Canada's Competition Regime: Thinking Strategically

A Practical Guide for Business

Business Practices Session:

Price Maintenance, Price Discrimination and Predatory Pricing: Overview and Practical Issues

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Price Maintenance, Price Discrimination and Predatory Pricing: Overview and Practical Issues

The price of a product is often its most important selling feature. Pricing of goods and services is also the focal point of laws intended to maintain a competitive marketplace. The primary competition legislation in Canada is the *Competition Act*.[1]

In this paper, we will discuss some of the provisions of the *Competition Act* which deal with pricing. When does pricing cross the line between healthy competition and anti-competitive conduct, and how one can recognize when a competitor may have crossed that line? When are low prices too low? When do price incentives become discriminatory trade practices? When are suggested retail prices illegal?

The Competition Act

The *Competition Act*[2] (the "Act"), seeks to “maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy” and ultimately "to provide consumers with competitive prices and product choices".[3] In doing so, the Act governs wide areas of business conduct. While the limitations on that conduct are not often precise, the possible consequences of a violation are severe — fines, imprisonment, civil damages and potentially enormous litigation expenses.

The Commissioner of Competition is the official responsible for investigating complaints of anti-competitive conduct under the Act. To help her enforce the Act, the Commissioner has a significant arsenal of investigative tools at her disposal, including examination of witnesses, information and document requests and the power of search and seizure. Coming under the scrutiny of the Competition Bureau (the "Bureau") in an investigation can be costly and inconvenient, and should be avoided. Moreover, conduct which violates the Act can result in both criminal and civil liability, which can be harmful to a company's profitability as well as its reputation.

We offer a brief overview and some practical suggestions on the following topics:

1. Resale Price Maintenance (s. 61);

[1] R.S.C. 1985, c. C-34
[2] *Ibid.*
[3] *Ibid*, s. 1.1.

2. Price Discrimination (s. 50(1)(a)); and
3. Predatory Pricing (s. 50(1)(c)).[4]

Section 61 - Price Maintenance

The price maintenance provisions of the Act prohibit producers or suppliers of a product from attempting, by "agreement, threat, promise or any like means", to influence upward or discourage the reduction of the price at which anyone sells or advertises the product.[5] The Act defines a "product" to include a service. Unlike most of the other offences under the Act, this section does not require proof that the conduct have an anti-competitive intent or effect. As a result, the mere existence of the conduct is enough to breach the section, and this has led to many criminal convictions under the Act. It can also give rise to civil damage claims.[6]

Generally, price maintenance is considered to be harmful to competition in the market because it limits the ability of retailers to compete on price. The theory is that such behaviour tends to result in artificially higher prices for consumers and protects inefficient retailers that would otherwise be subject to competitive pressures.[7]

The price maintenance provisions do not restrict the prices a seller may charge for its products. Rather, they deal with actions taken to affect the prices charged by others, principally retailers. Whether or not conduct is illegal can be affected by the nature of the relationship between a manufacturer and its distributors. If the distributor buys from the manufacturer and resells to others, actions taken by the manufacturer to "influence upward" the prices charged by the distributor can be caught by the price maintenance provisions. Where, however, sales are made from the manufacturer directly to buyers, with the distributors acting merely as agents, the manufacturer can determine the end price without contravening section 61.[8]

Historically, price maintenance has been one of the most commonly prosecuted offences under the Act. It may lead to a fine at the discretion of the court, imprisonment for up to five years, or both. The highest fines to date imposed on a company was $250,000 and on an individual was

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[4] The Act contains other pricing provisions, most importantly the conspiracy provisions in s. 45, which are not discussed in this paper. Also see Houston and Pratt, "Legal Issues in Pricing: Protecting your Reputation and Avoiding Liability", 5th Annual Canadian National Forum on Pricing, 2001.

[5] *Supra*, note 1, s. 61(1)(a).

[6] *Supra*, note 1, s. 36.

