the ability to engage in conduct which is predatory, exclusionary or disciplinary can itself be a good indication of the presence of market power." It would be circular reasoning to point to a low-pricing policy as evidence of market power and then conclude that because the firm has market power the low-pricing policy must be predatory. Anyone can institute a low-pricing policy. This does not mean it will be profitable or that the person has market power. In other words, conduct can be exclusionary without being an indication of market power. For example, consider the exclusionary nature of franchise arrangements. Such contractual arrangements are indicative of the franchisor's or franchisee's market power. Only the ability to recoup lost profits is indicative of market power.

The above quoted sentence should be deleted from the Guidelines, as it is likely to be misleading. The Guidelines should clearly indicate that low prices will not be considered evidence of market power.

The Guidelines should also refer to the more comprehensive discussion of the evaluation of market power and the delineation of relevant markets in the *Merger Enforcement Guidelines*.

(iv) Conditions of Entry and Exit – Behavioural Barriers

The reference to "excessive" investment in research and development or advertising in paragraph 58 should be explained or deleted, particularly as it is generally the policy of Industry Canada to encourage additional investment in research and development.

Paragraph 59 deals with natural or regulatory barriers to exit, not barriers created by firm behaviour. The paragraph should be moved to the section on "structural barriers" (after paragraph 56). The point that "barriers to exit…increase the prospects that competitors will increase prices as opposed to exiting the market" is significant. In certain circumstances a predatory pricing policy may substantially lessen competition without inducing exit.

This section of the Guidelines should comment on the circumstances in which contracts and contractual practices may be considered as behavioural barriers.

(v) Conditions of Entry and Exit – Reputational Barriers

The discussion of "reputational barriers" refers in various places to the effect of a reputation for "unreasonably low pricing". The Guidelines should not discourage firms from establishing a pattern or reputation of low pricing as such behaviour will generally be pro-competitive. It would be helpful to emphasize in this section that pricing at or above cost, no matter how low, will never be considered anti-competitive.

Paragraph 63 should follow paragraph 51 as it is relevant to more than just reputational barriers. It should also be amended. Why would the time period during which the potential for new entry is evaluated be shortened if the industry is one "where only minimal investment and expertise is required and where there is a history of rapid effective entry"? The prospects for entry are relevant because if a firm expects entry before it could recoup its costs then it would not be rational to engage in predation. Adjusting the relevant time period based on the ease or

history of entry in the manner described makes it more likely that predation will be found in industries where it is least likely to occur, and vice versa.

(vi) Conditions of Entry and Exit – Ability to Recoup Losses

The Guidelines state that "a firm can recoup losses incurred in one market by exercising market power in another product or geographic market(s)". In our view, it is critical that such a conclusion be reached only after the application of a rigorous analytical theory to the specific facts. For example, absent reputation effects, predation in one market will have no impact on a firm's ability to raise prices in another market, so there can be no "recoupment". While it is possible for a firm with market power to set off profits in market A against losses in market B, this behaviour is not economically rational unless the firm expects to recoup the losses in market B through bundling or future price increases.

The examples at the end of the paragraph (preserving long-term stability of an existing market structure and establishing an industry standard to exclude others or maintain market control) are examples of preserving market power through predation. Contrary to what the Guidelines indicate, they are examples of low pricing behaviour motivated by the prospect of recoupment. This is another instance of where the Guidelines appear to be confused about the meaning of recoupment.

(vii) Effect or Tendency of Eliminating a Competitor

As indicated above, strategic low-pricing behaviour which deters entry is lawful and pro-competitive as long as there is no competitive harm. In other words, low pricing may be competitive pricing. This section should be clarified.

(viii) Designed to Substantially Lessen Competition or Eliminate a Competitor

Paragraph 68 indicates that a policy designed to substantially lessen competition or eliminate a competitor may contravene section 50 even if it is "entirely ineffective". We agree with the statement in paragraph 37 that a low-pricing

policy with an anti-competitive "tendency" or "design" is subject to enforcement action even before it has had a noticeably anti-competitive impact. However, a policy which is unlikely to have – or is incapable of having – an anti-competitive impact should not be subject to enforcement action regardless of the policy's design. A corporation with no market power should never be found to violate the unreasonably-low-pricing provisions of the *Act*, even if the corporation's marketing documents reflect a desire to "crush" a rival.

(ix) Prices Lower than Those Exacted Elsewhere in Canada

As indicated under "Competitive Impact", above, the Section believes that the effects of a policy of selling products at different prices in different areas of Canada should be evaluated with reference to relevant geographic antitrust markets. The Guidelines should make it clear that this will be the Bureau's policy.

(x) Prices that are "Unreasonably Low"

We repeat our concerns under the above discussion on avoidable cost standard.

The Guidelines should emphasize that above-cost pricing will never be considered unreasonably low and that a price below an appropriate measure of cost will only be considered unreasonable is there is no valid business justification for it.

It is unclear how charging a low price would enable a firm to build inventory. This example should be deleted.

E. Low Pricing Resulting From Market Expansion (Part 5)

The third bullet in paragraph 82 should refer to the requirement in the *Act* that the conduct would substantially lessen competition or eliminate a competitor (not simply "would harm competition").

F. Enforcement Outcomes (Part 6)

Paragraph 86 indicates that a fine may be imposed in lieu of a prison term for a violation of paragraph 50(1)(b) or 50(1)(c). As this penalty is not prescribed by the *Act,* the Guidelines should indicate the authority for imposing a fine (e.g. sections 734 and 735 of the *Criminal Code*). It should also clarify that for a person other than a corporation a fine can be imposed in addition to a prison term.

The discussion of other remedies should refer to the possibility of proceeding under section 79 of the *Act*.

VI. CONCLUSION

The Section appreciates the opportunity to provide its comments concerning the Guidelines. As is evident from the above discussion, we have some significant concerns with the Guidelines. We look forward to having an opportunity to comment on any further revision.

