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THE ECONOMIC CONSEQUENCES AND CONSTITUTIONALITY OF ADMINISTRATIVE MONETARY PENALTIES FOR ABUSE OF DOMINANCE

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The 2009 amendments to the Competition Act introduced administrative monetary penalties ("AMPs") for a finding of abuse of dominant position of up to $10 million for the first order, and a $15 million for each subsequent order. The quantum of such an AMP is to be determined according to a list of "aggravating or mitigating factors," including gross revenue and profits affected by the practice, the party's financial position, the history of compliance with the Act and "any other relevant factor."

The author argues that this provision is both inefficient and potentially unconstitutional (following from the Supreme Court of Canada's holding in Wigglesworth), because 1) the Act does not explicitly constrain the AMP quantum to a level that internalizes the economic impacts of the anti-competitive conduct; and 2) some of the aggravating factors lack a coherent connection to the economic impact of anti-competitive conduct.

The author concludes that the Commissioner should clarify the circumstances under which AMPs for abuse of dominance will be sought. AMPs should be calibrated to market impacts based on evidence of estimated deadweight loss and economic profits, in order to ensure that AMPs remain purely deterrent and do not reach a denunciatory magnitude.

Les modifications de 2009 à la Loi sur la concurrence ont créé des sanctions administratives pécuniaires (SAP), en cas d'abus de position dominante, d'un montant maximal de 10 millions de dollars pour une première ordonnance et de 15 millions de dollars pour toute ordonnance subséquente. Le montant d'une SAP est déterminé en tenant compte d'une liste de « circonstances aggravantes ou atténuantes », y compris le revenu brut et le bénéfice provenant des ventes sur lesquelles le comportement

a eu une incidence, la situation financière de la personne visée par l'ordonnance, le comportement antérieur de cette personne en ce qui a trait au respect de la Loi et « tout autre élément pertinent ."

L'auteur soutient que cette disposition est à la fois inefficace et peut-être inconstitutionnelle (vu la position adoptée par la Cour suprême du Canada dans l'affaire Wigglesworth), parce que : 1) la Loi ne limite pas explicitement le montant de la SAP à un niveau qui internalise les répercussions économiques du comportement anticoncurrentiel; et 2) certaines des circonstances aggravantes sont dépourvues d'un lien cohérent à l'incidence économique d'un comportement anticoncurrentiel.

L'auteur conclut que le commissaire devrait préciser les circonstances dans lesquelles il demanderait des SAP pour abus de position dominante. Les SAP devraient être modulées en fonction des répercussions sur le marché, à la lumière de preuves quant à l'évaluation de la perte de poids mort et des bénéfices économiques, de sorte que les SAP restent strictement un outil dissuasif et n'atteignent pas des montants relevant de l'exemplarité.

1. Overview

The 2009 amendments to the *Competition Act*[2] introduced administrative monetary penalties ("AMP") for a finding of abuse of dominant position under section 79 of the *Act*. Although an AMP for abuse of dominance has yet to be imposed,[3] the amended *Act* empowers the Competition Tribunal (the "Tribunal") to impose a maximum AMP of $10 million for the first order and a maximum $15 million for each subsequent order,[4] and the quantum of such an AMP is to be determined according to a list of "aggravating or mitigating factors." These include gross revenue and profits affected by the practice, the party's financial position, the history of compliance with the *Act* and "any other relevant factor."[5]

The stated purpose of this AMP is to promote compliance with the *Act* and not to punish.[6] However, the remarks of the now-former Commissioner of Competition, Melanie Aitken, in regards to the proposed amendments express the deterrence objective but also clearly view an abuse of dominance finding to mean that an "offending company" is

"breaking the law."[7] Indeed, as commentators have observed, the addition of an AMP provision for abuse of dominance marks a departure from the original framework and philosophy for reviewable conduct under Part VIII of the *Act* – specifically, that market conduct that is not prohibited on a *per se* basis should be presumed legal until proven to be anti-competitive under a civil standard.[8]

Following from the addition of this AMP, commentators have called for clarification regarding the circumstances under which the Commissioner of Competition (the "Commissioner") will seek an AMP for abuse of dominance and the Commissioner's basis for the quantum of AMP sought.[9] Notably, the Competition Bureau's recently published final enforcement guidelines for abuse of dominance did not provide any guidance on these issues.[10] As this paper will further explore, commentators have noted that this ambiguity around the AMP provision risks chilling pro-competitive behaviour and observed that the constitutionality of this AMP provision may be challenged.[11]

This paper argues that, without further clarification on how an AMP quantum will be determined, the present prescription for this AMP is both inefficient and potentially unconstitutional. Specifically: 1) the *Act* does not explicitly constrain the AMP quantum to a level that internalizes the economic impacts of the anti-competitive conduct; and 2) some of the aggravating factors lack a coherent connection to the economic impact of anti-competitive conduct.

