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Limbo dancing and predatory pricing in Europe
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Predatory pricing is, in Europe as in Canada, oft-alleged but seldom proved. Broadly speaking, it consists in one competitor setting a price which is “too low”, such that one or more competitors find themselves unable to compete at that price. The trouble is that this scenario sounds a great deal like Adam Smith’s invisible hand going to work, determining that only the fittest survive in the Darwinian world of a market economy. What is it that distinguishes predatory pricing from vigorous competition? How low can you go?

This question has long vexed courts and competition law enforcement agencies in Europe, Canada and other jurisdictions. The answer has in turn depended in part on the perceived goals of competition law enforcement, as well as on the accepted economic wisdom of the time. Given the issuance of revised *Predatory Pricing Enforcement Guidelines*¹ in Canada in 2008, with their firm commitment to analyzing predatory pricing under the rubric of abuse of dominance rather than the out-dated criminal provision in the *Competition Act*,² it is instructive to examine the treatment of predatory pricing by both the courts and the enforcement agencies in Europe and to examine the extent to which it differs from that in Canada.

Our conclusion is that, despite radically different legal provisions, the treatment of predatory pricing by European courts has been remarkably similar to that in Canada. So too, Canada’s Competition Bureau has come to share views which are broadly similar to those of DG Competition with respect to the pre-conditions for a predatory pricing case. In both cases, the enforcers are out ahead of the courts to a certain extent, however, so the extent to which they bring the courts along with them in future cases will be interesting. Even with respect to settled law, however, there are some important differences between the two jurisdictions and limbo-dancing price-makers should take note.

Article 82 of the *Treaty establishing the European Community* provides the basis for predatory pricing law in Europe.³ Article 82 provides:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

¹ Competition Bureau, *Predatory Pricing Enforcement Guidelines* (Ottawa: Industry Canada, 2008) available online at: http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/vwapj/Predatory_Pricing_Guidelines-e.pdf

² R.S.C. 1985, c. C-34

³ EC, *Consolidated Versions of the Treaty on European Union and of the Treaty Establishing the European Community*, [2002] O.J. C 325/01 at Article 82, C 325/65 (emphasis supplied).

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

For the purposes of Article 82, predatory pricing is said by DG Competition to have occurred when:

a dominant company lowers its price and thereby deliberately incurs losses or foregoes profits in the short run so as to enable it to eliminate or discipline one or more rivals or to prevent entry by one or more potential rivals thereby hindering the maintenance or the degree of competition still existing in the market or the growth of that competition.⁴

Predatory pricing by a dominant firm is a civil offence under EC law, and like other instances of abuse of dominance, can be punished with fines of up to 10% of turnover.⁵ Indeed, significant fines have been imposed on companies engaged in predatory pricing abuses. For instance, in *Deutsche Post*⁶ a € 21.6 million fine was ordered and in *France Télécom*⁷ a € 10.35million fine was imposed. In *Tetra Pak I*,⁸ the Commission imposed a fine of € 75 million on Tetra Pak for its abusive practices violating Article 86 (now Article 82), including predatory pricing.

Against the background of established case law regarding abuse of dominance generally and predatory pricing in particular, the European Commission initiated a process in 2005 to review the policy underlying Article 82 and its appropriate enforcement approaches thereto. The broad policy concerns behind the Article 82 review were explained at the time by EC Competition Commissioner (the “Commissioner”), Neelie Kroes, who acknowledged that, historically, “fairness” rather than consumer welfare had been the primary concern of Article 82. However, she suggested that with the evolution of economics, competition policy needed to evolve accordingly.⁹ She posited the view that “the objective of Article 82 is the **protection of competition** on the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources.”¹⁰ The Commissioner expressed her philosophy in simple words: “First, it is competition, and not competitors, that is to be protected. Second, ultimately the aim is to avoid consumers harm.”¹¹ Based on this principle, aggressive competition should be encouraged, even if it hurts competitors, as long as it benefits consumers in the short and long term. The Commissioner was convinced that “the exercise

⁴ *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*, European Commission, Brussels, December 2005 at para. 93.

⁵ Article 15(2), EEC Council: Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty, Official Journal 013 , 21/02/1962 P. 0204 - 0211. Available online at < <http://eur-lex.europa.eu>>. See Appendix 1 for a copy of Article 15(2).

⁶ Commission Decision of 20 March 2001, Case COMP/35.141, OJ L 125/27, 5.5.2001 [*Deutsche Post*].

⁷ Case T-340/03 *France Télécom SA v. Commission*, Court of First Instance (C.F.I.) (30 January 2007) [*France Télécom*].

⁸ *Tetra Pak International SA v Commission of the European Communities*, T-83/91, [1994] E.C.R. II-00755 (C.F.I.) [*Tetra Pak I*].

⁹ Neelie Kroes, Commissioner of Competition (EU), “Preliminary Thoughts on Policy Review of Article 82” (Speech at the Fordham Corporate Law Institute, 23 September 2005), online at <http://ec.europa.eu/comm/competition/antitrust/art82/index.html>.

¹⁰ *Ibid.* [emphasis in original]

¹¹ *Ibid.*

of market power must be assessed essentially on the basis of its effects in the market, although there are exceptions such as the *per se* illegality of horizontal price fixing.”¹²

In December 2005, as part of the review process, DG Competition released a public discussion paper (the “Discussion Paper”) on possible changes to its approach to the enforcement of all aspects of Article 82.¹³ As we will see below, although the Discussion Paper advocated impugning allegedly abusive behaviour only when it could be proven likely to damage competition (an “effects-based approach”), the need to respect established European precedent has resulted in an approach that – even if the Discussion Paper were implemented by the European courts – would give dominant firms somewhat less pricing flexibility in Europe than in Canada.

Although predatory pricing is a criminal offence in Canada — or perhaps because of that fact — enforcement proceedings have actually been more rare in Canada than in Europe. Section 50(1)(c) of the *Competition Act*¹⁴ provides that:

50. (1) Every one engaged in a business who

...

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

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

There is no requirement that the alleged predator be dominant, nor that competition — as opposed to a competitor — be harmed. Despite the strict legal provision, however, there have been very few prosecutions and the Competition Bureau’s recently revised *Predatory Pricing Enforcement Guidelines* make it clear that allegations of predatory pricing will in the first instance be investigated by the Bureau under the civil abuse of dominance provisions.¹⁵ In that regard, section 79 of the *Competition Act* enables the Competition Tribunal, on application by the Commissioner of Competition, to issue an order prohibiting anti-competitive conduct and requiring such actions as are necessary to restore competition if it finds that (a) a dominant firm, (b) has engaged in a “practice” of “anti-competitive acts”, with (c) the effect or likely effect of substantially lessening or preventing competition:

79. (1) Where, on application by the Commissioner, the Tribunal finds that

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

(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,

¹² *Ibid.*

¹³ *Supra* note 5.

¹⁴ R.S.C. 1985, c. C-34.

¹⁵ Section 36 of the *Competition Act* permits private parties that have been damaged by behaviour that violates the criminal provisions of the Act to sue in court for such damages, even if there has been no criminal conviction. In practice, however, private enforcement actions under the *Competition Act* have been relatively rare and are confined mainly to class actions for damages following convictions in criminal price-fixing cases.

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.¹⁶

(2) **Additional or alternative order** – Where, on an application under subsection (1), the Tribunal finds that a practice of anti-competitive acts has had or is having the effect of preventing or lessening competition substantially in a market and that an order under subsection (1) is not likely to restore competition in that market, the Tribunal may, in addition to or in lieu of making an order under subsection (1), make an order directing any or all the persons against whom an order is sought to take such actions, including the divestiture of assets or shares, as are reasonable and as are necessary to overcome the effects of the practice in that market.