Draft

Competition Bureau

ENFORCEMENT GUIDELINES FOR ILLEGAL TRADE PRACTICES: UNREASONABLY LOW PRICING POLICIES

Under Paragraphs 50(1)(b) and 50(1)(c) of the Competition Act

March 8, 2002

[Paragraph numbers added for ease of reference]

PREFACE

Competition delivers many benefits to consumers, including competitive prices and product choices. Low prices are usually a good indication that competition is healthy and active in the marketplace. While competitive prices and low pricing are beneficial to consumers generally, certain pricing behaviour can be designed to frustrate and interfere with the process of competition in the longer term. This type of undesirable pricing behaviour may have short-term benefits for the consumer but will ultimately lead to higher prices or other anti-competitive effects. These guidelines address paragraphs 50(1)(b) and 50(1)(c) of the Competition Act (the "Act") which set out criminal offences of geographic price discrimination and selling products at prices unreasonably low.

The Competition Bureau (the "Bureau") first published its Predatory Pricing Enforcement Guidelines in 1992 to clarify its enforcement policy and to ensure that the public understood when low pricing might result in an investigation under the Competition Act (the "Act"). Those guidelines, which addressed only paragraph 50(1)(c), evaluated predatory pricing using a two-stage approach. The first stage evaluated an alleged predator's ability to exercise market power and recoup losses incurred as a result of a policy of predatory pricing. The second stage involved an assessment of whether the prices in question were below average variable cost, otherwise known as the Areeda and Turner test. However, since that time, there have been changes in the economy as well as developments in economic thinking concerning low-pricing behaviour. For this reason, the original guidelines have been updated to reflect a modern perspective on low-pricing issues. These guidelines have adopted three principal changes.

First, the ability to recoup losses will no longer be considered as the primary screening criterion. Rather, it is properly considered as one of many factors for determining whether or not unreasonably low anti-competitive pricing policies have been adopted. However, the Bureau is of the view that, while an ability to recoup losses can be an indicator of a policy of unreasonably low pricing, it is not an element necessary to be proven under paragraphs 50(1)(b) and 50(1)(c). Secondly, in carrying out the cost-revenue analysis to determine below-cost selling, the Bureau will use 'avoidable cost' as opposed to average variable cost and average total cost used in the previous guidelines. It is now recognized that average variable cost is not appropriate for the analysis of a firm producing multiple products. Accordingly, avoidable cost is the appropriate standard which will be used in the Bureau's analysis addressing both single-product and multi-product firms.

Finally, the Bureau has included a new section in these guidelines dealing specifically with unreasonably low pricing resulting from market expansion.

The Bureau is always aware of business realities. In today's fast paced, global economy, markets are constantly changing, demanding flexible and innovative responses to competitive challenges. Transparency and certainty of enforcement efforts are essential in this context. These Guidelines explain how the Bureau enforces these provisions of the Act, with the aim of deterring anti-competitive behaviour and, at the same time, avoiding a chilling effect on normal and healthy price competition.

Konrad von Finckenstein, Q.C.
Commissioner of Competition

Interpretation

These Guidelines supersede all previous statements of the Commissioner of Competition (the "Commissioner") or other officials of the Competition Bureau.

The Guidelines explain the general approach of the Commissioner and the Bureau to the administration and enforcement of the legislation. They are not intended to restate the law or to constitute a binding statement on how the Commissioner will exercise his discretion in a particular situation. Consequently, they should not replace the advice of legal counsel. Enforcement decisions of the Commissioner or the Attorney General of Canada, and the ultimate resolution of issues, depend on the surrounding circumstances. Guidance regarding a specific situation may be requested from the Bureau through its Program of Advisory Opinions. These guidelines and advisory opinions are also not intended to bind or affect in any way the discretion of the Attorney General in the prosecution of matters under the Act. Final interpretation of the law is the responsibility of the courts.

How to Contact the Competition Bureau

These Guidelines and other publications of the Bureau are available on the Internet at the Bureau's Web site address. To obtain general information, make a complaint under the provisions of the legislation, or request an advisory opinion, please contact the Bureau by any one of the means listed below:

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PART 1: INTRODUCTION

1. The purpose of the Competition Act is to maintain and encourage competition to achieve important economic objectives. These include providing consumers with competitive prices and product choices as well as ensuring that small and medium-sized enterprises have a fair opportunity to participate in the Canadian economy.

2. Vigorous price competition is a hallmark of competitive markets. In most cases, lower prices are driven by competitive market forces, and consumers benefit from the rivalry among the firms in that market. Given the objectives of the Act, it might seem a bit puzzling that there should be any concern about unreasonably low prices. However, while the Act encourages vigorous price competition, it also ensures that marketplace transactions are conducted on the basis of fair, competitive rivalry rather than through anti-competitive behaviour. Unreasonably low pricing is one example of such behaviour. It means involvement in a policy of selling below cost in order to deter entry into a market, or to force competitors out of a market. While consumers may benefit from the resulting low prices for a brief period, they can be harmed in the long-run if the low pricing leads to diminished competition and, ultimately, higher prices or reduced levels of service, product quality or innovation.

3. Distinguishing between low prices resulting from illegal behaviour and those stemming from legitimate competitive rivalry can be difficult. The Bureau exercises caution when considering enforcement action against alleged unreasonably low pricing behaviour in order not to inhibit beneficial price competition.

4. The Guidelines that follow are organized into five parts:

   - Part 2 describes the geographic price discrimination and unreasonably low pricing provisions of the Competition Act (paragraphs 50(1)(b) and 50(1)(c)).

   - Part 3 provides an overview of how the Bureau administers and enforces the Act. In particular, it focuses on how the Bureau screens cases of alleged unreasonably low pricing in such a way that its resources are directed to those most likely to harm the competitive process.