Despite the AMP's stated deterrent purpose,[12] an AMP formulated based on the current aggravating factors may not be consistent with a purely deterrent purpose (i.e. such an AMP may exceed what is necessary to promote compliance with the *Act*). The factors could result in a denunciatory AMP quantum if these are not applied specifically to internalize the *ex ante* incentives for anti-competitive conduct facing the given respondent. Indeed, on their present reading, the factors potentially provide a scope for an AMP quantum that far exceeds any actual or anticipated economic profits or lessening of market efficiency.

In *R v Wigglesworth*,[13] the Supreme Court established that a provision may attract protection under section 11 of Canada's *Charter of Rights and Freedoms*[14] if the penalty for breach of that provision is "penal" by "nature" or "consequence," and further indicated that fines of large

magnitude may represent a "penal consequence" if they appear to be imposed for the purpose of redressing the "wrong done to society."[15] Therefore, if an AMP exceeded an exclusively "deterrent" purpose and thereby became "denunciation," the present AMP specification would represent a "penal consequence." With abuse of dominance determined only on a civil standard of proof, an AMP quantum for abuse of dominance that is not purely deterrent could then infringe the due process requirements under section 11 of the *Charter*.

Moreover, from a policy perspective, given the presence of potential "false positives" for abuse of dominance, the present AMP provision also risks "chilling" pro-competitive behaviour. When such misidentification is possible, a monetary penalty for misconstrued conduct will reduce the expected value of undertaking pro-competitive acts. That is, "good" competition may be deterred since such conduct may now incur an AMP of unclear quantum if erroneously found to be anti-competitive. Such chilling can thereby reduce consumer welfare and overall market efficiency by perversely deterring pro-competitive behaviour.

However, a well-tailored AMP could serve a valid deterrent purpose. Yet, in order for an AMP to be properly calibrated for deterrence, the aggravating or mitigating factors should be incorporated into an explicit internalization of the economic impacts of the anti-competitive conduct. If the AMP provision is not to be denunciatory, various aggravating or mitigating factors cannot be adduced in a fragmentary form to point ordinally to a relatively higher or lower AMP quantum. Rather, it should be incumbent upon the Commissioner to prove that the AMP sought in the given matter corrects the *ex ante* incentives facing the respondent.

As such, this paper argues that, when faced with an application for an AMP under section 79, the Tribunal should require the Commissioner not only to provide an accounting of the bare aggravating factors, but to adduce expert economic evidence to quantify the economic impacts of the impugned conduct – specifically, the economic profits and losses in economic efficiency. In order to ensure that an AMP is purely deterrent (in accordance with subsection 79(3.3) of the *Act*) and constitutionally compliant, the Tribunal should base the AMP quantum explicitly on the economic impacts that are proven on a balance of probabilities.

Importantly, with an AMP determined on this basis, the potential chilling would be lessened. Even if pro-competitive conduct were mistaken as an anti-competitive act, the remedy would likely only be injunctive since a monetary penalty would require the Tribunal to additionally quantify the economic impacts on a balance of probabilities. Consequently, a competitor's *ex ante* decision to undertake a pro-competitive act would suffer less distortion than under the current nebulous grounds on which an AMP might be granted.

This paper will then proceed by: 1) discussing the economic theory for abuse of dominance; 2) examining the current statutory framework for abuse of dominance; 3) explaining the potential for "chilling" pro-competitive conduct; 4) considering the constitutionality of the current AMP; and 5) concluding that i) a clarified AMP would better serve the objectives of the *Act*, and ii) explicitly calibrating an AMP to economic impacts would buttress the provision to constitutional challenge.

2. Economic Rationale for Constraining Abuse of Dominance

Broadly, the prohibition of abuse of dominance responds to the incentive for an incumbent monopolist (or oligopolists in the case of joint dominance) to maintain its market power and monopoly pricing.