[7] J. Anthony VanDuzer, "Assessing the Canadian Law and Practice on Predatory Pricing, Price Discrimination and Price Maintenance," (2000-2001) 32 Ottawa L. Rev. 179-234.

[8] *Supra*, note 1, s. 61(2).

$10,000. In addition to fines, courts have also often imposed orders prohibiting the anti-competitive conduct. While the Bureau's enforcement actions under section 61 have decreased in recent years, there have continued to be prosecutions, convictions and settlements.[9]

Not every attempt to persuade a reseller to increase prices or to prevent a discount constitutes an offence. A supplier can suggest appropriate resale prices but must make it clear that there is no obligation or threat to follow the suggestion.[10] It has been held that "it is not illegal to attempt to maintain prices by discussion, persuasion, complaints, suggestions, requests or advice, provided that the attempt does not include the means prohibited" (that is, by agreement, threat, promise or any like means).[11]

The Act expressly provides that by advertising a resale price, a producer or supplier will be considered to be attempting to influence the resale price, unless it is made clear that the product may be sold at a lower price.[12] The Bureau has stated that by using language such as the following, a person issuing a suggested retail price can avoid being found to attempt to influence the resale price:

> "The dealer is under no obligation to accept these suggested resale prices and may sell at any price he chooses. If he chooses to sell at prices other than those suggested, he will not suffer in any way in his business relations with ABC Company or any other person (over whom ABC Company has control or influence)".[13]

Although section 61 does not require negative effects on competition, whether or not the supplier has market power is still an important factor in the Bureau's enforcement discretion. For example, a supplier's attempt to maintain prices where the retailer could obtain a similar product from a variety of sources is less likely to harm competition than if the price maintenance occurred in an environment in which there were few suppliers offering the product in question. In the former case, the Bureau would be less likely to take action.

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[9] *R.* v. *Royal LePage Real Estate Services Ltd.* (1993), 12 Alta. L.R. (3d) 282, [1994] 1 W.W.R. 228, 50 C.P.R. (3d) 161, 105 D.L.R. (4th) 556, 143 A.R. 241, (Q.B.), *R.* v. *Toyota Canada Inc.*, March 27, 2003, Court File No. T-1065-02, also see the settlement of price maintenance case involving Re/Max Ontario-Atlantic Canada Inc. (Re/Max Ontario), Re/Max of Western Canada (1998) (Re/Max Western) and Re/Max International Inc., available online at http://cb-bc.gc.ca/epic/internet/incb-bc.nsf/vwGeneratedInterE/ct02499e.html

[10] *Supra*, note 1, s. 61(3).

[11] *R.* v. *Les Must de Cartier Canada, Inc.*, 27 C.P.R. (3d) 37 (Ont. Dist. Ct.).

[12] *Supra*, note 1, s. 61(4).

[13] Background Papers, Stage 1 Competition Policy, Bureau of Competition Policy, Consumer and Corporate Affairs Canada, April 1976.

Often, an overt act is not required to contravene the section. For example, Canadian courts have held the following to constitute price maintenance:

- A suggestion from a supplier to a retailer that it increase its prices where there was a contract that was easily terminated and where the retailer depended heavily on the supplier;[14]

- An agreement with retailers that they may follow other retail prices down but may not initiate any price reductions;[15]

- A supplier's agreement with retailers to stop a price war;[16] and

- Offering a 5% commission to a retailer on the condition that the retailer sell according to specified terms, including price.[17]

The price maintenance provisions also prohibit producers from refusing to supply a product to a reseller "because of" the low pricing policy of that reseller.[18] In determining whether a refusal to supply is contrary to the price maintenance provisions, courts have held that the buyer's low pricing policy need not be the only factor in the decision to refuse to supply, but it must be a significant consideration. Refusing to supply for other reasons is not an offence.[19]