   - Part 4 explains how the Bureau interprets the specific elements that must be proved in order to establish a violation of paragraphs 50(1)(b) and 50(1)(c).

   - Part 5 explains how the Bureau views low pricing resulting from market expansion of a well established firm into a new market.

   - Part 6 describes the different enforcement outcomes that could result from allegations of unreasonably low pricing.

PART 2: RELEVANT PROVISIONS

5. The Competition Act contains both criminal and civil provisions. Criminal offences are prosecuted before criminal courts, and offenders can face substantial fines and even imprisonment. Civil matters are adjudicated by the Competition Tribunal which has powers to issue injunctive and remedial orders with respect of mergers and anti-competitive practices which are likely to prevent or lessen competition substantially.

6. Though anti-competitive low pricing is covered by several provisions of the Act, it is most commonly addressed under paragraphs 50(1)(b) and 50(1)(c), which are criminal provisions, and sections 78 and 79, the civil abuse of dominance provisions. The Bureau's approach to the administration and enforcement of sections 78 and 79 is described in its Enforcement Guidelines on the Abuse of Dominance Provisions.

7. The following section summarizes the elements of paragraphs 50(1)(b) and 50(1)(c). A more detailed discussion can be found in Part 4 of these Guidelines.

Paragraphs 50(1)(b) and 50(1)(c)

8. Paragraphs 50(1)(b) and 50(1)(c) state:

Everyone engaged in a business who ...

(b) engages in a policy of selling products in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening competition or eliminating a competitor in that part of Canada, or designed to have that effect, or

(c) engages in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect,

is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

9. Paragraphs 50(1)(b) and 50(1)(c) require the following minimum elements that must be proved beyond a reasonable doubt for an offence to occur:

1. the firm or person against whom allegations are made must be engaged in a business;

2. the low pricing must be part of a "policy of selling products"; and

3. the policy must have at least one of the following effects or designs:

- the effect or tendency of substantially lessening competition;

- the effect or tendency of eliminating a competitor;

- be designed to substantially lessen competition; or
- be designed to eliminate a competitor.

10. The two provisions differ from each other in the following respects:

    4. 50(1)(b) requires proof of a policy of selling products at prices that are lower in one area of Canada compared to another (prices exacted lower than elsewhere in Canada);

    5. 50(1)(c) requires proof of a policy of selling products at prices that are unreasonably low.

PART 3: ENFORCEMENT CONSIDERATIONS

11. In administering and enforcing the Competition Act, the Bureau's key objective is to safeguard the process of competition. In cases involving paragraphs 50(1)(b) and 50(1)(c), the Bureau applies the Act in a manner that maintains and promotes healthy, vigorous price competition, while deterring anti-competitive conduct. Identifying truly harmful low-pricing behaviour requires that a delicate balance must be struck; otherwise, anti-competitive activity might go unchecked, or legitimate price competition might be inhibited.

12. Typical complaints received by the Bureau regarding low pricing allege a competitor's excessively low prices threaten to drive the complainant's firm (and possibly others) from the market. Complainants usually ask the Bureau to explain the steps involved in an investigation and to determine whether the low-pricing activity of their competitor warrants the Bureau taking enforcement action. Complainants then provide the Bureau with the relevant information supporting the allegations, including information on prices, the magnitude and duration of price reductions and costs. The Bureau considers the quality and quantity of the evidence provided, as well as the likelihood that continued investigation would uncover further evidence. The Bureau also prioritizes its cases in order to make effective and efficient use of its financial and human resources.

1. Thresholds for Examination

13. When the complaint involves alleged low-pricing behaviour, the Bureau first makes an initial assessment to confirm that the alleged behaviour is not legitimate price competition, and also to ensure that the Bureau pursues enforcement actions where unreasonably low pricing is likely to harm the competitive process. For example, complaints regarding low pricing sometimes reveal upon examination that the competitor was selling at prices above their costs. The courts have concluded that selling at prices which are above costs can never be unreasonable and does not offend paragraphs 50(1)(b) and 50(1)©).

14. If prices appear to be below cost, the Bureau then defines the relevant market both geographically and in terms of products. This procedure assists the Bureau in determining the field in which firms are competing, the extent of that competition, and the effects on competition and competitors of the behaviour proscribed under the Act. Defining a relevant market is not an end in itself, but is part of a framework of analysis that is used to determine the competitive effects of alleged anti-competitive behaviour.

15. Defining a relevant market involves a variety of considerations. For one, it is necessary to determine, from both the demand and the supply side, how easily products can be substituted. Substitutes are considered to be in the same market. The Bureau looks at the functional characteristics of products, including their physical and technical characteristics, and their end use. The views, strategies and behaviour of sellers and buyers are important as well, especially in terms of how they respond to changes in the relative prices of products. Transportation costs and shipment patterns can also help to define the geographic dimensions of the market.

16. Once the relevant market has been defined, the Bureau assesses the likelihood that the behaviour will harm competition, and therefore consumers and businesses. The following considerations are taken into account:

- A low-pricing incumbent firm with an existing market share of less than 35% is considered to be less likely to engage in low-pricing behaviour harmful to competition. In order not to discourage legitimate price competition, the Bureau will not examine further the alleged low pricing by the incumbent firm unless their market share is considerably greater than their rivals.

- If the low-pricing firm has a market share of more than 35% but barriers to entry into the market are low, the Bureau will also conclude that the low-pricing conduct is more likely to be of the kind that benefits the economy, consumers and businesses. Consequently, no further examination is performed.

- In cases where the low-pricing incumbent firm has a market share of more than 35%, or if its market share is considerably greater than its rivals, and barriers to entry are significant, the Bureau will continue to examine whether the elements of paragraphs 50(1)(b) or 50(1)(c) have been violated.