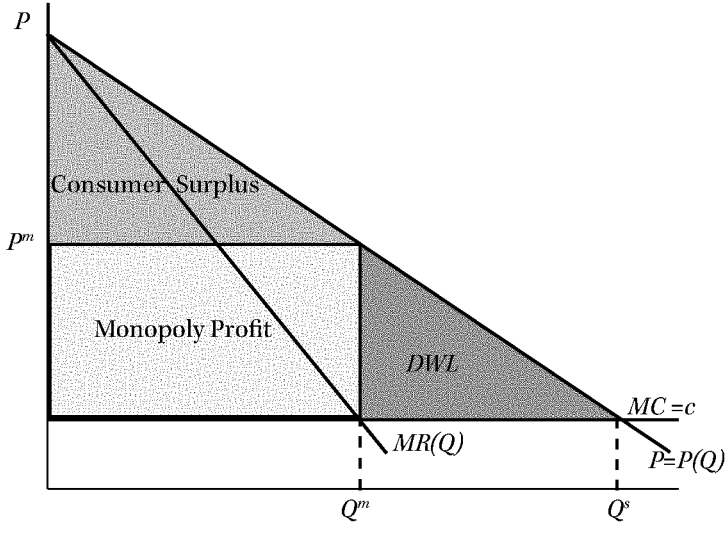

Figure 1: Inefficiency in monopoly setting[18]

Generally, the exercise of market power to impose monopolistic pricing results in both a transfer of consumer surplus to the monopolist and losses in overall social surplus relative to a counterfactual competitive market (so-called "deadweight loss"). Figure 1 illustrates the inefficiency resulting from monopoly pricing, reflected in the deadweight loss (DWL) when a monopolist prices monopolistically, such that marginal revenue (MR) equals marginal cost (MC), relative to a competitive equilibrium where price (P) equals marginal cost.[16]

Such monopoly pricing can only persist in the absence of competition, as new entrants would have an incentive to undercut the monopolist's price in order to earn profits. In order to maintain these monopoly profits (or "economic profits"),[17] the monopolist then has an incentive to exclude other players from the market.

Exclusionary strategies can take the form of predation of current competitors or the threat of predation for potential entrants. Competitors may also be excluded by strategies that exclude potential entrants from selling to certain customers or would increase their costs of production (termed "raising rivals' costs").

Predation involves an incumbent firm reducing its price below its production cost in order to drive an entrant from the market. A potential entrant, who can produce at a cost less than the incumbent, will be attracted by the profitable opportunity in the market. By cutting prices so as to impose a loss on the entrant and if able to withstand the losses itself, an incumbent may force the entrant to exit the market. If the incumbent can present a credible threat to predate, a potential entrant may be deterred from entering the market.[19]

Exclusion of potential entrants may also be accomplished by vertical integration or contractual exclusivity.[20] Similarly, long-term contracting may be used to inefficiently tie-up suppliers or customers, depriving potential entrants of available market share.[21]

3. Abuse of Dominance under the *Act*

These concerns about economic efficiency motivate the prohibition of abuse of dominance as a "reviewable practice" under the *Act*. The *Act* features both a criminal track, which is reserved for offenses that

are prosecuted by the Attorney General in court and require a criminal standard of proof, and reviewable practices, which are adjudicated by the Tribunal under a civil standard of proof in accordance with the *Competition Tribunal Act*.[22]

Prior to the amendment to permit AMPs under section 79, the abuse of dominance provisions focused on remedying the anti-competitive conduct, providing for injunctive orders and reasonable actions to restore competitive within the impacted market.[23]

The reviewable practice of abuse of dominance requires proof of three economically-grounded elements: 1) a dominant position; 2) anti-competitive conduct; and 3) a substantial prevention or lessening of competition.[24] The *Act* non-exhaustively enumerates anti-competitive acts, and proving such conduct also involves an element of intent, requiring the Commissioner to establish that the particular act was undertaken for a predatory, exclusionary or disciplinary purpose.[25]

The elements for finding abuse of dominance clearly presume a civil standard and remedies for the reviewable practice. Moreover, the history of abuse of dominance – particularly its inception from the decriminalization of "monopoly"[26] and the recent removal of "predatory pricing" as an offence[27] – exhibit the policy rationale for a tribunal approach using a civil, rather than criminal, standard.

