# COMMENT AND ANALYSIS

## REFLECTIONS ON MCDONALD ON ABUSE OF DOMINANT POSITION

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In a recent issue of the *Record*, Bruce McDonald has provided an insightful analysis of the abuse of dominance provisions of the *Competition Act*.[1] McDonald's article provides incisive commentary on such complex matters as joint dominance of a market, the meaning of anti-competitive acts and the application of the remedies available under the abuse provisions. The article is particularly effective in bringing to bear some recent U.S. antitrust jurisprudence on issues that may arise under the Canadian law.

This paper presents additional commentary on several issues discussed in McDonald's article. These include the meaning of a class or species of business, the application of the abuse provisions to anti-competitive acts other than those explicitly mentioned in the *Act*, and the test of "lessening competition substantially". It also develops a few aspects of the abuse provisions that are not covered in McDonald's article, including the treatment of intellectual property rights and the significance of superior competitive performance. The closing section discusses the design of the abuse provisions in light of recent developments in antitrust thought.

The abuse of dominance provisions are contained in sections 50 and 51 of the *Competition Act*.[2] Subsection 51(1) - the substantive provision under which abuse cases are to be brought before the Competition Tribunal requires proof of three elements:

(i) a person or persons "substantially or completely control, throughout Canada or any area thereof, a class or species of business";

(ii) that person or persons have engaged in "a practice of anti-competitive acts"; and

(iii) the practice has had, is having, or is likely to have, "the effect of preventing or lessening competition substantially in a market."[3]

The other subsections of section 51 contain provisions dealing with remedial orders, the relationship of anti-competitive acts to "superior competitive performance", the application of section 51 to intellectual property rights, a limitation period and the interface of abuse of dominance with other

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sections of the *Act* dealing with mergers and conspiracies. Section 50 provides an illustrative list of anti-competitive acts that may be dealt with under section 51.

### Class or Species of Business and the Relevant Market

As noted, the first element in an abuse of dominance case requires that the firm(s) against whom an application is brought "substantially or completely control, throughout Canada or any area thereof, a class or species of business." McDonald discusses this concept essentially as if it is equivalent to the relevant product and geographic market as referred to in paragraph 51(1)(c). In our view, it should be clarified that the class or species of business referred to in paragraph 51(1)(a) may be different from (and often narrower than) the more general concept of the product market. While the latter concept, properly applied, takes account of substitution possibilities in production and consumption, the former may not.[4] Similarly, the concept of "any area of Canada" may be narrower and more arbitrarily defined than the relevant geographic market, which should take account of the possibility of trans-shipment of a product across different geographic areas. It is apparent that Parliament would not have used these different terms in the same subsection unless it intended that they could be given different meanings.

It should also be noted that, in some cases, the class or species of business and area considered for purposes of paragraph 51(1)(a) may be completely different from the relevant market as defined for purposes of paragraph 51(1)(c). The basis for this view is that paragraph 51(1)(c) refers to the lessening of competition in "a market" and not "the market" in which the firms are shown to be dominant. The significance of this interpretation is that it permits application of the abuse provisions to situations in which a dominant position in one product line (or area) is used to lessen competition in a related or unrelated market.

As suggested by McDonald, the issue of market definition is likely to be a critical step in abuse cases. The primary approach to market definition used in the U.S. the - "antitrust markets" approach based on expected responses to hypothetical price increases incorporated in the Department of Justice Merger Guidelines - has recently been criticized by Stigler and Sherwin as being operationally difficult and inconsistent with economic principles.[5] They favour a classical approach based on statistical observations of parallel price movements. A strong defence of the U.S. Guidelines' approach has been provided by Scheffman and Spiller.[6] They argue that the concept of antitrust markets is more directly related to competition policy concerns regarding the feasibility of collusive or monopolistic behaviour than the concept of economic markets.

It should be anticipated that the issues relating to market definition that have been raised above may eventually be discussed before the Competition Tribunal. Regardless of the outcome, the definition of the relevant market in abuse cases under the *Act* will doubtless continue to require consideration of business concerns such as buyer preferences, the physical characteristics and uses of a product, location of users and production facilities, transportation costs, perceived substitution possibilities, etc.

### The Concept of an Anti-competitive Act

The second key element to be proven by the Director of Investigation and Research in an abuse of dominance case is that the firms cited in the application have engaged in "a practice of anti-competitive acts." The concept of an anti-competitive act is not defined but an illustrative list of such acts is provided in section 50 of the *Act.* The list includes such acts as margin squeezing by a vertically integrated supplier, vertical acquisitions by suppliers or customers, inducing a supplier to sell only or primarily to certain customers, the use of fighting brands and several other acts. Each of the acts includes an anti-competitive purpose or object element such as eliminating or preventing the entry or expansion of a competitor in a market.

It is important to note that the acts listed in section 50 are directed at the maintenance or entrenchment of market power. With one possible exception, they do not deal with the mere exercise of market power in the sense of charging higher-than-competitive prices.[7] This is in contrast to the abuse of dominance provision of the European Economic Community. Article 86 of the *Treaty of Rome* is specifically concerned with abuse in the sense of (a) "directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions"; or (b) "limiting production, markets or technical development to the prejudice of consumers".[8] Thus, it is apparent that in drafting the list of anti-competitive acts the framers of the *Competition Act* rejected an approach which would involve the direct regulation of prices in favour of one which is concerned with conduct that is harmful to the competitive process.

Some of the examples of anti-competitive acts in section 50 appear to overlap with other sections of the *Competition Act* directed at specific exclusionary practices. For example, paragraph (h), referring to the act of "requiring or inducing a supplier to sell only or primarily to certain customers..." seems to correspond to the practice of exclusive dealing as dealt with under section 49 of the *Act*. It should be noted, however, that the latter applies only to exclusive dealing requirements imposed on buyers whereas the former applies to similar arrangements imposed on suppliers. Similarly, paragraph (i), referring to "selling articles at a price lower than acquisition cost..." has some overlap with the prohibition of predatory pricing under section 34(1)(c). The latter, however, is limited by the standard of proof beyond a reasonable doubt which applies in criminal cases and by the requirement to establish a policy of selling products at prices "unreasonably low".[9] Thus, the examples in section 50 complement more than they overlap with the other provisions of the *Act* aimed at specific exclusionary practices.

