RECENT DEVELOPMENTS IN THE COMPETITION POLICY TREATMENT OF PREDATORY PRICING

By R.D. Anderson and S.D. Khosla*

I. Introduction

Recent economic writings and judicial decisions carry important implications for the competition policy treatment of predatory pricing -- the deliberate charging of unreasonably low prices for the purpose of driving a competitor out of business or deterring entry by new competitors. The treatment of such conduct is a subtle and far-reaching issue, since the efficient operation of a competitive market economy requires broad scope for vigorous price cutting. There is a danger that, in seeking to protect against unfair price cutting, antitrust policy may unintentionally inhibit healthy price competition.[1] Several rules for distinguishing predatory from non-predatory price cutting have been proposed by economists. In the U.S., these rules have been widely considered in the courts, resulting in more sophisticated treatment of predatory pricing cases in recent years.[2]

In Canada, predatory pricing is dealt with under sections 34(1)(b) and 34(1)(c) of the Combines Investigation Act.[3] The courts' decisions in two recent cases under section 34(1)(c) provide important insights into the treatment of such conduct. In R. v. Hoffmann-La Roche Ltd.[4], Mr. Justice Linden of the Ontario High Court discussed the reasonableness of defensive price cutting as a response to entry of new competitors and put forward a framework for the evaluation of predatory pricing allegations. In R. v. Consumers Glass Co. Ltd. and Portion Packaging Ltd.[5], Mr. Justice O'Leary examined the implications of excess capacity for the assessment of price cutting. These cases go a long way to establish a "rule of reason" for the treatment of predatory pricing in Canada.

The treatment of predatory pricing and related practices has also emerged as an important issue in the context of regulated industries. In both the U.S. and Canada concerns have been expressed about the scope for anti-competitive cross-subsidization in the regulated (or partially regulated) telecommunications industries. At the same time, the trend to deregulation in the transportation industries has prompted a re-examination of the treatment of predatory practices in these industries. In Canada, predatory pricing by the railways is dealt with under section 276 of the Railway Act, which requires rates to be compensatory. In his recent position paper on national transportation policy, Freedom to Move, the Minister of Transport has announced that section 276 of the Railway Act will be repealed, and predatory pricing by the railways will be dealt with under the provisions of the Combines Investigation Act.[6]

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* Bureau of Competition Policy, Ottawa. The views expressed are the authors' and not necessarily those of the Bureau.

The treatment of predatory pricing is also of interest in relation to the current debate over legislation dealing with unfair practices in international trade. An important focus of this debate is the comparison of standards for the treatment of "predatory" conduct under the anti-dumping and domestic competition laws.[7] The report of the Royal Commission on the Economic Union and Development Prospects for Canada highlights the need for lowering of non-tariff barriers in Canada-U.S. trade. To the extent that steps are taken to establish a free trade agreement between the two countries, there may be greater reliance on domestic competition laws to govern bilateral trade.

This article reviews current developments in the economics and law of predatory pricing. In particular, section II considers the modern economic view of predatory price cutting and the various rules that have been proposed for distinguishing predatory from non-predatory prices. Section III examines the scope and application of the predatory pricing provisions of the Combines Investigation Act as well as the facts and opinions presented in the Hoffmann-La Roche and Consumers Glass cases. Section IV discusses the recent developments respecting the treatment of predatory pricing in regulated and quasi-regulated industries. Section V summarizes the implications of these developments for the treatment of predatory pricing in Canada.

II. The Economic Analysis of Predatory Pricing and the Proposed Rules

During the early twentieth century it was widely believed that predatory pricing was an effective means of obtaining market power that would be pervasive in the absence of legislative prohibition. The typical pattern of predation was believed to involve the elimination of small competitors by a larger firm through drastic price cuts in local markets. Sustained losses would eventually force the competitors to exit the market, leaving the predator free to raise its prices and earn monopoly profits. Concern about such behaviour helped to shape popular perceptions of "cut-throat competition" and contributed to the antitrust attack on the great industrial trusts in the U.S. in the early 1900s.[8]

The modern economic analysis of predatory pricing began with a re-examination of the facts in one of the classic U.S. industrial trust cases, Standard Oil Co. of New Jersey v. United States. The case involved the operation of the Standard Oil Company as a trust or holding company exercising control over the Rockefeller family's oil refining properties throughout the United States. Much of the impetus for the prosecution came from popular allegations that the Standard Oil Co. had attained its near-monopoly status in the oil refining business through systematic predatory pricing. Determining that Standard's pricing and other practices "operated to destroy the potentiality of competition where it otherwise would have existed," the U.S. Supreme Court upheld Standard's conviction under the Sherman Act and ordered its dissolution in 1911.[9]