Even if a party refuses to supply because of the reseller's low pricing, such a refusal would not be considered an offence if it falls under one of the four defences listed in subsection 61(10). These defences apply when the supplier demonstrates a reasonable belief that the reseller was engaged in a practice of:

(a) selling the product as a loss-leader;

(b) selling the product not for the purpose of making a profit, but to attract customers to the store in order to sell other products;

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[14] *R.* v. *Shell Canada Products Ltd.* (1989), 24 C.P.R. (3d) 501 (Man. Q.B.) leave to appeal refused (1990), 45 B.L.R. 231 (Man. C.A.).
[15] *R.* v. *Sunoco Inc.* (1986), 11 C.P.R. (3d) 557 (Ont. Dist. Co.) affirmed (1988), 28 C.P.R. (3d) 287 (Ont. C.A.).
[16] *R.* v. *Campbell* (1979), 51 C.P.R. (2d) 284 (B.C. Co. Ct.).
[17] *R.* v. *Campbell* [1964] 2 O.R. 487 (C.A.).
[18] *Supra*, note 1, s. 61(1)(c).
[19] A refusal to supply may be reviewable under section 75 where the aggrieved party can show, among other things, that it is "substantially affected in its business" by the refusal.

(c) engaging in misleading advertising in respect of the product; or

(d) not providing a level of service that a reasonable buyer would expect.[20]

A manufacturer may be concerned that the image of its product will be diminished if it is sold by discounters. If it refuses to supply its product to discount outlets in order to protect that image, is it thereby violating section 61(1)(b)? In *R. v. Must de Cartier Canada, Inc.*, [21] a charge of price maintenance was dismissed on the basis, among other things, of the Court's finding that *Cartier* had a legitimate concern that the advertised sale of its products at discount prices adversely affected the "*Cartier* image" of high quality jewellery products. In effect, the refusal was not because of the low pricing policy of the discounter, but rather to protect the image of the *Cartier* trademark and trade name.

As noted above, section 61 does not require proof of anti-competitive effects. While the absence of such effects will make the Bureau less likely to take action, the same cannot necessarily be said for private plaintiffs. On its face, section 61 captures price-fixing agreements which would normally be prosecuted under section 45. There is the potential for private plaintiffs to sue alleged price-fixers under section 61, thereby avoiding the often difficult task of proving a substantial lessening of competition.[22]

Price Discrimination

Unlike price maintenance, the price discrimination provisions of the Act have given rise to very few prosecutions under the Act. The current package of proposed amendments to the Competition *Act* would decriminalize price discrimination entirely, making it instead a civil reviewable practice.[23] In the meantime, however, actions which contravene the price discrimination provisions are subject to criminal prosecution and civil damage claims.

Section 50(1)(a) of the Act makes it an offence for a supplier to charge different prices to competing purchasers for similar quantities of a similar article. The section reads as follows:

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[20] *Supra*, note 1, s. 61(10).
[21] *Supra,* note 11.
[22] Houston et al, "Remedies for Anti-competitive Conduct", CBA Annual Fall Conference on Competition Law, 1998.
[23] See *A Plan to Modernize Canada's Competition Regime*, available online at http://www.parl.gc.ca/InfoComDoc/37/1/INST/Studies/Reports/indurp06-e.htm. and *Options for Amending the Competition Act: Fostering a Competitive Marketplace*, available online at http://www.ppforum.com/competitionact/dp2003.pdf.