McDonald suggests that the class of unlisted anti-competitive acts may be limited by the *ejusdem generis* rule.[10] In our view, this rule, at least in its strict sense, should not apply. The opening words of section 50 indicate that the illustrative list of anti-competitive acts is provided "without restricting the generality of the term". This explicit indication by Parliament that the scope of the term is not restricted should in itself over-ride any application of *ejusdem generis.*[11] Furthermore, it is important to note that, while each of the examples of anti-competitive acts in section 50 contains an anti-competitive purpose element of some kind, Parliament seems to have gone out of its way to express these elements in different ways.[12] This supports the view that Parliament intended to give a liberal interpretation to the term "anti-competitive acts".

In our view, the application of section 51 to acts not mentioned in section 50 may prove to be as important as its application to the acts included in the list. The additional, unlisted acts may be of many types. In his article, McDonald discusses one possible additional anti-competitive act, namely the breach of a duty to cooperate with competitors by a dominant firm. His discussion is based partly on the recent opinion of the U.S. Supreme Court in the *Aspen Skiing* case, which appears to support a limited duty to cooperate with competitors.[13] Like McDonald, we are inclined to give greater weight to the view of Judge Posner in the subsequent *Olympia* case, in which he gave a narrow reading of the *Aspen* decision: "If [*Aspen Skiing*] stands for any principle that goes beyond its unusual facts, it is that a monopolist may be guilty of monopolization if it refuses to cooperate with competitors in circumstances where some cooperation is indispensable to effective competition."[14] It is difficult to reconcile a broadly based duty to cooperate with competitors with the fundamental objectives of competition policy.

A potentially more important application of section 51 concerns practices involving "raising rivals' costs", for example, through sham litigation or strategic manipulation of administrative processes.[15] In discussing such matters, Bork has commented:

> Predation by abuse of governmental procedures, including administrative and judicial processes, presents an increasingly dangerous threat to competition.... The antitrust laws can make a major contribution both to free competition and to the integrity of administrative and judicial processes by catching up with this means of monopolization.[16]

In the U.S., the Supreme Court has held that the antitrust laws are applicable to such abuse of judicial or administrative processes to harass or deter competitors.[17] In Canada it has been suggested that multinational drug firms may have initiated baseless litigation under the *Patent Act*, possibly for the purpose of deterring entry by new competitors.[18]

Another alleged example of raising rivals' costs involves the strategic use of collective bargaining arrangements. For example, Williamson's analysis of the U.S. *Pennington* case suggests that an expensive industry-wide wage contract in the U.S. coal mining industry may have been actively promoted by capital-intensive established firms since it had a proportionately smaller impact on their costs than on their less well-established labour-intensive competitors.[19] The issue of raising rivals' costs is reviewed in a recent U.S. Department of Justice Working Paper.[20] The paper questions the usefulness of dealing with these practices under the new rubric of raising rivals' costs. Nevertheless, it recognizes the importance of addressing the anti-competitive significance of the underlying practices under the antitrust laws. The abuse of dominance provisions may provide a vehicle for addressing these concerns in extreme cases.

Paragraph 51(1)(b) requires not only a finding of anti-competitive acts but also a practice of such acts. This ensures that firms may not be the subject of an application based merely on an isolated instance of an act. As McDonald suggests, the concept of a practice requires an element of persistence or a recognizable pattern of anti-competitive acts.[21] It should be noted that this element does not necessarily require repeated instances of the same act; two or more acts of different types may suffice.

### The Treatment of Intellectual Property Rights

Another potentially important use of section 51 involves the application of the section to restrictive practices involving intellectual property rights. In this regard, it is important to consider the implications of the exception for such rights in subsection 51(5) of the *Competition Act*. This provision states that:

> For purposes of [section 51], an act engaged in pursuant only to the exercise of any right or the enjoyment of any interest derived under the *Copyright Act*, *Industrial Design Act*, *Patent Act*, *Trade Marks Act* or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act.

The exception for intellectual property rights in subsection 51(5) appears to be based on a similar exception in the definition of a monopoly in the *Combines Investigation Act*.

Subsection 51(5) indicates clearly that section 51 is not intended to affect the legitimate exercise of intellectual or industrial property rights. The wording covers not only express rights but also interests "derived under" the relevant statutes, possibly through the operation of licensing agreements. Subsection 51(5) does not, however, provide a blanket exemption for intellectual property rights holders from the application of the section. The phrase "pursuant only to the exercise [of such rights]" suggests that section 51 remains applicable to the use of intellectual property rights in ways which go beyond the purposes contemplated in the statutes. Thus, the language of subsection 51(5) arguably permits the application of section 51 to a broad range of acts considered to be abuses of intellectual property rights. These could include practices such as field-of-use restrictions and post-sale territorial market restraints in patent licensing agreements which have been the subject of antitrust litigation in the U.S.[22]

**Lessening of Competition Substantially**

The third element in subsection 51(1) requires the Director to show that the practice of anti-competitive acts "has had, is having or is likely to have the effect of lessening competition substantially". This is similar to the test found in section 64 of the *Competition Act* dealing with mergers as well as section 49 concerning tied selling, exclusive dealing and market restriction. It should be noted, however, that unlike the latter provisions, the test in paragraph 51(1)(c) explicitly encompasses situations in which the substantial lessening of competition has occurred in the past.[23]

A similar test is also found in the U.S. in section 7 of the *Clayton Act*, the principal provision under which mergers are reviewed in that country. As McDonald suggests, the Canadian and U.S. cases under these provisions indicate that the test is a functional one which may involve consideration of market shares, concentration, entry conditions, business justifications for a practice and other economic factors relevant to the competitive effects of the practice.