A careful re-examination of the trial record in Standard Oil by John S. McGee in 1958 found no evidence of predatory conduct by the company, in the sense of local price cutting to drive competitors out of the market.[10] McGee determined that in most cases Standard preferred to buy out its competitors at market value and avoid costly price wars. McGee also raised important general questions about the viability of predatory pricing as a monopolizing strategy. He pointed out that predatory pricing would normally be a more costly means of achieving monopoly power than the direct acquisition of competitors at market value. He also suggested that once a competitor has been driven out of business, the possibility of re-entry would normally prevent the predator from raising its prices above competitive levels and recouping its losses.[11] For these reasons, McGee concluded that predatory pricing is rare and unlikely to be successful.

Economists have put forward three main criticisms of McGee's reasoning. First, Telser has suggested that predatory pricing may be effective where the predator has a lower cost of capital (a "longer purse") than the target firm.[12] Second, Yamey has argued that while McGee may have been correct in suggesting that predatory pricing is more costly than direct acquisition of competitors, the latter alternative may be ruled out by the anti-merger laws in the U.S.[13] Third, and perhaps most important, it has been pointed out that McGee's analysis omits the role of strategic behaviour and threats. As Posner has suggested, predatory pricing may be a viable and profitable strategy in circumstances where predation in one geographic market deters entry in the predator's other markets.[14]

It should be noted, however, that many antitrust scholars, including Easterbrook, Bork and McGee, remain of the view that successful predation would be rare, even in the absence of legislative prohibition. In their view, capital markets are sufficiently perfect to sustain a target firm through a predatory campaign if it is efficient for the target to remain. Threats of predation are unlikely to be a credible deterrent, since businessmen understand that carrying out the threat would be very costly.[15]

The controversy over the viability of predatory pricing and the conditions in which it is likely to occur has led to a heated debate over the treatment of such conduct under competition legislation. Several rules have been put forward for distinguishing predatory from non-predatory price cuts. Ideally, such rules should assist in the identification of predatory pricing while providing maximum scope for pro-competitive price cutting and being easy to apply in the courts.

In 1975, Areeda and Turner put forward a simple cost-based rule. In essence, their rule provides that:

(i) all prices at or above short run marginal cost (or, where marginal cost data are unavailable, average variable cost) should be presumed lawful; and

(ii) all prices below short run marginal cost (or average variable cost) should be presumed predatory unless they are at or above average total cost.[16]

The Areeda-Turner rule has been widely cited by the courts in the United States. One commentator suggests that it "has influenced the case law perhaps more than any other work in all of antitrust literature."[17] However, the appropriateness of reliance solely on a short run marginal cost standard has been questioned by several antitrust economists. As Scherer has pointed out, long run welfare maximization is the generally accepted aim of antitrust policy. He believes that "long term economic welfare is maximized in some cases when the monopolist's price exceeds its marginal cost and in other cases when marginal cost is undercut."[18] Greer argues that the Areeda-Turner rule unnecessarily excludes relevant documentary evidence of predatory intent.[19] Finally, Joskow and Klevorick have argued that no single rule is appropriate to all market situations; a more flexible approach is required to ascertain the existence of predation in individual markets.[20]

Two additional rules put forward for dealing with predatory pricing should be noted. First, Baumol has proposed a rule of "quasi-permanence of price reductions" under which dominant firms that lower their prices in response to entry would be prevented from raising them for periods of up to 5 years.[21] The rationale is essentially to prevent firms from recouping their losses following a predatory campaign. However, Baumol's proposal has been criticized on the grounds that it is excessively interventionist and could inhibit pro-competitive price-cutting.[22] Second, Williamson has proposed a rule under which dominant firms would be prevented from expanding their output in response to entry by new competitors.[23] This rule, too, has been criticized on the ground that it would inhibit rather than encourage efficient adjustment to market forces.[24]

As an alternative to the above rules, Joskow and Klevorick have proposed a "two-tiered" rule of reason approach to predatory pricing cases.[25] They believe their approach will minimize implementation costs and preserve the flexibility needed to address particular pricing situations in different markets. The first, "structural" tier of their analysis is designed to determine whether the market in question is susceptible to monopolization. This involves an examination of: (i) factors indicating that the alleged predator already possesses market power (e.g., market share and historical profitability); (ii) entry conditions in the market (e.g., capital requirements, brand preference, the ease of transfer of productive resources and the observed pattern of entry and exit); and (iii) the dynamic evolution of the market, including whether the source of any technological change has been the alleged predator or new entrants. Only if this structural analysis reveals a danger of monopolization would they proceed to the second tier of their approach.