(3) **Limitation** – In making an order under subsection (2), the Tribunal shall make the order in such terms as will in its opinion interfere with the rights of any person to whom the order is directed or any other person affected by it only to the extent necessary to achieve the purpose of the order.

(4) **Superior competitive performance** – In determining, for the purposes of subsection (1), whether a practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal shall consider whether the practice is a result of superior competitive performance.

Section 78 gives a non-exhaustive list of anti-competitive acts that includes, among other things: (a) squeezing, by a vertically integrated supplier, of the margin available to a competing but unintegrated customer, for the purpose of impeding or preventing the customer's entry into or expansion in a market; (d) use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor; and (i) selling articles at a price lower than acquisition cost for the purpose of disciplining or eliminating a competitor.

Section 78 and 79 of the *Competition Act* was, in fact, modeled on what is now Article 82 of the Treaty. Unlike in Europe, the Competition Tribunal in Canada cannot impose fines for abuse of dominance and private parties also cannot sue for damages. Especially in light of recent legislative proposals to enable the Tribunal to impose "administrative monetary penalties" in the millions of dollars for abuse of dominance,¹⁷ however, it is interesting at this stage of legal development in both jurisdictions to examine the similarities and the differences in approach to predatory pricing in Europe and in Canada.

¹⁶ *Supra* note 15 at s. 79(1).

¹⁷ Bill C-19, supported by the then-Liberal government in 2006, proposed to repeal the criminal predatory pricing provision, but to enable the Competition Tribunal to impose fines of up to \$10 million for abuse of dominance, and up to \$15 million for a "repeat offence". It died on the order paper with the federal election call in late 2006. Bill C-454, a private member's bill introduced in the recent minority Conservative Parliament, called for those same measures as well as the ability of private parties to bring abuse cases before the Tribunal (currently, abuse cases are the preserve of the Commissioner) and of the Tribunal to award damages therefore. As Parliament has again been dissolved with the call of another federal election, these reform measures (supported in large part by the Commissioner) will again await another day. For a discussion of the policy implications of introducing fines for abuse of dominance, see Hutton and McKenna, "My Brother's Keeper? fines and damages for 'violations' of the civil reviewable practice provisions of Canada's Competition Act", CBA Annual Competition Law Conference, Ottawa, Canada, October 2-3, 2003.

Predatory Pricing in Europe: the case law

The fundamentals: When are prices “unfair”?

Given a presumed profit motivation for healthy competition, prices are usually thought to be “unfair” when they go below some measure of the dominant firm’s costs. The question has long been asked, however, as to the appropriate measure of costs. The leading European case on predatory pricing is *AKZO*.¹⁸ In that case, a relatively small company, ECS, sold benzoyl peroxide to flour mills in the UK as a whitening agent. AKZO sold the same product in the broader European Community for use in the manufacture of plastics. This was a much larger market than that served by ECS, and ECS decided to start selling to the plastics industry as well. AKZO apparently did not appreciate the new competition, and made it clear to ECS that it was willing and able to undercut prices in the flour milling sector in order to maintain its position in the plastics sector, even if it meant taking a loss. ECS sought and received a protective order against AKZO, but even with this order in place, AKZO’s subsequent pricing practices were found by the European Commission to have breached Article 86 (now Article 82). On appeal, this finding was upheld by the European Court of Justice (the “ECJ”).

According to the Court’s decision in *AKZO*, two main categories of prices may be considered to be abusive when set by dominant companies. First, prices set below average variable cost (AVC, *i.e.* costs which vary depending on the quantities produced) “must be regarded as abusive.” Since sales at such prices will always generate a loss, there is presumed to be no rational explanation for such a practice other than a desire to eliminate competitors and subsequently raise prices.¹⁹ Second, prices set above AVC but below average total cost (ATC, *i.e.* variable cost plus fixed cost) will be regarded as abusive “if they are determined as part of a plan for eliminating a competitor.”²⁰ AKZO’s prices were found to have been between AVC and ATC and it was therefore necessary to determine the motivation for such prices.

*Deutsche Post*²¹ is an interesting supplement to the *AKZO* line of cases; in that case the Commission recognized that the classification of costs as variable or fixed changes over time. Deutsche Post had a government-sanctioned monopoly on the market for letterpost delivery services. It also ran a mail-order package delivery service. The complainant, UPS, alleged that Deutsche Post had offered loss-making prices on its package delivery service and that it was subsidizing these prices with revenue from its letterpost monopoly. The Commission ruled that the complaint was well-founded, finding that for five years Deutsche Post’s package prices had not covered the long-run average incremental costs (LAIC) of providing that service. The Commission’s decision required Deutsche Post to reorganize its finances, separating the two services, with the letterpost arm “charging” the parcel delivery arm for services at the same rate that would be charged to any third-party competitors. The case established the principle that “a dominant company, especially one with a statutory monopoly, which then sets up a new business must cover the entire incremental cost (all the variable and fixed costs) incurred by the new venture entirely from its revenues from that new business.”²²

Prices above ATC are generally not considered to be predatory since they will only eliminate less efficient competitors. European courts and enforcers have not ruled out finding an

¹⁸ *AKZO Chemie BV v Commission of the European Communities*, C-62/86, [1991] E.C.R. I-03359 (E.C.J.), reversing on other grounds, the Commission’s decision: 85/609/EEC, IV/30698-ECS/AKZO Chemie, Official Journal 1985 L374, p.1 [*AKZO*].

¹⁹ *Ibid.* at para. 71.

²⁰ *Ibid.* at para. 72.

²¹ *Supra* note 7.

²² D.G. Goyder, *EC Competition Law*, 4th ed. (Oxford: University Press, 2003) at 288.

abuse of dominance on the basis of even profitable prices, however, if “exceptional circumstances indicate that such price cuts have led or will lead to substantial harm to consumers.”²³ *Compagnie Maritime Belge*,²⁴ for example, presented the Commission with such exceptional circumstances. Several members of a shipping consortium, CEWAL, were found to hold a position of dominance. Overall, CEWAL members had more than a 90% share of the relevant shipping market. When a new, non-member competitor, G&C, sought to compete with them, CEWAL responded by sailing “fighting ships” on the same routes and ports as G&C. The fighting ships matched the prices which G&C was charging to freight customers, and the impact of the reduced earnings was spread over and absorbed by all the members of the consortium. The court held that this was an abuse of dominance because it eliminated the principal, if not only, means of competition available to G&C, and any other company that might wish to compete with CEWAL.²⁵ (Besides which, CEWAL in fact admitted at the hearing that the purpose of its conduct had been to eliminate G&C from the market).²⁶

Intent in the grey zone between AVC and ATC

One of the trickiest parts of a predatory pricing case can be to distinguish competitive from anti-competitive intent. Under-cutting a rival’s prices in order to “steal” its business is a hallmark of the competitive process. How to distinguish healthy from anti-competitive undercutting in the “grey zone” between AVC and ATC?

AKZO’s intent to eliminate was proven by its threats to sell to ECS’s customers at a loss, by the offers it actually made to ECS’s customers at prices “well below what was necessary to compete with ECS,”²⁷ and by the fact that it offered lower prices to customers of ECS than to other customers.²⁸

The European Court followed similar reasoning in the subsequent predatory pricing case, *Tetra Pak I*.²⁹ There, the standard of proof for anti-competitive intent was met by reference to:

the duration, the continuity and the scale of the sales at a loss, the accounting data showing that the dominant company imported some products only to resell them below cost in the targeted area, deliberately incurring losses. The file showed as well that the prices in the targeted area were lower by 20% at least and often by 50% than the prices applied in other geographic markets. Finally, the file contained reports of the board of directors referring to the need to make major financial sacrifices in prices and supply terms to fight competition.³⁰

The ability to infer predatory intent from pricing practices, as combined with other concurrent practices targeting a particular competitor(s), has been said to simplify the approach and

²³ *Supra* note 5 at para. 127.

