SUBSTANTIALLY LESSENING COMPETITION - A NOTE ON THE HOFFMAN-LAROCHE JUDGMENT

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In a decision handed down on February 5, 1980, Mr. Justice Linden of the Supreme Court of Ontario found Hoffman-Laroche guilty of violating the predatory pricing provision of the Combines Investigation Act.[1] Section 34 (1)(c) of the Act reads as follows:

> Everyone engaged in a business who... (c) engages in a policy of selling articles at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have such effect,
>
> is guilty of an indictable offence and is liable to imprisonment for two years.[2]

The Court, having determined that Roche had, in fact, sold articles at unreasonably low prices (Valium to hospitals at zero price for a period of a year) turned to the predatory pricing part of 34(1)(c) ("...designed to have such effect"). The verdict of guilty flowed from the Court's finding that the pricing policy at issue was designed to have the effect of substantially lessening competition or eleiminating a competitor, a design not only revealed by internal memoranda, but inferred from the very nature, the sheer outlandishness, of the pricing policy followed.[3]

This note is concerned with a subsidiary question: the meaning to be assigned to the phrase "substantially lessening competition" when the effect or tendency, as distinct from the design, of an unreasonably low pricing policy is at issue. In Hoffman-Laroche, the Court's approach to the concept of a substantial lessening of competition was not, in fact, critical to its decision. In future cases, however, should a court be required to reach a decision based on the effect of a pricing policy, the interpretation of the term by the Hoffman-Laroche Court could assume considerable importance.

Little guidance is available as to what is to be understood by a substantial lessening of competition (or, for that matter, what is an unreasonably low price). In Section 32, the conspiracy part of the Combines Investigation Act, the key concept is the undue lessening of competition, a concept to which ambiguity still is attached, despite its long history of judicial interpretation. Section 33, dealing with merger, refers back to Section 2 in which illegality is said to require that "competition is or is likely to be lessened to the detriment or against the interest of the public." In the Irving case, which reached the Supreme Court of Canada, an important question was the substantiality of the competition facing the acquired newspapers in the markets which they served; the limited nature of that competition was a factor in the Supreme Court's upholding the Court of Appeal's reversal of the Trial Court's

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finding of guilt.[4] In Part IV of the Act, covering matters reviewable by the Restrictive Trade Practices Commission, the sections dealing with exclusive dealing, tied selling, and market restriction, the Commission is called upon to determine whether or not the practices in question will produce the "result that competition is or is likely to be lessened substantially." In the Bombadier case, the Commission, undertaking economic analysis and employing procedures not to be expected in a criminal court, considered the question of a substantial lessening of competition flowing from Bombadier's exclusive dealing policy. In rejecting the allegation of an adverse effect on competition, the Commission was impressed by the "existence and continuing viability of strong competitors to Bombadier" as well as "much evidence that entry at the retail level is easy." The Commission was satisfied that "at least at a provincial or regional level, Bombadier's competitors were able to overcome whatever barriers to their expansion were created by Bombadier's exclusive dealing policy."[5]

It may initially be observed that although Mr. Justice Linden, in ruling on the admissibility of the evidence of expert economist witnesses, had stated that "expert evidence as to... the meaning of phrases such as having a substantial effect on competition"[6] would be helpful, there is no indication in the judgment that such evidence was forthcoming. The expert evidence introduced on the meaning to be assigned to the concept of an unreasonably low price was, however, extensively discussed in the judgment with the Court's perference for the approach of the defence economist playing a large part in the reasoning employed to reach a verdict.

II

The judgment, in its consideration of the effect of Roche's Valium giveaway programme includes the following:

> When information came to Horner about this Roche programme, Horner decided to curtail its efforts in the hospital market during the period of the free Roche goods.[7]

And a Horner letter to hospital pharmacists is quoted

> In the event that you receive any such (free) offer, we will not be able to meet this competition. (p. 162)

And Horner went on to indicate its willingness

> to terminate any contract for Vivol you might have. This would enable you to take advantage of any offer of free material. (p. 162)

so that Vivol purchasers would not have

> to suffer because of our inability to match any such competition. (p. 162)

The judgment notes that during the period of free Valium supplied by Roche, Horner "did not have much market in the hospital segment of the market... selling to only 15 or so hospitals of over 100 beds." It confirms that Horner "was largely kept from entering the hospital market in any significant way for the year of free Valium" though it was "quite successful in the non-hospital segments of the market. (p. 163)