The second, "behavioural" tier of the Joskow-Klevorick approach involves an examination of price-cost relationships. Like Areeda and Turner,

they would consider as predatory any price set below average variable cost. Furthermore, Joskow and Klevorick would deem as predatory a price below average total cost, unless the alleged predator could show that this price minimizes short run losses (e.g., in a situation of excess capacity). Finally, as in Baumol's rule, a reversal of a significant price cut within two years could raise an inference of predatory pricing.

The Joskow-Klevorick approach has been criticized on two principal grounds. First, there are problems with the specific structural tests they employ.[26] During the past decade economists have raised questions about the importance of such traditional entry barriers.[27] Second, investigation of these matters in particular cases can be a costly and time-consuming process.[28] Nevertheless, the concept of a rule of reason in predatory pricing cases is defensible. Factors such as ease of entry in an industry would certainly bear on the feasibility of predatory pricing. A combined structural and behavioural approach may well provide the most efficient means of distinguishing predatory from non-predatory pricing.

In the U.S. there are indications that cost-based tests are giving way to a combined structural and behavioural approach in predatory pricing cases. In two recent cases before the Federal Trade Commission, an approach similar to that of Joskow and Klevorick was employed. In General Foods Corp., the Commission rejected the allegation of predatory pricing primarily on the basis that successful predation was precluded by low entry barriers. Similarly, in ITT Continental Baking, the Commission determined that there was little possibility of successful predation, based on the low market share of the alleged predator, a low level of market concentration and a lack of entry barriers. In this way, the Commission was able to resolve the cases without undertaking an extensive inquiry into price-cost relationships.[29]

III. The Treatment of Predatory Pricing Under the Combines Act

In Canada, predatory pricing is dealt with under sections 34(1)(b) and 34(1)(c) of the Combines Investigation Act. These provisions deal with two specific forms of predation: "geographic predatory pricing", involving the sale of products at prices lower than those available from the same supplier elsewhere in Canada (sub-section 1(b)) and the traditional form of predatory pricing through the use of unreasonably low prices (sub-section 1(c)). These are sometimes termed as primary line provisions, since they are concerned with the lessening of competition at the seller's own level of the market. Section 34 also deals with the sale of products to competing buyers at different prices (sub-section 1(a)). The latter provision is concerned not with predation against a seller's competitors but with the effects of price discrimination on buyers (the "secondary line").[30]

The provisions contained in section 34 of the Act were originally enacted in 1935, in response to recommendations of the Royal Commission on Price Spreads. These provisions were initially included in the Criminal Code, and were transferred to the Combines Investigation Act in 1960 with minor amendments.[31] In 1976, the coverage of section 34 was broadened to include services as well as goods, as part of the Stage I amendments to the Act. It appears that the provisions of section 34 were originally intended for the protection of smaller competitors from displacement by larger firms.[32] Since their enactment, however, they have been generally construed as serving the fundamental objectives of Canadian competition policy, i.e., providing protection from "the undue and abusive lessening of competition which operates to the oppression of individuals or is injurious to the public generally."[33]

The use of predatory practices may also form part of a monopolization case under section 33 of the Combines Investigation Act, as an indication that the accused firm has unreasonably extended or entrenched its market power. In Eddy Match Co. Ltd. v. the Queen,[34] evidence that the Eddy Match Co. had employed "fighting brands" - the marketing of specially designated versions of its products at heavily discounted prices - contributed to the company's conviction under section 33. Such treatment of predation is similar to the situation in the U.S., where predatory practices are frequently dealt with under the general monopolization provision of the Sherman Act. However, allegations of predatory pricing in Canada are usually dealt with under section 34(1)(c) of the Combines Investigation Act.

Conviction under section 34(1)(c) of the Act requires proof of four specific elements:

(i) that the accused was "engaged in a business";
(ii) that the alleged predatory pricing was part of a "policy of selling products" rather than an isolated incident;
(iii) that the products were sold at "unreasonably low prices"; and
(iv) that the prices charged had "the effect or tendency of substantially lessening competition or eliminating a competitor, or were designed to have such effect."[35]

It should be noted that the section does not require both the intent and effect of lessening competition substantially or eliminating a competitor; either the effect or the intent will suffice.