Recent jurisprudence under the Australian *Trade Practices Act* is also relevant to the application of paragraph 51(1)(c), since the Australian *Act* refers to "substantial lessening of competition." Recent cases under the *Act* suggest that this test has a qualitative as well as a quantitative dimension and that the critical consideration is the degree to which competition is observed to be lessened rather than the importance of this lessening in proportion to the total market. In a 1981 decision, an Australian court stated that the test required "a lessening of competition that is real or of substance as distinct from a lessening that is insubstantial, insignificant or minimal."[24] In a 1982 decision involving the same phrase, the court indicated further that "Although the words 'substantially lessened in a market' refer generally to a market, it is the degree to which competition has been lessened which is critical, not the proportion of that lessening to the whole of the competition which exists in the total market."[25]

In interpreting the test of lessening competition substantially, it is also important to consider the superior competitive performance factor (SCP) in subsection 51(4) of the *Competition Act*. Subsection 51(4) states that:

> In determining, for the purposes of subsection (1), whether a practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal shall consider whether the practice is a result of superior competitive performance.

The purpose of this factor seems to be to assist the Tribunal in distinguishing conduct which is genuinely exclusionary and should be prohibited from conduct which merely represents successful competition. This is consistent with the principles of the *Competition Act* and also, more generally, with the defence of "superior skill, industry and foresight" in monopolization cases under section 2 of the *Sherman Act*.[26] Some factors which might be relevant to the application of SCP may include economies of scale or scope, innovation and research, entrepreneurial effort and skill, distribution and marketing methods, etc. However, the direction in the statute to consider whether the practice of anti-competitive acts (and not the lessening of competition) results from SCP may limit the application of this factor under the abuse provisions.

### Interface of Abuse of Dominance with the Merger and Conspiracy Provisions of the *Act*

Another aspect of the abuse provisions which is not explicitly covered by McDonald is subsection 51(7). In conjunction with sections 32.01 and 70 of the *Competition Act*, this subsection prohibits concurrent proceedings under the abuse of dominance, conspiracy and merger provisions of the *Act*, when based on the same or substantially the same facts. It should be noted that the Director is not necessarily precluded from initiating subsequent proceedings under the merger or conspiracy provisions, once proceedings under the abuse provisions have been dropped (or vice versa).[27] Nevertheless, in light of subsection 51(7) and its companion provisions the Director will be required to make a choice as to whether to proceed initially under the abuse, conspiracy or merger provisions.

The choice between proceeding under section 51 or 32 will arise in situations involving joint dominance of a market. As noted, paragraph 51(1)(a) refers specifically to control of a class or species of business by "one or more persons". The words of Pennell, J. in the *Large Lamps* case, regarding a similar phrase contained in the monopoly provision of the *Combines Investigation Act*, suggest that the abuse provisions are applicable where two or more firms coordinate their activities so as to "work together as a unit".[28] This might encompass situations involving joint dominance without agreement. The choice of proceedings in such cases could also depend on factors such as the availability of civil procedures and rules of evidence in cases before the Competition Tribunal, the different tests applicable under the abuse and conspiracy provisions, the absence of a criminal intent (*mens rea*) requirement in the abuse provisions and the requirement to show a practice of anti-competitive acts and not merely a single instance which applies in abuse cases.

The choice between the merger and abuse of dominance provisions could arise, for example, in situations involving a series of acquisitions in an industry by a dominant firm. In such situations it may be the cumulative effect of such actions (i.e., the practice of anti-competitive acts) rather than any single purchase which lessens competition substantially. In these circumstances, the abuse provisions may be more readily applicable than the merger provision.[29]

### Other Matters

Turning to more general matters, it is interesting to consider the application of the abuse of dominance provisions in relation to the regulated conduct defence in the *Competition Act* jurisprudence. This doctrine is generally considered to provide a defence from the *Act* for business activities that are effectively regulated pursuant to validly enacted federal or provincial legislation.[30] The jurisprudence supporting the defence has arisen, however, primarily in the context of criminal rather than civil proceedings under the *Act*. It has been suggested that the application of the defence may be less clear in relation to a non-criminal provision such as section 51.[31]

The design of the abuse of dominance provisions reflects a number of insights of modern antitrust legal and economic scholarship. First, the provisions implicitly recognize that the acts listed in section 50 are not necessarily harmful to competition in all circumstances. While the acts mentioned are deemed to be anti-competitive for purposes of section 51, no remedy is available under the *Act* unless the facts are shown to satisfy the separate tests incorporated in the section, including the specific requirement to show that competition is lessened substantially. Thus, the acts listed in section 50 are not, in fact, *per se* illegal. This is consistent with modern antitrust thought which emphasizes that practices such as those mentioned in section 50 may be anti-competitive, pro-competitive or competitively neutral depending on the circumstances.[32]

Second, the abuse provisions are based on the important and now generally accepted premise that only firms that already possess a substantial degree of market power are likely to be able to limit competition through predatory or monopolistic acts. This insight is developed particularly in recent economic literature on predatory pricing.[33] The importance of this insight is that it enables competition policy authorities to screen out improbable cases of anti-competitive acts on the basis of structural indicators, without undertaking a detailed evaluation of the effects of specific acts in the market.