²⁴ Joined Cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports SA (C-395/96 P), Compagnie maritime belge SA (C-395/96 P) and Dafra-Lines A/S (C-396/96 P) v Commission of the European Communities* [2000] ECR I-01365 [*Compagnie Maritime Belge*].

²⁵ *Ibid.* at para. 117.

²⁶ *Ibid.* at para. 119.

²⁷ *Ibid.* at para. 108.

²⁸ *Ibid.* at para. 115.

²⁹ *Supra* note 9 at para.247. In this case, The Commission found that Tetra Pak was in a dominant position on the markets in aseptic machines and cartons intended for the packaging of liquid foods, and it abused that position on those markets and on the markets in non-aseptic machines and cartons. Tetra Pak held 89% of the market in aseptic cartons and 92% of that in aseptic machines. The Commission found that Tetra Pak had infringed Article 86 (now Article 82) by several practices, including charging price of cartons at predatory price (below average variable costs) to eliminate competitors, and imposed a fine of ECU 75 million on Tetra Pak. This decision was upheld by the C.F.I.

³⁰ Philip Lowe, *Introductory address to the Seminar ‘Pros and Cons of Low Prices*, 5 December 2003, online: European Union Competition website, <http://ec.europa.eu/comm/competition/speeches/text/sp2003_066_en.pdf>.

obviates the need for dawn-raid hunts for “smoking gun” documents.³¹ It is also important to note that all predatory pricing cases in Europe require the Commission to show first that the alleged predator is dominant in the market in question, such that their actions are likely to have a significant effect on rivals and would-be rivals. Neither the Commission nor the Courts have focused too heavily, accordingly, on distinguishing between competitive and anti-competitive intent. Rather, the focus has generally speaking been on the existence or lack thereof of a profitable business rationale for the price other than the elimination of a competitor.³²

Recoupment: *Tetra Pak II*

Aside from the appropriate measure of costs, the role of recoupment has often been at the heart of debates about predatory pricing enforcement. If a firm can never raise its prices to supra-competitive levels in order to recoup the losses incurred from the below-cost prices, then even if the predatory pricing successfully drives out a competitor, customers will only be benefited by the low prices. The European view of recoupment has focused less on consumer benefit, however, than on protecting the competitive process itself, as reflected in another leading case, *Tetra Pak II*.³³

In decisions below, *Tetra Pak* had been found to be dominant in the aseptic packaging market, but not in the market for non-aseptic packaging. Even though the impugned conduct occurred in the non-aseptic market, because the two markets were so closely related, *Tetra Pak* was found to have abused its dominance in the aseptic market via its conduct in the non-aseptic market. The Court reaffirmed *AKZO*'s holding that prices below AVC would be automatically regarded as abusive, without the need to establish intent to eliminate. *Tetra Pak* tried to defend itself by arguing that, since it was not dominant in the aseptic market, there was no realistic chance of recouping its losses by later raising prices in that market, and therefore no abuse of dominance. The Court rejected this argument, and stated that the possibility of recoupment is not necessary for a finding of predatory pricing. “It must be possible to penalize predatory pricing whenever there is a risk that competitors will be eliminated... The aim pursued, which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors.”³⁴

The Latest Case: *France Télécom*

*France Télécom (FT)*³⁵ largely follows the line of cases originating with *AKZO*; the Court uses the same dual below-AVC/above-AVC-below-ATC benchmark for costs as in previous cases, and it again did not require proof of recoupment for a finding of predation.³⁶ *FT* did, however, add to the prior law on predatory pricing in one considerable respect: the rejection of the so-called “meeting the competition” defence.

The ECJ rejected *FT*'s contention that it had merely aligned its prices with those of its competitors, and that it was irrelevant that the price set by competitors happened to be below its own costs.³⁷ The Court noted that its previous jurisprudence and prior Commission decisions on this defence, of which only *AKZO* was cited by *FT* in support of its argument,

³¹ *Ibid.*

³² See *AKZO supra* note 18.

³³ Case C-333/94 P *Tetra Pak International SA v Commission of the European Communities* [1996] ECR I-05951 [*Tetra Pak II*].

³⁴ *Ibid.* at para. 44.

³⁵ *Supra* note 8. In this case, Wanadoo Interactive SA (“WIN”) was part of the France Télécom group and covered the operational and technical aspect of internet access service in France. The Commission found that WIN infringed Article 82 by charging for its ADSL services “predatory prices that did not enable it to cover its variable costs until August 2001 or to cover its full costs from August 2001 onwards, as part of a plan to pre-empt the market in high-speed internet access during a key phase in its development.” (*Supra* note 8 at para.5). The Commission imposed a fine of EUR 10.35 million. This decision was upheld by the Court of First Instance.

³⁶ *Ibid.* at para. 219.

³⁷ *Ibid.* at para. 171.

had been restricted to rather specific circumstances.³⁸ In any case, because of the nature of the special responsibility imposed on dominant businesses by Article 82, dominant businesses may be deprived of the right to employ business tactics which would be unobjectionable when employed by a non-dominant business.³⁹ Thus, the “meeting the competition” defence will fail in Europe if it can be shown that the purpose behind the price alignment was not to protect the firm’s commercial interest from attack, but actually to “strengthen this dominant position and abuse it”.⁴⁰

In this case, the ECJ did not directly discuss how to differentiate legitimate price cuts from predatory pricing. The court followed the cost tests developed in previous case law and did not require “any demonstration of the actual effects of the practices in question.”⁴¹ In light of the issuance of the Discussion Paper by the Commission only the prior year, and its suggestion that there should be greater focus on the likely economic effects of exclusionary practices such as predatory pricing, some commentators have suggested that in France Telecom, the court missed an opportunity to require proof of recoupment to find an abuse under Article 82.⁴²

The Discussion Paper: Proposed Reform in Europe

As mentioned above, the Commission’s 2005 Discussion Paper⁴³ on exclusionary abuses sought to both clarify the case law and to espouse an effects-based approach to abuse of dominance enforcement that would not impugn behaviour unless it stood to harm consumers. In the case of predatory pricing, however, the need to respect clear precedent resulted in an approach that is nonetheless still in some sense more about protecting competitors (or competition) than consumers.

The Commission stated that when analyzing exclusionary abuses, including predatory pricing, the purpose of Article 82 was not to protect competitors from genuine competition with a dominant company, but to ensure that competitors were able to enter and compete in the market on their merits.⁴⁴ “The central concern of Article 82 with regard to exclusionary abuses is thus foreclosure that hinders competition and thereby harms consumers.”⁴⁵ The Discussion Paper recognizes this principle as consistent with the definition of “abuse” given by the ECJ:

“An objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on basis of the transaction of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.”⁴⁶

Based on this definition, the Discussion Paper implied two factors that must be present for a finding of exclusionary abuse: 1) considering its form and nature, the conduct has the

³⁸ *Ibid.* at para. 179.

³⁹ *Ibid.* at para. 186.

⁴⁰ *Ibid.* at para. 185.

⁴¹ *Ibid.*

⁴² Michal S. Gal, “Below-Cost Price Alignment: Meeting or Beating Competition?” (2007) New York University School of Law, Law and Economics Research Paper Series at part II.

⁴³ *Supra* note 5.

⁴⁴ *Ibid.* at paras. 55-57.

⁴⁵ *Ibid.* at para. 56.

