Comment

LENIENCY PROGRAMS AND GROWING FINES: THE RISK OF OVER DETERRENCE

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Introduction

In April 2008, the publication of a draft bulletin outlining Canada's leniency program sparked widespread discussion on global best practices for ferreting out cartel activity. Internationally, leniency programs have garnered acceptance as an effective means to encourage disclosure of difficult-to-detect cartel behavior. These programs, coupled with increased enforcement efforts, have radically changed the outlook for businesses considering cartel activity. While Canada's program appears to be an ideal model, its implementation provides an opportunity to examine whether such programs have become counterproductive to the goals of competition law. A reasoned discussion over the proper means and levels of cartel enforcement is even more pressing as companies must use every lawful method of competing merely to survive. At risk is more than the occasional cartelist getting away with illegal acts, but rather the livelihoods of thousands of law-abiding employees of those companies and the benefits that are lost when regulators prosecute marginal cases and gray – not black – conduct.

Cartel fines from public enforcement alone are staggering. For example, in the on-going Air Cargo Cases, a single airline may pay nearly one billion USD in criminal and administrative fines. British Airways has already agreed to pay more than 500 million USD in criminal penalties in the U.S. and United Kingdom, yet still faces further possible multi-million dollar fines by the European Union (EU), Canada, Japan, Australia, Korea and others.

These amounts could be dwarfed by the billions sought in private civil actions. A U.S. plaintiffs firm has initiated a €1 billion (approx. 1.4 billion USD) action in the United Kingdom against British Airways PLC. The same firm is suing British Airways and other airlines in the U.S., and civil actions are pending in Canada and Australia.

Fines of this magnitude raise serious concerns. First, multi-jurisdictional public enforcement, coupled with growing private claims, risk generating excessive fines that have little correlation to the alleged harm caused by the cartel overcharge. The economics used to support such large fines is largely unsupported. Over-fining cartelists could cause more harm than good. For example, compliant companies may avoid all contact with competitors, even for legal collaborations – such as research ventures – for fear they could be targeted by an overzealous regulator. If the penalty for speeding is death, people won't drive. Second, poorly crafted and mismanaged leniency programs skew business incentives and promote strategic, anti-competitive behavior. In order to address these concerns and optimize the effectiveness of enforcement efforts, national regulatory agencies and courts must take several important steps.

In particular, competition authorities should consider several key recommendations, including (1) international cooperation on enforcement and fine levels to ensure overall fines are not excessive, (2) closer scrutiny of amnesty applications to prevent both accidental and anti-competitive abuse, (3) stimulating an increased willingness to dismiss borderline private claims at an early stage, (4) the exercise of judicial restraint in multi-jurisdictional claims to prevent undue overlap, and (5) the enforcement of provisions restricting eligibility to prevent ringleaders from obtaining amnesty.

The Current State of Cartel Regulation – Two Major Concerns

How Much is too Much: Preventing Excessive Fines

Government Enforcement

There is a growing danger of a disparity between the size of fines relative to the harm caused by cartel overcharges. The level of criminal punishment, both in terms of imprisonment and fines, has increased dramatically along with the vigor of governmental enforcement.

Canada would do well to avoid the problems with current U.S. fine policy where cartelists face staggering penalties. A single phone call can cost a company up to 100 million USD. Moreover, the maximum penalty for a violation of the *Sherman Antitrust Act* can be increased from the statutory maximum to twice the gain derived by the cartel's illegal activity or twice the loss suffered by victims. In fact, the Department of Justice, Antitrust Division (the Division), calculates the total gain or loss based on the entire cartel conspiracy, not just the gain or loss flowing from the particular defendant's participation.

Despite serious concerns about the legality of the gain/loss formula[2], the Division continues to use the policy to force defendants to settle cases. The Division refuses to negotiate plea agreements with any company or individual that wants to challenge the validity of the gain/loss provision, requiring that they waive all challenges under *United States v. Booker*[3], and stipulate that the recommended fine or sentence is reasonable. Accordingly, the Division reports "having no trouble" negotiating fines above the 100 million cap under the *Sherman Act.* And do not forget, recently, EU fines have been even higher! The European Commission can impose a fine that is unrelated to the size of a cartel member's overcharges. A company participating in competition infringements can be fined up to 10% of its total worldwide group turnover in the preceding business year. This approach differs from other countries that use affected turnover as a base calculation and could be catastrophic for global conglomerates participating in a cartel in a small industry.

Even as fine levels skyrocket, international detection and enforcement has also increased dramatically. Cartels are now subject to public enforcement in more than 100 jurisdictions,

many of which are very actively pursuing cases. Accordingly, multinational companies now face prosecutions in multiple jurisdictions. Thus, the chances for detection are higher than they used to be, and multiple fines for the same cartel are now the norm.