Third, despite their use of structural considerations as a screening device, the abuse of dominance provisions also reflect the view that firms should be held accountable only for overt anti-competitive acts, and not mere structural dominance. In this sense, sections 50 and 51 represent a rejection of the "no fault" approach to monopolization incorporated in various legislative proposals particularly in the U.S. in the 1960's and 1970's.[34] This is consistent with recent industrial organization thought which has condemned the no-fault approach as excessively interventionist and likely to interfere with the achievement of important efficiencies.[35] In this respect, the abuse of dominance provisions have more in common with earlier U.S. antitrust jurisprudence, for example *U.S. v. United States Steel Corporation*, in which the U.S. Supreme Court held that "the law does not make mere size an offense or the existence of unexerted power an offense. It requires...overt acts."[36]

In conclusion, it is apparent that the abuse of dominance provisions of the *Competition Act* are intended to apply only in cases of demonstrable anti-competitive impact. The disparate tests incorporated in section 51 - involving proof of dominance, a practice of anti-competitive acts and lessening of competition substantially - require careful consideration by the Director before seeking remedial orders. This feature of the legislation is consistent with important aspects of modern antitrust thought. According to Easterbrook, private market restraints are ultimately self-correcting, in that conduct which is harmful to consumers will eventually be rejected by the market. In contrast, governmental regulatory decisions affecting market conduct are difficult to reverse and may remain in force even after their original justification no longer applies.[37] The implication of this view is that competition policy authorities should intervene only in cases where market restraints are shown to have harmful anti-competitive effects.

## NOTES

1. Bruce C. McDonald, "Abuse of Dominant Position," *Canadian Competition Policy Record*, vol. 8, no. 1, March 1987, pp. 59-75.

2. R.S.C. 1970, c. C-23, as amended especially by S.C. 1986, c. 26.

3. Applications under the abuse provisions may be made only by the Director of Investigation and Research under the *Act*. Such applications are to be adjudicated by the Competition Tribunal under a civil standard of proof. The remedies available under the abuse provisions are limited to orders prohibiting specific acts or, in situations where such orders are considered insufficient to restore competition, such additional orders

(including orders requiring the divestiture of assets) as may be necessary to overcome the effects of a practice of anti-competitive acts. In addition, failure to comply with an order by the Tribunal may provide grounds for civil recovery of damages pursuant to section 31.1 of the *Act.* (A technical amendment is needed in section 31.1 to refer to the Competition Tribunal rather than the Restrictive Trade Practices Commission.) The constitutionality of section 31.1, however, is currently under challenge. See Calvin S. Goldman, "The Constitutionality of the *Combines Investigation Act* Civil Damages Remedy," *Canadian Business Law Journal*, vol. 11, no. 4, August 1986, pp. 385-409.

4. The distinction between a product and a class or species of business was recognized in the 1953 *Eddy Match* case. In that case, the Quebec Court of Appeal determined that wooden matches were a separate species of business from paper matches and other lighting devices, despite the apparent substitutability of these articles. *Eddy Match Co. v. the Queen*, (1953), 109 C.C.C. 1.

5. George J. Stigler and Robert A. Sherwin, "The Extent of the Market," *Journal of Law and Economics*, vol. XXVIII (3), October 1985, pp. 555-586.

6. David T. Scheffman and Pablo T. Spiller, " Geographic Market Definition under the U.S. Department of Justice Merger Guidelines," *Journal of Law and Economics*, vol. XXX (1), April 1987, pp. 123-147. A subsequent Department of Justice working paper raises a number of additional difficulties with the Stigler and Sherwin approach, emphasizing the scope for misinterpretation of statistical price correlations as the basis for defining markets. Sheldon Kimmel, "Price Correlation and Market Definition," (U.S., Department of Justice, Economic Analysis Group Discussion Paper No. 87-8, September 23, 1987).

7. The possible exception is in paragraph 50(f) of the *Competition Act*, which refers to the "buying up of products to prevent the erosion of existing price levels".

8. Other practices referred in Article 86 of the *Treaty of Rome* include:

   (c) Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and
   (d) Making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

   In commenting on the practices referred to in Article 86, Korah notes: "The Treaty does not prohibit the acquisition of market power, or even its extension or consolidation, but for the benefit of those forced to deal with a dominant firm, it does seek to restrain its use." Valentine Korah, *EEC Competition Law and Practice* (Oxford: ESC Publishing, 1986), pp. 119-120.

9. For an analysis of section 34(1)(c), see R. D. Anderson and S. D. Khosla, "Recent Developments in the Treatment of Predatory Pricing," *Canadian Competition Policy Record*, Vol. 6, No. 3, September 1985, pp. 1-16. It is also interesting to note that, while section 34(1)(c) applies to "products" including services, paragraph 50(i) refers only to articles.

10. McDonald, *supra* note 1, at p. 65. This rule holds that a general term may be restricted to the same genus as any specific words that precede it. See E.A. Driedger, *The Construction of Statutes* (Toronto: Butterworths, 1974), pp. 86-95 and references cited therein.

11. In addition, *ejusdem generis* generally is not applicable where, as in section 50, the specific words follow rather than precede the general term and are provided merely as examples. See Driedger, *Id.*, especially at p. 91.

12. While one of the examples refers to "the purpose of impeding or preventing [a] competitor's entry into, or eliminating him from, a market," another uses the words "to discipline or eliminate a competitor" and still another employs the phrase "the object of withholding...facilities or resources from a market." A further example refers to the buying up of products "to prevent the erosion of existing price levels."

13. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 105 S. Ct. 2847 (1985).

14. *Olympia Equipment Leasing Company et al. v. Western Union Telegraph Co.*, 797 F. 2d. 370, at p. 379.

15. S.C. Salop and D. Scheffman, "Raising Rivals' Costs," *American Economic Review*, vol. 73, 1983, pp. 265-71. See also Richard Schmalensee, "Standards for Dominant Firm Conduct," in Donald Hay and John Vickers, *The Economics of Market Dominance* (Oxford: Basil Blackwell, 1987), pp. 61-88.

16. Robert Bork, *The Antitrust Paradox* (New York: Basic Books, 1978), pp. 347-49.

17. This is known as the "Sham exception to the *Noerr-Pennington* doctrine." See *California Motor Transport Co. v. Trucking Unlimited*, (1972), 404 U.S. 508. See also *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, (1961), 365 U.S. 127.

18. Paul K. Gorecki, *Regulating the Price of Prescription Drugs in Canada* (Ottawa: Economic Council of Canada, Technical Report No. 8, 1981), p. 106. In one case, Jackett, C.J. remarked: "There is...some ground for thinking that many appeals under section 41 of the *Patent Act* are brought regardless of any considered opinion that there is, under the authorities, any valid ground for attacking the Commission's decision." *Eli Lilly v. S. & V. Chemicals, Ltd.*, 9 C.P.R. (2d) 17 at p. 18.