⁴⁶ Case 85/76 *Hoffmann-La Roche & Co. AG v Commission* [1979] ECR 461, at para 91. See also *Supra* note 5 at para. 57.

capability to foreclose the competitors from the market; and 2) market distortion, which hinders the maintenance or the growth of competition, in a market.⁴⁷ The foreclosure of one or two competitors in itself is not sufficient; all the factors need to be analyzed to find a credible theory of foreclosure that fits the facts of the case.⁴⁸ Factors that will be considered include the scope of the conduct in the market (does the behaviour target strategic customers of the competitors or the new entrants?); the existence of network effects and economies of scale and scope; and the degree of dominance of the perpetrator.⁴⁹

Despite its advocacy of an economic-effects based approach, however, the Discussion Paper supports a presumption of abuse for certain conduct. This presumption can nonetheless be rebutted by the dominant company with “convincing evidence” that there are objective justifications for the conduct or that the conduct does not or will not have exclusionary effects.⁵⁰

In the predatory pricing context, in order to identify foreclosure, the Discussion Paper says the Commission will apply an “as efficient competitor” test. The Commission asks the question: would the dominant company be able to survive the exclusionary conduct if it were the target? The Discussion Paper defines the “as efficient competitor” as “a hypothetical competitor having the same costs as the dominant company.”⁵¹ Foreclosure of an as efficient competitor can in general only result if the dominant company prices below its own costs.⁵² The question then becomes which cost benchmark will be applied?

The new benchmark: avoidable cost

As noted above, when assessing the existence of abusive predation under Article 82, the Courts and the Commission had applied certain cost benchmarks, namely AVC and ATC (or, in *Deutsche Post*, long-run average incremental costs, or LAIC). The Discussion Paper adopted a new benchmark: average avoidable cost (AAC), which more closely resembled the benchmark chosen in *Deutsche Post*. AAC is defined as the average cost “that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case usually the amount allegedly subject to abusive conduct.”⁵³ In some situations, AAC will be the same as AVC. In a case where the company has to incur fixed costs to behave abusively, however, both fixed cost and variable cost incurred in the alleged conduct will be included in the calculation of AAC, consequently AAC will be higher than AVC.⁵⁴ According to the Discussion Paper, the essential question that needs to be answered is “whether the dominant company, by charging a lower price for all or a particular part of its output over the relevant time period, incurred losses that could have been avoided by not producing that (particular part of its) output”⁵⁵. As stated in the Discussion Paper, if a company charges a price below AAC, then it means that the company is incurring losses that could have been avoided, and the company is not minimizing its losses. Therefore, absent evidence to the contrary, enforcers may assume that the dominant company made this sacrifice in order to exclude the targeted competitors.⁵⁶

When the price charged by the dominant company is below AAC, the Discussion Paper states that there is an automatic presumption of predation. This is the position supported by the ECJ in the AKZO case, except in that case the cost benchmark used by the court was

⁴⁷ *Supra* note 5 at para. 58.

⁴⁸ *Supra* note 10.

⁴⁹ *Supra* note 5 at para. 59.

⁵⁰ *Ibid.* at para. 60.

⁵¹ *Ibid.* at para. 63.

⁵² *Ibid.*

⁵³ *Ibid.* at para. 64.

⁵⁴ *Ibid.* at para. 65.

⁵⁵ *Ibid.* at para. 106.

⁵⁶ *Ibid.* at para. 109.

AVC, not AAC.⁵⁷ The implication of this approach is that once the Commission has established that the price charged by a dominant company is below AAC, no further evidence is required to find an abuse. The Commission does not need to examine elements such as the effect on the alleged prey, the predatory intent of the company, or the possibility of recoupment.⁵⁸ Rather, the lack of those elements can be used by the dominant company, along with other facts, to rebut the presumption.⁵⁹

In contrast with the court's strict *per se* approach expressed in *AKZO*, the Commission listed some possible defences that, in exceptional circumstances, can be used by the dominant company to justify a price below AAC.

For example, the Commission acknowledges that in exceptional circumstances, a company might be able to justify a price below AAC by showing that "although there is a likely exclusionary effect, the dominant company is actually minimising its losses in the short run."⁶⁰ This could be the case, for example, where demand has dipped and there are high costs for re-starting production or strong learning effects.

Consistent with the case law, the Discussion Paper states that the meeting-the-competition defence is generally not available for prices below AAC.⁶¹ An efficiency defence is similarly not generally available for predatory pricing.⁶²

Pricing above AAC, but below ATC

Although there may be a limited number of circumstances in which dominant companies can justify prices below AAC, there are a greater number of reasonable justifications for companies to set their prices above AAC but below ATC.⁶³ For example, when companies encounter a decline in demand, the short run profit maximizing price may temporarily fall below ATC. In cases where price is above AAC predation cannot be presumed, and the Discussion Paper posits that the Commission needs to prove, on the basis of objective factors, that the pricing of the dominant company is part of a plan or strategy to predate.⁶⁴

This (the predation intent) can be shown with the help of various elements, which individually or together may prove such a strategy. The following elements may in particular be important in this respect: direct evidence of intent, evidence that the pricing only makes commercial sense as part of a predatory strategy, the actual or likely exclusion of the prey, whether certain customers are selectively targeted, whether the dominant company actually incurred specific costs in order for instance to expand capacity, the scale, duration and continuity of the low pricing, the concurrent application of other exclusionary practices, the possibility of the dominant company to offset its losses with profits earned on other sales and its possibility to recoup the losses in the future through (a return to) high prices. Such a strategy or plan, by showing objective intent, is also an indication of likely effect.⁶⁵

⁵⁷ See *AKZO* supra note 18 at para.71. Also see *supra* note 5 at para. 109.

⁵⁸ *Supra* note 5 at para. 110.

⁵⁹ *Ibid.*

⁶⁰ *Ibid.* at para. 131.

⁶¹ *Ibid.* at para.132.

⁶² *Ibid.* at para. 133.

⁶³ *Ibid.* at para. 111.

⁶⁴ *Ibid.* at para. 112.

⁶⁵ *Ibid.*

In order to prove predatory intent, the Discussion Paper says the Commission can use both direct and indirect evidence. One example of direct evidence includes company documents which clearly show the dominant company's intention to eliminate a competitor.⁶⁶ According to the Discussion Paper, when there is direct evidence of intention to eliminate, no other elements need to be shown. The Commission assumes that when a company is pricing below ATC (and above AVC) and has a clear plan of predation, it also has the means to carry it out: the pricing will eliminate or discipline rivals and therefore the conduct has a negative impact on competition.⁶⁷

When direct evidence of predatory intent is not available, the case needs to be proved based on indirect evidence. In arguing such a case, the Commission considers that the following elements are relevant to show a predatory intent:

...does the pricing behaviour only make commercial sense as part of a predatory strategy or are there also other reasonable explanations, is there an actual or likely exclusionary effect, the scale, duration and continuity of the low pricing, does the dominant company actually incur specific costs in order for instance to expand capacity which enables it to react to entry, are certain customers selectively targeted, is there concurrent application of other exclusionary practices, does the dominant company have the possibility to off-set its losses with profits earned on other sales, does it have the possibility to recoup the losses in the foreseeable future through (a return to) high prices, can predation on one market have a reputation effect on other markets, is the prey particularly dependent on external financing and does the prey have counter strategies. The relevance of the different elements for individual cases may not always be the same and it is not possible to define in the abstract and in advance what is exactly required in an individual case to show a predatory strategy with such indirect evidence.⁶⁸

Even where price is above AAC, if the dominant firm can show it is minimizing its losses in the short run, this may be sufficient to rebut the allegation of predation. For instance, low prices may be necessary when there is a change in market structure that leads to "a dramatic fall in demand leading to excess capacity."⁶⁹ It also refers to the situation where a company is selling perishable inventory, discontinued product, where storage costs are prohibitive or where there are safety or health concerns over storage.⁷⁰

With respect to "meeting the competition", the Discussion Paper recognizes that in situations where a new rival enters a market with lower prices, the dominant company may have to reduce its prices below ATC to match those of its competitor, so as to minimize short-run losses. This defence is said only to apply, however, "if it is shown that the response is suitable, indispensable and proportionate."⁷¹

According to the Discussion Paper, a proportionality test will be applied to any "meeting the competition" defence to pricing below ATC but above AAC. There are said to be three parts

⁶⁶ *Ibid.*

⁶⁷ *Ibid.* at para. 114.