Private Enforcement

That's the good news. On the civil side, private damages in the United States have dwarfed public fines. Between 1990-2007, government fines from antitrust cases totalled an estimated 4.2 billion USD.[4] In that same period, private litigation resulted in approximately 18 billion USD in damages, of which approximately 6.2 billion stemmed from the same cases prosecuted by the government.[5] The combination of "treble" damages for direct purchasers, plus another "three" for indirect purchasers, plus disgorgement, plus public fines of twice-the-gain, can lead to six-fold, eight-fold, or even greater overall damages paid by a cartel.

Additionally, private enforcement by direct or indirect purchasers is increasingly available worldwide, including in Canada, the United Kingdom and Germany. Indeed, the European Commission published a white paper in 2008 highlighting victim compensation as a right required by Community Law, and suggested a series of proposals for increased private enforcement options.

The Cost

What began as a ramped-up effort to enforce antitrust cartel law might quickly result in catastrophic over deterrence. The full cost of over deterrence is not only the real costs made by private litigants and antitrust authorities in preventing and rolling up cartels, but also the missed profits of perfectly legal activities turned down by companies out of fear of fines. These latter costs increase with the size of the fine that can be imposed. The ultimate balancing should yield penalties that are commensurate to the harms imposed by cartel overcharges.

This issue is only made more poignant by the unprecedented economic challenges facing companies today. As more and more companies face difficult times, the cost of over deterrence poses greater risks that cartel over-enforcement could drive innocent out of business, costing thousands of employees jobs. Some enforcers argue that these difficult times militate in favor of increased enforcement and even higher fines to ensure competition is preserved. The greater risk, however, is that such aggressive tactics will discourage honest competition and legal cooperation and, as discussed below, cause firms to act strategically in reporting alleged cartel behavior to harm their rivals.

Comment

The Leniency Wildcard

Amnesty Programs

To entice corporate violators of the antitrust laws to voluntarily report their conduct, the Division adopted a revised Corporate Leniency Policy in 1993. Many other countries have followed suit. The Division will grant complete amnesty only to the first party that reports its conduct. Like Canada, it is designed to prosecute only hard-core conduct. The Division recognizes that given the rush to secure a "marker," there will be situations where the applicant will report conduct that the Division subsequently concludes is not hard-core. If the Division makes such a determination, the applicant is not granted amnesty.

As a result of the leniency program, the workload of the Division has increased significantly. In FY 2007, the Division obtained the second highest overall fine total in a single year and the cumulative sentences were more than twice the total jail time recorded in any previous year.[6] Antitrust authorities in the EU offer a corporate amnesty program similar to that of the Division.

The Problem: Too Much Success?

But at what point is the risk of detection and over-fining so high that a company over-reports or acts strategically to harm a competitor? To avoid potential fines of 100 million USD in the U.S., 10 million CDN in Canada, a 10% surcharge on worldwide turnover in the EU, a firm has to be first in the door. The reported activity must be criminal/hard core in nature – no rule of reason issues here. The practical solution to getting your free pass is to ensure you are fast and that your behavior is black, not gray. Authorities must be concerned that applicants might "kick it up a notch" to ensure that their transgressions get enforcers' attention and qualify as cartel behavior. This can happen in at least two ways.

First, reporting companies may take gray behavior and color it black. Despite neat labels, the lines between anti-competitive and pro-competitive behavior are blurred, and vary across jurisdictions. Companies or counsel zeal may influence executives to malign otherwise legitimate behavior by telling them that they can get amnesty only if various conversations were part of a scheme to fix prices. Ironically, the worse the executive's description, the better it is for the company. So a cornered executive is pressed to deliver a conspiracy: "Somebody's going to jail. So if you did anything wrong, tell us, keep your job, and face no penalties." It does not take much to presume that those employees may choose the safe route and confess a cartel. "I guess he may have thought I was agreeing ...Yeah. I guess we agreed that it would be crazy to go below $41."

Judging from the jury's reaction, this dynamic may have played a large role in the Gary Swanson trial in the DRAM matter. In that instance, the DOJ sought to use the testimony of an executive

from the amnesty applicant to prosecute the former Hynix executive. Following a hung jury, the first thing the jurors discussed was their belief that the amnesty-receiving executive, and only direct witness, was full of lies.[7]

Furthermore, where you have a global company participating in a cartel in one country, there may be the tendency to over-report that activity in different jurisdictions to ensure that the company covers all of its bases. Indeed, there's often an incentive to over-report. For example, in Canada, failure to report wrongdoing in one area results in expulsion from the amnesty program and prosecution in all areas, presumably with the same evidence the company used to get into the program. So, reporters have all the incentive in the world to paint as broad a picture as possible. The company or individual who reports a wide range of acts risks little. If some of the conduct is found to be illegal, reporting likely results in immunity covering everything. And in the U.S., amnesty applicants avoid treble civil damages by assisting plaintiffs in their case.

Second, given the balance of risks, leniency programs may lead to false or malicious reporting. There is a large disparity in results for the first company to disclose versus subsequent disclosers or companies that challenge the allegation. This presents the opportunity for companies to use leniency programs to gain competitive advantage or injure the competition. The party in the best position to move first and strategically is often the firm that was the ringleader. The ringleader possesses the most intimate knowledge of the scope and breadth of the cartel activity and its executives are likely to be the most knowledgeable witnesses. Even though most regulators purport to disqualify ringleaders from receiving amnesty, a cursory look at press reports would seem to confirm the consensus that these provisions are not adequately enforced.