50(1) **Illegal Trade Practices** - Every one engaged in a business who

(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 or articles from his 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 is respect of a sale of articles of like quantity and quality,

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

For price discrimination to occur, the following elements must exist:

- there must be a sale--leasing, licensing and agency transactions are not covered;
- the sale must be a sale of an "article", not a service. Articles are defined in section 2 of the Act as "[…] real and personal property of every description including
  (a) money,
  (b) deeds and instruments relating to or evidencing the title or right to property or an interest, immediate, contingent or otherwise, in a corporation or in any assets of a corporation,
  (c) deeds and instruments giving a right to recover or receive property,
  (d) tickets or like evidence of right to be in attendance at a particular place at a particular time or times or of a right to transportation, and
  (e) energy, however generated."
- the seller must grant a "discount, rebate, allowance, price concession, or other (price related) advantage" to one purchaser that is not available to another;
- the discrimination must be in respect of a sale of a similar quality and quantity of articles;
- the purchasers must be in competition with one another;

- the price discrimination must be a "practice" (i.e. a systematic pattern of behaviour) rather than an isolated incident. Short-term price reductions, occasional discounts for promotional events and generous terms offered to attract new customers are generally not considered to constitute a "practice"; and

- the practice of price discrimination must be done "to the knowledge" of the seller.

Price discrimination does not require proof of anti-competitive effects, although that will be an important factor in the Bureau's enforcement discretion.

The price discrimination provisions do not require sellers of articles to charge the same prices to all purchasers. They apply only to sales of "like quantity and quality" and as such do not prohibit volume discounts, or different prices for articles of different quality. Discounts or price concessions given to some purchasers do not necessarily have to be given to other purchasers so long as they are made available to purchasers of a like quantity and quality of goods. Also, in order to contravene the section, the sale must be part of a "practice". "One off" discounts are not prohibited.

The *Price Discrimination Enforcement Guidelines* ("PDEGs"),[24] issued by the Commissioner, offer additional insight into the essential elements of the offence.[25]

The PDEGs state that price concessions that are granted to one purchaser do not automatically need to be given to competing purchasers, as long as they are "available". In other words, while a seller is not required to proactively offer price concessions given to competing purchasers, it must make those concessions "available" in situations where a similar quantity of a similar article is sold.

The seller's obligation to disclose previously granted price concessions to subsequent purchasers can vary. The PDEGs state that the obligation depends on whether the original price concession was granted unilaterally by the seller or was the result of negotiations between the seller and the purchaser. In cases where a seller unilaterally grants a concession (for example, offering a standard volume rebate) the seller should subsequently disclose that concession to competing purchasers. In contrast, in situations where the parties negotiate an exchange of a service for a price concession (for example, the buyer agrees to pick up the goods in exchange for a lower

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[24] Commissioner of Competition - Competition Act, Price Discrimination Enforcement Guidelines (Ottawa: Consumer and Corporate Affairs Canada, 1992).
[25] It is important to consider, though, that while the PDEGs do reduce some uncertainty, they are not legally binding.

price), the seller does not need to announce that discount to competing purchasers, but only needs to be prepared to accept a similar deal if a competing purchaser requests it. If a competing purchaser simply asks for the seller's "best deal", there is no obligation to disclose the special concession. Unfortunately, the PDEG's does not offer guidance for situations that fall somewhere between the above examples.

In some cases it may be difficult for a seller to know whether two particular purchasers are "in competition" with one another. Since the price discrimination provisions are essentially concerned with the possible effects on competition in downstream markets (whether the goods are resold to end-users or used as inputs of production), the PDEGs advise that purchasers are competitors of one another if they are "rivals for the custom of the same buyers pursued by the allegedly favoured firm." In other words, if they market to the same set of customers, they could be competitors. Additionally, the PDEGs state that a seller should consider two purchasers to be competitors if they set their prices with close regard to each other's pricing policies.

The PDEGs also provide guidance on buying groups in the context of the price discrimination provisions. Where a group of buyers wishes to obtain a volume discount based on the combined sales of the individual buyers, the PDEGs advise that the group should be a legal entity, must take title to the goods and must assume responsibility for payment. Otherwise, discounted sales to members of the group based on combined volumes could violate the price discrimination provisions.

The price discrimination provisions of the Act can also be relied upon by a seller to justify a refusal to grant certain price concessions. A seller could refuse a discount to a particular purchaser on the grounds that it would otherwise be required to make that concession available to competing purchasers.