It was in the light of the above that the Court tackled the question of whether the zero price policy of Roche (a policy already found to involve unreasonably low prices) had had the "effect or tendency of substantially lessening competition or eliminating a competitor." The Court, in introducing its consideration of the question, re-iterated that

> "evidence (had been) adduced that Horner virtually withdrew from the hospital market temporarily when it discovered that Roche was supplying them with free goods. (p. 189)

but, having made this point, goes on to say

> But this does not necessarily mean that the competition was substantially lessened by this conduct of Roche. There was virtually no competition in diazepam before Horner's launch, because roche had the patent which gave them a monopoly on sales of diazepam. By temporarily subduing Horner's efforts in the hospital arena, its competition and that of the other potential competitors was lessened to a degree, but it may not have been substantially lessened. After all, Horner's share of the hospital market was only tiny... Nor was Horner completely eliminated from the hospital market. (p. 189)

As the Crown stressed design or intention during the case, rather than effect, this approach to the interpretation of a substantial lessening of competition is not important to the decision reached. it is, however, deserving of note, as it is difficult to square with the presumed intent of Parliament in including a predatory pricing provision in the legislation. The approach taken to the demonstration of a substantial lessening of competition seems to protect a sufficiently dominant firm from a charge of predatory pricing, in terms, that is, of the effect of the pricing policy. A firm with, say, 90% or more of a market, can evidently not follow a pricing policy which has the effect of substantially lessening competition, there not being enough existing competition, prior to the pricing policy adopted, to meet the substantiality requirement. Substantial lessening requires, evidently, a prior substantiality of that which is to be lessened. But predatory pricing, insofar as it is a problem, is of concern not only because it may help achieve a monopoly position (by a lessening of existing competition), but, and perhaps of greater importance, because is may help to perserve an existing monopoly, or dominant position, by rendering difficult, because unprofitable given the predatory price, the emergence of a potential competitor, or expansion of a presently minor competitor. It is difficult to believe that Parliament, by its use of the substantially lessening phrase, meant

to exclude from the offence the use of unreasonably low prices to preserve, in the face of competitive threats, an already dominant position. But the approach to the concept of a substantial lessening of competition adopted by the Court, an approach that is understandable given the location of the word "substantial" before "lessening", seems to reduce the applicability of the provision, at least in terms of effect, in the case of dominant firms, which are, surely, the firms in whose behaviour policy is most concerned. Perhaps an interpretation of "substantially less than it would have been had unreasonably low prices not been set" would rescue the provision, but this not only stretches the meaning but requires a prediction of probably market shares. It is, of course, possible to focus on the elimination of a competitor effect, so that the suggested implication of the interpretation of substantially lessening competition hinted at in the judgment may be of minimal significance. In Hoffman-Laroche, however, this alternative to substantially lessening competition could not have been successfully argued. Through the zero price period, the competitor, Horner, was not eliminated, as it continued to make sales to the hospital market.

III

There are two other points of some interest that may be made. The impact of Roche's pricing policy on Horner was confined to the hospital market for diazepam in which Roche's Valium was competing with Horner's Vivol. In other segments of the diazepam market, Horner was able to prosper.

> "Horner was still able to sell between 1970 and 1974 (the first year of which period being the year of the Valium giveaway policy) over $12,000,000 worth of Vivol, its normal profit margin being around 60% of the selling price. Horner's efforts, therfore, were quite successful in the non-hospital segments of the market."[8]

It is pertinent to ask whether or not evidence of success elsewhere in the diazepam market is relevant to the question of substantially lessening competition or even of eliminating a competitor. (It is not suggested that it was deemed relevant by the Court.) The Court found that the hospital market was a relevant market so that the effect on competition would have been deemed substantial had it been substantial in that particular market. As well, had Horner been eliminated from the hospital market (as it was not), the fact that Horner continued to thrive in the non-hospital market for diazepam, or in the drug market generally would seem to be irrelevant to the elimination of a competitor issue. In other words, a competitor can be eliminated from a market, and hence cause 34 (1)(c) to be satisfied, even though it goes from strength to strength in other, perhaps closely related, markets.[9] The success of Horner in the non-hospital diazepam market was not evidence that a competitor had not been eliminated, though it suggests a quick return to the market from which it had been excluded, once the predatory pricing policy is abandoned.