The four elements of section 34(1)(c) establish the basis for a rule of reason treatment of predatory pricing in Canada. The application of these elements, especially items (iii) and (iv), necessarily involves the courts in making judgements about complex aspects of business behaviour. The concepts of "unreasonably low" and "substantially lessening competition" require the courts to distinguish carefully between anti-competitive and pro-competitive price-cutting. The tests used by the courts in applying these concepts largely define the treatment of predatory pricing under the Act. The recent cases of Hoffmann-La Roche and Consumers Glass provide useful indications of the courts' interpretation of these terms.

The Hoffmann-La Roche case concerned the pricing practices employed by Hoffmann-La Roche ("Roche"), a Swiss-based multinational drug company, in response to the entry of a new competitor to the market for two of its largest-selling products, diazepam (Valium) and chlordiazepoxide (Librium). During the 1960s Roche enjoyed a virtual monopoly over the supply of these drugs in Canada, as a consequence of its patents on the processes by which they are manufactured. In 1969, Parliament enacted legislation expanding the compulsory licensing provisions of the Patent Act to permit the manufacture and importation of patented drugs by non-patent holding companies.[36]

In 1969 and 1970, Frank Horner Ltd., another drug manufacturer, took advantage of these developments to intensify its efforts to sell its own brands of these drugs to Canadian hospitals and consumers at lower prices than Roche's. Roche responded by implementing a series of progressively severe cuts in its prices for Valium and Librium, including: (i) a series of offers to Canadian hospitals to provide 1 free capsule of either drug for every 1 or 2 capsules purchased; (ii) tenders to provide up to 2 million capsules of Librium to the federal Department of Supply and Services for a total of $1; and (iii) the giving away of approximately 82 million capsules of Valium to Canadian hospitals and governments during the period June 1970 to June 1971. As a result of these events, Roche was charged with having violated section 34(1)(c) of the Combines Investigation Act. On February 5, 1980, Mr. Justice Linden of the Ontario High Court of Justice found Roche guilty in respect of the giving away of Valium free to hospitals but not guilty with respect to other aspects of its pricing policy. The conviction was appealed to the Ontario Court of Appeal and upheld on all points.[37]

Mr. Justice Linden stated that the determination of whether prices are unreasonably low must be based on all of the circumstances involved in the case.[38] To assist in the determination of this issue, he put forward four specific factors to be considered by the court. First, the court should consider the actual difference between prices and costs. The greater the reduction below cost, the more likely it is that the price is unreasonable. Second, the court should consider the length of time during which the prices are in place. A low price which is reasonable if employed for a day or a week may be unreasonable if left in place for a month or a year. Third, the Court should consider whether the low price is adopted as a defensive or an offensive measure. A level of prices that is reasonable in the former situation may be unreasonable in the latter. Fourth, the Court should take into account any legitimate external or long run benefits that accrue to the seller by keeping its prices below cost.

In the case at hand, Mr. Justice Linden considered that the various deals in which 1 capsule of Valium or Librium was provided free with 1 (or 2) purchased did not constitute sale at unreasonably low prices. In his view, not all of these deals represented sales below cost. In any case, the deals were justified by the importance of the hospital market to Roche's overall marketing strategy. Maintaining sales in the hospital market was considered important because doctors who are exposed to a brand of a drug in a hospital will often

prescribe the same brand in their private practice. He also considered that the $1 tenders made by Roche to supply the government with up to 2 million capsules of Librium did not represent sales at unreasonably low prices. He believed that these tenders were short run measures justified by their perceived long run benefits to Roche.[39]

Mr. Justice Linden determined, however, that Roche's giving away of the 82 million capsules of Valium to hospitals over the period June 1970 to June 1971 did constitute selling at an unreasonably low price. He based this determination on the magnitude of the price cut (to zero) and the duration of the give-away (two consecutive six month periods). In his view, the give-away campaign was manifestly an over-reaction to the threat posed by Frank Horner Ltd. In his own words, "If the sales at the zero price in these circumstances were not for unreasonably low prices, then it would be hard to imagine any situation where they would be."[40]

The fourth element of a conviction under section 34(1)(c), dealing with the effect on competition in the market or the intent of the accused firm, also required careful consideration by Mr. Justice Linden. He noted that the Crown had not pressed its case on the first alternative dealing with the effect of Roche's prices, relying instead on the second alternative of intent to lessen competition substantially or eliminate a competitor. He cited several internal Roche memoranda that were introduced by the Crown, including one which suggested that the Valium give-away "will not only abort Horner's efforts but serve as a warning to others who seem to be showing an interest in this product."[41] He considered that these documents evidenced a predatory intent on Roche's part. He also emphasized Roche's "drastic" action in cutting the price of Valium to zero for two consecturive six month periods. In his view, this over-reaction to the threat posed by Horner manifested the intent necessary for conviction under section 34(1)(c).

