COMMENT ON:

"Enforcement Guidelines for Illegal Trade Practices: Unreasonably Low Pricing Policies Under Paragraphs 50(1)(*b*) and 50(1)(*c*) of the *Competition Act*"

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General

1. Although the document is useful, as a "Guidelines" for informing firms, it suffers from being unclear and not as helpful as it could be. I would suggest a much longer section explaining the avoidable cost test, starting with some clear definitions of what all of the relevant cost concepts mean.

2. Another helpful addition would be some examples, such as those provided with the *Intellectual Property Guidelines.* These examples would show practices that would and would not be considered predatory pricing by the Bureau.

A clear statement of the proposed cost test is required

3. Under 5 i) *Price Cost Comparison* – the first paragraph is vague and misleading. The sentence "The rationale for this cost-based test is that it is reasonable to expect that a business will operate with a view to covering its costs" is vague and somewhat disingenuous. Surely, the Competition Act does not take a position on whether businesses should or should not cover their costs. The major reason for a cost-based pricing test is as an aid to separating true predatory behaviour from normal competitive pricing, not as a test that unambiguously *identifies* cases of predatory pricing. It is well known that many firms price their products below cost for lots of

different reasons, most of which have nothing to do with predation. Penetration pricing in new markets, pricing of complementary products, inventory management, are three of the better known circumstances when this can occur.

4. In the third paragraph of this section the first sentence is unclear. What does "the time period over which the cost based analysis is carried out" mean? I would rewrite this section in the following way. Start with a set of definitions of various cost concepts, including variable, fixed, and sunk costs. These should then be extended to include avoidable costs, which is not an easy or straightforward concept. The important point to emphasize is that avoidable costs differs from variable costs in that it includes product specific fixed costs. Both Church and Ware's textbook and Baumol's well known article on avoidable costs and predation would of use here.

5. The phrase "fully allocated cost" at the end of the fourth paragraph of this section should not be used unless a definition is provided. There is no reason to suppose that a typical businessperson would know what this means, and in any case it is not a precise concept without further clarification.

6. There should next be a discussion in this section of why these cost concepts are relevant to identifying predatory pricing. I believe there was such a discussion in the old Predatory Pricing Guidelines. The timing issues could be brought out at this point.

7. Finally, as far as timing goes, the guidelines should make it clear that avoidable costs can be defined in an *ex ante* and *ex post* sense in the following way. The normal *ex post* meaning is the costs, including fixed costs, that would be avoided if a firm ceased production of the target product or service. But in an allegation of predatory pricing, it is sometimes claimed that the predator adds capacity *as part of the predatory pricing strategy*. The avoidable cost concept that is described, but not clearly, in the draft guidelines for this case is *ex ante* to the investment in capacity i.e. "the costs that would have been avoided had the firm not invested in the additional capacity" which is clearly larger and more inclusive than the first definition given above. All of this should be clearly and carefully spelled out.

Recoupment

8. Under *Conditions of Entry and Exit* (iv) *Ability to Recoup Losses*. The import of this section is contained in the last sentence "..an ability to recoup losses… is not a necessary element to be proven under paragraphs 50(1)(b) and 50(1)(c).

9. This represents a major change from the earlier position of the Bureau and, of course, contrasts sharply with U.S. Federal jurisprudence on predatory pricing.

10. There are several reasons why I think it unwise to abandon the need to establish likely recoupment as a necessary condition for any claim of predatory pricing to succeed.

11. All predatory pricing allegations face a severe identification problem of separating true predatory pricing from aggressive competition. Both benefit consumers in the short run, but the latter benefits consumers in both short and long run, whereas the former leads to a period of monopoly pricing or "recoupment" at some time after the predatory campaign has been successful.

12. It is crucially important to recognize that both cost-based tests and the recoupment test are aimed more at dealing with this identification problem than they are designed to produce theoretically precise tools for "testing" accurately for predation. Pricing below cost is neither necessary nor sufficient for instances of true predation to occur. The role of the cost based test for predation is to make it highly unlikely that a firm found guilty of predatory pricing could have been engaged in aggressive competitive behaviour, to the benefit of consumers. This point was recognized by Areeda and Turner in their original article.

13. The recoupment test serves the same purpose. The effect of requiring that a firm convicted of predatory pricing must display a likelihood that they can recoup the early losses of a predatory campaign, is to "raise the bar" for successful convictions, making it unlikely that a firm would be convicted, if, for example, they were pricing below cost in order to develop a future market, or just responding to entry in the best way that they were able to determine. To quote Judge Easterbrook: "More importantly, if there can be no 'later' in which recoupment could occur, then the

consumer is an unambiguous beneficiary even if the current price is less than the cost of production. Price less than cost today, followed by the competitive price tomorrow, bestows a gift on consumers. Because antitrust laws are designed for the benefit of consumers, not competitors…, a gift of this kind is not actionable.[1]

14. The recognition of the newer "strategic" theories of predatory pricing in no way reduces or removes the need for the recoupment test. The best established of these strategic theories provide a framework for analyzing rational predation where there is a multiple market connection between the market where the aggressive pricing takes place and other markets where the dominant firm operates. In the case of reputation theories, the other markets may be future markets in which potential entrants are deterred by the current actions of the predatory firm. The second established class of strategic models pertains to financial market predation, in which an entrant's access to capital on equal terms to the predator can be manipulated by a campaign of low pricing. But in both of these cases, predation must be profitable for it to be rationally attempted i.e. there is still a need for the predator to recoup the losses of their predatory campaign, whether this occurs in other markets or not. If the Competition Bureau is making an allegation of predatory pricing involving a modern strategic theory, the need to separate true predatory pricing from acceptable competitive behaviour is just as great as in the case of a non-strategic theory. And, given that the strategic theory will have to identify where and in what distinct markets the alleged predator might reasonably expect to gain a monopoly advantage, there is no reason why the theory cannot be tested against the criteria that the practise must be expected to be profitable.

[1] 881 F.2d at 1401. (Citations omitted).