# Is the Price Right?: Comments on the *Predatory Pricing Enforcement Guidelines* and *Price Discrimination Enforcement Guidelines* of the Bnreau of Competition Policy

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The Director of Investigation and Research responsible for enforcement of the *Competition Act* has recently released guidelines regarding paragraphs 50(1)(*a*) and 50(1)(*c*) of the *Act*. The *Price Discrimination Enforcement Guidelines* and *Predatory Pricing Enforcement Guidelines*, while not legally binding, are nevertheless required reading for corporate counsel, giving useful insight into the Director's approach to these important offences. The authors undertake an in-depth study of these two sets of guidelines. While hailing the advent of these helpful documents, they identify some theoretical and practical difficulties which remain unresolved, and offer suggestions for further debate of these complex issues.

Le Directeur des enquêtes et recherches responsable de l'application de la *Loi sur la concurrence* a récemment publié ses lignes directrices sur les alinéas 50(1)*a*) (discrimination par les prix) et 50(1)*c*) (prix d'éviction) de la *Loi*. Bien qu'elles n'aient pas force de loi, les avocats œuvrant auprès des compagnies ne sauraient se passer de ces lignes directrices, qui fourmillent de renseignements utiles sur l'approche préconisée par le Directeur pour ces importantes infractions. Les auteurs entreprennent une analyse approfondie de ces deux publications. Tout en reconnaissant leur importance et leur utilité, ils soulèvent certains problèmes théoriques et pratiques et offrent une nouvelle perspective dans le but d'approfondir le débat.

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*Synopsis*



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## Introduction

On May 21, 1992 and September 14, 1992 respectively, the Director of Investigation and Research ("Director") of the Bureau of Competition Policy ("Bureau") released the final versions of the *Predatory Pricing Enforcement Guidelines*[1] and the *Price Discrimination Enforcement Guidelines*.[2] These *Guidelines* now join the *Merger Enforcement Guidelines*[3] and the *Misleading Advertising Guidelines*[4] in the Bureau's arsenal of tools to encourage compliance by Canadian business with the provisions of the *Competition Act*.[5]

The need for such guidance cannot be overemphasized. Price discrimination and predatory pricing are the subjects of more requests for advice from the Bureau than any others, yet there have been extremely few reported cases to provide guidance in the interpretation of the legislation. In the absence of applicable jurisprudence, Canadian businesses may unwittingly violate the competition laws, with serious criminal and/or civil consequences. Moreover, and most pernicious from the point of view of Canadian economic efficiency, firms may hold back from the aggressive fringe of competition for fear of violating the *Act*, even though much of that aggressive behaviour may actually promote "efficiency and adaptability" of the Canadian marketplace for goods and services.[6] By providing practical guidance to business people as to the range of permissible behaviour, these *Guidelines* have had a significant impact on Canadian business pricing practices.

The success of these *Guidelines* as compliance tools depends upon the extent to which they clarify the analytical approaches taken by the Director to paragraph 50(1)(*a*) (price discrimination) and paragraph 50(1)(*c*) (predatory pricing), and upon the extent to which they enable Canadian businesses and their corporate counsel to apply the analysis in a practical manner to pricing decisions. In light of the underlying purpose of the *Act* to enhance the efficiency of the Canadian economy by promoting competitive markets, their success must also be measured against the soundness of their underlying economics.

On both counts, it is our view that the *Price Discrimination Enforcement Guidelines* will be the more effective. The various components of price discrimina tion are clearly defined in practical terms, and applied to common busi-

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[1]Director of Investigation and Research — *Competition Act, Predatory Pricing Enforcement Guidelines* (Ottawa: Supply & Services Canada, 1992).

[2]Director of Investigation and Research — *Competition Act, Price Discrimination Enforcement Guidelines* (Ottawa: Supply & Services Canada, 1992).

[3]Director of Investigation and Research — *Competition Act, Merger Enforcement Guidelines* (Ottawa: Supply & Services Canada, 1991).

[4]Director of Investigation and Research — *Competition Act, Misleading Advertising Guidelines* (Ottawa: Supply & Services Canada, 1991).

[5]*Competition Act*, R.S.C. 1985, c. C-34, as am. by R.S.C. 1985 (1st Supp.), c. 27, ss. 187, 189, R.S.C. 1985 (2d Supp.), c. 19, Part II, R.S.C. 1985 (3d Supp.), c. 34, s. 8, R.S.C. 1985 (4th Supp.), c. 1, s. 11, R.S.C. 1985 (4th Supp.), c. 10, s. 18, S.C. 1990, c. 37, ss. 29-32, S.C. 1991, c. 45, ss. 547-550, S.C. 1991, c. 46, ss. 590-594, S.C. 1991, c. 47, ss. 714-717, S.C. 1992, c. 1, ss. 44-46, 145, S.C. 1992, c. 14, s. 1, S.C. 1993, c. 34, ss. 50-51 [hereinafter the *Act*].

[6]*Ibid.*, s. 1.1: (Purpose of the Act).

ness situations. Moreover, the result-oriented approach espoused in the *Price Discrimination Enforcement Guidelines* should discourage unwarranted complaints and encourage aggressive pricing behaviour. Our "criticism" of these *Guidelines* is that, in their zest for encouraging economically beneficial pricing strategies, they at times seem to read more precision into the legislation than is warranted. Some of the more liberal aspects of the Director's price discrimination analysis may not necessarily be shared by private plaintiffs seeking damages, and businesses should apply such aspects with caution.

The *Predatory Pricing Enforcement Guidelines* will also be helpful to business people who suspect that their own or others' aggressive pricing policies may be illegal. The jurisprudence in this area leaves many questions unanswered, and the *Guidelines* enunciate generally applicable tests for the first time. While in our view the *Predatory Pricing Enforcement Guidelines* can be faulted for being at times inconsistent and/or impractical, one should never forget the enormous contribution of such a thorough and thoughtful articulation of the Director's approach to competition law enforcement.

Part I of this paper will provide an overview and critique of the *Predatory Pricing Enforcement Guidelines*, while Part II will deal with the *Price Discrimination Enforcement Guidelines*. We then summarize our principal conclusions.

## I. *Predatory Pricing Enforcement Guidelines*

Predatory pricing is defined as "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."[7] It is an indictable offence, carrying the possibility of up to two years in prison for individuals found guilty of the practice.[8]

As stated in the *Predatory Pricing Enforcement Guidelines* ("*Guidelines*" in Part I):

> While the Guidelines reflect the law developed to date in these cases, it is apparent that the Courts have had limited opportunity to interpret this provision. Accordingly, the Guidelines are intended to supplement the jurisprudence by providing the Director's enforcement policy regarding the section.
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> ...
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> In essence, the complainant lays out a set of suggested facts, and asks the Director to assess the likely outcome of the alleged predation.
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> The purpose of the assessment is to distinguish predatory pricing from otherwise vigorous and desirable price competition.[9]

The Director therefore recognizes the controversy in the legal and economic communities surrounding the appropriate interpretation of paragraph 50(1)(*c*). The *Guidelines* are a welcome attempt to clarify the Bureau's approach to these issues. Of course, the *Guidelines* may or may not be accepted by the courts. In the meantime, it will nonetheless be helpful for business planners to know how

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[7] *Ibid.*, s. 50(1)(*c*).

[8] *Ibid.*, s. 50(1).

[9] *Predatory Pricing Enforcement Guidelines, supra* note 1 at 4-5.

the Director will approach such topics, so that they may confidently plan aggressive, but legal, pricing strategies.

In this Part, we review the jurisprudence relating to predatory pricing, and highlight the key aspects of predatory pricing which are in need of clarification. We then evaluate the Director's approach to these issues in light of both current economic theory and the *Guidelines*' contribution to the certainty that business planners require if they are to successfully walk the line between aggressive, pro-competitive pricing strategies and criminal activity. The desirability of greater precision in the *Guidelines* is then addressed, followed by a review of the applicability of the civil offence of abuse of dominance to predatory pricing.

### A. *Uncertainty in the Jurisprudence*

To date, there have only been three reported predatory pricing decisions by Canadian courts.[10] These cases have provided some indication as to how courts will interpret the provision, but have left many more questions unanswered.

*R.* v. *Producers Dairy Ltd.*[11] involved a forty-eight-hour milk price war between leading dairies supplying Ottawa supermarket chains in 1961. Both the Provincial Court and the Ontario Court of Appeal acquitted Producers of the charge of predatory pricing, on the basis that the forty-eight-hour, "defensive" price reduction did not constitute a "policy" of selling. The issue of whether the prices had been "unreasonably low" was never addressed.

*R.* v. *Hoffmann-La Roche Ltd.*[12] saw the first, and to date the sole, conviction for predatory pricing in Canadian history. Hoffman-La Roche Ltd. had been the sole Canadian producer of two tranquillizers known as Librium and Valium. In 1969, Frank Horner Ltd. entered these markets under a compulsory drug patent license. Hoffman-La Roche responded by, among other things, distributing Valium free of charge to hospitals and governments over two six-month periods.

The central issues at trial were whether (1) there had been a "policy" of selling, (2) at prices "unreasonably low," and (3) with the effect, tendency or intent to substantially lessen competition or eliminate a competitor. The trial judge held that a "policy" involved conscious conduct by the responsible employees of the accused of a continuing and repetitive nature. The purpose behind the price cut was held to be irrelevant as to whether or not the behaviour constituted a policy of pricing; rather, intent would be relevant for determining the issue of whether a price is "unreasonably low."[13]

[10] A fourth case was launched in the autumn of 1992 by PWA Corporation, the parent of Canadian Airlines International, against Air Canada in respect of its role in the recent price war between the two airlines. This case, should it go to trial, will be the first since the publication of the *Guidelines*. We will watch with interest to see the extent to which the *Guidelines* influence the outcome of the suit (as of 9 June 1993, the case had not yet gone to trial).

[11] (1966), 50 C.P.R. (2d) 265 (Ont. C.A.).

[12] (1980), 28 O.R. (2d) 164, 109 D.L.R. (3d) 5, 48 C.P.R. (2d) 145 (H.C.J.) [hereinafter *Hoffmann-La Roche* cited to O.R.], aff'd (*sub nom. R.* v. *Hoffmann-La Roche Ltd. (Nos. 1 and 2)*) (1981), 33 O.R. (2d) 694, 125 D.L.R. (3d) 607 (C.A.).

[13] *Ibid.* at 194-96.

As for the appropriate test for "unreasonably low" prices, the court held that prices above short-run historical (book) production costs are never unreasonable, but that prices below that level may be unreasonable, depending on the circumstances. Three other factors — the duration of the prices, the competitive circumstances (including whether the pricing was proactive or reactive), and the expectation of legitimate long-term benefits for the seller — were also considered. The court rejected direct, short-run production costs as the relevant point for comparison, preferring to recognize the long-run cost expectations that factor into pricing decisions. Without saying that giveaways were always unreasonable, the Court held rather that they constituted unreasonably low prices in the circumstances, given the harm the giveaway caused to Hoffman-La Roche (over a million dollars in lost sales for each six-month period), the duration of the program, and its proactive nature.