Mr. Justice Linden's opinion in the Hoffmann-La Roche case is important because it sets a standard for the evaluation of allegations of predatory conduct. It does not attempt to specify precisely what level of prices will be viewed as unreasonable. Rather, it indicates that this question must be resolved by considering all of the circumstances in the case, including price-cost relationships, the timing of price cuts and their relation to the competitive environment of the firm.

From an economic viewpoint, the case is important because it provides one of the few proven examples of predation, in the sense of drastic price cutting coupled with a clear intent to exclude competitors. At the same time, it underscores the limitations of predation as a strategy for monopolization. As Linden notes in an "ironic finale," by the late 1970s both Roche and Horner were largely excluded from the hospital market for diazepam and chlordiazepoxide, which had been taken over by lower-priced generic firms.[42] It appears that Roche's predatory pricing strategy was irrational, given the ease with which new firms could enter the industry under the expanded compulsory licensing provisions of the Patent Act.[43]

The Consumer Glass case provides an additional recent example of the application of section 34(1)(c) of the Combines Investigation Act. The case centered around the pricing strategy adopted by Portion Packaging Ltd., a subsidiary of the Consumers Glass Co., in the Canadian market for small plastic cup lids. Prior to 1975 Portion was the sole independent supplier of such lids in Canada. However, Portion was experiencing a decline in sales due to a trend on the part of its important customers (Canadian manufacturers of plastic cups) to convert to manufacturing their own cup lids. Indeed, Portion was producing at only 70% of its capacity and had resolved to phase itself out of the market. In the spring of 1975, two of Portion's senior executives resigned to form a new company, Amhill Enterprises Ltd., to manufacture cup lids. Amhill then approached Portion's customers offering to supply them with cup lids at 2-3% below Portion's prices. In response, Portion initiated a policy of discounting its prices, eventually to a level of 21% below the original price. The evidence indicated that this price was below the company's average total cost but above its average variable cost.[44]

In his reasons for judgement, Mr. Justice O'Leary reviewed some of the rules proposed by economists for distinguishing predatory from non-predatory prices. He quoted at length from the Areeda-Turner proposal, under which prices in excess of the defendant's average variable cost are presumed lawful. Professor Turner was called as an expert witness by the defence during the trial. Mr. Justice O'Leary also quoted from a critique of Areeda and Turner by Professor Greer, who was called as an expert witness by the Crown. Without accepting that any single rule should be determinative in all cases, Mr. Justice O'Leary considered that Portion's prices could not be viewed as unreasonably low, given that: (i) the prices remained above average variable cost; (ii) there was considerable excess capacity in the market; and (iii) Portion was attempting to minimize its losses. He suggested that pricing below average total cost might be natural where there was excess capacity in a market.[45]

In sum, Mr. Justice O'Leary's opinion in the Consumers Glass case re-inforces the rule of reason treatment of predatory pricing under section 34(1)(c) of the Combines Investigation Act. As in the Hoffmann-La Roche case, no single factor was dispositive. Rather, the Court examined the price-cost relationships and intent of the pricing strategy in the context of the general market conditions. From an economic perspective, the case underscores the significance of excess capacity in predatory pricing cases. In situations of excess capacity a price below average total cost should not necessarily be viewed as unreasonable.

IV Predatory Practices and Regulated Industries

The danger of predatory practices may well be greater in regulated or partially regulated industries than under normal market conditions. There

are several reasons for this concern. First, as Jordan points out, the possibility of a predator recouping his initial losses from a predatory campaign may be enhanced if there are government-imposed restrictions on subsequent re-entry by the target firm or other competitors.[46] In the ocean liner shipping industry, the use of entry-deterring devices such as loyalty contracts may have facilitated recoupment and encouraged predation.[47]

Second, a firm operating in a partly regulated environment may be able to recoup losses from predation merely by re-allocating costs from its non-regulated to its regulated market. There is a tendency for regulated firms to expand into non-regulated markets in this way. This pattern has been documented in the U.S. telephone industry. Indeed, it formed the core of the U.S. government's monopolization case leading to the recent break-up of the American Telephone and Telegraph Company.[48]