Predatory Pricing

Subsection 50(1)(c) of the Act reads:

> 50(1) **Illegal Trade Practices** - Every one engaged in a business who
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> (c) engages in a policy of selling products in any area of Canada 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.

The classic predation case involves a dominant firm using below-cost pricing to drive its competitors out of a market or to deter new entry in order to profitably raise prices above competitive levels in the future.[26]

It may seem strange that while competition laws generally encourage low prices, this subsection punishes individuals for prices that are too low. The rationale behind predatory pricing laws is that the temporary benefits enjoyed by consumers in the form of lower prices will be offset by artificially high prices in the long-term from the lack of future competition. The "mischief" which predatory pricing laws are supposed to address is not the initial low prices, it is the subsequent higher prices that the predictor can charge once its competitors have been driven from the market.

In practice, distinguishing predatory pricing, which is illegal, from vigorous price competition, which competition laws encourage, is difficult.

The Bureau's approach to predatory pricing is set out in its *Predatory Pricing Enforcement Guidelines* ("PPEGs"):[27]

- Typically, an allegation of predatory pricing involves a firm with significant market power trying to maintain or increase its market power through predatory conduct. The Commissioner uses a rough proxy market share of 35% as a guideline, below which it is unlikely an alleged predator has market power. Evaluating a firm's market power also includes an analysis of existing market conditions, including barriers to entry.

- A critical issue in a predatory pricing case is whether the prices were "unreasonably low". The PPEGs specify that:

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[26] See *R.* v. *Hoffman-LaRoche* (1980), 28 O.R. (2d) 164, *aff'd* (1981), 33 O.R. (2d) 694, 15 B.L.R. 217, 58 C.P.R. (2d) 1, 24 C.R. 3d 193, 62 C.C.C. (2d) 118, 125 D.L.R. (3d) 607 (C.A.), *Boehringer Ingelheim (Canada) Inc.* v. *Bristol-Myers Squibb Canada Inc.* (1988), 83 C.P.R. (3d) 51 (Ont. Gen. Div.), *U.S.* v. *AMR Corp*., 140 F. Supp. 2d 1141, 1194, upheld at *U.S.* v. *AMR Corp.*, 10th Cir., No. 01-3202, 7/3/03.

[27] Commissioner of Competition - Competition Act, Predatory Pricing Enforcement Guidelines (Ottawa: Consumer and Corporate Affairs Canada, 1992) at p. 516.

- a price set above the seller's average total costs is not regarded as "unreasonably low" regardless of the seller's market power;

- a price set below average variable cost is likely to be regarded as "unreasonably low" unless there is a clear justification such as the need to sell off perishable inventory; and

- in cases where the price is set in the "grey area" between average total cost and average variable cost, the Bureau's finding will depend on surrounding circumstances (eg. changes in demand patterns, market capacities, etc.)

- The conduct must constitute a "policy". A single sale or a temporary low price offered as a defensive reaction to a competitor's pricing is unlikely to be considered a policy. Rather, to be a policy, a pricing initiative should be a "deliberate corporate program of pricing in the market" and should be of "sufficient duration to constitute a price offering in the context of the given market."

- The conduct must "be designed to" or have the "effect or tendency of" substantially lessening competition or eliminating a competitor.

The PPEGs also refer to "recoupment", suggesting that the Bureau's focus is on cases where the alleged predator has recouped or is likely to recoup the losses it incurred while engaging in the predatory conduct. It is questionable whether in this context there is any substantive distinction between proving "recoupment" and proving a substantial lessening of competition.

The Bureau can also deal with predatory pricing under the "abuse of dominance" provisions of the Act, as an alleged "practice of anti-competitive acts" by a dominant market participant.[28] The PPEGs indicate that where the alleged predation is carried out in conjunction with other anti-competitive acts, or where the conduct is better dealt with by a the Competition Tribunal (the specialized tribunal which decides abuse of dominance cases), the Commissioner will choose to proceed under the abuse of dominance provisions.