Given this civil standard, a finding of abuse of dominance cannot be equated with moral blameworthiness. Therefore, the current elements for abuse of dominance – in particular, the inference of intent from an anti-competitive act[28] and the reverse onus for a "valid business justification"[29] – cannot be reconciled with penal consequences.

Ultimately, a legal finding of abuse of dominance will rely extensively on economic theory and evidence. In such a context of findings based on probabilistic economic modeling, civil remedies remain nonetheless valid. A finding of abuse of dominance justifies an injunction against the particular conduct. Imposing damages calibrated to the social costs would also be justified as a civil remedy. However, penalties that denounce the impugned conduct as morally blameworthy are inconsistent with the burden of proof, inferences of intent, modeling approximations and economic assumptions undergirding any finding.

4. Chilling of Pro-competitive Conduct

The risk of over-deterrence posed by AMPs is underscored by alternative efficiency explanations for apparently anti-competitive conduct. When such "false positives" are possible, the threat of a monetary penalty will "chill" market participants who are considering pro-competitive conduct. In contrast, if facing an injunctive remedy, efficient "good" competition would not be significantly deterred.[30] However, the potential AMP may reduce the expected value of pro-competitive conduct and consequently deter efficient activities – particularly where risky investments in innovative products are involved.

Specifically, Winter illustrates scenarios in which conduct might be labeled anti-competitive when it is in fact pro-competitive.[31] Firstly, for predatory pricing, the price-cost comparisons are fraught with ambiguity, typically employing average avoidable cost as a proxy for marginal cost,[32] and it is unclear whether price reductions to "invest in market share" would be recognized as a valid business justification. Where such switching costs are present and profits accrue in related markets, price reductions may be a pro-competitive response to "invest in market share."[33]

Secondly, Winter shows where exclusive contracts that foreclose a market to competitors may be nonetheless efficient. For instance, a firm may "compete for the market," offering price decreases that compensate consumers for any loss in variety. If barriers to entry remain low, potential competitors remain a constant source of discipline.[34] While conduct may be theoretically exclusionary, the impact on competition is a highly empirical question, necessarily often relying on probabilistic economic evidence.[35]

When such false positives are possible, a monetary penalty will reduce the expected value of undertaking pro-competitive acts. Since the current provision allows for the AMP quantum to be determined on bases other than quantified market impacts, a finding of abuse of dominance could result in a sizable AMP even where the reduction of consumer surplus and deadweight loss are not conclusively quantified. Since a false positive could nonetheless attract a substantial penalty, this penalty could then deter pro-competitive conduct and consequently negatively impact market efficiency.

5. Constitutionality of Deterrence versus Denunciation

Optimal deterrence theory provides the rationale for setting the cost of damages for anti-competitive conduct with reference to market impacts.[36] For abuse of dominance, an AMP quantum set with reference to the assessed economic profits and deadweight loss would accomplish this objective.[37] This follows Landes' prescription for optimal deterrence of antitrust violations that a monetary penalty should be set equal to net harm to other persons divided by the probability of such a finding.[38] For a party considering anti-competitive conduct that reduces social surplus, such a penalty would offset any expected positive net gain.

Consider a stylized example: if a respondent's expected economic profits were $2 million and deadweight losses were $1 million (totaling $3 million of foregone consumer surplus relative to the competitive counterfactual), a $3 million penalty would fully discourage the specific anti-competitive conduct since the respondent would be forced to bear all of the social costs of the conduct.[39]

Thus, specific deterrence is accomplished once the penalty is equal to the social costs of the behaviour (here, $3 million) and there would be no additional deterrence from a penalty of $4 million (or $5 million or $6 million, etc). That is, a rational party would act no differently if facing a $4 million (or $5 million or $6 million, etc) penalty than if facing one of $3 million.

The same result would follow for general deterrence (i.e. no additional deterrence from a penalty exceeding the private benefits and social costs) since any other market participant would expect a penalty similarly determined based on the expected economic profits and deadweight loss in their particular circumstances. That is, market participants generally could expect no positive net benefit from such inefficient anticompetitive conduct.