19. Oliver Williamson, "Wage Rates as a Barrier to Entry: The *Pennington* Case in Perspective," *Quarterly Journal of Economics*, vol. 82, 1968, pp. 85-116. Williamson concludes that "wage premiums can be used to erect a barrier to entry, and thus the uniform wage agreement may indeed be a device by which monopoly advantage is secured." (p. 113).

20. Timothy J. Brennan, "Understanding 'Raising Rivals' Costs'," (U.S., Department of Justice, Economic Analysis Group, Discussion Paper No. 86-16, September 26, 1986).

21. McDonald, *supra* note, 1, pp. 70-71. See, generally, *R. v. William E. Coutts Co. Ltd.*, [1968] 1 O.R. 549.

22. It should be noted, however, that in the 1980's U.S. antitrust officials have increasingly taken a much more lenient view of restrictive patent licensing practices than in previous years. See, e.g., J. Paul McGrath, "Patent Licensing: A Fresh Look at Antitrust Principles in a Changing Economic Environment," *Patent and Trademark Review*, Vol. 82, no. 9, September 1984. See also Charles F. Rule, "The Antitrust Implications of International Licensing: After the Nine No-Nos," (Remarks before the Legal Conference of the World Trade Association, October 21, 1986).

23. See R. D. Anderson and S. D. Khosla, "Recent Developments in Canadian and U.S. Merger Policy," *Canadian Competition Policy Record*, Vol. 7, No. 3, September 1986, pp. 46-65, at p. 58. The merger provisions apply in situations where a merger or proposed merger "prevents or lessens, or is likely to prevent or lessen, competition substantially". (*Competition Act*, s. 64). Similarly, section 49 applies in situations where "competition is or is likely to be lessened substantially".

24. *Cool and Sons Ltd. v. O'Brien Glass Industries Ltd.*, (1981) A.T.P.R., p. 43,003.

25. *Dandy Power Equipment Ltd. v. Mercury Marine Ltd.*, (1982) A.T.P.R., p. 43,888.

26. See *U.S. v. Aluminum Co. of America*, 148 F. 2d 416 (2nd Cir., 1945).

27. The scope for subsequent proceedings under an alternative provision of the *Competition Act* may be affected, however, by the doctrines of *res judicata*, issue estoppel and/or related considerations.

28. See *R. v. Canadian General Electric Co. Ltd. et al.*, (1976), 15 O.R. (2d) 360, at pp. 406-408.

29. For an analysis of the merger provisions, see Anderson and Khosla, *supra* note 23.

30. Calvin S. Goldman, *The Competition Act as it Relates to the Regulated Sector* (Notes for an address to the Canadian Association of Members of Public Utility Tribunals, September 10, 1986 Reported in *Canadian Competition Policy Record*, vol. 7, No. 3).

31. This issue is of interest especially in light of the recent series of rulings that the federal competition law is a valid exercise of authority under the trade and commerce power provided in section 91(2) of the *Constitution Act, 1867*. See Goldman, *Id.*, pp. 34-35.

32. See, e.g., Frank H. Easterbrook, "Vertical Arrangements and the Rule of Reason," *Antitrust Law Journal* vol. 5, 1984, pp. 135-76.

33. James C. Miller III and Paul Pautler, "Predation: The Changing View in Economics and the Law," *Journal of Law and Economics*, vol. XXVII (2), May 1985, pp. 495-502. See also Paul C. Joskow and Alvin K. Klevorick, "A Framework for Analyzing Predatory Pricing Policy," *Yale Law Journal*, vol. 89, December 1979, pp. 213-270. For a discussion of these developments with reference to Canadian competition law, see Anderson and Khosla, *supra* note 9 and R.D. Anderson and S.D. Khosla, "Review of McFetridge and Wong on Predatory Pricing in Canada," *Canadian Competition Policy Record*, vol. 7, No. 1, March 1986, pp. 16-21.

34. See, e.g., *Report of the White House Task Force on Antitrust Policy*, July 5, 1968, Section II and Appendix A, reprinted in *Journal of Reprints for Antitrust Law and Economics*, vol. 1, Winter 1969.

35. See, e.g., Yale Brozen, *Concentration, Mergers and Public Policy* (New York: MacMillan, 1982).

36. *U.S. v. United States Steel Corp.* 251 U.S. 417 (1920).

37. Frank H. Easterbrook, "The Limits of Antitrust," *Texas Law Review*, vol. 63, No. 1, August 1984, pp. 1-40.

## ABUSE OF DOMINANCE OR ABUSE OF REASON?

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The monopoly provision of Canada's competition law has had a long and tortured history. Much discussed and criticized, it was finally replaced by the abuse of dominant position section in the 1986 *Competition Act*. Proponents of the 1986 reforms promised an end to the torture, but we predict that the muddled thinking inherent in the abuse of dominant position section will, if anything, result in more confusion and controversy. We feel that in order to remedy the confusion and controversy, the abuse of dominant position section should be replaced with an exclusionary practices section which is based on clear economic reasoning and is carefully focused in scope.

The proponents of the 1986 reform were disturbed by the lack of convictions handed down by the courts. From its enactment in 1910 to its replacement in 1986, the monopoly section resulted in only one contested conviction, Eddy Match.[1] In the debates leading to the amendments, bureaucrats and politicians focused on three reasons why there had been such a paucity of convictions and why, in their view, the law needed reform:[2]

1) The law was criminal, but the behaviour being censured did not have the moral taint necessary to be considered criminal, so judges would not convict;

2) Judges, not being economists and having very little familiarity with the issues, did not have the tools to creatively deal with the law;

3) The law was not sufficiently certain to guide the behaviour of businessmen and the decisions of the judges.