With respect to the requirement that the impugned pricing have the effect, tendency or intention to substantially lessen competition or eliminate a competitor (the "harm" element of the offence), the Court inferred predatory intent from comments in internal company documents, from the magnitude of the price cuts, and from the fact that losses of $2.6 million were incurred in order to prevent a forecasted $0.6 million encroachment by Frank Horner. Essentially, despite protestations that intent was irrelevant with respect to the objective unreasonableness of the prices, the same factors which had led the Court to determine that the price had been unreasonably low, then led it to conclude that the intent had been to eliminate Frank Horner as a competitor.

From *Hoffmann-La Roche*, therefore, one can conclude that sales above total cost are never unreasonable. Whether short-run or long-run costs are the appropriate measure is left in some doubt. From the commingling of evidence concerning the "objective" reasonableness of the price and intent, the court appeared to convict largely on the basis of intent.

The third major predatory pricing case, *R.* v. *Consumers Glass Co.*,[14] involved an allegation by a new manufacturer of disposable plastic cup lids that the incumbent, Consumers, had attempted to prevent the newcomer's entry by engaging in predatory pricing. The case focused on the issue of whether or not Consumers' prices had been "unreasonably low." In a situation in which Consumers had already experienced declining sales and excess capacity, the new entrant had commenced operations with enough capacity to cover the entire market, at prices significantly less than those charged by Consumers. The Court held that pricing below average total cost, but above average variable cost, had been aimed at loss minimization, not predation, and was legal under the circumstances. The definition of costs used by the court appears to have been short-run variable costs. The Court criticized any reliance on intent as a factor in finding prices to be "unreasonably low."

Finally, one of the anti-competitive acts alleged in the *NutraSweet*[15] decision under the abuse of dominance provisions of the *Act* was predatory pri-

[14](1981), 33 O.R. (2d) 228, 124 D.L.R. (3d) 274 (H.C.J.) [hereinafter *Consumers Glass* cited to O.R.].

[15]*Canada (Director of Investigation and Research)* v. *NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) [hereinafter *NutraSweet*].

cing.[16] The Competition Tribunal pointed out that the proper cost comparison would be average *total* cost if a firm were operating near capacity, but average *variable* cost if it were operating below capacity, a point which had not been considered in the predatory pricing cases.[17]

Thus, while the jurisprudence appears to have determined a workable approach to the determination of whether there is a "policy" of selling, considerable uncertainty remains concerning the appropriate test for "unreasonably low" and the extent to which "intent" ought to impact upon the analysis. The *Guidelines* attempt to articulate generally applicable tests in these regards.

### *B. The Bureau's Approach to "Unreasonably Low"*

As stated in the *Guidelines*, while all elements of the offence must eventually be addressed, "the reasonableness of the prices themselves is the threshold issue."[18] The *Guidelines* initially state that this requires a two-step analysis: Step 1 is a determination of whether market preconditions exist which are sufficient to allow the alleged predator to later recoup the losses incurred from the low prices; and Step 2 is a determination of whether the prices charged are reasonable in relation to cost. Before analysing these steps in detail, we first offer a few comments on the two-part structure of the test.[19]

#### 1. General Comments

At first glance, Step 1 appears completely out of place as part of the determination of whether or not prices are "reasonable." Indeed, much of the analysis seems to derive from the approach of the *Merger Enforcement Guidelines* to "substantial lessening of competition,"[20] and would appear to address the question of whether or not the prices will harm competition, rather than whether they are reasonable.

Practically speaking, however, this analysis must be undertaken at the outset, rather than as part of the analysis of harm to competition. Otherwise, due to the way the provision is drafted, an alleged predator could be found guilty of predatory pricing on the basis of below-cost pricing and an intent to harm its competitors, even if the market structure is such that there is no way for it to recoup its losses through sustained price increases once the predation is successful. Yet, without such supra-competitive prices, there can be no harm to society, as opposed to competitors and the alleged predator itself. Like a common law judge, the Director has interpreted paragraph 50(1)(*c*) in light of the harm it is designed to address, and deemed that the anti-competitive effects must be plausible in order for prices to be found to be "unreasonably low."

Step 2, which is a price-cost comparison, should therefore not be undertaken unless the alleged predator has sufficient market power to reap monopoly profits. Initially, this appears from the *Guidelines* to be the Director's intended approach: "The First stage analysis is undertaken to determine whether it is

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[16] See Part I.*D* below.

[17] *NutraSweet*, *supra* note 15 at 43-45.

[18] *Predatory Pricing Enforcement Guidelines*, *supra* note 1 at 5.

[19] *Ibid.* at 6.

[20] *Merger Enforcement Guidelines*, *supra* note 3, Part 2 at 3-5.

plausible that this pricing could achieve the anti-competitive effects described in subsection 50(1)(*c*) of the *Act*. If the Director concludes that this is unlikely, no further investigation occurs."[21]

Later, however, the *Guidelines* appear to contradict themselves on this point, saying that, even upon a negative finding under Step 1, "whether or not the Director should consider the matter further will depend on the second stage analysis which determines if the alleged predator's prices reflect inherent cost advantages or are below its costs."[22]

The *Guidelines* would have done well to make it perfectly clear that price-cost comparisons will not be undertaken unless the market structure analysis indicates that a predation strategy has some possibility of success. This would also do much to reassure business planners that they will not be subjected to the time and expense of a Bureau investigation unless the market is conducive to predation.

2. Step 1 — Market Power

*a. Market Share*

The success of any predation strategy will depend upon the power of the predator to control prices in the relevant market. The *Guidelines* indicate, therefore, that the first task for the Bureau is to *define the appropriate market* in terms of both product and geographic boundaries. The market is defined, according to the *Guidelines*, by "identifying all actual and potential sources of competition that may constrain the exercise of market power by the alleged predator."[23] The business planner is then referred to the *Merger Enforcement Guidelines*[24] for more information on the market analysis undertaken by the Bureau. As has been commented upon elsewhere, however, the *Merger Enforcement Guidelines* do little to assist the business person to determine with any confidence the appropriate market definition, especially within the time frame required for decision making in a dynamic economic environment.[25]

According to the *Merger Enforcement Guidelines*, a market:

> is defined in terms of the smallest group of products and the smallest geographic area in relation to which sellers, if acting as a single firm (a "hypothetical monopolist") that was the only seller of those products in that area, could profitably impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger.[26]

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[21] *Ibid.* at 6.

[22] *Ibid.* at 8. Still later, the *Guidelines* reinforce the impression that the Director may prosecute a predatory pricing complaint despite the absence of market power by stating that "where the evidence sought in the first stage is insufficient, that does not mean that the Director may not infer the likelihood of unreasonably low prices from the totality of the circumstances ..." (*ibid.* at 11).

[23] *Ibid.* at 6.

[24] *Supra* note 3.

[25] See R. M. Davidson, "When Merger Guidelines Fail to Guide" (1991) 12:4 Can. Comp. Pol. Rec. 44.

[26] *Merger Enforcement Guidelines*, *supra* note 3 at 7.

A price increase of at least five per cent sustained for at least one year would normally be considered to be significant and non-transitory.[27] This test will not, however, always be applied as, for instance, larger price increases will be considered when the absolute value of the product is low, and smaller price increases will be relevant in the case of very closely substitutable goods.

The *Merger Enforcement Guidelines* mention several sources of information as to the effective range of product and market substitution, including actual consumer behaviour, statements of future consumer intent, trade statistics, correlations of price movements between related products and geographic areas, the functional interchangeability of products, transportation costs between markets, and barriers to foreign competition.[28] The resultant analysis would, however, take even the Bureau some time to complete once all the data is in, and depends, one suspects, on the parameters chosen for the particular economic model used. The *Merger Enforcement Guidelines* do little, therefore, to let a business person know what practical litmus test can be applied *ex ante* to determine the relevant market for the purpose of pricing decisions.

The business planner is likely saved in this regard by the fact that even the Bureau appears unable to fully implement the complex economic theories which it espouses. The *Merger Enforcement Guidelines* admit that, in practical reality, "[t]he views, strategies and behaviour of buyers are often among the most important sources of information."[29] Once the appropriate competitive market is defined, the Bureau assesses *the position of the alleged predator within that market.* The *Guidelines* state that "[i]t is unlikely that an alleged predator with a market share of less than 35 percent would have the ability to unilaterally affect industry pricing."[30] It is also stated there, however, that the relative size of competitors in the market will be a factor, as will be the use of strategic behaviour by the firm to build and entrench market power. One is left wondering what the significance is of the thirty-five per cent benchmark, when, in reality, it appears that the entire "market power" analysis will still be performed. It would have been helpful to state more clearly what role the thirty-five per cent benchmark would play, and whether or not relative firm size and industrial concentration are always relevant in this initial stage of the Step 1 analysis.

### *b. Conditions of Entry*

Assuming either that the threshold market share is surpassed or that no such threshold is actually relevant, the market will be analyzed to search for barriers to entry which would reduce or eliminate the ability of potential competitors to re-enter the market and, within two years, to bid prices back down to competitive levels should the alleged predator attempt to reap supra-normal profits in the aftermath of predation. Once again, the gist of the analysis is outlined in the *Guidelines*, but the reader is referred to the *Merger Enforcement Guidelines* for the Bureau's definitive treatment of the topic.[31]

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[27] *Ibid.* at 8.
[28] *Ibid.* at 10-18.
[29] *Ibid.* at 11.
[30] *Predatory Pricing Enforcement Guidelines, supra* note 1 at 6-7.
[31] *Ibid.* at 7.

The *Predatory Pricing Enforcement Guidelines* and the *Merger Enforcement Guidelines* identify two sets of factors which could pose barriers to effective and timely entry by potential competitors: cost advantages and sunk costs.

*Cost advantages* include externally imposed cost advantages to incumbents such as: tariffs and non-tariff barriers to imports (when the incumbent controls the domestic supply), inter-provincial barriers to trade in inputs (again important if the incumbent controls the provincial supply of inputs), and regulatory control of market entry.[32] Cost advantages deriving from factors internal to the firm, such as transportation costs, control over technology, and control over distribution channels are also mentioned.

The *Guidelines* indicate that *any* cost advantage, regardless of its nature, will be considered to increase the ability of the alleged predator to wield its market power in a way that is harmful to consumers. The problem with this approach is that legitimate firm-internal cost advantages, such as low-cost sources of inputs, are really examples of factors leading to more efficient operation by the incumbent than by its potential competitors. It is only cost advantages which the incumbent enjoys relative to an equally or more efficient competitor that can facilitate price increases to above-normal levels in the future.

The real question is not whether the incumbent enjoys price advantages over its competitors, but whether market conditions exist that will allow it to refrain from passing on such cost benefits to its consumers. If potential competitors are less efficient than the incumbent and the only so-called "barrier to entry" is the greater efficiency (*i.e.* firm-specific cost advantage) of the incumbent, then the incumbent will be able to price no higher than its competitors' costs. The competition still acts as a valid deterrent to truly exploitative pricing (*i.e.* pricing above that of the next most efficient producer or potential producer), and the incumbent still reaps the benefits of its more efficient production.