2. Preliminary Examination

17. If the thresholds described above are met, the Bureau continues with a preliminary examination of the lawfulness of this behaviour, based on the elements of unreasonably low pricing described in Part 4 of these Guidelines. The Bureau pays particular attention to the duration, frequency, depth, and pattern of the low-pricing behaviour. The Bureau also examines any price-cost information that might be available, although it recognizes that information about the low-pricing firm's costs might be limited at this early stage of the process. Where the low-pricing firm is a well established firm

expanding into a new market, the Bureau also seeks to determine whether the firm's low pricing represents a temporary introductory price promotion or another legitimate business low-pricing objective such as selling off perishable inventory.

3. Formal Inquiry

18. At the conclusion of the preliminary examination, the Bureau will recommend whether or not there is reason to believe that an offence has been, or is likely to be, committed, and the Commissioner may decide to commence a formal inquiry under the Act to determine all relevant facts. The decision to commence a formal inquiry is based on whether the low-pricing activity meets the required elements of the Act.

19. Once a formal inquiry is underway, the Bureau can make use of court-authorized formal powers to gather further evidence about matters under investigation. These powers can include orders for oral examination of witnesses under oath, written returns of information and/or the production of records as well as orders for search-and-seizure.

20. At the conclusion of the inquiry, the Bureau will decide how the case should be resolved. The range of resolutions available is described in the Bureau's Conformity Continuum Information Bulletin

4. Option of Proceeding under Section 79

21. The Bureau may also address unreasonably low pricing under section 79, the abuse of dominance provision of the Competition Act. This is a non-criminal (or "civil") provision that seeks to address abusive behaviour by a firm or firms dominant in the marketplace that engage in a practice of anti-competitive acts which are likely to prevent or lessen competition substantially. Section 79 authorizes the Commissioner to apply to the Competition Tribunal, a specialized body composed of judges and lay members, for remedies that are reasonable and necessary to overcome the anti-competitive effects of activity which meets the elements of section 79. The application of section 79 to unreasonably low pricing is addressed more specifically in section 4.3 of the Bureau's Enforcement Guidelines on the Abuse of Dominance Provisions.

22. The Bureau will pursue allegations of unreasonably low pricing under section 79 when there is a dominant player, or a dominant group of firms, in the market. To determine the presence of dominance, the Bureau examines market shares and barriers to entry and assesses whether the players in question substantially or completely control the class or species of business.

23. When the prerequisite elements have been met and pricing conduct falls within the scope of both paragraph 50(1)(c) and section 79 of the Competition Act, the particular facts of each case dictate which provision the Bureau should employ to remedy the situation.

24. If a firm has a history of non-compliance with the Act or the nature of the conduct is egregious, a referral to the Attorney General with a recommendation of prosecution under section 50 with its consequent punitive remedies is appropriate.

25. The Bureau usually will proceed with an abuse of dominance inquiry when the provisions of section 79 are established and there is also an element of unreasonably low pricing as part of a broader pattern of anti-competitive acts. Finally, when evaluating whether to undertake civil or criminal proceedings, the Bureau weighs the effectiveness of remedies available to the Competition Tribunal under section 79 against the criminal sanctions available under section 50.

5. Alternative Case Resolution

26. In appropriate cases, the Bureau attempts to resolve the matter through alternative case resolution, thereby avoiding a full inquiry or judicial proceedings. This reduces uncertainty, saves time and avoids lengthy court actions. Written undertakings (a commitment to do or not to do something) may eliminate the need for further Bureau action. The Bureau may accept an undertaking if it remedies the effects of anti-competitive activity. Some matters can be settled simply by having the Bureau contact the company involved to explain the law.

PART 4: ELEMENTS OF UNREASONABLY LOW PRICING

27. If the thresholds for examination described in Part 3 have been met, the Bureau will then analyze the evidence to determine if the elements of the offence are met. This part provides guidance on how the Bureau interprets the specific elements that must be proved under paragraphs 50(1)(b) and 50(1)(c).

28. It is important to note that one particular factor can have a bearing on several elements of an offence. For example, the conduct of a firm, or the impact of its anti-competitive conduct, can be used as evidence both of the firm's capacity to exercise market power, and of underlying policy of selling at unreasonably low prices. Likewise, a factor can relate to elements described both in paragraph 50(1)(b) and in 50(1)(c). The Bureau examines all these elements with the knowledge that pricing decisions are made in the context of a complex and dynamic marketplace. It is important to note that each of the three elements must be proved in order to successfully establish an offence.

29. Once again the elements of paragraphs 50(1)(b) and 50(1)(c) are:

    1. the firm or person against whom allegations are made must be engaged in a business;

    2. the low pricing must be part of a "policy of selling products"; and

    3. the policy must have one of the following effects or designs:

- the effect or tendency of substantially lessening competition;

- the effect or tendency of eliminating a competitor;

- be designed to substantially lessen competition; or

- be designed to eliminate a competitor.

30. Again, the two praragraphs differ from each other in the following respects:

    4. 50(1)(b) requires proof of a policy of selling products at prices lower in one area of Canada than in another;

    5. 50(1)(c) requires proof of a policy of selling products at unreasonably low prices.

1. Engaged in a Business (Paragraphs 50(1)(b) and 50(1)(c))

31. The unreasonably low pricing provisions apply to persons "engaged in business". Subsection 2(1) of the Act defines "business" as including the following:

    (a) manufacturing, producing, transporting, acquiring, supplying, storing and otherwise dealing in articles; and

    (b) acquiring, supplying and otherwise dealing in services.

32. It also includes the raising of funds for charitable or other non-profit purposes.

2. Policy of Selling Products (Paragraphs 50(1)(b) and 50(1)(c))

33. Paragraphs 50(1)(b) and 50(1)(c) state that low pricing must be part of a "policy of selling products". Under section 2 of the Act, a product is defined as either an article or a service.

34. As part of its deliberations, 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. It found that the low pricing in question, which lasted two days, did not constitute a policy. 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, the selling needed to be ongoing or repeated. In the latter case, the Court found that products "given away" at no charge for a six-month period constituted a policy of selling.