However, the AMP as currently prescribed provides scope for a penalty well in excess of the incentives to undertake the conduct. The aggravating factors include "the effect on competition" and "actual profits," which could align with a compensatory or restitutionary basis for damages. However, including "gross revenue," "the history of compliance" and "any other relevant factor" potentially detaches the

determination of the AMP quantum from actual market impacts. As well, since "actual profits" is already an enumerated factor, the inclusion of "gross revenue" as another independent factor is irrational since this measure lacks any quantitative connection to efficiency losses or economic profits from the conduct.

As such, the current "aggravating factors" import considerations unrelated to the market impact and, therefore, could justify a quantum that far exceeds a rational deterrent level. More precisely, an AMP quantum at an arbitrarily high amount – say, twenty-fold of the gross revenues in the affected market – would certainly deter anticompetitive conduct. Yet, it would far exceed the level at which the conduct would already be fully deterred. Indeed, such an AMP quantum would not be rationally connected to either the harm to consumers and the market generally or to the direct incentives (i.e. potential economic profits) to engage in the conduct. Therefore, such an AMP quantum, computed without reference to efficiency losses and economic profits, could only be denunciatory.[40]

Such a distinction between "denunciation" and "deterrence" is supported by the jurisprudence. Notably, denunciation is a legitimate feature of the criminal law, imposing a stigma corresponding to the moral blameworthiness of conduct that has been proven beyond a reasonable doubt.[41] Denunciation is much less consistent with the civil context, given the incongruence of condemning conduct as "encroaching on our society's basic code of values" when that conduct has only been proven on a balance of probabilities.

In contrast, deterrence – whether specific or general – is prospective and preventative.[42] Moreover, for any penalty, the emphasis on general deterrence must be reasonable.[43] A penalty aimed for general deterrence is "neither punitive nor remedial" and is set consequentially, "designed to discourage or hinder like behaviour in others."[44]

Therefore, while a deterrent penalty will not be effective if it is a mere licence fee, it also should not be harsh so as to exceed its deterrent function. Whatever the nomenclature, if a penalty is set according to factors unrelated to the relevant incentives or set beyond the threshold that would rationally deter the conduct in question, a penalty cannot be purely deterrent and must be denunciatory.

These points can be summarized as follows:

- Deterrence is prospective and is concerned with discouraging the particular conduct by the specific respondent or other parties who might be considering such conduct.
- There is a distinction between penalties that merely deter the particular conduct and those that denounce it as morally wrongful.
- Given the distinction, there must be a threshold above which a penalty is no longer deterrence and represents denunciation.
- This threshold must be at the level at which the social costs are fully borne by a respondent since:
    - at this level, any expected private benefits are fully offset and the respondent cannot then expect a positive gain from the conduct; and
    - a penalty beyond this level would not additionally modify the behaviour of a rational respondent relative to a penalty at this level.

As such, if the AMP quantum is set in excess of expected economic profits and deadweight loss, the present AMP may represent a "penal consequence" as defined in *Wigglesworth*. If Justice Wilson's holding in *Wigglesworth* that a fine of a certain magnitude may be a "penal consequence" is to be at all meaningful, courts must be willing to determine when a fine is for the "purpose of redressing the wrong done to society." Such a threshold is logically the level beyond which a fine has no additional function as a deterrent. Beyond that threshold, the penalty can only serve to denounce the conduct. Similarly, if the fine quantum is determined according to factors that are not rationally connected to the incentives to engage in the conduct, it cannot be said to be purely for deterrence.

Furthermore, in *Martineau v MNR*,[45] the Supreme Court of Canada indicated that a fine is potentially penal where "sentencing factors" are the basis of the quantum while a civil penalty based on a "purely economic" and "mathematical" determination does not infringe Charter rights.[46]

Similarly, the Federal Court of Appeal's recent judgment in *United States Steel Corporation v Canada (Attorney General)*[47] indicates that, while the magnitude of an AMP is not determinative, the penalty must be strictly intended for a deterrent purpose in order to be valid.[48] Indeed, *U.S. Steel* clearly equates "punishment" with "denunciation."[49]

Additionally, it should be stressed that the finding in *U.S. Steel* that the particular penalties under the *Investment Canada Act*[50] are constitutionally valid does not directly affirm the constitutionality of the AMP for abuse of dominance.[51]