The only cost advantages which are relevant, therefore, are those that increase the likelihood that the alleged predator possesses sufficient market power either to reap supra-normal profits, or (a possibility which the *Guidelines* do not recognize but which is consistent with monopolistic behaviour) to operate inefficiently on a sustainable basis. Such cost advantages include the "institutional" factors mentioned above, including tariff and non-tariff barriers to trade, interprovincial barriers to trade and government regulation of industries.

Similar criticism can be made of the generic use by the Director of *sunk costs* as a criterion for finding exploitable market power. The discussion in the *Merger Enforcement Guidelines* of sunk costs identifies three potential sources of sunk costs: (1) market specific investment, (2) product differentiation by the incumbents, and (3) strategic behaviour of incumbents.[33]

[32] *Ibid.* at 8. The costs of applying for regulatory approval and the financial consequences of an unsuccessful application are said in the *Predatory Pricing Enforcement Guidelines* to be cost advantages to the incumbent (*ibid.*), but are more properly classified as sunk costs. They represent an initial investment but will not otherwise affect the ongoing cost of production once regulatory approval is granted.

[33] *Merger Enforcement Guidelines*, *supra* note 3 at 33-36, Appendix 1 at I-IV.

The first, market specific investment, will not prevent efficient entry by potential competitors in the case of efficient international capital markets; neither will it increase the likelihood that existing competitors will be permanently driven from the market. According to McFetridge and Wong, market-specific investment will not deter equally efficient competitors from entering the field (so-called strategic entry deterrence); nor will it be a factor affecting existing competitors who have, presumably, already sunk such costs. If relatively inefficient competitors are thus deterred, consumers are only better off as a result: "The control of strategic entry deterrence involves some serious problems. First, successful entry deterrence does not necessarily reduce welfare. If allocative efficiency is our goal, we may not wish to prohibit all or perhaps any entry deterring behavior."[34]

Furthermore:

> To the extent that costs are sunk, predation against existing firms, firms that have already entered or expanded and thus have the same commitment to the market as the predator, will be futile ... The same feature of market structure, irreversible market-specific investment, that makes strategic entry deterrence possible also makes classical predation less likely.[35]

Lying behind the analysis of strategic entry deterrence by McFetridge and Wong is the assumption that capital markets function efficiently. If this is true, then entry costs, no matter how high, will be financed if they are reasonable in relation to the expected rate of return and risk of the investment. Finance costs do create a cost differential between a potential entrant and the incumbent, but any post-predation price increase by an alleged predator will still be limited by the potential competitor's costs. We would argue that pricing by a predator below such an efficient entry-inducing price does not exploit consumers. As it is with efficiency-induced cost advantages, so with market specific sunk costs: potential competition still acts as a valid deterrent to truly exploitative pricing by a predator.

Of course to the extent that capital markets are not efficient, market-specific investments may hinder entry by efficient rivals into a given market. If Canadian capital markets are indeed inefficient, however, competition policy aimed at aggressive pricers will not solve the economy-wide problems created and, worse, runs the risk of forcing consumers, rather than financial institutions, to finance the new entry through higher prices.

The second source of sunk costs listed in the *Guidelines* — investment in brand names, advertising and research and development — results in product differentiation by consumers and may make it difficult for potential entrants to compete. This is true, however, only because consumers place a value upon the brand name or the bells and whistles involved. If the incumbent tries to raise its prices beyond that which the consumers are willing to pay for its perceived "superior" product, it will quickly find itself with a loss in market share and,

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[34]D.G. McFetridge & S. Wong, "Predatory Pricing in Canada: The Law and the Economics" (1985) 63 Can. Bar Rev. 685 at 704-05.
[35]*Ibid.* at 705-06.

depending on the elasticity of demand, perhaps in revenue as well. There *is* a limit to what people will pay for a perceived luxury good, and the Director should trust consumers' wishes in this regard.

It is in the third potential source of sunk costs, described in the *Guidelines* as "strategic behavior,"[36] where one sees a potential for successful anti-competitive behaviour. Strategic behaviour, according to the *Merger Enforcement Guidelines*, includes such practices as exclusive dealing, tied selling, unilateral renewal clauses in long-term contracts, and meet-the-competition clauses, all of which are either reviewable practices under the *Act* or could be reviewable in the context of the abuse of dominance provisions under sections 78 and 79 of the *Act*.[37] Such practices potentially restrict competition and provide no concomitant increase in efficiency or reduction in production costs and could well lead to higher prices for consumers if undertaken by a dominant firm.

3. Step 2 — Price-Cost Comparison

*a. The Appropriate Test*

Step 2 in the Director's analysis of "unreasonably low" is a price-cost comparison. The Director's analytical approach to this question must be viewed in the context of the flurry of economic tests proposed in the United States in the 1970s and early 1980s.[38]

The test proposed by the Director appears to most closely resemble that proposed by Joskow and Klevorick.[39] Their approach, like that of the Director, combines an initial structural test for effective market power with a price-cost comparison. Like the Step 1 structural tests in the *Guidelines*, the test set out by Joskow and Klevorick first examines the size, distribution and stability of mar ket shares. If sufficient *prima facie* market power is found to warrant further investigation, then the conditions of entry such as scale economies, capital requirements and advertising budgets are investigated. A final structural test, not mirrored in the *Guidelines*, would involve an examination of the dynamic effects of competition on costs and products, and attempts to integrate changing technology into the otherwise static analysis.

If the structural analysis indicates the possibility of a successful predation strategy, then Joskow and Klevorick advocate a modified Areeda-Turner price-cost comparison.[40] This was the original in a series of proposed price tests. After a consideration of the neo-classical static market model of supply and demand, Areeda and Turner concluded that (1) a price above marginal cost cannot be

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[36]*Predatory Pricing Enforcement Guidelines*, *supra* note 1 at 8, 10.

[37]See Part I.*D*, below, for a discussion of the application of these sections to predatory pricing.

[38]See generally, McFetridge & Wong, *supra* note 34 at 703-20, for a summary of the various tests proposed in the U.S. antitrust literature.

[39]P.L. Joskow & A.K. Klevorick, "A Framework for Analyzing Predatory Pricing Policy" (1979) 89 Yale L.J. 213.

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

predatory; (2) a price below marginal cost is predatory unless it remains above average total cost. Recognizing, however, that data on marginal cost are not practically available, and preferring to err on the side of under- rather than over-regulation, they advocated the simple rule of thumb that a price above reasonably anticipated average variable cost is conclusively presumed lawful, while a price below this benchmark is conclusively presumed unlawful.

A legal criticism of this simple rule is that it will not label as predatory certain strategic behaviour that may nonetheless constrain efficient competition. Pricing between average variable and average total cost would be permissible under the Areeda-Turner rule, even though such behaviour could be predatory if, for instance, there are institutional barriers to competitive entry and no demand-side pressures for a lower price. An economic criticism, that it is based upon short-run rather than long-run costs, is applicable to many proposed pricing tests and is discussed further below.

Under the modifications proposed by Joskow and Klevorick, a price set by a dominant firm below its average variable costs in a structurally non-competitive industry would be conclusively predatory. Prices set above average variable costs but below average total costs would be predatory unless the dominant firm could show that this was a loss-minimizing behaviour in the face of declining demand and/or excess industry capacity. Finally, in another step not mirrored in the *Guidelines*, prices set above average total cost would be considered by Joskow and Klevorick to be predatory if they were raised within two years and the increase could not be justified by increases in either costs or demand.

The approach taken in the *Guidelines* can, therefore, be said to be a "modified Joskow-Klevorick" test for predatory pricing. If certain structural market tests are "passed" (or failed, from the point of view of the subject of the investigation), then a price-cost comparison is undertaken. If the price is below average variable cost, it is predatory. If the price is between average variable and average total cost, it may be predatory, depending on the circumstances. For the Director, however, a price above average total cost is never predatory.

Given the very sparse nature of the information that can be gleaned from the decided cases to date, and the reluctance of the courts to wholeheartedly adopt any pricing theory, the very fact that a generally applicable model has been chosen by the Director is undoubtedly helpful to compliance planners. There are, however, a few areas in which the explanation in the *Guidelines* of the test could be improved.

*b. Definition of Cost*

The benchmarks for price comparisons are average variable cost and average total cost. Average variable costs are defined in the *Guidelines* to include "use-related plant depreciation and all other costs that vary with the levels of output."[41] Fixed costs are those "associated with investment in real plant and

[41] *Predatory Pricing Enforcement Guidelines*, *supra* note 1 at 10-11.

machinery and any other fixed assets which do not vary with output produced."[42]

One problem with these definitions is that no indication is given as to the time-frame within which "variation" is to be measured. The economics and accounting literature makes it very clear that the classification of fixed and variable costs depends upon the time frame used in the analysis.

From the point of view of economic theory, it is the long-run costs which are relevant for predatory pricing. The evil whose prevention is attempted by paragraph 50(1)(*c*) involves a strategic, long-range plan to either force a competitor to abandon its capital investments or to deter a potential competitor from investing. Therefore, as postulated by Skeoch and McDonald in 1976,[43] the appropriate analysis involves the issue of "reasonably anticipated long-run costs of production and distribution."[44] To paraphrase Skeoch and McDonald, today's prices are based, not on today's costs, but on tomorrow's expected costs.[45] They decried the use of short-run, historical costs to justify prices, as they feared that this would discourage business from responding to demand-side pressures in the marketplace and ultimately harm consumer interests. Reference to long-run costs is missing from the final *Guidelines* and may result in the entrenchment of the very short-run, cost-justification approach to pricing which Skeoch and McDonald feared to be so inimical to competition and efficiency.

Another important distinction when discussing cost definitions is whether the costs are historical (book) costs or anticipated (forecasted) costs. Skeoch and McDonald were quite critical of reliance upon historical accounting costs. Given that any pricing strategy involves advance planning, anticipated costs should always be preferred to actual historical cost data. As Clemens states:

> Typically, the determination of average costs (or standard costs plus a margin for overhead and profit) is a function of the cost accountant in the lower echelons of management. *Cost analyses, however, represent only the basic data from which price and production strategy is plotted in light of other factors by top flight management.* In different terms, average costs are significant to those in the management hierarchy who follow policy, but not necessarily to those who make it. [emphasis added][46]

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[42]*Ibid.* at 11.

[43]L.A. Skeoch & B.C. McDonald, *Dynamic Change and Accountability in a Canadian Market Economy* (Ottawa: Information Canada, 1976) [hereinafter *Skeoch-McDonald Report*] at 218-22, 260-76.

[44]*Ibid.* at 218. This point should be clarified by acknowledging that "long-run" refers to a functional definition, rather than any absolute period of time. As pointed out in the *Skeoch-McDonald Report, ibid.*:

> The concept of the short and long run, in the explanation of prices, is a functional one and cannot be defined in calendar time, for it differs from industry to industry. It all depends on the speed with which equipment and labour in the particular case can respond to changing levels of output.

[45]*Ibid.* at 219. It is stated in the *Skeoch-McDonald Report, ibid.*, that: "Price reductions can be made in anticipation of the introduction of such a 'best plan'; indeed, price reductions may be essential to achieving a volume of sales needed to implement the new technology or the new system of organization."