In Canada, similar concerns about the possibility of telecommunications carriers cross-subsidizing their non-regulated operations have been expressed by the Director of Investigation and Research, Combines Investigation Act in several interventions before the Canadian Radio-Television and Telecommunications Commission. In the course of the CRTC Telecommunications Cost Inquiry, the Director indicated that his principal concern was to ensure that the costing methodologies employed by the Commission do not enable Bell Canada and other carriers to cross-subsidize competitive services with revenues from their monopoly operations.[49] The Commission's difficulty in policing such cross subsidization arises because the assignment of the common costs of joint production is inherently arbitrary.[50] In recognition of this difficulty, the Director has recently taken the position that the prevention of anti-competitive cross-subsidization by telecommunications carriers requires the "structural separation" of monopolistic and competitive activities through the use of separate subsidiary corporations.[51]

Concerns about the characteristics of regulated industries have resulted in the enactment of special provisions dealing with predatory pricing in the Canadian railway industry. Section 276 of the Railway Act requires that "freight rates shall be compensatory". Section 276(2) of the Act provides further that "a freight rate shall be deemed to be compensatory when it exceeds the variable cost of the movement of the traffic as determined by the Canadian Transport Commission." It should be noted that the definition of variable cost used by the Commission includes capital costs and corresponds more closely to an economist's concept of long-run marginal cost.[52] Furthermore, unlike section 34(1)(c) of the Combines Investigation Act, section 276 is not subject to an additional test of predatory intent or effect.

The CN Newfoundland Container Rates case, reviewed by the Canadian Transport Commission in February 1985, illustrates the problems inherent in the cost-based standard of predatory conduct in section 276. The case involved the rates charged by Canadian National Railways for its new "Terra Transport" intermodal (water plus rail) container service to

Newfoundland.[53] The fundamental area of disagreement between CN and the Railway Transport Committee in the case concerned the treatment of CN's expected future traffic increases in the evaluation of its rates. CN expected that its low container rates would generate substantial additional traffic over the medium term, resulting in a significant reduction in unit costs. In essence, CN suggested that its new container service should be given a grace period for development of traffic before being required to establish compensatory rates. While the Railway Transport Committee clearly attempted to take account of the expected traffic increase, in CN's view it failed to consider all of the relevant evidence.[54] It seems possible that CN's expectations of future traffic increases would have been given greater weight if they were considered in a rule of reason analysis under section 34(1)(c) of the Combines Investigation Act.

As noted, the Minister of Transport has announced in his recent position paper on national transportation policy that section 276 of the Railway Act will be repealed. Predatory pricing by the railways will be dealt with under the provisions of the Combines Investigation Act. In announcing this change, the position paper comments:

> The Government realizes that the charging of non-compensatory rates over extended periods is not desirable when done for anticompetitive reasons. However, in a less regulated environment railways should be given greater pricing freedom to enable them to adjust to market pressures.[55]

The position paper seems correct in suggesting that the treatment of predatory pricing under the Combines Act will provide the railways with greater scope for adjustment to market forces than the pure cost-based standard under section 276 of the Railway Act.

V. Conclusions

The competition policy treatment of predatory pricing is a subtle and far-reaching issue. The efficient functioning of a competitive market economy requires broad scope for competitive price cutting. There is a genuine concern that, in seeking to prevent unfair price cutting, antitrust policy may inadvertently frustrate its objectives of fostering competition and economic efficiency. In addition, while scholarly opinion is mixed, there is an important segment of opinion which doubts that predatory pricing is likely to be a viable strategy for monopolization under normal market conditions.

These considerations support the need for an approach to predatory pricing that will identify actual instances of the practice while ensuring broad scope for competitive price cutting. A number of possible rules have been put forward by economists. While each of these rules has its uses, none is appropriate in all circumstances. A rule of reason approach is needed to take account of price-cost relationships as well as relevant structural conditions in the assessment of allegations of predatory pricing.

Such an approach can easily be accomodated within the existing Canadian law. The language of section 34(1)(c) provides the basis for a rule of reason treatment of predatory pricing. The judicial analysis of pricing behaviour in Hoffmann-La Roche and the implications of excess capacity in Consumers Glass re-inforces this approach.

The treatment of predatory practices in regulated industries involves special concerns. Special measures to prevent predation may be justified where regulation creates barriers to re-entry of competitors or incentives for cross-subsidization. With the trend to deregulation, however, the need for such measures is being re-considered. The Minister of Transport's announcement that Section 276 of the Railway Act will be repealed has enhanced the importance of the more flexible approach under the predatory pricing provisions of the Combines Investigation Act.

NOTES

1. Robert Bork, The Antitrust Paradox (New York: Basic Books, 1978), pp. 144-155.

2. Terry Calvani and James M. Lynch, "Predatory Pricing under the Robinson-Patman and Sherman Acts: An Introduction," Antitrust Law Journal, vol. 51, 1982, pp. 375-398.