As well, while the Ontario Court of Appeal recently upheld the constitutionality of an AMP for breaches of securities law,[52] this decision considered the incentives facing the respondents, finding the AMP consistent with the appellants' profits from the breach,[53] and emphasized constraints on the constitutionality of an AMP. Importantly, Justice Sharpe observed that:

> The constitution does not impose a defined limit on what is permissible by way of administrative monetary sanctions. The limit can only be determined by reference to the purpose of the penalty in relation to the regulatory mandate of the tribunal.[54]

Rowan would then strongly imply that AMPs for abuse of dominance cannot exceed the deterrent purpose that subsection 79(3.3) prescribes. The logical limit of an AMP for abuse of dominance would be the penalty that internalizes the quantified economic impact of proven anti-competitive conduct.

Given the character of the reviewable conduct, a "purely economic" and more "mathematical" determination could have been prescribed as the basis of this AMP. Indeed, given that an applicant must prove a "preventing or lessening of competition substantially in a market" in order for the Tribunal to find abuse of dominance, some reduction in efficiency should underlie any such finding. Therefore, the Tribunal could rightly require evidence that quantified these market impacts – specifically, that quantified the economic profits and deadweight loss – in order to set the AMP quantum. Given that an actual or likely lessening of competition (reflecting a reduction in economic efficiency) is an element of abuse of dominance, to simply apply "aggravating factors" to indicate a relatively higher or lower quantum would

not seem to constrain the penalty to a purely deterrent level. That is, if exceeding the market impacts, a penalty determined based on the aggravating factors could cross from deterrence into denunciation and thereby represent a "penal consequence."

Finally, the Tribunal did consider and uphold as constitutional an AMP under section 74.1 of the *Act* (relating to administrative remedies for deceptive marketing practices) in *Commissioner of Competition v Gestion Lebski.*[55] In that decision, the Tribunal rejected the argument of the respondents that the section 74.1 AMP (imposed in the matter for conduct under section 74.01) represented a penal consequence and endorsed the view that the particular AMP was intended to promote compliance with the *Act.*[56]

However, the holding in *Gestion Lebski* that the section 74.1 AMPs do not contravene section 11 of the *Charter* is not determinative of the constitutionality of AMPs under section 79.

Firstly, the maximum AMP quantum in question was of a much lower magnitude than the current maximum for an AMP under section 79 (prior to the 2009 amendments, the maximum AMP under subsection 74.1(1) was $100,000 for a corporation for a first order and $200,000 for a second order),[57] and the Tribunal held that, while the AMP quantum was not insignificant, is was not so large to constitute a penal consequence.[58] The Tribunal did not speculate as to what threshold would result in a penal consequence.

Notably, Rogers Communications Inc. ("Rogers") has challenged the constitutionality of the current section 74.1 AMP before the Ontario Superior Court in response to an application brought against Rogers by the Commissioner for alleged misleading advertising in which a $10 million AMP was sought.[59] As of April 2013, Rogers' challenge had not yet been determined.

Secondly, the Tribunal in *Gestion Lebski* dismissed the respondents' argument about the absence of a "mathematical calculation" as a basis for the AMP quantum without comment and did not give explicit consideration to whether the aggravating or mitigating factors under subsection 74.1(5) of the *Act* were rationally connected to the stated deterrent purpose of the AMP.

As this paper has argued, for an AMP quantum to be constitutional, the quantum must be deterrent (and not denunciatory) and, to this end, the Tribunal (or applicable court) should determine the AMP quantum in a purely deterrent manner. Therefore, even if the aggravating or mitigating factors under subsection 74.1(5) were held to reflect compensatory and restitutionary considerations and to be rationally connected to the damage inflicted by deceptive marketing practices,[60] the rational connection of the aggravating factors for an AMP for abuse of dominance under subsection 79(3.2) must be evaluated in the context of that particular proscribed conduct.

Moreover, while not taking a position on whether the aggravating factors under subsection 74.1(5) are rationally connected to deterring the proscribed conduct, economic damages from deceptive marketing practices in general may not be as amenable to quantification as are the deadweight loss and economic profit within the context of abuse of dominance.[61] As such, even if a ordinally-assessed factor-based approach is held to be suitable for determination the section 74.1 AMP, it does not follow that a higher/lower-type application of the factors would be sufficient for the determination of an AMP quantum for abuse of dominance. As discussed above, for a positive finding of abuse of dominance, quantification of the economic impacts is feasible and, with evidence of lessening of competition already necessarily in play, an approach explicitly based on deadweight loss and economic profits could be adopted.