35. When determining whether low pricing constitutes a policy, the Bureau considers the surrounding circumstances. In Hoffmann-La Roche, the Court found that any course of pricing action as a "policy of selling", it must be established that it was planned and deliberate conduct by responsible employees of the company. For example, evidence that a program is aimed at eliminating a competitor through below-cost pricing can indicate that the pricing is part of a planned course of action.

36. A particular price which applies to one, or relatively few, market transactions is unlikely by itself to constitute an unreasonably low pricing policy. Similarly, prices which may have applied generally in the market for only a brief period of time are unlikely to represent the sort of "policy of selling" contemplated in paragraphs 50(1)(b) and 50(1)(c) of the Act. On the other hand, in markets where the bulk of purchasing is done over a short period of time, such as seasonal markets and those 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 "policy of selling products" as envisaged by the provisions.

37. It is possible for an offence to be committed even if the pricing strategy does not ultimately result in a substantial lessening of competition or the elimination of a competitor. The Bureau is of the view that it should not have to wait to take action until an unreasonably low pricing policy has had a noticeably anti-competitive impact. In addition, to constitute a "policy of selling", it is not necessary to show that the low-pricing behaviour was officially authorized by the company.

3. Competitive Impact

38. Under both paragraphs 50(1)(b) and 50(1)(c), it must be proved that the policy has one of the following three anti-competitive effects:

(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.

39. Paragraphs 50(1)(b) and 50(1)(c) differ from each other in terms of the relevant geographic market toward which the effect, tendency or design is aimed. The geographic price discrimination elements of paragraph 50(1)(b) require proof that the alleged low-pricing firm engaged in a policy of selling at prices in the geographic market that were lower than prices it charged at the same time elsewhere in Canada and the policy had the proscribed effect (or the tendency or design to have this effect) in the geographic market in which the low pricing occurred. Paragraph 50(1)(b) does not require prices to be unreasonably low. The unreasonably low pricing provision in paragraph 50(1)(c) requires that a policy of selling at prices that are unreasonably low having the proscribed effects, but does not require a comparison of prices in different geographic markets or regions.

40. The Bureau is of the view that the word "tendency" in 50(1)(b) and 50(1)(c) implies more than the mere possibility that the policy will produce one of the proscribed effects. To avoid characterizing potentially pro-competitive low pricing as anti-competitive, the Bureau interprets this word as requiring evidence that the low-pricing policy, if continued, will probably have a proscribed effect.

41. Where the alleged unreasonably low pricing policy has already caused demonstrable and measurable economic effects, these effects can be used to assess the extent of the harm to competition and competitors. However, where the policy has not been in place for long enough to have this impact, the Bureau assesses the likelihood of competitive harm occurring over time. An unreasonably low pricing policy by a firm with considerable financial strength relative to its competitor(s) will be more likely to bring about the effects proscribed by the Act. This kind of firm may be better able to outlast competitors in a period of sustained price reductions.

42. Similarly, the Act prohibits anyone engaged in business from adopting low-pricing policies designed to substantially lessen competition or eliminate a competitor even where the policy is not effective or in place for a long enough period of time to achieve its intended objectives.

43. A consideration of the effects, tendencies or designs which must be proved under paragraphs 50(1)(b) and 50(1)(c) follows.

(a) Effect or Tendency of Substantially Lessening Competition

44. Generally, in competition law matters, a substantial lessening of competition occurs when an anti-competitive practice, policy or merger transaction creates, preserves or enhances market power, that is, the ability to profitably influence price, quality, service or innovation, relatively independently of market forces. A substantial lessening of competition does not require the creation or preservation of a monopoly or the virtual elimination of all sources of competition in a market.

45. While the degree and duration of the lessening of competition are relevant to determining the extent of market power, rigid numerical criteria (such as a particular percentage price rise over a period of years) are not required. A detailed explanation of market power can be found in the Bureau's Merger Enforcement Guidelines and in various decisions of the Competition Tribunal.

46. The principal indicators of market power are market shares and levels of concentration in, and barriers to entry to, the relevant market. However, the actual behaviour of a firm can also be important. The ability to engage in conduct which is predatory, exclusionary or disciplinary can itself be a good indication of the presence of market power.

Levels of Concentration and Market Share

47. The level of market concentration and the market share held by the low-pricing firm are important factors affecting its potential for exercising market power. Market concentration is the extent to which leading suppliers control the supply of a product in a market. It is measured by the number of sellers in the market, and their combined market share. The Bureau is of the view that the greater the level of concentration in the relevant market, the more likely it is that a policy of unreasonably low pricing will adversely affect competition and competitors. The Bureau analyzes the impact of the alleged low-pricing policy on concentration levels and market shares to determine whether the policy has maintained or increased the market share of the alleged low pricing incumbent firm.

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

49. Differences in the relative size of market shares can also be important. For example, a firm with relatively moderate market share may be able to exercise market power if that share is considerably greater than its rivals.

50. As noted in the discussion of Enforcement Considerations, the Bureau usually will pursue cases where the low-pricing incumbent firm has a market share of more than 35%.

Conditions of Entry and Exit

51. Barriers to entry or exit can create and entrench the exercise of market power. Where entry into the market is prevented or inhibited, it will be easier for a firm to recoup the money it lost as a result of its below-cost pricing. After a competitor has been eliminated, barriers to entry will allow the firm to raise its prices without attracting new competitors into the market.

i) Structural Barriers

52. Barriers to entry or exit include structural factors which prevent or inhibit the entry of new firms into a market, or the exit of firms from a market. Barriers to international and interprovincial trade, sunk costs and regulatory requirements are examples of structural barriers.