There has been considerable debate over which measure of costs to use in determining whether prices are "unreasonably low". The traditional view is that the appropriate measure is "average variable costs". The approach currently favoured by the Bureau is the "avoidable cost" test — the

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[28] *Supra*, note 1, s. 78, 79, and see further example in Houston and Pratt, "The Role of Intent in Abuse of Dominance Cases in Canada", CBA Annual Fall Conference on Competition Law, 2003.

costs a firm could have avoided if it did not produce the good in question. Avoidable costs include all of the variable costs of production, together with any product-specific fixed costs, but do not include overhead. In the *Air Regulations*, "avoidable costs" are prescribed as the appropriate cost measure where predatory pricing is alleged as abuse of dominance by a dominant domestic airline. In the recent Air Canada decision,[29] the Competition Tribunal dealt in detail with application of the avoidable cost test to an airline. The U.S. Court took a different approach in the *American Airlines* case.[30]

Another controversial issue is whether "price matching" can be predation, or whether price undercutting is required. In *Boehringer*, an Ontario Court held, relying on U.S. jurisprudence, that undercutting was necessary and that simply matching the prices of one's rival could not be predation even if those prices were below the defendant's costs.[31] The Bureau takes a different view, as have some more recent U.S. cases.[32]

The Bureau's approach to predation is largely consistent with U.S. jurisprudence and with the economic theory underlying predation laws. That approach, however, requires a "flexible" interpretation of the words of s. 50(1)(c). On its face, the section can be read to impose a much lower burden on the party seeking to prove predation (for example, a civil plaintiff). Section 50(1)(b) does not set out a recoupment requirement, nor does it require any anti-competitive effect if it is shown that the pricing was intended to eliminate a competitor or to lessen competition substantially. To date in Canada there have been very few civil cases brought pursuant to the predatory price provisions of the Competition Act. When faced with apparently below cost prices by a competitor, it is an avenue that may be worth exploring.

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[29] *Commissioner of Competition* v. *Air Canada*, 2003 Comp. Trib. 13
[30] *Supra*, *American Airlines*, note 26.
[31] *Supra*, *Boehringer*, note 26.
[32] *Spirit Airlines, Inc.* v. *Northwest Airlines, Inc.*, U.S. District Court, Eastern District of Michigan, Southern Division, March 31, 2003, Case No. 00-71535.

Some Do's and Don’ts

DO: Communicate a clear message to all personnel that lawful pricing policies and fair dealing are top priorities.

DO: Establish a system of employee incentives and rewards to encourage compliance. Company ethics and values come from the top.

DO: Set up a corporate compliance policy that includes a competition law component, and designate a corporate compliance officer to oversee implementation and execution.

DO: Establish procedures to promptly notify appropriate personnel of possible violations.

DO: Conduct in-house audits to ensure that pricing policies are followed and to learn where improvement is needed.

DO: Pay particular attention to potential issues arising in the following circumstances:

- customer terminations (wholesaler, retailer, dealer)
- refusals to supply a distributor or customer
- advertising programs that require display of a suggested retail price

DO: Document the legitimate basis for terminating or refusing to supply a reseller

DO: Keep careful accounting records regarding production costs.

DON'T: Price products below avoidable costs or variable costs on an extended basis.

DO: Document the rationale for pricing below cost in specific instances.

DO: Ensure that key personnel remain informed regarding recent developments in competition law.

DO: Ensure that price lists, distributor contracts and other documents that contain suggested resale prices also include the appropriate language to demonstrate that distributors are under no obligation or threat to charge suggested prices.

DO: Keep detailed records of all dealings with customers, particularly with respect to price negotiation.

DON'T: Quote firm prices to end-users for contracts to be filled by distributors, wholesalers or other resellers.

DO: Consult with competition counsel.