6. Clarifying the current AMP

The potential unconstitutionality of the currently prescribed AMP for abuse of dominance then results from: 1) the denunciatory aspect, which represents a "penal consequence"; and 2) the presently non-formulaic and highly discretionary manner of its determination. The "penal consequence" is inconsistent with the tribunal process and civil standard of proof for the reviewable practice.

In contrast, civil remedies that require disgorgement of profits and payment of compensatory damages would be consistent with the civil process. An AMP quantum set according to quantified market impacts would avoid "chilling" pro-competitive conduct and would

not represent an unconstitutional "penal consequence," being strictly deterrent rather than denunciatory.

For abuse of dominance, any harm is amenable to statistical quantification. The "substantial lessening of competition" element already requires a counterfactual comparison and a calculation of the competitive price level is necessary to define the extent of the relevant market. The evidence required to support a finding of abuse of dominance could be employed to quantify the magnitude of market impacts within an appropriate statistical confidence interval.

With an AMP determined on this basis, "good" competitors would likely face only an order prohibiting the particular conduct and would not risk an outsized penalty. While "false positives" might be identified on a balance of probabilities, it is less likely that significant market impacts could be quantified where the conduct is truly pro-competitive. As such, the chilling effect of the current AMP on pro-competitive conduct would be alleviated.

To this end, the Commissioner should revise his guidance to clarify the circumstances under which AMPs for abuse of dominance will be sought. If the Tribunal imposes an AMP for abuse of dominance, it should expressly calibrate the quantum to the market impacts and, to that end, should require the Commissioner to adduce statistical evidence regarding estimated deadweight loss and economic profits. Additionally, the Tribunal and courts adjudicating the current AMP provision should, given the purely deterrence purpose in subsection 79(3.3), read the provision to require the Commissioner to adduce evidence that quantifies the economic impacts of the conduct. AMPs imposed by the Tribunal should be expressly calibrated to the economic profits and deadweight loss from the anti-competitive conduct so that the AMP quantum is not of a denunciatory magnitude.

Endnotes

[1] Grant Bishop is a JD Candidate at the University of Toronto Faculty of Law. The author is grateful to Edward Iacobucci, Ben Dachis, Robert Sharpe, and the CD Howe Institute's Competition Council who provided helpful feedback on this paper, as well as to Kenneth Jull for whose seminar at the University

of Toronto Faculty of Law an earlier draft was written and to the editorial board of the University of Toronto Faculty of Law Review who also provided insightful comments. All errors, omissions and opinions are the author's own.

[2] *Competition Act*, RSC, 1985, c C-34 [*Act*].

[3] On 20 December 2012, the Commissioner of Competition initiated an application for abuse of dominance against Direct Energy Marketing Limited and Reliance Comfort Limited Partnership for alleged anti-competitive conduct in their rental of water heaters. The application seeks AMPs of $15 million from Direct Energy and $10 million from Reliance. (*Commissioner of Competition v Direct Energy Marketing Limited* (20 December 2010), CT-2012-003, online: Competition Tribunal < http://www.ct-tc.gc.ca> (Notice of Application); and *Commissioner of Competition v Reliance Comfort Limited Partnership* (20 December 2010), CT-2012-003, online: Competition Tribunal < http://www.ct-tc.gc.ca> (Notice of Application)).

[4] *Act*, *supra* note 2 s 76(3.1).

[5] *Ibid*, s 76(3.2).

[6] *Ibid*, s 79(3.3).

[7] "Speaking Notes for Melanie L Aitken, Interim Commissioner of Competition, The Senate Banking, Trade and Commerce Committee Hearings Regarding *Competition Act* Amendments, Ottawa, Ontario" (13 May 2009) online: Competition Bureau < http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03065.html>, stating: "Finally, the amendments enhanced penalties for those who break the law. ... Similarly, the *Act* did not effectively deter anti-competitive conduct in the area of abuse of dominance, where the Tribunal was generally limited to requiring the *offending* company to discontinue the activity going forward. In other words, the company got to keep any money it made *breaking the law*, having excluded healthy competition through anti-competitive conduct that was designed to eliminate competition. What is key is that these amendments introduce material incentives to comply with the law." [emphasis added]

[8] George Addy, John Bodrug & Charles Tingley, "Abuse of Dominance in Canada: Reflections on 25 years of Section 79 Enforcement" [2012] Can Comp L Rev 2 at 302.