It is important to look to the case history to understand the thinking of the reform proponents. The low-water mark for proponents of reform came with the Supreme Court of Canada's judgment in the *K.C. Irving Case*.[3] Chief Justice Laskin repudiated the principle laid down in *Eddy Match*, which stated that once the Crown proved complete control of a market, detriment to the public would be presumed.[4] The Chief Justice made it clear that there must be evidence to show detriment to the public.[5] Since the Crown had not proven detriment, there could be no conviction registered. However, Chief Justice Laskin's judgment did not give any guidance as to what would be considered detriment by the courts. This left a cloud of uncertainty over the law and put an onus on the government to make it clear to businessmen what business conduct was to be prohibited.

The eventual response of the reform advocates was Bill C-91, and in particular the abuse of dominant position provision (sections 50 and 51), which was passed by the House of Commons a decade later on June 5, 1986. Bill C-91 addressed the three problems perceived by the reform advocates.

1) Moving the law from criminal to civil jurisdiction;

2) Replacing the courts as adjudicators with a Competition Tribunal;

3) Drafting a more detailed law, including an illustrative list of anti-competitive acts.

The least controversial aspect of the Abuse provisions was the move from criminal to civil law. This was recommended by the Economic Council in 1969 and by other commentators since that time.[6] There was no serious opposition to this move, which was appropriate given the substance of the section. Unfortunately, the second and third responses were not equally well conceived and therein lies the source of the confusion. The second response was misguided - assuming a problem which did not exist - and the third was an abject failure of logic and reason.

The second step, replacing the courts as adjudicators with the Competition Tribunal, was ill-advised, as it addressed the symptoms rather than the problem. Reformers were concerned with the lack of convictions and that a coherent law, particularly in the area of detriment, was not developing through judicial reasoning. However, on both these grounds it can be argued that the judges were not to blame. First, given the ambiguous wording and opaque purpose of the law as well as the convoluted positions taken by the Crown, it is not surprising that a coherent law failed to develop. Second, given the case selection by the government enforcement branch, an output of one contested conviction was about right. For example, consider two of the "betes noirs" of the reformers: *Canadian Breweries*[7] and *K.C. Irving*. What economist would argue in 1987 that the decisions in *Canadian Breweries* or *K.C. Irving* were inappropriate? Why, for instance, was the government concerned in *Canadian Breweries* about the market structure of the industry when prices and quality were strictly regulated? The demise of Canadian Breweries by the natural forces of competition over the next decade vindicated the judges' decision. With respect to *K.C. Irving*, what economist would argue that the ownership of a local newspaper in one town has anything to do with the competitive dynamics of the newspaper market in another town, even if that town happens to be in the same province?

From the case law, we reject the proposition that judges are incapable of applying the law. Chief Justice Laskin's demand for proof of detriment to the public should have been taken as a challenge to be met by the government rather than as a license to replace the courts. Judges are guided and constrained by the law and are not free to act on the basis of moral outrage - the apparent motivator behind many of the famous Canadian monopoly cases. The Tribunal, on the other hand, will not operate under the same constraints. Although the present Tribunal is composed of four members of the Federal Court of Canada and three lay members, the *Act* provides for the possibility of a Tribunal composed of one judge and four lay members (section 10(1)). The judge(s) can be outvoted on issues of fact and mixed fact and law. If a future government wants a more interventionist competition policy, it has great latitude to achieve this goal simply through its choice of appointments to the Tribunal.

Ignoring the red herring regarding judges, the central problem in reforming the law was defining what business behaviour caused detriment to the public, or, more precisely, what business conduct should be prohibited by the law. This entailed correcting the third problem listed above, that of uncertainty. Did the government's solution remedy the problem? Does the list of anti-competitive acts in section 50 provide guidance to businessmen and enforcers as to what behaviour is prohibited? The answer to both questions is an emphatic no. There are two problems with the list which prevent the section from being coherent and workable. First, the list included ambiguous examples and, worse, censures business conduct which is not anti-competitive. Second, the list is not backed by a theme or economic theory which would make it applicable to novel fact situations.

# CANADIAN COMPETITION POLICY RECORD

The abuse of dominant position section specifies the following list of anti-competitive acts:

A. squeezing, by a vertically integrated supplier, of the margin available to an unintegrated customer, who competes with the supplier, for the purpose of impeding or preventing the customer's entry into, or expansion in, a market;

B. acquisition by a supplier of a customer who would otherwise be available to a competitor of the supplier, or acquisition by a customer of a supplier who would otherwise be available to a competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or elimination from a market;

C. freight equalization on the plant of a competitor for the purpose of impeding or preventing that competitor's entry into, or elimination from, the market;

D. use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor;

E. pre-emption of scarce facilities or resources required by a competitor for the operation of business, with the object of withholding the facilities or resources from a market;

F. buying up of products to prevent the erosion of existing price levels;

G. adoption of product specifications that are incompatible with products produced by any other person and are designed to prevent entry into, or elimination from, a market;

H. requiring or inducing a supplier to sell only or primarily to certain customers, or to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in market; and

I. selling articles at a price lower than the acquisition cost for the purpose or disciplining or eliminating a competitor.

It is truly difficult to justify <u>most</u> of the above as economic offenses in the self-interest of an alleged perpetrator designed to inhibit competition.

To begin with the squeezing of an unintegrated producer (Section A), it is difficult to produce an economic rationale for providing legal protection from competition for unintegrated firms in industries in which competition has proven that the most efficient form of business organization is the vertically integrated firm. Besides, if an upstream firm has market power it will realize the corresponding return at the factory gate; it does not need to integrate forward to enhance its market power. The extension of monopoly power through vertical integration is a specious argument. The purchase of a customer by a supplier (Section B) relies on the same specious vertical integration argument to impute exercise of market power. Likewise, the restriction of the activity of a supplier (Section H) is simply a slight variant of the specious vertical integration argument. This section deals with achieving the alleged anti-competitive rewards of vertical integration through a contractual arrangement rather than through acquisition.