53. New entrants often are at a cost disadvantage relative to incumbent firms, particularly where initial production and/or sales are not sufficient to achieve economies of scale or scope. Tariff or non-tariff barriers to international trade, such as quota or ownership restrictions, impose costs on potential foreign competitors which are not borne by domestic firms. Similarly, interprovincial barriers to trade and regulatory control over entry may present potential entrants with considerable, and possibly insurmountable barriers to entry. For example, if approval from a government regulatory body is

required to enter a market or industry, this might well pose a barrier, in terms of time, cost and risk associated with entry.

54. A scarcity of production inputs, or a lack of access to necessary technology, could also represent an important cost disadvantage to potential entrants. In some cases, necessary inputs and technology may be controlled by existing industry members, including the firm in question. The firms may be integrated to such an extent that they significantly control the sources of raw materials used in the down-stream production processes, or possess patent rights to products and processes necessary for the most efficient production of the goods in question. Such controls, however legitimately they have been obtained, may nevertheless represent obstacles to the effective entry of competitors into the markets involved.

55. The need to make investments that cannot be recovered if entry is unsuccessful is referred to as "sunk costs". The latter can impede entry in two ways. First, they may be so significant relative to total entry costs and expected rates of return that they deter entry altogether, or prolong the time required to become an effective competitor. Second, even if such barriers do not completely deter entry, they may lead firms to decide to enter at a reduced scale, in an effort to minimize financial risk. This latter circumstance may in turn result in entry which does not represent effective competition to the existing market participants.

56. A common form of sunk costs involves the need to invest in market-specific assets. For example, in some manufacturing industries the highly sophisticated, specialized equipment dedicated to the production of unique products may have little or no appreciable value outside the specific application for which it is intended. Where such sunk costs represent a significant part of the investment needed for entry or expansion, they are viewed by potential entrants as being higher risk investments.

ii) Behavioural Barriers

57. The market power of a firm can be enhanced by behaviour which creates or strengthens barriers to entry. In any given industry there may be a number of factors which promote product differentiation advantages. Non-price factors such as technical service, reputation, geographic proximity, and even well established buyer/seller relationships may influence a buyer's purchasing decisions and favour the incumbent firm. Where such non-price factors appear to be significant in terms of quickly attaining the level of sales required to succeed, they may pose a hindrance to effective and sustainable entry to a market.

58. Strategic behaviour by an incumbent firm may also make new entry more difficult. A firm may engage in conduct that could have an adverse effect on existing rivals or even potential entrants in order to deter their entry. The Commissioner will consider whether entry will be impeded or delayed by an incumbent by looking for behaviour such as the following:

- using excess capacity to increase outputs and depress prices in response to an entry attempt;
- excessive investment in research and development or advertising;
- pre-emptive acquisitions of inputs required by an entrant to enter the incumbent's market; or
- pre-emptive expansion of capacity.

59. Barriers to exit can include sunk costs and other costs such as regulatory requirements which impose significant costs on firms exiting a market. For example, a firm may have to remediate a production site to comply with environmental regulations once production ceases at its premises. Barriers to exit may increase the incentive of a firm to sell at below-cost prices to discipline competitors to compete less vigorously or end price discounting as well as increase the prospects that competitors will increase prices as opposed to exiting the market.

iii) Reputational Barriers

60. A firm can also deter entry by establishing a reputation for unreasonably low pricing. By demonstrating its willingness to price below cost, a firm can signal to potential competitors that it will respond aggressively if they attempt to enter its markets. The creation of a barrier to entry by virtue of reputation can increase a firm's market power and enhance the exclusionary effects of its conduct.

61. 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 unreasonably low pricing, then the entrant will discontinue its expansion and possibly exit the market. The incumbent firm thereby creates a reputation for unreasonably low pricing that deters the entry or expansion of other firms in that market or in other markets in which the incumbent competes. In any given market, an unreasonably low pricing policy used to gain a reputation is more likely when the firm in question operates in more than one geographic or product market. An incumbent firm with "deep pockets" might use its superior access to operating funds in order to help it cover the costs of its pricing strategy. If the financing of an entrant is conditional on its ongoing profitability, then an incumbent's unreasonably low pricing policy can reduce the entrant's access to credit and increase its financing costs. In such circumstances, a policy of selling at low prices is more likely to have the effect, tendency or design proscribed by paragraphs 50(1)(b) and 50(1)©).

62. In determining whether the firm has a reputation for unreasonably low pricing, the Bureau will conduct an analysis that compares the subject market(s) with conditions in other "similar" markets where the firm is not present. To determine whether the firm enjoys less competition in the subject market(s), the Bureau will consider whether:

(i) concentration of firms is higher in markets in which the firm operates than in similar markets in which it does not;

(ii) the firm's sales and profits in markets in which it operates are higher for a substantial period than are typically observed for firms operating in similar markets;

(iii) low prices charged by the firm in the past have resulted in exit and no new entry for an extended period after the low-pricing policy has been discontinued; and

(iv) higher prices failed to induce new firms to enter the market.

63. In evaluating the potential for new entry, the Bureau will consider the time it is likely to take the firm to raise prices and recoup the costs of the pricing strategy. As a rule of thumb, the Bureau will begin with a two-year time period, and then adjust for the nature of the industry. For example, in an industry where only minimal investment and expertise is required and where there is a history of rapid effective entry, the Bureau will evaluate the possibility of new entry in response to a significant price increase over a period significantly shorter than two years. If entry is likely within the relevant time period, then the probability of recouping the losses from the low-pricing strategy is reduced. The approach to entry conditions is discussed in more detail in Merger Enforcement Guidelines.

iv) Ability to Recoup Losses

64. When a firm has market power, it can more easily recoup foregone revenue due to its below-cost pricing. The ability to recoup losses in this way is an additional indication of market power, whether it occurs in the market where the low pricing took place or in another market. A firm can recover its losses by increasing prices by a large amount in a short period of time, or by increasing prices by a series of small amounts over a longer period, during which new entry is unlikely to occur. Alternatively, a firm can recoup losses incurred in one market by exercising market power in another product or geographic market(s). A firm's reputation for unreasonably low pricing can deter its competitors from lowering their prices or expanding their operations, and can deter potential competitors from entering a market, for fear of provoking an aggressive response. Such "reputational" effects can increase the firm's market power and thus make it easier to recoup losses. Low-pricing behaviour can also be motivated by reasons other than recoupment. For example, it may be rational for a firm to adopt a low-pricing policy and sacrifice present profits in order to preserve the long-term stability of an existing market structure. Additionally, a low-pricing policy could assist in establishing an industry standard to exclude others or maintain market control.