⁶⁸ *Ibid.* at para. 115.

⁶⁹ *Ibid.* at para. 131.

⁷⁰ *Ibid.* at para 80. "Such necessity must be based on objective factors that apply in general for all undertakings in the market. On the basis of these factors the dominant company must be able to show that without the conduct the products concerned can not or will not be produced or distributed in that market. In these situations the Community Courts apply strictly the condition of indispensability. It is considered not the task of a dominant company to take steps on its own initiative to eliminate products which it regards, rightly or wrongly, as dangerous or inferior to its own product."

⁷¹ *Ibid.*

to this test: 1) the conduct must be a suitable way to achieve the legitimate goal; 2) the conduct must be indispensable, *i.e.*, the same result cannot be achieved by other less anti-competitive means; and 3) “it must be a proportionate response in view of the aim of Article 82.”⁷² This requires, with a view to protect consumer welfare, “a case-by-case weighing of the interest of the dominant company to minimise its losses and the interest of its competitors to enter or expand.”⁷³

The Commission considered the possibility of recoupment as being relevant to proving a company’s predatory intent;⁷⁴ however it concluded that “[a]s dominance is already established this normally means that entry barriers are sufficiently high to presume the possibility to recoup.”⁷⁵ Thus, consistent with the case law, proof of recoupment is said not to be necessary in order to find an abuse, but the Discussion Paper permits a dominant company nevertheless to invoke the impossibility of recoupment as a defence.⁷⁶

The Commission considers that efficiency claims will not apply to predatory pricing, although it could be applied to other offences under Article 82.⁷⁷

Pricing above ATC

According to the Discussion Paper, prices above ATC will normally not be considered to be predatory, absent exceptional circumstances where such conduct will lead to or has led to substantial harm to consumers.⁷⁸

The Commission listed two examples of possible such exceptional situations. One is when companies in a collective dominant position acted collectively to discipline competitors and share the losses.⁷⁹ Another example is when an efficient new entrant is entering a market, and is obliged to operate for a short period of time with high costs. In such a situation, the dominant company could prevent the entry of the new company by lowering its prices below the ATC of the new company, yet maintaining them above the ATC of the dominant company due to certain advantages enjoyed by the dominant company or the unique features of that market.⁸⁰

Long-run average incremental costs (LAIC) as a cost benchmark

In certain cases, such as cases concerning the telecom sector or companies protected by a legal monopoly, the Commission has applied LAIC, not AAC, as the cost benchmark below which predation is presumed.⁸¹ In these cases, pricing above LAIC but below ATC “is assessed like pricing above AAC but below ATC in all other sectors.”⁸²

⁷² *Ibid.* at para 82.

⁷³ *Ibid.*

⁷⁴ *Ibid.* at para. 112.

⁷⁵ *Ibid.* at para. 122.

⁷⁶ *Ibid.* at para. 123.

⁷⁷ *Ibid.* at para.133.

⁷⁸ *Ibid.* at para. 127.

⁷⁹ *Ibid.* at para.128. See also *Compagnie Maritime Belge* (cited in footnote 16) for an example of such an exceptional circumstance.

⁸⁰ *Ibid.* at para 129.

⁸¹ *Ibid.* at para. 124.

⁸² In certain sectors, the Commission has used LAIC, not AAC as the cost benchmark below which predation is presumed. LAIC takes account of only the product specific fixed costs, whereas ATC takes account of all variable and fixed costs (see *supra* note 5 at para. 65). 1) “It is presumed that pricing below LAIC is predatory in cases concerning activities protected by a legal monopoly.” In order to prevent cross-subsidisation by the dominant company, “the decisional practice requires the dominant company to cover with its pricing in the free market at least all the variable and fixed costs it makes in order to be active on that (another, often related) market, in other words to price above LAIC (see *supra* note 5 at para.125). 2) An LAIC benchmark will also be applied in ‘sectors which recently have been liberalised or which are undergoing liberalisation, such as the telecom sector.’... “These sectors concern network industries, with very high fixed costs and very low variable costs, where it is considered that the use of an AVC or AAC benchmark would not reflect the specific economic realities of these industries.” An LAIC benchmark would be helpful to prevent the predatory behaviour of the incumbent dominant company, “which may try to protect and maintain their monopoly positions that resulted from their previous legal monopoly or access to state funds” (see *supra* note 5 at para.126).

The role of recoupment

In the Discussion Paper, the Commission holds the view that the possibility of recoupment is a factor that can be considered with respect to the intent to predate; however, it is not necessary to prove recoupment to find an abuse.⁸³ The Commission considers that recoupment is shown where the “predation avoids or delays a decline in price that would otherwise occur as a result of the increased competition that would have come if the competitors were not eliminated, disciplined or deterred of entry.”⁸⁴

If relevant to the analysis, it will in general be sufficient to show the likelihood of recoupment by investigating the following elements: 1) entry barriers to the market; 2) the strengthening of the position of the dominant company; and 3) foreseeable changes to the future market structure.⁸⁵ The Discussion Paper further states that “[a]s dominance is already established this normally means that entry barriers are sufficiently high to presume the possibility to recoup.”⁸⁶ Therefore, the Commission does not consider that “it is necessary to provide further separate proof of recoupment in order to find an abuse.”⁸⁷ This presumption, in the view of the Commission, is consistent with the Court’s approach in *Tetra Park II*.⁸⁸

The Discussion Paper notes the difficulty in distinguishing between predatory pricing and legitimate price competition. The lowering of prices by a company, which is the most visible character of predatory pricing, is also a vital part of healthy market competition, to the benefit of consumers. Low pricing is not *per se* predatory. Pricing is also not predatory only because it generates losses for a dominant company in the short term.⁸⁹ Pricing is predatory only when a predator deliberately lowers its prices in the short term with the intention to eliminate or discipline its rivals or to prevent their entry into the market.⁹⁰ A company will make this sacrifice when it is reasonable to expect that after the foreclosure, the company will be able to raise the price and recoup the losses incurred in the short term.⁹¹ If there is no possibility of a predator recouping its short-term losses, then competition in the market has not been weakened by the exclusionary conduct, and consumers will benefit from the low price.

Some commentators suggest that, if recoupment is not possible, there should be no finding of abusive predatory pricing under Article 82.⁹² The Commission responds to such a consideration by including the possibility of recoupment, not as part of the predatory pricing claim, but as a possible defense. This approach apparently reflects the Commission’s desire to consider market effects in an Article 82 assessment, yet not to radically divert from the traditional approach of the European Court, which had not considered the possibility of recoupment to be critical in predatory pricing cases.

Canadian Case Law on Predatory Pricing

Cases under the criminal provision

The criminal prohibition against “unreasonably low” pricing with the intent, tendency or design of substantially lessening competition or eliminating a competitor was enacted, along

⁸³ *Supra* note 5 at para. 122. See also texts to footnote 74.

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

⁸⁹ *Ibid.* at para. 95. Short-term losses as a result of a low price can be a necessary investment for a company entering a new market or introducing new products to customers.

⁹⁰ *Ibid.* at para. 96.