The Court's use of the word "temporarily" is also worthy of comment. In addition to the substantiality requirement, or perhaps as a component of substantiality, the length of time during which the "competition (of Horner) and that of the other potential competitors was lessened"[10] is apparently being assigned some importance. The length of time was the actual period of the giveaway, as, with the cessation of free Valium policy, Horner, and others, quickly returned to the hospital diazepam market. It may be, therefore, that the Court, in questioning the substantiality of the lessening of competition, had in mind the post-free Valium emergence of effective competition for the Roche product.

IV

It may be argued, therefore, that the Hoffman-Laroche judgment develops a novel proposition if the Court was arguing that competition has been substantially lessened only if prior to an unreasonably low pricing policy, substantial competition already exists. In addition, there may be an implied requirement that, after the cessation of an unreasonably low pricing policy, substantial competition does not emerge. In either case, it seems fair to suggest that it would be difficult to prove that a sufficiently dominant firm had, in fact, substantially lessened competition so that, in such cases, it is the intent or design branch of the predatory procing provision which must be established.[11]

FOOTNOTES

1 Regina v. Hoffman-Laroche Ltd., Supreme Court of Ontario, 48 C.P.R. (2d), 145. Upheld on appeal to Ontario Court of Appeal 58 C.P.R. (2d) 1.

2 Combines Investigation Act, R.S., C-314, 5.1.

3 "Roche's response was so outlandish that it demonstrates to me that it was not competing with a competitor, but that it was seeking to eliminate its competitors and to substantially lessen competition." 48 C.P.R. (2d), 195.

4 The Irving case is discussed in James P. Cairns, "Merger Policy in Canada and the Supreme Court Decision in K.C. Irving Ltd.", Alberta Law Review, Vol. XIX, 1981, No. 2.

5 Before The Restrictive Trade Practices Commission, Between Director of Investigation and Research and Bombadier Limited, October 14, 1980, mimeo. Part IV of the judgment discusses the question of a substantial lessening of competition.

6 44 C.P.R. (2d), p. 38. The Court had indicated a desire to know whether or not there was any expert evidence as to the meaning of the phrase. It is doubtful that an economist would be prepared to assign a generally

accepted meaning to such a phrase as "substantially lessening competition." He would be more willing to suggest criteria to determine whether or not competition had been lessened, but the substantiality of any lessening would be more a matter of judgment.

7 48 C.P.R. (2d), p. 162. Horner is Frank Horner Ltd. which was attempting to enter the hospital diazepam market, hitherto supplied by Roche's Valium, with its competing brand, Vivol.

8 Ibid., p. 163.

9 The Court specifically rejected the Defence argument that "the whole market... not just a part of it, must be considered in deciding whether their prices were unreasonably low." (underlining supplied). But it seems clear that the substantiality of effect on competition, or elimination of a competitor, was also being considered with reference to the hospital market only. "To violate the language of s. 34 (1)(c), it is not necessary to attack on all fronts at the same time; it is enough to concentrate on one segment of that market, such as hospitals. The very essence of predatory pricing is to single out for attack one geographical area... or one type of purchaser or product." Ibid., p. 184.

10 Ibid, p. 189. The Roche policy is described as "temporarily subduing Horner's efforts in the hospital arena."

11 It should, however, be mentioned that a dominant firm practising predatory pricing might be liable to a charge under the monopoly provision of the Act on the ground of operating the business "to the detriment or against the interest of the public, whether consumers, producers, or others." The Court would have to be satisfied that the firm met the Act's criterion for monopoly, i.e., that it "substantially or completely controlled throughout Canada or any area thereof the class or species of business in which they are engaged." Would the sale of diazepam to the hospital market have been regarded as a "class or species of business in which Roche was engaged"? (It may be pointed out that the original Information included a monopoly count but the accused was discharged at the preliminary hearing and the Crown only proceeded with the predatory pricing charge). It may also be noted that, in the proposed 1977 revision of the Act (never passed), the Competition Board was to deal with cases of "monopolization" which included "eliminating a competitor by predatory pricing" so as to "entrench such control (of a class or species of business) or to extend monopoly power into another market." Section 31.72.