In what may be a telling development, leniency has become a cottage industry to some in the antitrust bar. Instead of conducting an objective, balanced assessment of whether there are hard core criminal violations, lawyers may simply tell their clients that the conservative, low risk route is to find a way into amnesty. If there is any smoke, assume there is a fire and run into amnesty. This is not a criticism of lawyers as much as evidence of an imbalance in the system. But the lawyers don't do so badly. Legal fees are expensive, even for the innocent.

Enforcement efforts should not stray from focusing on the most egregious violations by pursuing reports made up largely of innuendo. Given limited resources and imperfect information, it is wiser to focus on the most significant deviations from the law.[8] By doing so, authorities can produce the most significant results from enforcement efforts and avoid the dangers of over deterrence.[9]

Recommendations

The global success of leniency programs and increased enforcement efforts should be applauded. But in the race towards greater enforcement lies the risk of deterring legitimate and efficient

business practices. In order to maintain the benefits from tough anti-cartel enforcement and protect against over deterrence, governments should examine five key recommendations.

(1) Initiate international cooperation on enforcement and fine levels. Competition authorities should work through the International Competition Network and create guidelines to ensure that overall fine levels are not excessive and are tied to the real-world harm caused by the cartel. Additionally, courts should take judicial notice of fines likely to be levied in other jurisdictions related to the same conduct. Alternatively, courts could allow defendants to plead and prove this information.

(2) Apply greater scrutiny to amnesty applications. Competition authorities should require applicants to provide clear proof of illegal activity, instead of accepting second-hand innuendo. Although this may limit the number of cases pursued, the resulting cases would use the competition authority's resources efficiently with less risk of deterring productive, efficient business activity. Authorities should recognize that some leniency applicants are exaggerating or acting strategically. Having to prove a solid case will make potential applicants think hard before contacting the authorities.

(3) Develop or enforce limitations on amnesty for ringleaders. Today, the first in the door gets amnesty. Despite rules to the contrary, there are cases where it seems apparent that ringleaders, when first in, receive amnesty. In essence, this rewards the instigator and encourages strategic behavior. Competition policy should never reward companies that instigate bad behavior.

(4) Dismiss borderline cases early in the process. Authorities must also encourage private action judges to dismiss borderline cases early. The Supreme Court in *Twombly*[10] implored U.S. district court judges to do so, but judges continue to resist. Make the hard decision. Letting a dog case proceed helps no one.

(5) Encourage the exercise of judicial restraint. Judges and regulators must exercise restraint and limit damages to harm occurring within the jurisdiction's borders. Judges should be cognizant of fine levels in accepting pleas and in approving class action settlements. This is not a welfare plan or a tax. This step would go a long way toward eliminating the cross-border overlap of fines.

The current economic climate merely underscores the need for rapid reform of the methods of cartel enforcement throughout the world. In these dangerous times, governments should encourage all forms of legal competition, not discourage lawful behavior through overly aggressive enforcement and crushing fines in the billions of euros or dollars.

Conclusion

By reexamining current enforcement mechanisms, competition authorities can avoid the risk of stymieing productive business activity with runaway fines and clogged courtrooms. Adopting

these measures will go a long way toward working a better balance between the goals of deterring cartel behavior and encouraging pro-competitive competition.

Notes

[1] The author would like to acknowledge Holly Smith for her contribution to this article.

[2] See *United States v. Booker*, 543 U.S. 220 at 243-44 (2005), holding that any fact required for a sentence beyond the statutory maximum must be found by the jury and proved beyond a reasonable doubt (re-affirming *Apprendi v. New Jersey*, 530 U.S. 466 (2000) and *Blakely v. Washington*, 542 U.S. 296 (2004).

[3] 543 U.S. 220 (2005).

[4] Robert H. Lande & Joshua P. Davis, "Benefits From Private Antitrust Enforcement: An Analysis of Forty Cases", (2008) 42 U.S.F.L. REV. at 893-94, 915.

[5] *Ibid.* at 893-95, 915.

[6] Scott D. Hammond, Deputy Assistant Attorney General for Criminal Enforcement, Antitrust Div., U.S. Dept. of Justice, "Recent Developments, Trends, and Milestones in the Antitrust Division's Criminal Enforcement Program" (Paper presented at the 56th Ann. Spring Meeting of the ABA Section of Antitrust Law (26 March, 2008, available at: http://www.usdoj.gov/atr/public/speeches/232716.htm.)

[7] Dan Levine, *Hung Jury in Chip Price-Fixing Case*, The Recorder, Mar. 7, 2008.

[8] Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law*, 3rd ed. (2006) vol. 1 at 135.

[9] *Ibid.*

[10] *Bell Atlantic Corp. v. Twombly*, No. 05-1126, slip op. (U.S. May 21, 2007).