As for the other sections, freight equalization (Section C) or delivered pricing is still a puzzle not completely solved by economists. The definition of a "fighting brand" (Section D) is at best an exercise in creative story-telling and the effect of so-called "fighting brands" on consumer welfare and long-run competition is ambiguous. The buying up of product (Section F) is both self-defeating for the so-called "abuser", and entirely self-correcting from the market's perspective. With respect to the adoption of incompatible product standards (Section G), one is left wondering in what way these practices are profit-maximizing and how they insulate the firm from entry.[8]

The list is simply and plainly not a list of "anti-competitive acts". Many of the items on the list are acts which confused economists don't understand but which make those economists highly suspicious of businessmen. Hardly the basis on which to build law!

Even if all the listed acts were truly anti-competitive, the section would not be operational because there is no theme which ties the list together. To be useful, a statutory list must either be exhaustive or have a demonstration effect. Sections of the *Income Tax Act* use the former method so that if any activity is not listed it is presumed not to be covered by the *Act*. The abuse of dominant position section attempts to use the latter method. A non-exhaustive list is useful if the adjudicator can analogize from the list to a novel fact situation. However, the list of anti-competitive acts will be of limited assistance to the Tribunal because it is economically incoherent. Instead of being tied together by a theory of what business conduct is anti-competitive, the list is a muddled compilation of conduct taken from previous combines cases. No common idea ties conduct such as purchasing a customer who would be available to a competitor (Section B), freight equalization (Section C), and purchasing product to prevent the erosion of price levels (Section F). How can a list of acts without a theme be, in practice, non-exhaustive? Unless the fact situation closely resembles one of the listed acts, the Tribunal will have no assistance from the list in determining whether conduct is anti-competitive. Hardly a demonstration effect.

To illustrate this problem with the list, consider how the section would apply to the present situation involving long-distance telephone companies in the United States. AT&T is clearly in a dominant position with 85-90% of the market. Though almost certainly not by intent, AT&T has pushed its two major competitors, U.S. Sprint and MCI, to the brink of extinction. The behaviour of AT&T does not involve the use of vertical integration, fighting brands, freight equalization or any of the listed anti-competitive acts. Would the abuse of dominant position section apply to their conduct? What reasoning would the Tribunal apply to the case? Would they attempt to analogize from the crazy quilt of listed acts to ATT's conduct? If they find substantial lessening of competition pursuant to section 51(1)(c), would they reason backwards and hold that there must have been a practice of anti-competitive acts? Given the absence of economic rationality in the section, the Tribunal members have the choice of shooting from the hip or, as the courts did for 76 years, give the benefit of the doubt to businessmen who are trying to arrange their affairs in the face of an uncertain law.

To rescue the abuse of dominant position provision from this muddled and ineffectual state and make it a certain, coherent enforceable law, two things are needed. One is an explicit statement of the purpose or goal of the provision, and the other is a statement of the scope of the law. Both of these can be accomplished through clear economic reasoning.

The problem of determining the objectives of the law is not restricted to the abuse of dominant position provision. Section 19 of the *Competition Act* describes the objectives of the *Act*, and reads as follows:

> The purpose of this *Act* is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

In analysing this section, Professor Michael Trebilcock has recognized that "several of the objectives are inherently contradictory".[9] For example, if ensuring small business has an "equitable opportunity" means that they must be insulated in some way from the cost and strategic advantages of large enterprises, then consumers will be denied competitive prices. If the Tribunal and the Courts are expected to use equity as grounds for their decisions, they will be completely without assistance from economic theory and Canada will be left with an indeterminate competition law.

The heart of the issue is whether there is a single objective which is appropriate for competition policy. Interestingly, the issue has not been vigorously debated by Canadian academics as it has been in the United States. The most influential book in this area has been Robert Bork's *Antitrust Paradox*.[10] He argues persuasively that "the only legitimate goal of...antitrust law is the maximization of consumer welfare".[11] This goal is consistent with the efficient operation of the economy and it provides the courts with a justifiable standard by which to judge corporate conduct.

Bork's view has come increasingly to guide the enforcement thinking of the Antitrust Division of the Department of Justice and the Federal Trade Commission. The dropping of the *IBM* and *Ready-To-Eat Cereal* cases in 1982 by Justice Antitrust Division and the FTC, respectively, was a clear signal of the change in antitrust thinking.[12] In both these cases, small producers complained about the practices of the dominant player(s) in the industry. However, both industries were very competitive with consumers being the beneficiaries. The courts themselves began to cite Bork increasingly in their judgments, showing the growing influence of economic reasoning in antitrust courts.[13] While the differences between the Canadian and American law and economy must be appreciated, the economic framework and structured reasoning which has developed through a long activist antitrust history in the United States can be extremely useful. We ignore the American experience at our peril.

It is important to realize that the "consumer welfare" view does not rely on the fact that big business is in any sense necessarily "better" or more efficient than small business. It is acknowledged that in some areas, such as employment creation, small business can be more effective, but competition policy is simply not the appropriate tool to favour small business. Direct transfer payments or tax benefits achieve the same goal without creating the inefficiencies of implanting equitable considerations into a broadly-based legal structure such as competition law. The drafters of the abuse of dominance section were not oblivious to the criticism that the provision may apply to legitimate business behaviour that had the effect of removing a competitor from the market. The response was to direct the Tribunal to consider whether the impugned conduct was "a result of superior competitive performance". This ignores the consumer welfare issue entirely. It does not matter whether the outcome was a result of technical efficiency, better strategy, good luck, nice weather or superior competitive performance. If the effect is that the consumer gets reduced prices and/or improved product selection, the Tribunal should not be censuring the conduct because it is "unfair" in that it eliminates a competitor from the market. The consumer welfare test provides a measurable, justifiable standard which is consistent with the efficient operation of the Canadian economy. As such, it should drive the logic of the abuse of dominance provision.