3. R.S.C. 1970, c. C-23, as amended by S.C. 1974-75-76, c. 76.

4. 109 D.L.R. (3d) 1 (1980); affirmed 125 D.L.R. (3d) 607 (1981).

5. 124 D.L.R. (3d) 274 (1981).

6. Minister of Transport, Freedom to Move: A Framework for Transportation Reform (Ottawa: Supply and Services, 1985), p. 37.

7. The predatory pricing and price discimination laws of Canada and the U.S. are much more narrowly conceived than the two countries' anti-dumping laws. See Klaus Stegemann, The Consideration of Consumer Interests in the Implementation of Anti-dumping Policy (Paper presented at the O.E.C.D. Symposium on Consumer Policy and International Trade, November 1984), pp.20-24. At a recent conference on anti-dumping legislation, there was a consensus among government, industry and legal experts that only a very small minority of anti-dumping cases involve predation. Klaus Stegemann, ed., Report of the Policy Forum on Special Import Measures Legislation (Kingston: John Deutsch Institute for the Study of Economic Policy, 1984), p. 48.

8. Donald Dewey, Monopoly in Economics and Law (1959).

9. 221 U.S. 1 (1911).

10. John S. McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," Journal of Law and Economics, vol. I, 1958, pp. 137-169.

11. McGee, id., at 140-141.

12. Lester G. Telser, "Cutthroat Competition and the Long Purse," Journal of Law and Economics, vol. IX, 1966, p. 259-277.

13. Basil Yamey, "Predatory Price-cutting: Notes and Comments," Journal of Law and Economics, vol. XV, 1972, pp. 137-47.

14. Richard A. Posner, "Exclusionary Practices and the Antitrust Laws," University of Chicago Law Review, vol. 41, 1974, p. 506.

15. See Frank H. Easterbrook, "Predatory Strategies and Counter-strategies," University of Chicago Law Review, vol. 48, 1981; and Bork, supra note 1.

16. Phillip Areeda and Donald F. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act," Harvard Law Review, vol. 88, February 1975, pp. 697-733.

17. Calvani and Lynch, supra note 2, at 380.

18. F.M. Scherer, "Predatory Pricing and the Sherman Act: A Comment," Harvard Law Review, vol. 89, March 1976, pp. 869-890.

19. Douglas F. Greer, "A Critique of Areeda and Turner's Standard for Predatory Practices," Antitrust Bulletin, Summer 1979, p. 237.

20. Paul L. Joskow and Alvin K. Klevorick, "A Framework for Analyzing Predatory Pricing Policy," Yale Law Journal, vol. 89, December 1979, pp. 213-270.

21. William J. Baumol, "Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing," Yale Law Journal, vol. 89, November 1979, pp. 1-26.

22. John S. McGee, "Predatory Pricing Revisited," Journal of Law and Economics, vol. XXIII, October 1980, pp. 289-329, at 317-318.

23. Oliver E. Williamson, "Predatory Pricing: A Strategic and Welfare Analysis," Yale Law Journal, vol. 87, December 1977, pp. 284-340.

24. McGee, supra note 22, at 314-316.

25. Joskow and Klevorick, supra note 20.

26. McGee, supra note 22, at 319-320.

27. See Yale Brozen, Concentration, Mergers and Public Policy (New York: 1984); and Harold Demsetz, "Two Systems of Belief about Monopoly," in Industrial Concentration: the New Learning (H.J. Goldschmid, H.M. Mann and J.F. Weston, ed., 1974).

28. McGee, supra note 22, at 320.

29. See James C. Miller III and Paul Pautler, "Predation: The Changing View in Economics and the Law," Journal of Law and Economics, Vol. XXVIII (2), May 1985, pp. 495-502 and references cited therein.

30. See Klaus Stegemann, The Consideration of Consumer Interests in the Implementation of Anti-dumping Policy, supra Note 7, pp. 20-24.

31. Specifically, the prohibition on territorial price discrimination was strengthened. See Department of Consumer and Corporate Affairs, Proposals for a New Competition Policy for Canada (First Stage), November 1973, p. 25A.

32. R.J. Roberts, Anticombines and Antitrust (Toronto: Butterworths, 1980), p. 220.

33. Judgement of Fitzpatrick, C.J., in Weidman v. Shragge (1912), 46 S.C.R. 1, at p. 4, quoted in the judgements in both Hoffmann-La Roche and Consumers Glass.