65. The Bureau is of the view that, while an ability to recoup losses will continue to be a factor to be considered, it is not a necessary element to be proven under paragraphs 50(1)(b) and 50(1)(c).

(b) Effect or Tendency of Eliminating a Competitor

66. To conclude that a competitor has been eliminated, the Bureau must be satisfied that a competing firm has, in fact, gone out of business or is otherwise no longer in a position to be an effective competitor in a particular market. Strategic-pricing behaviour that deters entry also constitutes a form of competitor elimination, and the Bureau considers such behaviour as meeting this element of the offence.

67. In cases in which the alleged low-pricing behaviour has not been in place long enough to eliminate a competitor but likely will have this effect if it continues, then this element of the offence will also have been met. 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 result of the low-pricing policy.

(c) Designed to Substantially Lessen Competition or Eliminate a Competitor

68. A low-pricing policy can also violate paragraphs 50(1)(b) and 50(1)(c) when it is "designed" to have the effect of substantially lessening competition or eliminating a competitor. The Bureau is of the view that this element is met if it is proven that the accused engaged in the prohibited conduct in order to cause either of these effects, even if the strategy is entirely ineffective in achieving its objective.

69. This is different from the other scenarios in that the Bureau seeks evidence of the aim of the policy. This evidence can be direct or indirect in nature. The Bureau examines a number of factors, including for example, the magnitude of the price cuts and the losses thereby 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 describing the alleged low-pricing firm's aim. The design or aim of the policy can be inferred on the basis of these and other factors surrounding the introduction of the low-pricing policy.

4. Prices Lower than Those Exacted Elsewhere in Canada: Paragraph 50(1)(b)

70. Section 50(1)(b) requires proof that a person has engaged in a policy of selling products "in any area of Canada at prices lower than those exacted by him elsewhere in Canada".

71. It is not unusual for the same products to be simultaneously sold at different prices in different geographic markets. Prices can be influenced by variations in costs, market demand or the intensity of local competition. Requiring a firm to charge the same prices in all of the markets in which it operates risks inhibiting legitimate price competition. For example, a firm may decide to forego competitive price incentives in one local market if it is required to similarly reduce its price in all of its markets. For these reasons, the Bureau

does not investigate every case where there are price differences among geographic markets in Canada. Rather, to avoid inhibiting legitimate competition, it will only investigate cases where the selling of a product in one local market at prices lower than in another market in Canada will ultimately harm the process of competition (see Part 3 above).

5. Prices That Are "Unreasonably Low" (Paragraph 50(1)(c))

72. Paragraph 50(1)(c) requires proof of a policy of selling products at "prices unreasonably low". The Bureau regards these words as encompassing more than just the amounts of the prices or their relationship to costs. The Bureau's analysis also takes into account the context in which the firm competes. What may on the surface appear to be unreasonably low pricing may be a justifiable response to the behaviour of a competitor, or to other market conditions.

i) Price-Cost Comparison

73. To determine whether a specific price is low enough to be considered "unreasonable", the Bureau determines whether the firm charging the price was able to cover its costs of supplying the product(s) in question. The rationale for this cost-based test is that it is reasonable to expect that a business will operate with a view to covering its costs. A firm that charges a price insufficient to do this without a legitimate business justification will not pass the Bureau's cost-based test.

74. When conducting its cost-based test, the Bureau recognizes avoidable cost as being the relevant cost concept. 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. In general, avoidable costs do not include sunk costs.

75. For the purposes of the price-cost analysis, there are two timing issues that need to be addressed: the time period over which the cost-based analysis is carried out, and the time period over which the costs of the firm are avoidable. The resolution of both these issues will depend on the availability of price and cost data, the period of time in which unreasonably low pricing is alleged, and the need to take account of random variations or fluctuations in demand. The second timing issue will also depend in part on the standard amount of time taken by a firm's management to assess business performance and implement any required changes.

76. Ordinarily, a multi-product firm incurs costs that are typical for the production of all its products or for a particular group of products. Thus, when the Bureau conducts its cost-based test for an allegation of unreasonably low pricing concerning only one of the firm's products, it will consider any common costs incurred in that product's production as unavoidable and hence excluded from its analysis. This reflects the fact that the firm still needs to incur these costs in order to produce other products not subject to the low-pricing allegation. Thus the Bureau's cost test based on avoidable cost does not require a firm to cover its fully allocated cost.

77. In the absence of business justification, the Bureau will consider a price that is below avoidable cost to be unreasonable, since in the normal course of business, a policy of selling at a price below this measure of cost would be profit maximizing only because of its anti-competitive effects. A firm pricing below avoidable cost is better off ceasing production altogether or increasing its price(s).

ii) Business Justifications for Low Pricing

78. Jurisprudence under section 50(1)(c) requires that the Bureau take legitimate business low-pricing objectives into consideration. For example, it may be reasonable for a company to sell excess, obsolete or perishable goods, or products for which demand is shrinking at below-cost prices. In the case of temporary cost increases or demand decreases, a firm may use below-cost pricing to retain existing customers or to build inventory in anticipation of increased business in the future. Companies may use below-cost promotional pricing to induce customers to try a new product. A firm may also use below-cost prices together with high volume production to gain production experience quickly in order to become more efficient in the future when it plans to recoup its costs. In each case, the Bureau considers the particular competitive context of the pricing in question, with no single factor predominating.