[46]E.W. Clemens, "Price Discrimination and the Multiple Product Firm" (1951-52) 19 Rev. Econ. Stud. 1 at 9, as cited in *Skeoch-McDonald Report, ibid.* at 267-68.

A common objection to the use of forecasted costs is that they are illusory and subjective. This objection is, however, equally applicable to historical or book costs. A 1956 study of the use of cost-justifications under the anti-trust provisions in the United States found that none of the book cost data had been developed for use by management in determining prices; rather, they had been constructed for the sole purpose of defending the lawsuit in question.[47] This phenomenon was also seen in *Consumers Glass*, in which the Court accepted the defendant's argument that costing systems designed for one purpose were not necessarily relevant for other applications.[48]

The *Guidelines* do profess to prefer forecasted costs, but then restrict their usage to circumstances where "well developed costing methodologies" are the "industry standard."[49] To be helpful to business, the *Guidelines* should have come out unequivocally in favour of forecasted long-run costs.

*c. The "Grey Area": Pricing between Average Variable and Average Total Cost*

Both the Areeda-Turner and the Joskow-Klevorick price rules discussed above agree that a pricing strategy below average variable cost is predatory. Where they differ is in the appropriate treatment of prices which fall between average variable and average total costs. For Areeda and Turner, the costs of unnecessarily prosecuting and perhaps wrongfully convicting businesses which engage in "grey area" pricing mitigate in favour of presuming such prices to be pro-competitive.

For Joskow and Klevorick, on the other hand, the greater danger lies in the wrong done to consumers by those wrongdoers whom Areeda and Turner would not prosecute. "Grey area" pricers would therefore have to justify their actions. The potential for wrongful conviction would be alleviated by applying the price-cost rule only if structural characteristics were conducive to the exploitation of monopolistic power.

The Joskow-Klevorick approach is repeated in the *Guidelines*, which state that the view taken of prices in the grey area "will depend on the surrounding circumstances."[50] Factors relevant to the analysis include excess capacity, declining demand, whether the alleged predator could have raised its prices but failed to do so, and evidence of predatory intent.

Unfortunately, these proposed factors either do not add to the market power analysis undertaken in Step 1, or are irrelevant to the question of reason-

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[47]C.D. Edwards, "Cost Justification and the Federal Trade Commission" (1955-56) 1 Antitrust Bull. 563 at 569 as cited in *Skeoch-McDonald Report, supra* note 43 at 221.

[48]*Consumers Glass, supra* note 14 at 254-56. The imprecision of even book costs can be particularly acute in multi-product firms. The problem is due not only to the inevitable arbitrariness in the allocation of fixed and joint costs between the products, but also to the interdependence of complementary products from the sales standpoint. See M.P. McNair, "Marketing Functions and Costs and the Robinson-Patman Act" (1937) 4 Law & Cont. Prob. 334 at 337, as cited in *Skeoch-McDonald Report, supra* note 43 at 264.

[49]*Predatory Pricing Enforcement Guidelines, supra* note 1 at 11.

[50]*Ibid.*

ableness from a competition point of view. It is questionable whether one would arrive at the second stage of the analysis at all in the case of a firm facing declining demand and excess industry capacity, as such a situation should not pass the Step 1 test for market power. The requirement that the alleged predator must have taken every opportunity to raise its prices reinforces the short-run nature of the Director's price-cost analysis and ignores the possibility of legitimate long-run planning involving pricing below average total short-run costs (*e.g.* to launch a new product). Finally, as we argne below, there is no real distinction between pro- and anti-competitive intent, and intent is of no practical use as an evaluative criterion for predatory pricing.

If factors which indicate that the incumbent may not be the most efficient producer were not included in the Step 1 analysis, they should be taken into account in Step 2 when analysing grey area prices. If all such factors were considered in Step 1, however, then one is left with a single average total cost rule, rather than a two-part rule, and there is no grey area.

Moreover, the *Guidelines* do not adequately address the Competition Tribunal's point in *NutraSweet* that the appropriate approximation of marginal costs is either average total or average variable costs, depending on whether the firm is operating at or below its maximum efficient level of production.[51] If this is the case, which appears reasonable, then there is really no grey area at all. Rather, there is one test, the data for which are based on different approximations depending on the circumstances.

4. Predatory Intent

One theme which appears in both the wording of the "harm" requirement of paragraph 50(1)(*c*) and the various stages of the analysis proposed in the *Guidelines*, is the notion that otherwise proper behaviour can be rendered improper if inspired by an improper intent. As mentioned in Part I.*B*.1 above, paragraph 50(1)(*c*), as written, would appear to impugn below-cost pricing undertaken with the *intention*, but neither the effect nor the possibility of lessening competition or eliminating a competitor. The *Guidelines* mirror this concern with "improper" intentions throughout.

The problem with using intent as a measure of the *actus reus* of this offence is, of course, that the same intent which is impugned in some circumstances is welcomed in others. The problem was clearly illustrated in the *Hoffmann-La Roche* decision, in which certain internal statements were cited by the trial court as direct evidence of predatory intent, while similar comments were cited as examples of healthy competitive behaviour, the "colourful jargon of the market-place," and "enthusiastic participation in a contest."[52] In *Consumers Glass*, the Court recognized this problem and cited with approval the statement in the U.S. case *Transamerica Computer Co.* v. *International Business Machines Corp.*[53] to the effect that a test based on intent ran the risk of under-

[51] *NutraSweet*, *supra* note 15 at 44.
[52] *Hoffmann-La Roche*, *supra* note 12 at 208.
[53] (1979), 2 *Trade Cases* 79,618 at 79,637.

mining the process of vigorous competition.[54] Zerbe and Cooper explain the discomfort felt by United States courts with using intent as a factor in predatory pricing cases:

> Both courts and commentators became increasingly dissatisfied with the idea that an action that was ordinarily encouraged — the cutting of prices — could be transformed into an illegal activity — a predatory price cut — by the mental state. Although defining a proscribed activity by the coincidence of a mental state and an action was accepted in criminal law, it appeared misplaced when applied to predation. From the courts' perspective, such an approach ran into two problems. First, price cutting was generally lauded by the established economics [*sic*] system, if not seen as absolutely essential to the functioning of the system. Second, as commentators began to point out, the free enterprise system demanded an attempt by all businesses to drive its [*sic*] competitors out of business. Simply stated, judges found it increasingly difficult to justify labelling some price cuts as illegal and others as lawful on the basis of an intent presumably shared by all good competitors.[55]

Despite this basic problem with using subjective intent as a criterion in the offence, the *Guidelines* refer repeatedly to outward appearances of "aggression" and improper intent in the various stages of analysis regarding "unreasonably low." In particular, substantial weight appears to be given to whether an alleged predator is the first to move its prices, or merely responds to a competitor's price cuts.

Even the Bureau's own discussion of intent, however, seems to indicate its discomfort with the probative power of intent. The *Guidelines* state that intent will be inferred from a number of factors, including the magnitude of the price cuts and the losses thereby incurred, the absence of any other rationale for the price cuts, and documentary and oral evidence which describes the intent of the alleged predator in carrying out these actions. This analysis will be modified, however, by an assessment of the ability of the alleged predator to realize its anti-competitive design, a modification which seems implicitly to recognize the indeterminacy of intent as an indication of predatory pricing, and essentially returns the analysis to Step 1.

In reality, "predatory" pricing is expected and welcome in a competitive market economy; such behaviour is rendered harmful by a particular set of market conditions which are largely beyond the predator's control. Assuming that the Director recognizes this fact, as the reading of the market power test into the test for "unreasonably low" prices would seem to suggest, the statements throughout the *Guidelines* that refer to intent as an indication of a "policy" of pricing or "unreasonably low" prices are most perplexing. The *Guidelines* would better achieve their goal of fostering competitive markets and providing compliance advice to business if they were to ignore intent in the test for "unreasonably low" prices, and confine it to the analyses regarding criminal *mens rea* and the harm element of the offence.

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[54]*Consumers Glass*, *supra* note 14 at 247.

[55]R.O. Zerbe Jr. & D.S. Cooper, "An Empirical and Theoretical Comparison of Alternative Predation Rules" (1982-83) 61 Texas L. Rev. 655 at 679.

### C. *Are the* Guidelines *Specific Enough?*

Much of the debate over the appropriate test to be applied when determining "unreasonably low" prices results from a difference of opinion as to which imposes the greater cost on society: allowing some successful predation to go undetected, or deterring business from following the most aggressive allowable pricing policies out of fear of prosecution and uncertainty as to the allowable limits of behaviour. The problem is that the most succinct rules, such as the Areeda-Turner rule, are easy to comply with, but also allow some potentially harmful activity to go unaddressed. The more sophisticated rules cover the ground more thoroughly, but are, as one of their authors admitted, impossible for courts to apply in practice.[56]

As may be clear from some of the foregoing comments on the *Guidelines*, it is our opinion that the greater potential evil to the Canadian economy lies in the chilling effect which vague and unpredictable rules will have on otherwise efficient pricing behaviour. From this point of view, there are several areas in which the *Guidelines* could be made more precise. Litmus tests for market definition, such as those proposed in the *Price Discrimination Enforcement Guidelines*[57] could be proposed which will be of practical assistance to businesses in their decision-making and compliance activities. The *Guidelines* should clearly indicate that no price-cost comparison will be undertaken unless the market structure analysis indicates the preconditions for successful predation. The appropriate definition of "cost" — reasonably anticipated long-run average variable cost — should be specified, along with an indication of how such cost is to be measured, or approximated. Finally, references to subjective indications of intent should be deleted from the discussion of "unreasonably low," and a statement should be made to the effect that the presence of "predatory" intent alone will not constitute the offence.

### D. *Why Not Simply Use "Abuse of Dominance"?*

The Skeoch-McDonald report of 1976 called for the prosecution of predatory pricing under the heading of "abuse of monopoly power," rather than as part of the price discrimination section:

> One of the central difficulties with using the criminal law in this field is that the function of criminal law and the purpose and capacity of the criminal sanction depend upon a substantive prohibition that is defined sufficiently precisely in advance that a person has fair notice, before engaging in the conduct, that it is against the law and the public interest for him to do so. Ideally a widely accepted moral disapproval of the conduct exists in addition to the specific prohibition. Competition law, however, cannot realistically define many undesirable events except in terms of their economic effect or likely economic effect. Mergers, uses of market power, and price differentials, for example, are desirable, inconsequential, or harmful only according to the market context in which they occur.[58]

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[56] F.M. Scherer, "Some Last Words on Predatory Pricing" (1975-76) 89 Harv. L. Rev. 901 at 903.
[57] *Supra* note 2. See Part II, below.
[58] *Skeoch-McDonald Report, supra* note 43 at 39-40.

This comment clearly applies with great force to predatory pricing. Indeed, the *Guidelines* themselves seem to recognize, in their general espousal of a threshold test for market power, that the evil which the section is designed to combat will in fact only be possible in certain limited circumstances resulting from structural impediments to competition in the marketplace.