Comment

THE COMPETITION BUREAU'S REPORT ON COMPETITION AND SELF-REGULATION IN THE CANADIAN LEGAL PROFESSION: A CRITICAL EVALUATION

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Introduction

A recent report from the Canadian Competition Bureau, "Self-Regulated Professions: Balancing Competition and Regulation" (2007)[1] expresses concern that self-regulation of Canadian professions may undermine competition in these sectors. The Bureau makes an empirical claim, that productivity in the professions is low in Canada relative to the U.S., which motivates its investigation of competition and self-regulation. In this paper, we critically assess the Bureau's report, focusing on this empirical claim. Section I considers the questionable empirical basis for the claim that productivity is low in Canadian professions, and the even more questionable connection between such a claim and competition and self-regulation in the legal sectors. Section II departs from an implicit analysis of competition based on an examination of productivity data and by way of case study moves to an explicit analysis of competition in Ontario's legal services market. Not only are legal services markets unconcentrated, but analysis of barriers to entry further supports a conclusion that Ontario's legal services markets are competitive in structure. While examination of self-regulation and competition is not itself objectionable, the Bureau does not provide a compelling empirical motivation for its study.

Comment

SECTION I: LABOUR PRODUCTIVITY AND THE COMPETITION BUREAU'S EMPIRICAL MOTIVATION

A. The Bureau's Empirical Concerns

The Executive Summary begins:

> Despite comprising a significant part of the service economy in Canada, perhaps as much as one fifth, the professions comprise one of the overall economy's least productive sectors. According to the Conference Board of Canada, professional services rate in the bottom quintile for productivity per hours worked. In addition, labour productivity in the professions in Canada is approximately half that of the professions in the United States. At the same time, the professions are one of the most regulated sectors of the Canadian economy, and the regulation in place in the professions is more restrictive in Canada than in many member nations of the Organization for Economic Co-operation and Development.[2]

The apparently dismal performance of the professions motivates the Bureau's study. Following on the first passage from the Executive Summary, the Bureau states:

> Given a considerable body of evidence that shows that reducing regulation improves competition and, as a result, productivity, it is reasonable to ask whether and how professional services could be less regulated in Canada. The Competition Bureau is ideally placed to answer this question, since one of its primary responsibilities is advocating for competition in Canada. On several occasions, the Bureau has advised Canadian regulatory bodies on how to improve their approach to regulation to realize the benefits of competition. The Bureau also has considerable experience investigating anti-competitive behaviour in the professional services sector.[3]

Thus, lest there be any uncertainty in drawing the potential connection between sub-par performance and competition, the Bureau makes the linkage explicit: it is worth studying competition in the professions since competition spurs productivity and the professions exhibit low productivity.

In our view, the evidence that the Bureau cites as motivating its study is not only insufficiently targeted for the Bureau to draw meaningful inferences, but the findings could, in fact, be evidence of greater competition in Canada than in the U.S. We examine each point in turn.

B. The Scope of the Evidence

The main study upon which the Bureau relies for its productivity data is a report of the Conference Board of Canada, *Mission Possible: Stellar Canadian Performance in the Global Economy*.[4] The study provides the empirical conclusion that labour productivity in Canadian professional services is less than half that in the U.S., and that it is in the bottom quintile of industries relative to the U.S.[5] The Conference Board itself relies on an Industry Canada study on U.S.-Canada relative labour productivity.[6] Rao, Tang and Wang study Canadian productivity in a variety of industries relative to the U.S. They find that productivity is lower in Canadian professional services than in the U.S., and that relative productivity in professional services is poor compared to other Canadian industries.

The empirical evidence cited by the Bureau lacks specificity. The Rao et al. study upon which the Conference Board and, in turn, the Bureau, rely does not purport to offer a profession-by-profession analysis of relative labour productivity. Rather, it groups the professions into a single class of "professional services." In the Rao et al. study, "professional services" is defined pursuant to the North American Industry Classification System code 54. This code includes an extremely wide range of professional services. The wide definition of professional services casts serious doubt about the utility of these productivity data in evaluating, or even motivating the evaluation of, regulation in any given profession. Regulation of veterinarian services has nothing to do with regulation of the legal profession. Thus, even if it were true that professional services as a whole were significantly underproductive compared to the U.S. or some other benchmark, it is not at all obvious that this would have any relevance at all to productivity in any particular profession. It is entirely possible, for example, that productivity in the legal profession is very high, while it is not in the accounting profession, and the average is relatively low productivity overall. In such a setting, reform to the legal profession could do more harm than good despite overall low productivity in the professions.

We are also sceptical about the connection between self-regulation and productivity in the legal profession. A conclusion that the legal profession in fact has lower productivity than in the U.S. does not indict regulation in the sector. The Bureau seems to move in a linear fashion from concerns about productivity to concerns about self-regulation. There are, of course, a host of factors that may impact productivity in the legal profession other than self-regulation.