⁹¹ *Ibid.* The exclusionary conduct thus should allow the predator to return to, maintain, or achieve high price afterwards; in other words, protect or strengthen its dominant position.

⁹² Michal S. Gal, “Below-Cost Price Alignment: Meeting or Beating Competition?” (2007) New York University School of Law, Law and Economics Research Paper Series at part II.

with the criminal prohibition against price discrimination, during the Great Depression in response to the *Report by the Royal Commission on Price Spreads and Mass Buying* in 1935.⁹³

It has been the subject of very little enforcement activity over the years. Indeed, only three cases were reported under the criminal provision. *R. v. Producers Dairy Ltd.*⁹⁴ involved a 48-hour milk price war between leading dairies supplying Ottawa supermarket chains in 1961. Both the trial and the appeal courts acquitted Producers on the basis that the 48-hour “defensive” price cut did not constitute a “policy” of selling. Whether the price had been “unreasonable” was not addressed.

*R. v. Hoffman-La Roche Ltd.*⁹⁵ was the first conviction for predatory pricing under the criminal provision. Hoffman-La Roche Ltd. had been the sole Canadian producer of the tranquilizers 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 to hospitals and governments over two 6-month periods. The court held that a “policy” involved conscious conduct by responsible employees of a continuing and repetitive nature. As to whether the price (of zero) had been “unreasonable” the court held that prices above short-run production costs are never unreasonable, but that prices below such level could be unreasonable depending on the circumstances. The court considered the duration of the give-aways, whether they had been proactive or reactive, and the expectation of legitimate long-term benefits for Hoffman-La Roche (it admitted that the more appropriate comparison was not to short-run production costs but to long-run cost expectations that factored into pricing decisions). The Court held that the give-aways had been unreasonable in the circumstances given the disproportionate harm (over \$1 million in lost sales for each 6-month period), its duration and proactive nature, and convicted. The Court inferred predatory intent (actual anti-competitive effect need not be shown under the criminal provision) from comments in internal company documents, from the magnitude of the price cuts, and from the fact that losses of \$2.6 million had been incurred to prevent about \$0.6 million in lost sales to Frank Horner. Essentially the same factors which led the Court to find the prices had been unreasonably low led it also to conclude that the intent had been to eliminate Frank Horner as a competitor.

The third major predatory pricing case in Canada was *R v. Consumers Glass Co.*,⁹⁶ which involved an allegation by a new manufacturer of disposable plastic cup lids that the incumbent, Consumers, had attempted to prevent its entry by engaging in predatory pricing. Consumers had been experiencing declining sales and excess capacity when the new competitor entered the market with enough capacity to satisfy the entire market demand, and at prices significantly lower than those that Consumers had been charging. The Court held that pricing below ATC, but above AVC, had been a loss-minimizing strategy on the part of Consumers and was legal under the circumstances. The Court criticized any reliance on intent as a factor in finding prices to be “unreasonably low”.

Private parties have also brought actions for damages in respect of alleged violations of the criminal predatory pricing provisions over the years. In one leading case, *Boehringer Ingelheim (Canada) Inc. v. Bristol-Myers Squibb Canada Inc.*⁹⁷ the court definitively

⁹³ (Ottawa, King's Printer, 1935). These provisions were first found in the *Criminal Code* and later found their way into the modern *Competition Act* in section 50.

⁹⁴ (1966), 50 C.P.R. (2d) 265 (Ont. C.A.).

⁹⁵ (1980), 28 O.R. (2d) 164, 109 D.L.R. (3d) 5, 48 C.P.R. (1d) 45 (H.C.J.), affirmed (sub nom. *R. v. Hoffman-La Roche Ltd. (nos. 1 and 2)*) (1981), 33 O.R. (2d) 694, 125 D.L.R. (3d) 607 (C.A.).

⁹⁶ (1981), 33 O.R. (2d) 228, 124 D.L.R. (3d) 274 (H.C.J.).

⁹⁷ [1998] O.J. No. 4007, 83 C.P.R. (3d) 51 (Gen. Div.).

concluded that price cuts to match those of a competitor are never “unreasonable”, even when they fall below the relevant measure of costs.

Predatory pricing as an abuse of dominance in Canada

As noted above, the Competition Bureau has been quite explicit in its most recent Predatory Pricing Enforcement Guidelines with regard to its conviction that predatory pricing ought not to be prohibited unless there is some realistic possibility that the lost profits will later be recouped through supra-competitive prices, and that it therefore should generally be dealt with in the civil context of an abuse of dominance case. In keeping with the continued existence of the criminal provision, it reserves the right to prosecute criminally in egregious cases, for example, where the predation was used in furtherance of an illegal price-fixing scheme (e.g., as part of a scheme of intimidation to enforce an illegal cartel).

Indeed, the treatment of predatory pricing as an example of abuse of dominance dates back to the *NutraSweet*⁹⁸ case in 1990. In that case, the Competition Tribunal pointed out that the proper cost comparison (more closely approximating marginal costs) would be ATC if a firm were operating near capacity, but AVC if it were operating below capacity, a point which had not been considered in the criminal case law.

More recently, as noted above, the Commissioner has been espousing the use of average avoidable costs as the relevant measure of when prices are “too” low. Indeed, pursuant to amendments to the *Competition Act* in 2000, the Airline Regulations stated that the operation of passenger airline capacity on a route or routes at fares that do not cover the avoidable cost of providing the service, or increasing capacity at such fares, would constitute an “anti-competitive act” for purposes of section 79 of the *Competition Act*.⁹⁹ In a case similar in outline, but different in result, to the U.S. Department of Justice’s case against American Airlines,¹⁰⁰ the Commissioner brought a case against Air Canada alleging that, from April 2000 to March 2001, in response to entry by two new low-fare airlines, Air Canada had engaged in a practice of anti-competitive acts and had abused its dominant position by increasing its capacity and/or decreasing its fares on certain routes in Eastern Canada in a manner that had not covered its avoidable costs of providing those services.¹⁰¹ The case was divided into two parts, and only the first part on whether Air Canada had covered its avoidable costs resulted in a decision¹⁰² (the bankruptcy of Air Canada and its eventual restructuring led to the discontinuance of the case before the second hearing as to whether the behaviour had substantially lessened or prevented competition).

The Tribunal held that “all costs that can be avoidable by not producing the good or service in question...[includes] the variable costs and the product-specific fixed costs that are not sunk.” It held that all of Air Canada’s non-overhead costs should be considered avoidable by either cancelling the flights (shedding) or by redeployment or disposal of resources, and it thus included all of its aircraft ownership costs, such as maintenance and insurance in the measure of avoidable costs (such non-variable costs having been expressly rejected by the U.S. courts in the American Airlines case when they upheld the appropriateness of AVC as the benchmark for reasonable costs).¹⁰³

The Tribunal also held that “beyond contribution”, being the contributions to revenues derived from the carriage of a passenger to a connecting flight on the same airline, was not

⁹⁸ *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.).

⁹⁹ *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service*, SOR/2000-324, paras. 1(a)-(c).

¹⁰⁰ *United States v. AMR Corp.*, 140 F. Supp. 2d 1141 (D. Kan. 2001), affirmed, 335 F.3d 1109 (10th Cir. 2003).

¹⁰¹ For a more detailed discussion of this case, see D. Jeffrey Brown, Paul Collins and Kevin Rushton, “*The Aspen Ski Case from a Canadian Competition Law Perspective*” (2005), 73 *Antitrust L.J.* 235 (2005).

¹⁰² *Canada (Commissioner of Competition) v. Air Canada*, (2003) 26 C.P.R. (4th).