Beyond the misplaced morality which comes from treating predatory pricing as criminal, Skeoch and McDonald point out that criminal procedures and safeguards are ill-suited to cases which must necessarily involve the extensive use of economics.[59] Criminal sanctions, too, are backward looking and behaviourally oriented and do little to address the problems of market structure which lie at the root of predatory pricing.

Section 78 provides a non-exhaustive list of examples of "anti-competitive acts" and includes, in paragraph 78(*i*), selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor. While the Competition Tribunal held in *NutraSweet* that this applied only to resale situations, it also held that "the term anti-competitive act in section 78 is broad enough to cover other predatory pricing."[60] The *Guidelines* themselves recognize the possibility that predatory pricing may be prosecuted under the civil standard of abuse of dominance rather than the criminal standard of paragraph 50(1)(*c*), but businesses are left on their own to apply the *Guidelines* to this non-criminal provision.[61]

In our opinion, addressing predatory pricing in the context of abuse of dominance is preferable to a criminal prosecution. Market power is an explicit prerequisite to an order under section 79. Out of necessity, this criterion has been inserted by the Director into paragraph 50(1)(*c*) without clear statutory authority and, therefore, in a rather equivocal fashion. While paragraph 78(*i*) still describes anti-competitive pricing with a reference to its purpose, the main body of the offence in section 79 makes it clear that actual or likely harm to competition is a necessary component of the offence. Thus, there is no possibility of convicting a business of predatory pricing on the basis of intent alone. Moreover, the non-exhaustive nature of the definition of anti-competitive acts leaves room for development of the definition of the offence as the jurisprudence in this area grows. Finally, as a practical matter, predatory pricing will often, as in *NutraSweet*, be combined with other anti-competitive acts. The Competition Tribunal held in that case that different individual types of anti-competitive acts taken together could constitute a "practice."[62] The Director will therefore almost always prefer to prosecute under the dominance provisions in order to have all anti-competitive behaviour considered at once.

Of course, many of the same uncertainties outlined in this paper would still exist were section 79 used to address predation. The *Guidelines* would still be necessary to address such questions as how costs are to be determined and mar-

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[59] *Ibid.* at 40.
[60] *NutraSweet*, *supra* note 15 at 44.
[61] *Predatory Pricing Enforcement Guidelines*, *supra* note 1 at 2.
[62] *NutraSweet*, *supra* note 15 at 35.

kets defined and when the Bureau would find such behaviour likely to substantially lessen competition.

With decriminalization, however, and a more appropriate statutory structure, business planners and the Bureau alike would benefit from a clearer understanding of the offence from the outset, and the aggressive pricing behaviour which is essential to efficient and adaptable competition will not be unnecessarily deterred.

## II. *Price Discrimination Enforcement Guidelines*

Price discrimination is defined as "the practice of a seller granting price concessions to one purchaser, which are not available to competing purchasers in respect of a sale of articles of like quality and quantity."[63] The *Price Discrimination Enforcement Guidelines* ("*Guidelines*" in Part II) do much more than clarify the existing approach of the Director to this offence. They reflect a more liberal approach to the section than has been applied historically; an approach which incorporates economic analysis to assist in the exercise of interpreting the many components of the offence. This more liberal approach is deliberately designed to assist Canadian businesses to price competitively in the world marketplace, while ensuring that the ability of competitors to compete with one another not be diminished by unequal price treatment at the hands of their suppliers. Part 1 of the *Guidelines* sets out the text of paragraph 50(1)(*a*) and its companion subsections 50(2) and 50(3),[64] and provides a brief explanation of the theory and history of the offence. The *Guidelines* state that the theory behind the price discrimination provision is

> that, at least in terms of the prices which competing sellers pay for their goods, those purchasing like quality and quantity can be assured that they should have an opportunity to be on an equal cost footing with their competitors with the market

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[63]*Price Discrimination Enforcement Guidelines, supra* note 2 at 2.

[64]Section 50 of the *Act, supra* note 5, states as follows:

> 50(1) Every one engaged in a business who
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> (*a*) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage that, at the time the articles are sold to the purchaser, is available to the competitors in respect of a sale of articles of like quality and quantity ...
>
> is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.
>
> (2) It is not an offence under paragraph (1)(*a*) to be a party or privy to, or assist in, any sale mentioned therein unless the discount, rebate, allowance, price concession or other advantage was granted as part of a practice of discriminating as described in that paragraph.
>
> (3) Paragraph (1)(*a*) shall not be construed to prohibit a cooperative association, credit union, caisse populaire or cooperative credit society from returning to its members, suppliers or customers the whole or any part of the net surplus made in its operations in proportion to the acquisition or supply of articles from or to its members, suppliers or customers.

> outcome determined by their own entrepreneurship and abilities, and not by the actions of third parties operating elsewhere in the distribution system.[65]

The description of the case law involving this section is necessarily brief. There have been only four convictions — three of which resulted from guilty pleas — and none of which were reported.[66] Still, the dearth of jurisprudence belies the regularity with which the business community has questions concerning the limits of legal price discrimination.

Part 2 of the *Guidelines* outlines the Director's interpretation of each element of the offence:[67] (1) the parties to the offence, (2) the transactions covered, (3) the products covered, (4) "discount, rebate, allowance, price concession or other advantage," (5) "available," (6) "purchaser," (7) "competitors of a purchaser," (8) "at the time the articles are sold," (9) "directly or indirectly," (10) "like quality and quantity," (11) "knowledge," (12) "a practice of discriminating," and (13) the cooperative exception. Appendix I of the *Guidelines* gives a brief synopsis of other sections of the *Act* that may be relevant to facts giving rise to price discrimination questions.

This commentary follows the structure of the *Guidelines* in providing our thoughts on the text.

### A. *Parties to the Offence*

Criminal liability under section 50 attaches only to the seller, and not to the buyer in an impugned transaction. This can be contrasted with the situation in the United States, where buyers are included in the offence.[68] In Canada, however, any purchaser who pressures a seller into engaging in such behaviour may still be liable to criminal charges under the "aiding and abetting" or "counselling" provisions of the *Criminal Code*.[69]

### B. *Transactions Covered*

Price discrimination is only illegal in respect of sales of articles. Unlike other sections of the *Act* which refer to the "supply" of goods or services, the

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[65] *Price Discrimination Enforcement Guidelines*, *supra* note 2 at 2. Upon reflection, it is clear that the victim of price discrimination by a seller will only be compromised *vis-à-vis* its competitors if it has no practical alternate source of supply. This will only be true when the seller is dominant in its selling market. While economic theory therefore cries out for a test for market power to be read into paragraph 50(1)(*a*), this cannot fairly be done given the wording as it stands. The Director cannot be faulted for failing to require market power as an element of the offence. Still, one is left wondering if the explicit requirement for market power under the abuse of dominance provision in s. 79 will not encourage the Director to apply for an order under s. 79, rather than to request a prosecution under paragraph 50(1)(*a*). The use of s. 79 is discussed in Part II.*N*, below.

[66] *R.* v. *Mary Maxim Knitting Wool* (16 May 1968), (Ex. Ct. C.) [unreported]; *R.* v. *Neptune Meters Ltd.* (2 June 1986), (Ont. Dist. Ct.), Borins D.C.J. [unreported]; *R.* v. *Simmons Ltd.* (15 October 1984), (Ont. Prov. Ct. (Crim. Div.)), Richards P.C.J. [unreported] [hereinafter *Simmons*]; *R.* v. *Commodore Business Machines Ltd.* (31 January 1989), O.J. No. 2588 (QL) (Ont. Dist. Ct.), Wren D.C.J. [unreported].

[67] *Price Discrimination Enforcement Guidelines*, *supra* note 2 at 4-25.

[68] Section 3 of the *Robinson-Patman Act*, 49 Stat. 1526 (1936) (codified at 15 U.S.C. §13 (1988)).

[69] R.S.C. 1985, c. C-46, ss. 21, 22.

price discrimination provision refers only to "sales." Leasing, licensing and consignment sales are not covered, as title to the goods does not transfer during the transaction. Note, however, that consignment sales entered into for the purpose of discriminating can be prohibited pursuant to section 76 of the *Act.*

There is no exception in section 50 for *sales between affiliates*, yet the *Guidelines* state that the Director may consider transfers which reflect the interests of the affiliates acting as part of a single economic entity to be something other than "sales." This view, unfortunately, appears to be in contravention of normal principles of statutory interpretation. Given the clear exemption for affiliates elsewhere in the *Act*,[70] the lack of one in section 50 must be taken to have been deliberate. Therefore, even if the Director declines to prosecute, price discrimination in favour of an affiliate could expose a business to a private prosecution under section 36 of the *Act*. It is our view that the courts would be hard pressed to agree with the Director's position. Furthermore, since the circumstances under which even the Director will consider a transaction to be exempt are not clearly spelled out, this putative exemption must be treated by affiliated businesses with caution.

The Director has even extended the "affiliate" exemption to cover concessions granted to an unrelated purchaser who assisted the seller in entering into the business of supplying an article. Favourable treatment afforded a customer who finances a new plant, for example, will not be considered by the Director to violate the section. The discount will be seen as a return on investment, rather than a price concession. In light of the lack of statutory authority for the Director's approach to affiliates in general, however, businesses involved in these types of transactions would perhaps be wise to make any such financial transactions between suppliers and purchasers the subject of agreements separate from the actual sale of the articles in question.

### *C. Products Covered*

Price discrimination is only illegal with respect to the sale of *articles*, as distinguished in section 2 of the *Act* from services. Price discrimination in respect of services, or in respect of the sale of articles which are merely incidental to the provision of services (such as stamps, which are merely a receipt for the purchase of postal services), is not prohibited. Note, however, that energy is considered to be an article, as is a ticket for admission to an event or a passenger transportation service. Furthermore, price discrimination by a dominant firm in respect of services can still be prohibited as an "anti-competitive act" under section 79 of the *Act.*

### *D. "Discount, Rebate, Allowance, Price Concession or Other Advantage"*

The terms "discount," "rebate," "allowance" and "price concession" are familiar to the business community and are interpreted by the Director to include "monetary arrangements advanced by a seller which reduce the effec-

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[70]See *e.g.* s. 61(2) of the *Act*, *supra* note 5, dealing with price maintenance.

tive price paid by a purchaser to a level below that of the face or nominal transaction price."[71]

The interpretation by the Director of "other advantage" has, however, undergone some change in the evolution of the *Guidelines*. In both the *Discussion Paper*[72] and the *Draft*[73] leading up to the *Guidelines*, "other advantage" was said to be broad enough to refer to non-monetary advantages such as free equipment, in-store demonstrations and displays, and just about any other advantage that a seller could bestow upon a purchaser. This interpretation appeared, however, to violate the interpretive principle of *ejusdem generis*. Since the other advantages referred to in paragraph 50(1)(*a*) are monetary in nature, the words "other advantage" should be interpreted as referring only to other monetary advantages. The *Guidelines* now recognize that such advantages as the provision of technical assistance, the use of free equipment, in-store demonstrations and displays, and gifts of tickets to theatrical or sporting events will not normally fall within the class of advantages which give rise to liability for price discrimination.[74]

### E. *"Available"*

The more liberal approach of the Director to price discrimination enforcement centres largely around the interpretation of the word "available." Whereas previously any monetary advantage which did not result from a difference in the quality and/or quantity of the articles sold would be considered by the Director to be in violation of the section, such differences will now be considered to be legal, provided that the conditions of eligibility are the same for all competing purchasers[75] and the program is "available" to all such purchasers. As before, there is no requirement as there is under section 3 of the *Robinson-Patman Act* in the United States for such concessions actually to be cost justified.[76]

The so-called "conditional discounts" which are now treated as permissible include not only absolute volume discounts, but also growth bonuses and loyalty rebates which are granted to customers whose purchases increase by a certain threshold amount from one time period to the next. So long as the time period is finite and the required increase in purchases known in advance, failure on the part of one purchaser to qualify for the discount will not affect its availability to all.