One important disconnection between labour productivity data and the effects of self-regulation concerns the role of capital and other inputs. If a particular industry in Canada is undercapitalized relative to the U.S., then labour productivity in that industry is likely lower than in the U.S., since capital contributes to the per-worker output of an industry. If the legal profession in Canada relies

less on capital than its American counterpart, then there is a significant potential explanation of a labour productivity gap that has nothing to do with self-regulation, unless one can tell a story of how Canadian self-regulatory rules restrict capital structure more than American rules. It may be that self-regulation concerning the partnership ownership structure of law firms affects the cost of capital, but it is not obvious how Canadian rules diverge in important ways from the U.S. on this score.

In fact, there is evidence that the Canadian professional services sector relies less on capital than does the American sector. Rao et al. report that machinery and equipment capital intensity in 2004 in Canadian professional services was only 34% of that in U.S. professional services. This is undoubtedly a major source of varying productivity across the two sectors.

Another reason to doubt the connection between self-regulation and productivity arises because lawyers are constrained to produce within the confines of a legal system over which they have little control. Suppose that there were a court system that required a large number of low-value interlocutory hearings before a decision could be rendered in a contract dispute. Or suppose that backlogs in courts deter cases from being heard in a timely fashion. Lawyers, rather than spending their time on relatively high-valued matters like the outcome of litigation, would have their productivity shackled by the court system, which is outside the purview of self-regulation. Thus, even if low productivity in the Canadian legal profession could be demonstrated, the causes of this productivity require careful study before one could conclude that self-regulation is the, or even a, cause.

C. Inferences about Competition from Labour Productivity Data in Professional Services

The Bureau's central concern with self-regulation is that it potentially limits competition in undesirable ways. Lack of competition in turn may be a contributing cause of the sobering productivity results that the Bureau cites to motivate its study. As this section explains, however, inferences about the state of competition in professional services cannot be drawn with any confidence from labour productivity results.

To explain our concerns, it is necessary to review how relative labour productivity figures are calculated. Once the appropriate exchange rate is calculated, the dollar value of production in each industry in each country is calculated. For the result that the Bureau cites, Rao would calculate the value of production of "professional services" in Canada and the U.S. in dollar terms. Production is not defined according to some unit of output (e.g., number of widgets produced), but rather according to dollar value – this is crucial to our analysis here, as we explain below.

Once the dollar value of production in the professional services market is calculated, labour productivity is found simply by dividing the value of production by the units of labour that were required to create this output. These ratios in the U.S. and Canada are compared to determine relative productivity in the professional sectors in each country.

Rao et al. find that Canadian productivity is low relative to the U.S. The Bureau relies on this to support an investigation into whether competitive restrictions in the professions are in part responsible for this poor performance. The problem with the Bureau's analysis is that anti-competitive practices in professional services could in fact increase the productivity statistics that Rao et al. produce. To return to a point just emphasized, productivity statistics that Rao et al. provide rely on the dollar value of production divided by the number of workers in the sector. The dollar value of production does not capture quantity of output only, but also the price at which it was sold. Thus, on this methodology, the productivity of an acre of planted corn would be measured not by the number of cobs grown, but by the market value of the corn sold. This methodology, perhaps particularly in the service sector, makes sense: it would be impossible to measure the "quantity" of legal services provided. But by examining revenue rather than quantity, the productivity figures depend on market conditions, not just on the production technologies of the suppliers in question.

Suppose that markets are perfectly competitive.[7] In this case, professional service providers are compelled to charge their marginal costs. The revenue in the industry will reflect the total costs of production. If, however, there is market power in an industry, because of anti-competitive self-regulation or some other reason, then revenue will be greater than total costs. This may affect productivity data. Consider two alternative scenarios. In the first scenario, each lawyer in a competitive market is very productive, perhaps because of greater investment in capital. In the second scenario, there is only one, very unproductive lawyer who is the only provider of legal services in a particular market. Each lawyer in the two scenarios may be able to charge $500 per hour: lawyers in the competitive market charge $500 per hour because of competition and their high degree of productivity; the lawyer in the second market is unproductive, but can charge a monopoly rate of $500 per hour. High productivity and market power are indistinguishable when examining the value of services sold per hour of a lawyer's time. The only way to distinguish productivity is to measure the "quantity" (not hours) of legal services provided per worker, but legal services cannot be reduced to quantity.

In some industries it may be feasible to account for market power. An analyst might be able to gauge the mark-up on a product sold by comparing the costs of inputs and the prices of output and attempt to back the market power mark-up out of the productivity analysis. Similarly, if there were an objective method of measuring the quantity of legal output, the market power factor would not necessarily cloud productivity statistics. One need not know the market price of corn to calculate how many cobs an acre produces; thus, productivity per acre can be calculated without reference to market conditions/power. If one could count the "cobs" produced by a lawyer, then one could compare labour productivity in competitive and non-competitive markets unproblematically. But it is not possible to measure a given "quantity" of legal services directly, which makes a direct analysis of quantity-produced-per-lawyer impossible. Moreover, without an ability to ascertain quantity, one cannot measure the mark-up on the price charged for a given quantity of legal services in an attempt to back out market power from the productivity

estimates. Competitive conditions will inevitably affect the measurement of productivity in the professional sector.

