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BY FACSIMILE

JOHANNE D'AURAY
DEPUTY COMMISSIONER OF COMPETITION
INDUSTRY CANADA, COMPETITION BUREAU
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50 VICTORIA STREET
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Dear Johanne:

Subject: COMMENTS OF CANADA POST CORPORATION ON THE COMPETITION BUREAU'S DRAFT ENFORCEMENT GUIDELINES FOR ILLEGAL TRADE PRACTICES: "UNREASONABLY LOW PRICING POLICIES" - RELEASED MARCH 8, 2002

Canada Post Corporation has reviewed the Competition Bureau's draft enforcement guidelines for illegal trade practices: "Unreasonably Low Pricing Policies" released March 8, 2002 (the "Guidelines"). The Competition Bureau has requested Canada Post's comments on the Guidelines.

Avoidable Cost is the Appropriate Standard

As a multi-service firm, Canada Post Corporation, employs a common infrastructure to provide the various services in the markets in which it operates. In doing so, it takes advantage of economies of scope. Economies of scope occur when it is cheaper to produce two products together than it is to produce them separately. A good example of this is provided by carrier delivery. It is clearly less costly to have one carrier deliver several products at once than it is to have a different carrier deliver each product.

The incremental cost a product or a group of products is the additional cost caused by the provision of that product or group of products, when its produced in combination with the other products supplied by a firm. When economies of scope exist, the total cost of production will exceed the sum of the incremental costs of all products being produced.

Canada Post has developed over many years, in conjunction with expert accountants and economists, an activity-based, incremental costing methodology that allocates costs among its services. It applies this methodology each year. This costing data is taken into account by Canada Post in setting and reviewing prices; it also serves as the basis for ensuring that Canada Post does not compete unfairly by cross-subsidizing its competitive services with revenues from its "exclusive privilege" services.

Each year Canada Post identifies the causal relationships between the cost of resources and the activities performed and between the activities performed and the services delivered. Those activity costs which are incurred because of the provision of a services are attributed to that service. Costs which cannot be attributed to the provision of a service are fixed costs common to more than one service. Where a common fixed cost is specific to a group of services, those activity costs are attributed at that higher level of aggregation.

There is often a misguided temptation to allocate common costs back to products on some arbitrary basis. In a fully distributed costing system all costs must be allocated to products. Because there is not a causal link between individual. products and common fixed costs, an arbitrary method must be used to allocate these costs. There is, consequently, an infinite number of possible allocation schemes and fully distributed costs. Very different product costs can arise under different allocation schemes. The common fixed costs can be distributed in proportion to any characteristic of the individual products including, but not limited to things like the volume produced of each product, the direct costs of production-for each product, the labour costs of production of each product, the revenue generated by each product or the time spent in producing each product. Because fully distributed costing must necessarily rely upon arbitrary allocations rules and not actual causation, it actually misallocates costs and produces misleading product costs. The flaws of fully distributed costing are well known, and have been known for a long time. Both academics and regulators have examined and rejected fully distributed costing.

Canada Post endorses the Guidelines adoption, of avoidable cost as the appropriate standard to be used in an analysis under the Competition Act for multi-product firms. Furthermore, Canada Post endorses the Bureau’s recognition that the avoidable cost test does not require a firm to recover its fully distributed costs.

Recoupment as an Essential Element of Predatory Pricing

Predatory pricing occurs when a Finn first lowers its prices so as to drive its competitors out of the market (and to deter potential entrants) and then raises prices after the competitors leave. Predatory pricing requires pricing below cost. This means the firm must be willing to suffer short-term losses on the product in hopes of making longer-term gains. For predatory pricing to work, potential entrants must not be able to enter the market again once the dominant firm has increased prices.

The Guidelines are somewhat confusing with respect to the treatment of whether it is absolutely necessary for a firm to be able to recoup the money it lost as a result of a below-cost pricing activity. The Guidelines state that it is the Bureau's view that while an ability to recoup losses will continue to be a factor to be given consideration it is not a necessary element to be proven under the predatory pricing provisions of the Competition Act. As such, the Guidelines seem to be premised on the theory that firms will engage in irrational, non-profit maximising behaviour. This premise is at odds with domestic and international jurisprudence. Moreover, the Guidelines discussion of barriers to entry is inconsistent with the notion that recoupment is not a necessary element of predatory pricing.

Sincerely,

Gerard Power