Although the *Guidelines* make no mention of the fact, this approach represents a significant departure from past practice. As recently as 1984, a year-

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[71]*Price Discrimination Enforcement Guidelines*, *supra* note 2 at 8.

[72]Director of Investigation and Research – *Competition Act, Price Discrimination, Section 50(1)(a) of the Competition Act: Discussion Paper* (Ottawa: Bureau of Competition Policy, July 1990) [hereinafter *Discussion Paper*] at 10.

[73]Director of Investigation and Research – *Competition Act, Price Discrimination Enforcement Guidelines, Draft* (Ottawa: Supply & Services Canada, 1991) [hereinafter *Draft*] at 7.

[74]*Price Discrimination Enforcement Guidelines*, *supra* note 2 at 8.

[75]Programs for which the conditions of eligibility appear to be neutral, but which have in fact been carefully designed to benefit only one particular customer at the expense of others will not pass this first part of the test, and will not be considered to be "available" to all.

[76]*Supra* note 68. See *Federal Trade Commission* v. *Morton Salt Co.*, 334 U.S. 37 at 43 (1948).

end performance rebate granted to customers whose annual purchases had increased by the requisite amount resulted in a conviction for price discrimination and a $15,000 fine for each count.[77] Similarly, so-called "functional discounts," which are granted in return for the provision by the customer of a service which is otherwise provided by the seller (such as warehousing or transportation services), will not be impugned so long as they are "available" to competing purchasers. It is not necessary that all competing purchasers actually possess the facilities to provide the services, so long as they can be purchased on the open market. The *Guidelines* also point out that sellers are free to enter into separate contracts with their customers for the provision of such services, in which case there is absolutely no question of paragraph 50(1)(*a*) coming into play at all.

A customer who fails to take advantage of conditional, functional, exclusive dealing or other price concession programs does not have grounds for complaint so long as the program was made "available" to it. The meaning of the word "available" is, therefore, key to understanding the Director's new approach to discount and incentive programs.

Is a seller obligated to inform all purchasers of every potential price concession, regardless of whether or not such information was requested? This is an interesting question. The use of the word "available" in section 50 contrasts with the use of the word "offer" in section 51 (dealing with promotional allowances),[78] and indicates, one would think, that a less active role on the part of the seller would qualify for compliance. According to the *Guidelines*, however, the duty on the seller to disclose the existence of a discount program is a qualified duty which depends upon the circumstances surrounding the sale. It is sometimes difficult to discern how the Director's use of the word "available" differs from that of the word "offer."

For instance, the *Guidelines* state that a seller who unilaterally offers a price concession, or grants a request for a price concession to one customer gratuitously, must inform competing purchasers of the program in sufficient detail to enable them to make a sound business decision as to whether or not to take the steps to qualify for the concession. On the other hand, if the concession results from negotiations initiated by a particular purchaser who offers to supply some service, there is no obligation on the seller to take steps to inform other purchasers of the concession. In this case, it will be enough to respond to the specific inquiries of competing purchasers regarding similar concessions. In contrast to the *Draft*, the *Guidelines* state that a seller need not disclose a particular concession even in response to a request for the seller's "best deal." This approach appears sensible, as it will encourage customers to bargain for conces-

[77]See *Simmons, supra* note 66.

[78]Section 51 prohibits a specific form of non-price discrimination, that of granting to a customer an advertising or display discount or other concession which is collateral to the sale of a product and which is not offered on proportional terms to that customer's competitors. The section does not apply to advertising concessions which are applied directly to the selling price of the product (see discussion in Part II.*M*, below).

sions, safe in the knowledge that they will benefit thereby with respect to any competitor who fails to ask for the same concession.

Apart from providing sound guidance as to the permissible response to a request for the vendor's "best deal," however, the *Guidelines* fall short in providing guidance as to how much disclosure is required in other situations. They assume that it is always possible in business situations to distinguish between negotiations initiated by a purchaser and those initiated by a vendor. Relying upon such a fine distinction, the *Guidelines* call upon vendors to "offer" concessions to all competing customers when the vendors initiate the negotiations, and merely to make them "available" when the customer initiates the discussions *and* offers to perform some service.

Three comments emerge from a close look at this distinction. First, Parliament must be taken to have deliberately distinguished between "offer" and "available," and the *Guidelines* appear to read in the word "offer" in situations involving vendor-initiated concessions.

Second, the *Guidelines* assume that one can always distinguish between vendor-initiated and customer-initiated negotiations. In many cases, however, individual negotiations between customers and their suppliers are merely the way in which business is habitually conducted. It is impossible to say that one side or the other has "initiated" the negotiations.

Third, the concessions which result from such negotiations will not always relate exclusively to services provided by the customer. They may, for instance, relate to the customer agreeing to use a single supplier for a given period of time. The reference to services as the only justification for granting price concessions which need not be effectively "offered" to all competing customers appears to bring the *Guidelines* close to requiring that all concessions be cost justified. In contrast with the United States, however, Canada does not require cost justification for price concessions, and this singular reference to services obscures that very important point.

Ironically, in light of our comments on the lack of precision of some aspects of the *Predatory Pricing Enforcement Guidelines*, it appears that these *Guidelines* have, in this area, attempted to be overly precise. In so doing, they have sacrificed real-world applicability for illusory clarity. Perhaps unwittingly, the Director has defined the only situation in which he considers "availability" to suffice so narrowly that it will very seldom apply. For the rest, it is difficult to see the difference between the Director's approach to "available" and "offer" as these words are commonly defined.

### *F. "Purchaser"*

The identity of the true purchaser of the goods becomes relevant in situations in which a customer is granted a price concession on the basis of its membership within a larger group. If the larger group — with its high volume of purchases — is considered to be the true purchaser, then the price advantage which benefits the group's members will not be discriminatory *vis-à-vis* the competitors of those members. If, however, the true purchaser is the member itself, and the member would not qualify on its own for the price concession, then such contracts may be discriminatory and run afoul of the section.

This issue is discussed in the *Guidelines* with respect to three common scenarios: buying groups, franchise systems and international volume price concessions.

1. Buying Groups

The *Guidelines* indicate that three factors will be relevant to determining if the group is the true purchaser for the purposes of section 50: (1) the group should be a legal entity capable of acquiring property in the articles purchased; (2) the group should in fact acquire title in the articles, although it need not take possession; and (3) the group should be liable and assume responsibility for payment for the goods purchased, even if the members pay for the goods as agents for the buying group.[79]

These same criteria have been articulated by the Director in the past.[80] What is new, however, is the Director's position that in order to satisfy the second criterion, the buying group need not document a second transaction between itself and its members. Such a transaction will be deemed to have taken place in the absence of evidence to the contrary. This new approach will help to eliminate unnecessary transaction costs and the costs of compliance with paragraph 50(1)(*a*).

For buying groups, it appears that the crux of the matter will be whether the group is liable for payment and in a position to satisfy its suppliers that it has sufficient resources to do so. A variety of mechanisms, such as retaining revenues from membership fees or rebates, or an agreement to collect surcharges from the members in the event of shortfall, are suggested. The bottom line is that the seller must reasonably believe that it can look to the group to satisfy payment for goods shipped to the members, even if the members take delivery and pay for the goods in the first instance.

It should also be noted that, consistent with the broader scope of allowable price concessions discussed under "availability," buying groups are not confined to merely accepting after-the-fact price rebates to distribute to their members. The definition of buying groups has been expanded from that used in the *Discussion Paper*, which referred only to rebates, to include "any association of independent firms which combines the volumes of the members' purchases for the purpose of qualifying for or earning price concessions based on volume."[81] Again, this relaxation on the part of the Director is to be applauded, as the economic distinction between *ex post* rebates and *ex ante* discounts is illusory.

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[79]*Price Discrimination Enforcement Guidelines, supra* note 2 at 15.
[80]L.A.W. Hunter, Director of Investigation and Research under the *Combines Investigation Act*, "Buying Groups and the Combines Investigation Act: Notes for an Address" (Quebec City, 17 June 1983) in D.S. Affleck & K.W. McCrachen, eds., *Canadian Competition Law*, vol. 2 (Don Mills, Ont.: Richard DeBoo, 1989-92) 45-243 at 45-248.
[81]*Price Discrimination Enforcement Guidelines, supra* note 2 at 14.

It is also important to note that the *Guidelines* imply that there is a positive duty on the part of the seller to inquire into the status of a buying group with which it proposes to deal. The *Guidelines* refer to the three factors stated above as "important indicators relevant to the *seller's* determination of whether the group is the true purchaser."[emphasis added][82] In reality, this obligation may prove to be costly for some businesses to comply with — albeit less costly than a conviction under paragraph 50(1)(*a*) of the *Act*.

2. Franchise Systems

With respect to franchise systems, the final *Guidelines* mention for the first time that the Director will be willing to allow price concessions granted on the basis of system-wide purchases in certain circumstances, despite the fact that the franchisees may order articles on their own behalf and be the only legal entity liable for payment for the articles purchased. The *Guidelines* state that, where the franchisor contracts with the seller to enter into contracts with its franchisees committing them to purchasing from that seller, the seller is justified in treating all of the franchisees as a single economic unit for marketing purposes, and granting price concessions based on the total franchise system purchases.

This approach may be correct in terms of cost justification by the vendor in light of the clear distribution and marketing savings involved in selling to franchise systems. However, it appears strained both in terms of the interpretation of the word "purchaser" and in terms of viewing a franchise system as a united economic whole. According to the Director's own definition of a purchaser as applied to buying groups, if a franchisee orders, takes delivery of and is solely liable to pay for the goods, then the franchisee is the true purchaser of the goods. The Director may "deem" it not to be the purchaser in order to give effect to the seller's real cost savings, but this would appear to conflict with the wording of the *Act*. In the absence of a cost justification defence in the *Act*, sellers should be careful to ensure that concessions granted to franchisees be justified in terms of the volume of purchases by those franchisees.