Market power may exaggerate labour productivity statistics. Thus, if market power in legal services arises because of anti-competitive self-regulation that leads to a smaller number of lawyers than competitive markets would support, all things equal, revenue per hour of professional services will be higher than in competitive markets. This in turn would tend to increase productivity as calculated by revenue over labour inputs. Market power in this instance would exaggerate productivity.[8]

It is therefore problematic for the Bureau to conclude that there may be competitive problems driving low productivity statistics in Canadian professional services relative to the U.S. Canadian and U.S. productivity measures would be comparable if the degree of competition in each market is the same, but not if they are different. Indeed, one could coherently argue that the reason why revenue over labour in Canadian professional services is lower than it is in the U.S. is because Canadian markets are more competitive than those in the U.S., and hence prices are lower all things equal.

None of this is to say that it is unwise for the Bureau to conduct a study of competition and self-regulation in the Canadian legal and other professions. But it is clear that the apparent empirical basis upon which the Bureau relies does not support the exercise. Not only is an examination of average productivity in professional services too broad to indict any particular profession's self-regulatory regime, but the result that Canadian professional services are less productive as measured by revenue over labour inputs may in fact reflect greater competition in Canadian markets. Until there is a non-market based measure of productivity, akin to counting corn cobs, any productivity study of the legal profession will be contingent on competitive conditions, and thus not particularly useful in drawing inferences about competitive conditions.

SECTION II: COMPETITIVE CONDITIONS IN THE ONTARIO LEGAL SERVICES MARKET

Productivity statistics do not suggest that Canadian professional services markets are uncompetitive. But this does not mean that the markets are competitive. By way of a case study, in this section we analyze more directly competitive conditions in Ontario's legal services market. While our analysis is hardly dispositive of the matter, our exploration suggests that the legal services market in Ontario appears to be robustly competitive.

A. Defining the Market

The first step in investigating the competitive conditions in a market is to define more precisely what the market is.[9] The Competition Bureau's *Merger Enforcement Guidelines* (2004) (MEGs) define relevant product and geographic markets by applying the "hypothetical monopolist" test.[10]

Put intuitively, relevant product (service) and geographic markets are defined by the willingness of consumers to substitute away from goods (or services) or switch to alternative (perhaps more distant) suppliers when faced with a small but significant and non-transitory price increase. The greater their willingness to switch, the broader the relevant market.

To undertake a thorough examination of competitive conditions in the legal services market in Ontario would require an examination of legal clients' price sensitivities. In some areas of practice, one would expect these sensitivities to be relatively large. In tax advisory work, for example, the line between legal practice and accounting advisory work may not be precisely drawn, which in turn suggests that an attempt to raise prices for legal advice on tax matters beyond competitive levels may induce clients to hire accountants instead. In other areas of practice, these sensitivities are likely smaller. If the price of criminal defence work rose by 5%, it is not obvious that clients would have more attractive alternatives.

Given that we do not undertake an empirical examination of legal clients' price sensitivities (or "demand elasticity", to use the conventional economic jargon), we cannot define product markets for legal services precisely. However, as we discuss, the data in our view resoundingly suggest robustly competitive market structures even on relatively narrow definitions. Similarly, we do not have data on clients' willingness to shop around for legal services from providers outside their immediate geographic region. Again, except for very small communities, however, even narrow market definitions do not suggest a lack of competition in Ontario's legal services markets. For very small communities, we do look to some implicit evidence of broader geographic competition, as we discuss.

In what follows, we will consider various product market definitions. One is the most general: legal services. Others are more specific product markets, such as corporate/commercial law; wills, estates and trust law; family law; and real estate law. We also treat geographic markets as being municipal in scope, rather than larger regional markets which may well be appropriate in some cases.

B. Market Concentration

Once markets are defined, the next step in determining competitive conditions concerns an evaluation of market concentration in the market. The MEGs take an approach in which a merger would be unproblematic if market shares of the merging parties are below certain thresholds, while if they are above the thresholds, further analysis would be required. There are, in general, two forms of anticompetitive behaviour that the MEGs and competition policy address. The MEGs set out different market share safe harbours depending on the nature of the competitive concern. If the concern is unilateral conduct, the Bureau suggests that it will not challenge a merger if the merging parties have a joint market share of under 35%. If the concern is multilateral conduct, the Bureau will not challenge a merger unless the four largest firms have a market share of at least 65%, and the merged entity would have at least a 10% market share.