The second problem with the abuse provision is that its scope is unclear. It appears to be the catch all provision which is intended to cover all conduct not mentioned in other sections of the *Act*. This is unsatisfactory in that it detracts from the certainty of the provision. To draft an abuse provision which completes the scheme of the *Competition Act*, the following questions must be addressed:

- What anti-competitive practices should be stopped by the law?
- What practices are covered by other sections of the *Act*?
- What is left?

The first question was systematically addressed by Professor (now Judge) Richard Posner in his book *Antitrust Law: An Economic Perspective*.[14] He argued that anti-competitive practices can be divided into three groups:

> ...practices that result in or facilitate collusive pricing; exclusioning practices; and practices that are monopolistic in the sense of increasing the gains from and hence incentives to engage in monopoly pricing but are neither collusive nor exclusionary.[15]

The first group of anti-competitive acts - collusive acts - are addressed in the present and former Acts in the conspiracy and merger provisions. The third group - what Posner refers to as "unilateral non-coercive monopolizing" is covered largely in the price discrimination section of the *Act* (both present and former). Price discrimination appropriates consumer welfare to the monopolist, but is non-coercive in that consumers who are higher on the demand curve willingly pay the increased price. Price discrimination is only inefficient to the extent that it provides incentive to firms to spend resources to acquire a monopoly position.

Before reform, the *Combines Investigation Act* included provisions designed to censure anti-competitive conduct of the first and third groups. Coverage of the second group - exclusionary acts - was incomplete. Predatory pricing is an exclusionary practice for obvious reasons, but there was little else in the act which dealt with Posner's second group. That is why it is important that the new abuse of dominance provision ensures broad coverage of exclusionary practices. For reasons of certainty and predictability, we argue that it should apply only to exclusionary practices. If there are anti-competitive practices in the other two groups which are not covered by the law, a separate provision should be drafted or another provision expanded, rather that the exclusionary practices section burdened and hence muddled by having to cover largely unrelated ground. An economically rational categorization of the law would add immeasurably to the certainty of the law.

We recommend that the abuse of dominant position section be restructured to narrow its scope and to ground it in economically sound principles. The first step would be to narrow the scope from the current ambiguous "anti-competitive acts" to the clearer "exclusionary practices". The list of practices could then be altered to present a clear theme from which the Tribunal could analogize. The list could be shorter, with some of the embarrassingly ambiguous subsections such as the buying of products to prevent the erosion of price levels removed.

The section would also be freed from its present paradox regarding the term "anti-competitive act". A firm can be found to be committing an anti-competitive act yet not be subject even to a civil order, if the lessening of competition has not been substantial. This begs the question of why an act which has been defined as anti-competitive should be condoned by the government. If the list is of "exclusionary practices", the question of whether there was a lessening of competition and whether it was significant determines whether the Tribunal make an order. The distinction may be subtle, but it is simply not fair to Canadian business people to characterize conduct as anti-competitive when it does not really lessen competition. The term "exclusionary practices" is more descriptive of the conduct to be prohibited and is an ethically neutral term.

The second change to the provision would be to add a subsection stating that the test to be applied by the Tribunal as to whether there was a lessening of competition is the impact of the practice on the welfare of the consumer (long, as well as, short term considerations). This would render the ambiguous "superior competitive performance" subsection unnecessary.

The result of this restructuring would be a section which would be grounded in economic theory, certain in application and, most important, understandable. The Tribunal would not shy from a firm and equitable application of the law. There is some fear about the application of the current confused abuse of dominant position provision by the Competition Tribunal. If moderate or pro-business individuals are appointed to the Tribunal, it may be predicted that the Tribunal, faced with applying an uncertain law, will follow the lead of the Canadian courts and recoil from intervening in the business world without coherent instructions from the legislature. If, on the other hand, activist members are appointed they will be able under the current vague and confusing section, to go on a rampage against perceived competitive evils. Unconstrained by a coherent law or structured economic principles, the Tribunal would be able to attack virtually any conduct it feels is "anti-competitive". The provision, as it currently stands, provides no guarantee of dispassionate rational adjudication.

It took Parliament 17 years from the time of the recommendations of the Economic Council to finally amend the monopoly provisions. The government should not make the same mistake again. Now that the law has been passed and is available for scrutiny by academics and practitioners, the government should be willing to amend the law to ensure its fair application. The government should look to the objectives it set for itself in section 19 of the *Competition Act*, and acknowledge that the abuse of dominant position section does not "promote the efficiency and adaptability of the Canadian economy" or "provide consumers with competitive prices and product choices", and should amend it as outlined.

## NOTES

1. *Eddy Match Company et al v. the Queen*, (1954), 109 C.C.C. 1.
2. *Competition Law Amendments: A Guide*, (Ottawa: Supply and Services 1985), pp. 21-23.
3. *Regina v. K.C. Irving Ltd. et al*, (1977), 72 D.L.R. (3d).
4. *Eddy Match*, p. 15.
5. *K.C. Irving*, p. 90.
6. Economic Council of Canada, *Interim Report on Competition Policy*, (Ottawa: Queen's Printer, 1969).
7. *Regina v. Canadian Breweries*, (1960), O.R. 601.
8. The authors wish to thank Professor Frank Matthewson of the University of Toronto for assisting in analysing and critiquing the list of anti-competitive practices.
9. Michael J. Trebilcock, "What are the Costs of Closure", *Canadian Competition Policy Record*, Vol. 7, No. 1, March 1986, p.2.
10. Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself*, (New York: Basic Books, 1978).
11. *Ibid.*, p. 51.
12. *United States v International Business Machines Corp.*,Civil Action No. 69, Civ. 200 (S.D.N.Y. 1974) (dismissal filed Jan. 8, 1982) and *Re Kellog Company et al:* (1982) 42 ATRR 182.
13. As of 1985, *Antitrust Paradox* had been cited in five Supreme Court (U.S.) opinions and thirty-five court of appeals decisions. 54 *Antitrust Law Journal*, p. 20.
14. Richard A. Posner, *Antitrust Law: An Economic Perspective*, (Chicago: University of Chicago Press, 1976).
15. *Ibid.*, p. 171.

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