¹⁰³ *United States v. AMR Corp.*, 140 F. Supp. 2d 1141 (D. Kan. 2001), affirmed, 335 F.3d 1109 (10th Cir. 2003).

properly included in the measure of avoidable costs, but could be considered as a legitimate business justification for operating a flight below avoidable cost, for purposes of determining whether there had been a “practice” of anti-competitive acts.

It should be noted that Parliament mandated the use of avoidable cost as the appropriate benchmark for prices by a domestic airline. Whether the Competition Tribunal will adopt it as the universal benchmark for appropriate prices of dominant firms remains to be seen.¹⁰⁴

Indeed, in a public letter sent in 2004 to major Canadian airlines, the Commissioner set out the Bureau’s approach to future predatory pricing and abuse of dominance cases in the airline industry.¹⁰⁵ It endorsed the Tribunal’s approach to avoidable costs, but indicated that “the application of the avoidable cost test is only to be triggered by a significant response by a dominant carrier to competition or new entry...As a general principle, where a dominant carrier’s response to competition consists only of reducing fares to levels which match, but do not undercut those of a competitor (“fare matching”), the Bureau will not take enforcement action...However, if such fare reductions were accompanied by a significant increase in capacity or a significant increase in the number of seats offered at the lowest price, this ‘safe harbour’ could not apply.

The most recent abuse of dominance case in Canada, *Canada Pipe*¹⁰⁶, concerned exclusive dealing and tied selling rather than predatory pricing. That said, the judgment issued by the Federal Court of Appeal, remanding the case to the Competition Tribunal, clarified that there are distinct legal tests in Canada for proof of each of “anti-competitive acts” and a “substantially lessening or preventing competition.” The Tribunal had rejected the Commissioner’s application in 2005, finding that while Canada Pipe was dominant in the relevant markets, its conduct did not amount to an anti-competitive act and did not prevent or lessen competition substantially. Specifically, the Court found that an “anti-competitive act” is identified by a central purpose to inflict a “predatory exclusionary or disciplinary effect on a competitor (discerned from the overall character of the act, its reasonably foreseeable or expected effects, any business justification¹⁰⁷ and evident of subjective intent). The Court specifically found that evidence of subjective intent was not sufficient.

The effects of the practice on competition are to be discerned by comparing the degree and efficacy of competition in the relevant markets both with and without the practice of anti-competitive acts. That is, “but for” the impugned practice, would the market be substantially more competitive? Since the Tribunal had examined only the existing state of competition, and not what it would have been absent the impugned practices, the Court remanded.

In light of *Canada Pipe*, accordingly, one would expect any future predatory pricing case brought under the abuse provisions to focus on whether a firm is dominant in a particular market; whether the firm had a practice of setting prices below AAC with the intent to eliminate or discipline a competitor (and whether AAC is the appropriate benchmark); and whether in the absence of such pricing practices the market would be (or would have been) substantially more competitive.

¹⁰⁴ Critics point out that the calculation of avoidable costs requires data and calculations that a typical firm simply does not possess when making its pricing decisions. Given the 80-odd witnesses called by the Commissioner of Competition in the *Air Canada* case, a case devoted entirely to the question of whether price had been above avoidable cost, the practicality of avoidable cost as a behavioural guide for businesses can certainly be questioned. See also Einer Elhauge, “Why Above-Cost Price Cuts To Drive Out Entrants Are Not Predatory--and the Implications for Defining Costs and Market Power” (2003) 112 Yale L.J. 681 at 814.

¹⁰⁵ Information Notice, Competition Bureau (Can), *Competition Bureau Clarifies Enforcement Approach to the Airline Industry* (Sept. 23, 2004), available at www.competitionbureau.gc.ca.

¹⁰⁶ *Canada (Commissioner of Competition) v. Canada Pipe Co.*, [2004] C.C.T.D. No. 2, 2004 Comp. Trib. 2; rev’d 2006 FCA 236, [2006] F.C.J. No. 1028; leave to appeal to S.C.C. refused [2006] S.C.C.A. No. 366.

¹⁰⁷ The Court held that a valid business justification must have a credible efficiency or pro-competitive explanation; enhanced consumer welfare is insufficient.

The new Predatory Pricing Enforcement Guidelines in Canada

In order to clarify its position in predatory pricing, and to provide predictability to businesses and the public, the Bureau has recently published an updated and revised version of the *Predatory Pricing Enforcement Guidelines* (“*Guidelines*”) which had first been published in 1992.¹⁰⁸ These *Guidelines* set out the Bureau’s position on predatory pricing, and describe the approach that the Bureau intends to take in fulfilling its enforcement role. The *Guidelines* are not a source of law; they are the policies and interpretation of a law enforcement agency and therefore are not binding. Nevertheless the *Guidelines* are useful in providing guidance to business people on which practices will and will not attract investigation or prosecution by the bureau, and in understanding the bureau’s position on the interpretation of the law, and the practicalities of enforcement. While respecting the differences between Canada’s and Europe’s legislative language, as well as case law, the new *Guidelines* are broadly similar in approach to that espoused in Europe’s Discussion Paper.

Market Power:

In order to run afoul of s. 79 of the *Act*, a person must have control or substantial control of a class or species of business in some part of Canada. The Bureau inquires into whether the party under investigation can exercise market power.

Market power, for the Bureau’s purposes, refers to the ability to raise prices above competitive levels for a significant period of time. The Bureau considers a significant period of time to be one year (or more).

The Bureau indicates that in the context of predation, the likely ability to recoup is one way to determine if the firm enjoys market power. Other than the likely ability to recoup, the Bureau indicates that evidence of high prices and profits or of price discrimination can indicate market power. The two primary indicators of market power, however, are market shares, and the conditions of market entry. The *Guidelines* indicate that generally firms with less than 35% market share will not be considered to be capable of exercising market power (indeed, the Tribunal has held that there is a presumption of market power with shares above 50%). The Bureau also indicates that the greater the market share of a firm, the more likely it is that the firm can exercise market power. The relative shares of other market participants may also make it more or less likely that the allegedly dominant firm can exercise market power.

The conditions of market entry are important because in markets where barriers to entry are low, an increase in prices, even by a firm that enjoys 100% market share, will be countered by new entrants to the market. The Bureau identifies three types of entry barriers that may make the exercise of market power in a given market more likely: structural barriers, regulatory barriers, and strategic barriers.

Structural barriers have to do largely with the nature of the market and its participants. Pre-existing economies of scale, the need for large capital investment, absolute cost differences between incumbents and entrants, and switching costs incurred by consumers in changing between one form and another, are all structural entry barriers pointed to by the Bureau. The Bureau indicates that it will also consider reputational factors as structural barriers to entry. If it will be difficult for a new entrant to overcome the reputation of an incumbent and induce customers to switch, the effort required to do so may be considered a barrier to entry.¹⁰⁹

Regulatory barriers are those created by the government, such as tariffs, barriers to trade, environmental regulation, or intellectual property rights. Like other barriers, regulatory action

¹⁰⁸ Competition Bureau, *Predatory Pricing Enforcement Guidelines* (Ottawa: Industry Canada, 2008) available online at: http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/vwapj/Predatory_Pricing_Guidelines-e.pdf

¹⁰⁹ *Supra* note 2 at 10 & 11.

can impose additional cost on the market entrant, and thus serve to dissuade entry into the market.

Strategic barriers are barriers that have been influenced or created by existing market participants, and make it more costly or risky to enter the market. One form of strategic barrier that the Bureau highlights in particular is the reputation of the incumbent firm for setting prices that effectively attack new entrants to the market. If an incumbent has a history of pricing below cost in reaction to new market entrants, or if the market is particularly susceptible to such behavior, the Bureau will consider this to be a barrier to entry.