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These safe harbours are useful in analyzing competition in Ontario's legal services market. Using data from lawyers' annual information forms that lawyers must file with the Law Society of Upper Canada as a condition of licensure, we examine the number of lawyers in a variety of municipalities, as well as number of firms on the assumption that lawyers within a firm coordinate their production, providing legal services generally and in practice areas. We do not include a firm as practicing in a particular area unless at least one lawyer at the firm reports spending at least 10% of her time in this area. Note that the numbers we provide on specific product lines understate competition because of this restriction. As the MEGs note, a producer not selling at all in a particular product (or geographic) market at competitive prices may nevertheless be included in the market if the producer would begin selling in that market in response to a price increase. In our data, we exclude *de minimus* participation in a line of legal services, but sellers providing less than 10% of their efforts in a certain line of business are very likely to be able to increase their participation above 10% in the event of anti-competitive price increases in that line of business. Indeed, since lawyers are licensed to practice in any area, lawyers not providing legal advice at all in a particular area may be induced by market power profits to begin doing so in the face of less than competitive market conditions.

The results from a sampling of legal services markets in different sizes of Ontario municipalities are as follows:

Type of Legal Practice		Toronto	London	Timmins	Orillia	Flesherton
	Population[11]	2.5 million	353,000	43,000	30,000	700
Overall	# of lawyers	13315	887	51	55	1
	# of firms	4239	853	41	52	1
Corporate/commercial	# of lawyers	3475	130	4	9	0
	# of firms	1282	65	4	8	0
Wills, estates, trust	# of lawyers	816	105	4	13	1
	# of firms	586	103	4	1	1
Family/matrimonial	# of lawyers	815	94	13	14	0
	# of firms	597	77	11	12	0
Real estate	# of lawyers	1658	141	12	17	1
	# of firms	1021	133	7	12	1

The number of firms practicing in a practice and geographic area does not indicate relevant market shares, so the safe harbour numbers of the MEGs are not directly applicable here. But for the larger municipal centres, it strikes us as highly implausible that any single firm would have a market share over 35%, or that any four firms would collectively have a market share of 65% or more. The average market share of London firms that provide family law services is just over 1%. Even if some firms are ten times the average size, this is a market that the Competition Bureau would view as robustly competitive. These figures are even more suggestive of competition if the total number of law firms is the focus, and it is plausible to assume (as

we do) that lawyers would begin to move into other lines of practice if these were particularly lucrative given a lack of competition.

On the other hand, market shares in the smaller centres appear much greater and may on their face suggest competitive concerns. But we doubt that these markets present competitive problems. The geographic definition we rely on in the table concerns location within the municipality itself. Given the relatively large cost of legal services for any given customer, we suspect that many would travel to other nearby centres rather than pay supra-competitive prices for local providers. It is implausible that buyers would spend much time traveling to realize a 5% lower price of a single grocery item, but it is not implausible that buyers would travel to realize a 5% savings on the cost of legal services, just as they would when shopping for household appliances or automobiles or doing the weekly family food shop. But one need not rely only on principled speculation; there is market evidence that geographic markets are broader than the municipalities. We examined yellowpages.ca for advertisements for lawyers serving Flesherton, Ontario, a town of 700 in southwestern Ontario. It turns out that there are over ninety law firms serving Flesherton, located in nearby towns like Hanover, Dundalk, Markdale and Shelburne, as well as relatively close larger centres, like Meaford, Owen Sound and Collingwood. Market share data suggest that legal services markets in Ontario are quite competitive.

C. Barriers to Entry

Even accepting narrow geographic and product market definitions, our sample of Ontario cities appears to have very competitive markets for legal services. But even if markets were concentrated, this would not end the assessment of competition. Another key consideration, as the MEGs stress, is barriers to entry. Concentrated markets do not pose competitive concerns if entry barriers are low. If new firms can enter in response to the exercise of market power, supracompetitive pricing would attract new entry and would only be transient. At the limit, even a firm with 100% market share cannot raise prices above competitive levels if entry of new competitors were costless and instantaneous. More generally, the MEGs suggest that the Bureau will not have competitive concerns about a merger, even if it creates concentrated markets, if entry would occur within two years that would constrain any significant price increase.

With respect to geographical markets, even if there were some residual concern about market power in smaller centres, it is highly implausible that market power could be sustained in any given centre for long. The major barriers to entry into the legal market concern investments in human capital: it takes time and effort to earn a law degree and earn one's professional accreditation. Once a lawyer is accredited within Ontario, however, there are almost non-existent barriers to entering different geographic markets. Indeed, given inter-provincial mobility agreements, entry into Ontario by lawyers from elsewhere in Canada is also very easy. Thus, if some geographic markets were robustly competitive, like London's, while others permitted lawyers to earn supra-competitive returns, one would expect there to be entry into the less competitive market as the result of lawyers migrating from the more competitive market. Even

very concentrated market shares, then, would not necessarily indicate market power. In reality, it is likely that there are few law firms in smaller centres because there is lower demand, and perhaps higher costs.