Moreover, the assumption underlying the Director's approach to franchise systems — that they function as integrated economic units where purchasing is concerned — is questionable. Whether this assumption will be appropriate depends upon whether the concession is used to benefit the franchisees or is retained by the franchisor. As is exhibited in the frequent contractual disputes between franchisors and franchisees, franchisees and franchisors often share only limited economic interests. It is quite conceivable, for instance, that a franchisor would negotiate a volume rebate in exchange for requiring its franchisees to source from a particular supplier, and keep the entire rebate to itself. Rather than attempt to redefine the word "purchaser," or to justify the preferential treatment of franchisees in terms of the buyer's interests, the better basis upon which to exempt concessions granted to franchise systems is the real cost saving afforded to the vendor. In the absence of a cost justification defence in Canadian

[82] *Ibid.* at 15.

competition law, however, vendors must be careful to ensure that the actual purchaser of the articles in question not receive an unwarranted price concession.

To this end, there are several alternative arrangements suggested by the *Guidelines* which clearly do not run afoul of the *Act*: the franchisor may order articles from the suppliers and direct their delivery to the franchisees; the franchisees could purchase articles on behalf of the franchisor; or the franchisor could itself purchase and take delivery of articles and then distribute them to the franchisees. However, all of these solutions involve liability on the part of the franchisor, an onerous burden that many are unwilling to undertake. A practical solution to the dilemma is actually suggested by the fact that the interests of a franchisor and its franchisee often diverge. If the franchisor keeps the signing consideration for committing its franchisees to itself, then the franchisees can purchase the articles for full price. The purchasers themselves receive no concessions, and the possibility of price discrimination disappears.

3. IVPC's

A similar problem arises with respect to international volume price concessions ("IVPC's"). IVPC's are price concessions granted to Canadian subsidiaries or affiliates of multinational firms on the basis of the multinational's worldwide purchases from either the seller itself or from the seller's own multinational group. Where the "substance of [the] transaction from the seller's point of view is the sale to a single economic unit, not a sale to each of its diverse parts,"[83] the Director takes the view that IVPC's may be granted with impunity despite the fact that the Canadian operation orders, takes delivery of and pays for the goods in question.

Again, while sound in terms of economic principle, this interpretation of the word "purchaser" appears to be stretched rather thin and should be relied upon with extreme caution.

### G. *"Competitors of a Purchaser"*

Paragraph 50(1)(*a*) only prohibits price discrimination between businesses which the seller knows to be competitors of one another in their downstream markets. Since consumers, charities, and non-market government institutions do not have any downstream markets, price discrimination against these groups is not constrained by the *Act*. With respect to the relevant business customers or market-oriented government agencies, it is competition in the customers' selling markets, not competition for inputs, which is relevant. Clearly, therefore, the definition of the relevant downstream market, both in terms of product and geography, is of key importance.

The *Guidelines* refer the reader to the *Merger Enforcement Guidelines*[84] for an explanation of the analysis which will be followed by the Director in determining whether two or more customers compete in the same product and geo-

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[83] *Ibid.* at 18.
[84] *Merger Enforcement Guidelines*, *supra* note 3.

graphic markets. As discussed above with regard to predatory pricing, the *Merger Enforcement Guidelines*' approach to market definition is highly technical and difficult for businesses involved in speedy transactions to apply.[85] Happily, the *Guidelines* do indicate several more readily discernible ways in which a business can determine if its customers compete in their downstream markets. If customers are known to pay close attention to each other's advertised prices or to engage in comparative advertising, or if one customer asks for a price concession specifically in order to gain an advantage over another customer, a seller may be presumed to know that the customers compete.

Where the seller could not reasonably be expected to know that two or more customers compete, it will be absolved of liability for price discrimination between them. The *Guidelines* suggest that there is a duty on the part of the seller to inquire as to whether or not customers compete where there are circumstances, such as those mentioned above, which warn the seller that such may be the case.

### *H. "At the Time the Articles are Sold"*

Since the price discrimination provision is not meant to restrict sellers from changing their prices over time, it is important that the Director examine only those price concessions which were available to a customer at the time the articles were sold to a competitor. In most simple transactions, goods are paid for and received at the same time, and there is no issue as to when the articles were sold. Long-term or complex transactions can give rise to questions as to the correct period of time for comparison purposes under paragraph 50(1)(*a*).

The *Guidelines* point out this problem and indicate that, since the price terms are the important aspects of the transaction for price discrimination questions, it is the time at which these terms are agreed upon which will be relevant.

### *I. "Directly or Indirectly"*

Paragraph 50(1)(*a*) prohibits granting discriminatory price concessions either "directly or indirectly." The *Guidelines* point out that this wording covers attempts by a seller to avoid the *Act* by incorporating a shell company to market the goods on a preferential basis to a preferred customer.

### *J. "Like Quality and Quantity"*

Prior to the *Guidelines*, the Director's approach to price discrimination enforcement was that price differences could only be justified on the basis of different quantities or qualities of the articles in question.[86] Under the new *Guidelines*, price differences are fine so long as they are made "available" to competing purchasers of goods of like quality and quantity. Although disputing

[85]See text accompanying notes 25-29.

[86]D.H.W. Henry, Q.C., Director of Investigation and Research under the *Combines Investigation Act*, "Notes for an Address to the Public Buyers Group of British Columbia" (Vancouver, 12 October 1962) in Affleck & McCrachen, eds., *supra* note 80, vol. 2, 45-99 at 45-103.

"like quality and quantity" is no longer a seller's *only* defence once a price differential is proved, it is certainly still open to a seller to assert that the articles sold are not of like quality and/or quantity.

The word "like" is used in the sense of "similar." Goods need not be identical to be of "like" quality. Generally, two articles will be considered to be of like quality, despite some differentiation in terms of physical attributes (*e.g.* colour), functions (*e.g.* precise features of a consumer electronic good), labelling or trade-marks if end-use consumers are not willing to pay more for one of the articles:

> In general, a trade-mark or label or other attribute which causes consumers to perceive a difference significant enough to be reflected in the price they are willing to pay for the article suggests to the Director that the article so differentiated should not be considered to be of "like quality" when compared with physically identical articles lacking the trade-mark or other differentiating feature.[87]

Similarly, "like" quantity does not mean that precisely the same number of articles need be ordered. The Director will consider industry practices in pricing the articles to determine if the quantities involved would ordinarily be afforded the same price treatment. This common-sense approach should not be difficult for industry to apply. The issue of "like" quantity is thus not likely to be highly contested for single product sellers.

For multi-product sellers, however, both the *Discussion Paper*[88] and the *Draft*[89] indicated that price concessions could only be granted on the basis of the total purchases if the articles sold were within the same general category of goods, such as consumer electronics. The rationale behind this restriction was never clear, since multi-product sellers benefit from high volume purchases regardless of any similarity in the end-use of the products sold. The final *Guidelines* now clearly state that volume rebates can safely be granted on the basis of aggregate purchaser volumes across product lines, regardless of the nature of the products, so long as any tied selling which may be involved does not lessen competition to the point where a review under section 77 of the *Act* is called for.[90]

### *K. "Knowledge"*

Price discrimination under paragraph 50(1)(*a*) of the *Act* is a criminal offence. A necessary element of the offence is, therefore, some measure of intent on the part of the perpetrator. The *mens rea* of price discrimination is supplied by the requirement that the seller have "knowledge" of each substantive element of the offence.

According to the *Guidelines*, "willful blindness" will also satisfy this element in the sense that a person who deliberately fails to inquire, while knowing that there is a reason for inquiry, will be deemed to possess the knowledge

[87] *Price Discrimination Enforcement Guidelines*, *supra* note 2 at 22.
[88] *Discussion Paper*, *supra* note 72 at 20.
[89] *Draft*, *supra* note 73 at 21-22.
[90] *Price Discrimination Enforcement Guidelines*, *supra* note 2 at 23.

which the inquiry would have supplied. Sellers cannot defend themselves against price discrimination charges by failing to ask whether, for example, customers who have never done so in the past actually meet some volume or growth quotas upon which new price discounts are based. Similarly, willful blindness as to whether or not two customers are competitors will be deemed to be knowledge of such competition. Again, the *Guidelines* would suggest the existence of a duty on the part of sellers, when in doubt, to make reasonable inquiries in order to assure themselves as to whether or not their price concession programs will result in discrimination.

### *L. "A Practice of Discriminating"*

Subsection 50(2) states that no single sale constitutes price discrimination unless the impugned price concession was part of a "practice" of discriminating. There must be some systematic pattern of discriminating. Temporary concessions granted in order, for example, to meet a competitor's terms, to win a new account or to enter a new market will not normally constitute a "practice." Similarly, one-time price concessions such as clearance or anniversary sales will not be part of a practice of discriminating. In any situation, however, the Director will look at the frequency, duration, consistency and purpose behind the pricing behaviour.

The Director's explicit recognition of the existence of a "meeting the competition" defence will be welcomed by the business community. This defence is explicitly included in the *Robinson-Patman Act* in the United States,[91] and its recognition by the Director is both sound in law and a welcome step toward the compatibility of our competition law regimes. Uncertainty remains over the time limits which the Director will consider reasonable for the application of this defence, but the statement nonetheless gives the green light to a more competitive pricing strategy by Canadian businesses.

Perhaps significantly, there is no separate mention of tender offers as there was in the *Draft*,[92] and it must be assumed that, in the Director's view, tender offers can form the basis for price discrimination if a "practice" of discriminating can be found.

### *M. Implications for Promotional Allowances (section 51)*

The *Guidelines* mention in the Appendix that section 51, which deals with discriminatory promotional allowances other than those applied directly to the sale price of the goods, may be relevant to fact situations which give rise to price discrimination issues. Unfortunately, there is no discussion of the Director's approach to enforcement of this provision, and it is not safe to assume that it will be the same as that which applies to price discrimination. The wording of section 51 leaves little room for maneuvering by a seller when granting allowances or other concessions to customers for use in advertising or displays.

[91] Section 3(*b*), *Robinson-Patman Act*, *supra* note 68.
[92] *Draft*, *supra* note 73 at 24.

To begin with, advertising allowances which are collateral to a sale but not directly applied to the purchase price must be offered by the seller on the same proportionate terms to all customers. The use of the word "offer" implies a duty on the part of the seller to take active steps to inform all customers of the availability of the allowance. A seller need only grant an offending allowance on one occasion; there is no requirement that it be part of a practice of discriminating, as there is for price discrimination. Furthermore, the prohibition covers allowances granted collateral to the sale of any "product," which includes both articles and services. Finally, the allowances can only be granted in proportion to the total volume of sales to each purchaser. Other criteria for qualification, such as sales growth or minimum sales volume would be quite acceptable in relation to price discrimination, but would constitute grounds for criminal liability when applied to non-price promotional allowances under section 51 of the *Act*.

Businesses who wish to steer clear of the strict dictates of section 51 should apply promotional allowances directly to the purchase price of the articles or services in question, by granting, for instance, a promotional discount calculated as a certain percentage of the sales price of the goods sold. The problem for the business community, however, is that businesses do not normally distinguish between price and non-price concessions. The bottom-line cost to the seller of granting any concession is all that is relevant to that seller, regardless of the formal manner in which the concession is eventually awarded. Clarification from the Director to bring section 51 into line with this economic reality would be helpful. If the wording of the section proves to be too restrictive to permit such clarification, then amendment of section 51 may well be warranted.