34. Eddy Match Co. Ltd. v. the Queen (1953), 109 C.C.C. 1. The facts in this case are discussed in Yamey, supra note 13. In Bill C-29, An Act to Amend the Combines Investigation Act, the use of fighting brands was one of the specific practices listed in the proposed section dealing with "abuse of dominant position." Bill C-29 was introduced in the House of Commons in March 1984 but died on the order paper when Parliament was dissolved.

35. See the discussion by Linden, J. in Hoffmann-La Roche, supra note 4, at pp. 34-54. See also R. v. Aluminium Co. of Canada Ltd. et al, (1976) 29 C.P.R. (2d) 183.

36. The patent holder receives a fee determined by the Commissioner of Patents for the use of the patented invention. See Report of the Commission of Inquiry on the Pharmaceutical Industry (Harry Eastman, Chairman, 1985), pp. 1-2.

37. 125 D.L.R. (3d) 607 (Ontario Court of Appeal).

38. Hoffmann-La Roche, supra note 4, at pp. 38-41. Mr. Justice Linden had no difficulty in determining that the first and second elements of an offence under section 34(1)(c) were satisfied - i.e., the accused was engaged in a business and a policy of selling articles. He dismissed defence contentions that (i) the prices employed were not a policy but a temporary expedient; and (ii) there was no "selling" when the articles were given away free of charge.

39. Hoffmann-La Roche, supra note 4, at p. 44.

40. Hoffmann-La Roche, supra note 4, at p. 45.

41. Hoffmann-La Roche, supra note 4, at p. 48.

42. Hoffmann-La Roche, supra note 4, at p. 21.

43. See James P. Cairns, "Predatory Pricing: Notes on Hoffmann-La Roche," Canadian Business Law Journal, vol. 9, 1984, pp. 242-254, at note 28. This note refers to an article by Paul K. Gorecki, "Monopoly, Entry and Predatory Pricing: The Hoffmann-La Roche Case," in Firms and Markets (Croom Helm, Forthcoming).

44. See Consumers Glass, supra note 5, at pp. 300-301.

45. Consumers Glass, supra note 5, at p. 300. It should be noted that the judgements in Consumers Glass and Hoffmann-La Roche have not answered the question of whether (or in what circumstances) a price below average total cost but above average variable cost may be found unreasonably low. The Annual Report of the Director if Investigation and Research, Combines Investigation Act, states that until this issue is clarified, "each allegedly predatory pricing situation will be examined by the Director in light of the relevant facts ... A price below average total cost will be considered in the light of its relationship to that cost standard or to variable cost, its duration, apparent purpose, whether aggressive or reactive, the market position of the parties, history of their behaviour and apparent long term consequences" as well as other considerations. Annual Report for the Year Ended March 31, 1982, p. 16.

46. William A. Jordan, Some Predatory Practices under Government Regulation? (University of Toronto-York University, Joint Program on Transportation, Research Report No. 26, January 1975). Jordan examines possible instances of predation in the pre-1978 U.S. regulated airline industry.

47. A loyalty contract is an arrangement by which an exporter commits his cargo exclusively to a shipping conference (cartel) for an extended period, thereby making it more difficult for non-conference carriers to enter the trade. For a discussion of conference practices, see John S. McGee, "Ocean Freight Rate Conferences and the American Merchant Marine," University of Chicago Law Review, vol. 27, 1960.

48. See the remarks of William F. Baxter, former U.S. Assistant Attorney General for Antitrust, quoted in Antitrust in Transition: Two Dialogues (New York: The Conference Board, Research Bulletin No. 184, 1985), p. 12.

49. Director of Investigation and Research, Combines Investigation Act, Annual Report for the Year Ended March 31, 1983, p. 73.

50. A. Alchian and W.R. Allen, Exchange and Production: Competition, Coordination and Control (Belmont, Ca.: 2nd ed., 1973), p. 256.

51. Director of Investigation and Research, "Notes for a Speech on an Agenda for Telecommunications Policy Change," Consumer and Corporate Affairs Canada, September 26, 1984, pp. 19-21.

52. "Variable cost may be defined as the long run marginal cost of output . . ." Canadian Transport Commission, Railway Transport Committee, Reasons for Order R-6313, p. 337.

53. See Canadian Transport Commission, Review Committee, Decision 1985-01 and references cited therein.

54. In December 1984, the Railway Transport Committee ordered CN to implement rate increases of up to 39 per cent on more than 1500 commodities. The Government of Newfoundland has indicated that it will challenge the increase as a breach of the terms of union between the province and the federal government. "Newfoundland to challenge freight rate increase," The Citizen, September 12, 1985, p. B14.

55. Minister of Transport, supra note 6, p. 37.