The combination of high market share and high barriers to entry generally means that a firm will be considered to have the ability to exercise market power. Specifically, this combination makes it more likely that any anti-competitive behavior will successfully reduce competition, and that the firm will then likely be able to raise prices to recoup its losses.

The Bureau may also look at the profitability of the complainant in attempting to predict the effects of price reductions in the market. If the price reductions will have the effect of driving the complainant into unprofitability in that market, that is a useful suggestion that the price reductions might have the effect of lessening competition. This factor will even be looked at where the complainant claims that it is being deterred from entering a market; the complainant will be asked to produce a profitability forecast.¹¹⁰

Prices & Costs:

Pricing can only be predatory if the price is set at a loss making level. In contrast to the approach in Europe but in keeping with Canadian case law, the *Guidelines* state categorically that, no matter how dramatic the price cut, if the price exceeds the appropriate measure of cost, then the price is competitive. According to the *Guidelines*, the relevant measure of cost is the average avoidable cost of selling the goods which are subject to the low prices.

When a firm lowers its prices it expects to increase its sales at the expense of its competitors. This means that the firm must supply more goods to market, to replace the goods its competitors are no longer selling. In the case of a price drop that is alleged to be predatory, it is the cost of these additional goods that is considered. The average avoidable cost is the amount that the firm would not have had to spend, if it had not produced those additional goods, divided over the total number of additional goods produced.

The Bureau approves of this measure of cost because it captures costs that are incurred on a per unit basis, as well as additional non-variable costs that have to be incurred to increase production. The avoidable cost measure also captures the opportunity cost of the increased production.¹¹¹ The Bureau takes the position that where price exceeds avoidable cost the price is economic, and therefore not predatory. When the price is set below avoidable cost the Bureau will presume it to be predatory, since it is generally not economically reasonable for a firm to sell goods at that price. As in Europe, this presumption is rebuttable by showing a reasonable business justification.

If a firm can show that it is pricing below avoidable cost in order to minimize losses, its prices will not be considered predatory. Examples of justifications that might be accepted by the Bureau are the sale of excess or obsolete products, promotional pricing on new products, or meeting the price of a competitor.¹¹²

¹¹⁰ *Supra* note 2 at 12.

¹¹¹ *Supra* note 2 at 13.

¹¹² *Supra* note 2 at 16.

The acceptance by the Bureau of the ‘price matching’ justification for pricing below cost is new in the current *Guidelines*. The Bureau has also taken pains to point out that not all kinds of price matching are justified. For example, where one product is superior to another in the same market, cutting the price of the superior goods to match that of the inferior ones would, in essence, be undercutting the inferior good. Similarly if the price matching occurs at the same time as additional product giveaways, or the provision of additional services, it would also be effectively undercutting the matched price.¹¹³

Practice of Anti-Competitive Acts:

Both the criminal and civil prohibitions of predatory pricing require that the pricing in question constitute a practice or policy. This has been interpreted by the courts to mean a practice that is repetitive, or of long duration, and not just a single transaction, or transient measure. The Bureau notes that it will interpret this requirement flexibly in circumstances where purchasing is done over a short period of time, or where the market is characterized by a few high value transactions. The Bureau also notes that several different anti-competitive acts may constitute a collective “practice”, and the requirement for a practice can be satisfied by the totality of the anti-competitive acts alleged. It is unnecessary to establish whether each type of anti-competitive act constitutes a practice.¹¹⁴

Prevent or Lessen Competition:

S. 79(1) of the *Act* requires that an anti-competitive price cut have the actual or likely effect of substantially lessening competition. The Bureau considers that competition will be substantially lessened when the anti-competitive practice enables the perpetrator to maintain or enhance market power. Consistent with *Canada Pipe*, the *Guidelines* state that the Bureau will ask whether the market would have been substantially more competitive if the anti-competitive practice had not been adopted (the “but for” test).

In relation to predatory pricing specifically, the Bureau will look into a reduction of competition with respect to the ability of a dominant firm to recoup its losses. Recoupment is generally accomplished by raising prices, itself an example of market power. The Bureau therefore makes an explicit connection between lessened competition and the ability to recoup. Where recoupment is not possible, it is unlikely that competition has been significantly lessened. The Bureau has however broadened the possible meaning of recoupment. In addition to earning back losses incurred during the predatory period, recoupment is also said to take the form of increased barriers to market entry, acquiring a reputation for predation, preserving stability in an existing market, coercing participation in an illegal conspiracy, or establishing an industry standard. The Bureau will also evaluate whether there are any strategies or circumstances in the market that might make it impossible for the anti-competitive firm to recoup.¹¹⁵

A Comparison of the Two Approaches

Broadly speaking, the law on predatory pricing has developed similarly in Canada and in Europe, despite very different legislative provisions. Certain very important differences have emerged, however, which serve to make Canada the safer jurisdiction in which to lower prices.

Courts in both jurisdictions have generally focused on AVC as an absolute lower limit to “reasonable” prices, with prices below AVC being presumed to be predatory and prices between AVC and ATC being subject to close scrutiny to determine the intended result.

¹¹³ *Supra* note 2 at 17.

¹¹⁴ *Supra* note 2 at 16.

¹¹⁵ *Supra* note 2 at 19.

Similarly, enforcers in both jurisdictions have committed to policing pricing practices only of dominant firms, and both have chosen AAC as their preferred cost benchmark, despite a lack of jurisprudential support.

That said, the different approaches to abuse of dominance generally are reflected as well in specific features of the approaches to predatory pricing.

For example, certain absolute defences to allegations of predatory pricing in Canada are subject to exceptions in Europe. Namely, Canada will not find an abuse of dominance by a dominant firm if it has merely matched prices set by a competitor, whereas in Europe price matching by a dominant firm could yet be abusive. Similarly, prices above ATC cannot lead to liability for abuse (or predatory pricing) in Canada, whereas certain exceptions to this rule are recognized in Europe. Indeed, under Canada's new *Guidelines*, prices above AAC are not abusive.

The role played by subjective evidence of intent to exclude is also quite different. Despite the Commissioner's pleadings to the contrary,¹¹⁶ the Federal Court of Appeal held in *Canada Pipe* that subjective evidence of exclusionary, predatory or disciplinary intent was not enough, and that all of the circumstances need to be considered to determine whether the overall character of the act is such that it should be taken to be intended to harm one or more competitors. This is in keeping, too, with the criticisms levied by the Court in *Consumers Glass* against trying to distinguish between "competitive" and "anti-competitive" intent when examining internal company records and statements. This is in contrast to the situation in Europe where, for prices between AVC (or AAC) and ATC, proof of subjective intent to exclude is sufficient to find the pricing was abusive.

At first blush, when reading the new Canadian *Guidelines*, one might think that the role of recoupment is different in Canada than in Europe. Indeed, given the burden in Canada on the Commissioner to prove the likely result of the pricing will be to strengthen, maintain or create a dominant position, one would think the Commissioner should need to prove that recoupment is likely (or *vice versa*). This would – if it were true – distinguish the Canadian situation even further from that in Europe, where recoupment need not be shown and is generally presumed from the existence of the dominant position. A closer examination of the *Guidelines* reveals, however, that the Bureau shares the view that the factors which lead one to conclude a firm is dominant will also suffice to show that recoupment is likely. In light of the Court of Appeal's ruling in *Canada Pipe*, requiring a detailed analysis of the degree and intensity of competition both with and without the low pricing, it remains to be seen whether the Tribunal will agree with what amounts to a presumption of anti-competitive effects. Despite what the *Guidelines* say, in Canada, dominance and below-cost pricing are not (yet) enough.

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¹¹⁶ Commissioner of Competition v. Canada Pipe Company Ltd., CT-2002-006, Memorandum of Argument of the Commissioner of Competition (Re-determination proceeding), at paras. 90 and 91.