Competitive conditions in the legal services market in Ontario appear robust. It is, however, possible that some kinds of regulation could distort the nature of competition in the sector. For example, minimum fee schedules (which of course do not exist under current regulation) could lead to market power rents, or to non-price competition that would be sub-optimal for clients that would prefer discounts. The Bureau does not point to any such naked restrictions on competition, but does make some critical observations about regulations that increase barriers to entry to the legal profession, such as potentially excessive articling requirements. We will not take the space here to discuss all the Bureau's remarks, but do express our scepticism about the anticompetitive threat from barriers to entry into the profession, at least in Ontario. As we have seen, there is a competitive market structure in Ontario's legal services markets. To be sure, there must be some positive return to being a lawyer that exceeds competitive alternatives, otherwise lawyers would not undertake the non-trivial investment in becoming a lawyer in the first place. That is, whatever returns lawyers expect from practice must at least cover the costs of entry into the legal profession; the marginal lawyer will earn future returns that just offset these costs. In the steady state, costs of entry may increase lawyers' returns from practicing, but these higher returns simply offset the higher costs of entry. There are no market power rents from higher regulatory costs of entry.

It is possible for lawyers to benefit from increasing the regulatory costs of entry, but only because of a change in existing policy. Existing lawyers may benefit themselves by restricting entry, and thus competition, going forward by increasing regulatory barriers to entry. But high costs of entry themselves, on which the Bureau focuses, should not themselves create market power rents over the lifetime of a lawyer.

Before concluding, we note another strong indication of the robust nature of competition, or at least an indication that self-regulation is not a potent force in restricting competition. While a minority of lawyers earn very high hourly fees, in the several hundred dollar range, most others earn much lower fees. Legal Aid Ontario, for example, pays hourly rates below $100. Hadfield[12], in a critique of self-regulation of the legal profession, acknowledges that in the individual legal services sector in the U.S., incomes and fees have either remained stable or decreased slightly with a perceived glut of lawyers and un- or under-employment – a view in part corroborated in Ontario in a recent study by a Law Society of Upper Canada Committee of the challenges facing sole practitioners and small law firms in maintaining financially viable practices.[13]

There are no regulatory restrictions preventing low-earners from earning $800 an hour. Thus, the significant variation in returns to lawyers does not result from regulation. While the higher-earning lawyers are a minority, they are responsible for a disproportionate share of the value of the legal services market. Given that there would be a group of lower-paid lawyers willing to

compete with them, the high returns that this cadre earns are not the result of less competition. Indeed, many of the higher-earning lawyers are involved in international business transactions, in which case they face stiff competition not only from other Canadian lawyers, but from international law firms.[14] Low productivity in this disproportionately valuable segment of the legal services sector, if it existed, could not be blamed on a lack of competition.

Notes

* This paper is derived from a larger study commissioned by the Law Society of Upper Canada, "Self-Regulation and Competition in Ontario's Legal Services Sector: An Evaluation of the Competition Bureau's Report on Competition and Self-Regulation in Canadian Professions." The larger study is posted on the Federation of Law Societies of Canada website: www. flsc.ca. The views herein are those of the authors.

1 Available at www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02523.html.

2 *Ibid.* at vii.

3 *Ibid.*

4 Glen Hodgson and Anne Park Shannon, *Mission Possible: Stellar Canadian Performance in the Canadian Economy* (2007).

5 *Ibid.* at 46.

6 In fact, it is not entirely clear how the Conference Board derived its results. At p. 46, it notes that it co-sponsored research in 2004 on labour productivity that it updated for the purposes of the 2007 report. It cites Brenda Lafleur and Andrew Sharpe, "The Canada-U.S. Productivity Gap: Deepening our Understanding", in *Performance and Potential 2004-05: How Can Canada Prosper in Tomorrow's World?* (Ottawa: The Conference Board of Canada, 2004), which presumably is the basis of the 2004 study to which the 2007 report refers, but the central results on relative productivity in the 2007 report are attributed to Someshwar Rao, Jianmin Tang and Weimin Wang, "What Explains the Canada-U.S. TFP Gap?" (Working Paper 2006-08). It is thus not clear how the updated 2004 results affect the Rao et al. 2006 results.

7 See, e.g., Aklilu Zegeye and Larry Rosenblum, "Measuring Productivity in an Imperfect World" (2000) 32 Applied Economics 91.

8 *Ibid.*

9 See, e.g., Competition Bureau, *Merger Enforcement Guidelines* (2004).

10 See also, Michael Trebilcock, Ralph Winter, Paul Collins and Edward Iacobucci, *The Law and Economics of Canadian Competition Policy* (Toronto: U of T Press, 2002), chap. 2 and 4.

11 Population data from http://www.citypopulatin.de/Canada-Ontario.html, except for Flesherton's, which was found at wikipedia.org.

12 Gillian Hadfield, "The Price of Law: How the Market for Lawyers Distorts the Justice System" (2000) 98 Michigan Law Review 953; Gillian Hadfield, "Legal Barriers to Innovation: The Growing Economic Cost of Professional Control Over Corporate Legal Markets" (2008) Stanford Law Review 101.

13 Final Report of the Sole Practitioner and Small Firm Task Force, Law Society of Upper Canada, March 24, 2005.

14 This observation suggests that the Toronto legal market is even less concentrated than the above data suggest.

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