### *N. Abuse of Dominance and Price Discrimination*

Price discrimination can form part or all of the basis of a civil prosecution by the Director under the "abuse of dominant position" provisions in sections 78 and 79 of the *Act*. In this case, the focus would be not only on the seller's actions, but also on the competitive effects of those actions.[93] The added focus on competitive effects is essential from an economic point of view.

[93] A s. 79 order can only be made upon a finding by the Competition Tribunal that:

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

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

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

The section requires that the impugned behaviour substantially lessen competition in a market, but does not require that this effect be felt in the abuser's own primary market. In its decision in *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606, 93 D.L.R. (4th) 36 [hereinafter *PANS* cited to S.C.R.] the Supreme Court of Canada held that an "undue" lessening of competition under s. 45 of the *Act* implied a significant or substantial degree of market power (*ibid.* at 652-55). The implication is that a "substantial lessening of competition" under s. 79 requires only a material degree of market power, making s. 79 applicable where price discrimination is practised by a dominant firm against all but the most marginal of customers. Thus, s. 79 is a potentially effective weapon against anti-competitive price discrimination, a practice whose competitive effects are felt in the purchaser's, rather than the seller's, market.

In fact, there are several advantages for the Director in proceeding under section 79 rather than paragraph 50(1)(*a*). Pricing programs which fall short of criminal price discrimination (*e.g.* in respect of services) may nonetheless constitute an abuse of market power if their effect is to lessen competition substantially. The Director can prosecute the case before the Competition Tribunal rather than the courts, and a civil rather than a criminal standard of proof applies. Moreover, the section provides the Director with the ability to combine different forms of behaviour to show abuse, without the requirement that each instance on its own form a practice of behaviour.[94] Given these evidentiary advantages, and the fact that the overall purpose of the *Act* is to constrain action with anti-competitive effects, one would expect to see price discrimination arise in the context of section 79 cases more frequently than in the context of section 50 prosecutions.

In fact, the *Discussion Paper* indicated that price discrimination which did not have anti-competitive effects would not likely be the subject of a criminal prosecution by the Director.[95] The Director stated in that document that most price discrimination matters would be resolved by information or investigation visits, undertakings or consent orders, rather than by criminal prosecution. No such statement has been made in the *Guidelines*. Despite this omission, the Director's policy is still to attempt to achieve compliance rather than to prosecute infractions in all but the most egregious of cases.

## Conclusions

Both the *Predatory Pricing Enforcement Guidelines* and the *Price Discrimination Enforcement Guidelines* should be required reading for pricing managers and legal counsel to Canadian businesses. They represent the first comprehensive review of these two offences by the government official responsible for the enforcement of the *Act* in Canada. While not legally binding, the analysis contained in the *Guidelines* will no doubt form the framework for argument in future litigation relating to paragraphs 50(1)(*c*) and 50(1)(*a*) of the *Act*. Of more immediate impact, however, will be their role in providing practical guidance to Canadian businesses that wish to engage in aggressive pricing strategies without fear of liability under the *Act*.

Without meaning to diminish the important contribution of the *Guidelines* to the development of competition law in Canada, we feel there are a few areas in which they fall short of their goals of providing practical business advice and an economically sound framework for legal analysis. Some of these shortfalls are due to the wording of the provisions with which the Director has to work. Others reflect, perhaps, the fact that the *Guidelines* have undertaken truly pioneering work in the field. In offering the comments contained in this paper, we are cognizant of the fact that it is very much easier to criticize than it is to create. We do so in the hope that our comments will lead to further debate on these important competition law topics.

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[94] *NutraSweet*, *supra* note 15 at 35.
[95] *Discussion Paper*, *supra* note 72 at 6.

Our principal comments regarding the *Predatory Pricing Enforcement Guidelines* are as follows:

(1) The two-part structure of the test for "unreasonably low" prices, following in large part the test proposed by Joskow and Klevorick, is legally and economically sound. By "reading in" a test for the market power of the alleged predator into the test for "unreasonably low," the Director will avoid prosecuting firms that are incapable of inflicting the monopoly prices on consumers that paragraph 50(1)(*c*) is designed to prevent.

(2) Due perhaps to the fact that the market power test is not explicit in the legislation, the Director has equivocated in the *Guidelines* as to whether or not the lack of such market power will preclude further investigation by the Bureau.

(3) The usefulness of the highly technical test for market definition from the *Merger Enforcement Guidelines* is rather less for *ex ante* pricing decisions than it may be for those contemplating mergers. The *Price Discrimination Enforcement Guidelines* propose more practical data to which a business planner can look to determine who competes with whom. Such practical tests could also be proposed for the *Predatory Pricing Enforcement Guidelines.*

(4) It appears that the Director will always be willing to look not only at market share, but also at relative firm size and the use of strategic behaviour by a firm in determining if that firm has sufficient market power to carry out a successful predatory plan. Since these factors also figure into the next part of the analysis of market power, the role of the thirty-five per cent benchmark for market share is unclear.

(5) The analysis of conditions for entry into the market focuses on cost advantages and sunk costs. Aside from the misclassification of some examples of these potential barriers to entry, our criticism is that the Director has failed to distinguish between barriers which result from the greater efficiency of the incumbent firm and those which are due to outside influences or strategic firm behaviour. Only the latter possibly pose a threat to efficient *competition*, as opposed to inefficient *competitors*. Exploitation of an incumbent firm's greater efficiency should not result in potential criminal liability. If Canadian capital markets are not efficient enough to finance effective competition in the presence of efficiency-enhancing sunk costs and economies of scope and scale, financial institution reform will be a much more effective tool than competition law to remedy the problem.

(6) Despite the recognition in the literature that only anticipated long-run costs are relevant for long-run pricing strategies such as predatory pricing, the *Guidelines* fail to distinguish between long-run and short-run costs. Moreover, the stated preference for the use of anticipated as opposed to book costs is equivocal.

(7) The analysis of prices which lie between average total and average variable costs needs further development. The factors proposed in the *Guidelines* for evaluating such "grey area" prices do not appear to add anything relevant to the analysis of market power. In fact, one is left with a test which says that, if

sufficient market power exists to warrant a price-cost comparison in the first place, then prices below average total cost will be predatory. Moreover, the Competition Tribunal's comments in *NutraSweet* to the effect that there is no grey area — but that marginal costs are better approximated by total or variable costs depending on whether the firm is producing at or below capacity — are entirely unaddressed. The Director has thus ignored a direct invitation by the Competition Tribunal to refine his analysis of the appropriate pricing test, and the question raised in *NutraSweet* awaits another day for a response.

(8) In our view, the intent of the alleged predator is irrelevant for the purposes of determining if its prices are unreasonably low. By including intent as a factor in *all* stages of his analysis, the Director has left open the possibility that a business will be accused of predatory pricing simply because it wishes to gain the upper hand on its rival. In our view, it is impossible to distinguish between predatory and non-predatory competitive intent. The Director is required by the wording of paragraph 50(1)(*c*) to consider intent as part of the "harm" element of the offence; furthermore, the *Charter*[96] mandates that intent be considered with respect to the *mens rea* of the offence.[97] We lament the inclusion of intent in the analysis of whether the prices are "unreasonably low," an inclusion which is not legally required.

(9) From our premise that intent has no role in an evaluation of the *actus reus* of pricing strategies, we conclude that predatory pricing is really only a problem when market conditions are conducive to its success. In a fully functioning competitive market, such strategies only harm their perpetrator and cannot lead to monopoly prices. The abuse of dominance provisions of sections 78 and 79 of the *Act* are therefore the more appropriate mechanism to deal with successful predation. The *Guidelines* indicate that the Director has the choice between proceeding under paragraph 50(1)(*c*) or section 79, but does not elaborate on how the Director's analysis might differ given the more flexible wording of the definition of "anti-competitive act."

Our principal comments regarding the *Price Discrimination Enforcement Guidelines* are as follows:

(1) The wording of paragraph 50(1)(*a*) leaves no room for inserting a test for market power into the analysis, yet there can be no harm to the "victim" of the discrimination unless the seller possesses such power. Again, proceedings under section 79, with its requirement that the seller be dominant in its market, would be preferable to criminal prosecution on policy grounds, yet the *Guidelines* make no reference to such a preference on the part of the Director, and do not specifically address the analysis which will be undertaken under section 79.

[96]*Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11.

[97]The Supreme Court of Canada's discussion in *PANS*, *supra* note 93 at 658-60 of *mens rea* as it applies to the conspiracy provisions under section 45 of the *Act* is relevant by analogy to predatory pricing. Following the logic in *PANS*, the Crown would be required to show that the predator had the subjective (*i.e.* actual) intention to set its prices below the relevant cost measure, and the objective (*i.e.* constructive) intention to substantially lessen competition or eliminate a competitor.

(2) A much more liberal approach to price discrimination than has hitherto been the case is heralded by these *Guidelines*. This approach recognizes the fact that competitive markets can result in many different forms of price concessions for many different legitimate reasons. Thus, conditional and functional discounts will now be permitted so long as they are "available."

(3) The Director's interpretation of the word "available" in paragraph 50(1)(*a*) seems to require a degree of action on the part of the seller which is difficult to distinguish from that required by the word "offer" in section 51. Assuming that Parliament intended the two words to mean different things, we question whether sellers will be required to actively inform potential customers of concessions granted to other customers to the extent indicated in the *Guidelines*.

(4) In an attempt to recognize the modern phenomena of buying groups, franchise systems and multinationals with considerable purchasing power, the *Guidelines* indicate that concessions granted to Canadian businesses due to their association with such larger entities will not be considered to be price discrimination so long as the Canadian business is the "true" purchaser. While this approach appears supportable under the wording of paragraph 50(1)(*a*) with respect to buying groups, it appears to us to stretch the meaning of the word "purchaser" a bit too far with respect to franchise systems and multinationals. We advise the use of caution by businesses who are contemplating granting price concessions to franchisees or IVPC's to Canadian affiliates of multinationals.

(5) The *Guidelines* indicate that the Director will exempt most transfers between affiliated businesses from the scope of the provisions. This exemption does not, however, appear to be supported by the legislation; again, caution is advised.

(6) The treatment of market definition in the *Price Discrimination Enforcement Guidelines*, while still referring to the technical analysis of the *Merger Enforcement Guidelines*, nonetheless provides businesses with practically available sources of information as to whether two purchasers compete in the same market. This practical approach could usefully be applied to the *Predatory Pricing Enforcement Guidelines* as well.

(7) Prior to the *Guidelines*, the only defence to charging different effective prices to different customers was that they were not customers in respect of the "like quality and quantity" of articles. While diminished in importance now that the defence of "like availability" will be permitted, "like quality and quantity" is still highly relevant. The Director's common-sense approach to the interpretation of these words is welcome, as is the recognition in the *Guidelines* that multi-product sellers can aggregate purchaser volumes across product lines for the purpose of granting volume-related price concessions.

(8) Section 51 of the *Act* deals with discriminatory non-price promotional allowances. It is obviously closely related to the price discrimination provision, yet the *Guidelines* do not indicate how the Director's approach to section 51 will differ from that applicable to paragraph 50(1)(*a*). This would have been useful

in light of the more restrictive wording of section 51 which leaves some of the defences to price discrimination unavailable to those accused of violating section 51.