79. There also may be other legitimate business reasons for pricing below cost. One such reason may be to remain competitive with a competitor's low prices. For example, if a new entrant lowers prices to establish a presence in a market, an incumbent firm may respond to this action in the short run by matching those prices. There is jurisprudence to the effect that 'meeting the competition' can be a defence to a charge of pricing below cost in certain circumstances. Generally, this situation would not be considered by the Bureau to be unreasonably low pricing. In assessing whether price matching is anti-competitive, the Bureau will examine each situation on a case-by-case basis to determine all facts and circumstances relevant to establishing whether the low-pricing policy can be justified on legitimate business grounds. 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'. If the pricing results in a situation where the matching firm is below its avoidable cost, the Bureau may take enforcement action under the section. In addition, the Bureau will consider the length of time the low prices are available in the market, and whether there is evidence to indicate that the matching firm is taking steps to reduce its own costs in order to remain competitive. The Bureau also considers the ability of the alleged low-pricing firm to compete through innovation or methods other than pricing below avoidable cost.

PART 5: LOW PRICING RESULTING FROM MARKET EXPANSION

80. Most of the concern regarding unreasonably low pricing relates to an established firm trying to protect or extend its market dominance by deterring or disciplining new entrants. However, there may be circumstances in which

a well established firm expands into a new market and attempts to advance its market position by engaging in unreasonably low pricing. While this is unlikely to happen if the new entrant's market share is relatively small and it lacks operations elsewhere, it becomes more feasible when the firm operates similar businesses in other markets, has "deep pockets", and has behaved in an aggressively competitive, and possibly anti-competitive, fashion in other markets. Such an entrant could finance its low-pricing strategy from its earnings in other markets, a parent with deep pockets or superior access to financing, and consequently be able to enter a new market and sustain losses for an extended period of time.

81. Understandably, a new entrant is initially likely to engage in some form of promotional pricing by offering products in the new market at prices lower than in its other markets. In determining whether low pricing is a concern, the Bureau will consider the length of the promotional period, the relative sizes of the price differences in relation to its other markets, whether and for how long the new entrant has achieved a foothold in the new market and the competitive conditions in the new market.

82. In the event of a complaint about alleged unreasonably low pricing by a new entrant, the Bureau applies the analysis described above. Unreasonably low pricing by a new entrant is more likely to occur, or to have occurred, when the Bureau finds that:

- the pricing behaviour satisfies the criteria outlined in these guidelines;
- there is no reasonable alternative explanation for the conduct;
- the conduct would harm competition in the market; and
- the entrant's prices are lower than prices it charges elsewhere for the same products under similar competitive circumstances.

83. When examining alternative explanations for the observed conduct, as well as its effects, the Bureau assesses whether the new entrant is more efficient than the incumbent firm, offers more or less variety, is more or less attractive to customers, and can cover its avoidable cost with the incumbent firm still in the market.

84. When evaluating the impact of the new entrant's conduct, the Bureau seeks to determine whether the entrant's continuing operation will likely lead to the elimination of multiple competitors, whether the entrant's behaviour will result in higher prices and other consumer costs (e.g., transportation costs), and whether the entrant's costs are similar to, or higher than, those of existing firms. If these criteria are substantiated, the Bureau will probably conclude that the low-pricing policy would have an adverse impact on competition in the market.

PART 6: ENFORCEMENT OUTCOMES

85. When a preliminary examination proceeds to the formal inquiry stage, a range of potential outcomes is possible. These outcomes are listed below, including the Bureau's Program of Advisory Opinions which is designed to provide advice on whether proposed business conduct is likely to raise an issue under the Competition Act.

1. Prosecution

86. If the Commissioner concludes that an offence has been committed, evidence may be referred to the Attorney General with a recommendation that criminal charges be brought. The Attorney General will then decide whether or not to follow that recommendation. A person found guilty of an offence under paragraph 50(1)(b) or 50(1)(c) may be imprisoned for a maximum of two years. A fine may be imposed in lieu of a prison term.

2. Other Remedies

87. The remedies for anti-competitive conduct are not limited to those resulting from a prosecution before the courts or proceedings before the Competition Tribunal. Under section 34 of the Competition Act, the Attorney General may apply for a prohibition order for a period of up to 10 years, to stop behaviour that constitutes, or is directed toward, the commission of an offence. In urgent circumstances, the Attorney General 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).

88. In lieu of formal proceedings under the Act, the Commissioner has the discretion to pursue alternative means of resolution. These less-formal remedies are described in the Bureau's Conformity Continuum Information Bulletin.

3. Discontinuance

89. If the Commissioner concludes that the evidence does not establish the elements of paragraphs 50(1)(b) or 50(1)(c), the inquiry is discontinued. The Commissioner then produces a formal report for the Minister of Industry, indicating the information obtained and the reason for the discontinuance. Following this, the target of the inquiry as well as the complainant(s) are notified in writing of the status of the inquiry.

4. Right of Civil Action

90. A right of private action also exists under section 36 of the Act. 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 Tribunal or court. Anyone who has suffered losses or damages as a result of conduct that is contrary to section 50 may sue those who engaged in the anti-competitive behaviour. Recovery can be equal to the loss or damage, if proof is provided by the person bringing the action.

5. Program of Advisory Opinions

91. If a business is not sure whether an activity, if entered into, would contravene the Act, it can submit a proposed plan or practice to the Bureau, which may then provide an opinion on whether the situation described raises competition concerns. Parties are not bound by the advice and are free to adopt their plan or practice even in the face of a negative advisory opinion. Similarly, the Bureau may re-examine the activity if the facts change. If Bill C-23 is enacted, advisory opinions will be binding on the Commissioner provided the subject fact situation is unchanged.