[9] National Competition Section, Canadian Bar Association, "Comment on Enforcement Guidelines: Abuse of Dominance" (May 2012) at 19, online: CBA <http://www.cba.org/cba/submissions/pdf/12-34-eng.pdf>; and CD Howe Institute Competition Policy Council, "The Distortive Power of AMPs: Why the Competition Bureau Must Clarify Its Stance on Administrative Monetary Penalties" (15 May 2012), online: CD Howe Institute < http://cdhowe.org/pdf/Report_of_CPC_May_2012.pdf>.

[10] Competition Bureau, "The Abuse of Dominance Provisions (Sections 78 and 79 of the *Competition Act*): Enforcement Guidelines" (20 September 2012), online: Competition Bureau <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03497.html>.

[11] Addy, Bodrug & Tingley, *supra* note 8 at 307. For earlier arguments regarding the constitutionality of AMPs for reviewable conduct under the *Act*, see John Laskin, "Administrative Monetary Penalties and Damages for Reviewable Conduct: Not So Fast!" (Paper delivered at the Competition Law Invitational Forum, Langdon Hall, Cambridge, 30 April 2003), [unpublished]; and letter from Peter Hogg to Retail Council of Canada (8 March 2005).
[12] *Act*, *supra* note 2, s 79(3.3).
[13] (1987), 37 CCC (3d) 385 (SCC) [*Wigglesworth*].
[14] *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act*, 1982, being *Schedule B to the Canada Act 1982* (UK), 1982, c 11 [*Charter*].
[15] *Wigglesworth, supra* note 13 at para 24.
[16] In a perfectly competitive market, any monopoly profits will be eroded by price reductions by competitive firms until the marginal cost of producing the last unit sold is equal to consumers' marginal benefit for that good (Q^S where MC=P(Q) in Figure 1). However, since a monopolist decides what quantity to produce and what price to charge, it need not take the market price as given. The monopolist can restrict quantity to support a price well above its marginal cost of production at that quantity. Facing a downward sloping demand curve, the monopolist will consider the reduction of the market price on the inframarginal quantity if production is increased by an additional unit. That is, when considering whether to produce an additional unit of a good, the monopolist considers two opposing effects: for an additional unit of production, revenue will increase by the price at which the additional unit is sold; however, an additional unit sold will reduce the market price received for the quantity up to that last unit. Consequently, "marginal revenue" (MR(Q)) decreases with increasing production quantity more rapidly than consumers' marginal benefit or "willingness to pay," represented by the demand curve (P=P(Q)). The resulting marginal revenue (MR(Q)) curve, shown in Figure 1, represents the benefit to the monopolist of producing a given quantity. The monopolist, acting rationally, will then set a price that maximizes its "monopoly profits" by producing a quantity of the good (Q^m) where marginal revenue is equal to its marginal cost of production (MC=MR(Q)).
[17] The "monopoly profits" reaped by the monopolist are distinct from the "accounting profits" that accrue to firms in a competitive market, compensating a firm's shareholders for their investments in the firm's capital at a market rate of return. Monopoly profits reflect the part of the consumer surplus that the monopolist has captured relative to the competitive counterfactual by imposing monopoly pricing.
[18] Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* (Toronto McGraw-Hill, 2000) at 34.
[19] For any rational theory (and credible threat) of predation, an incumbent must expect that it can recoup any losses suffered in the short-term by exploiting monopolistic pricing in the long-term to earn monopoly profits. The rationality of predation has been controversial theoretically and

somewhat inconclusive empirically. Since a predatory incumbent also incurs a loss by dropping prices, predation in a single, isolated market is only rational for an incumbent where the entrant or potential entrant faces some liquidity constraint such that it cannot withstand losses as long as can the incumbent – such as in the "long purse" predation model proposed by Jean-Pierre Benoit "Financially constrained entry in a game with incomplete information" (1984) 15 RAND J of Econ 4. As shown by Drew Fudenberg & Jean Tirole "Understanding Rent Dissipation: On the Use of Game Theory in Industrial Organization" (1987) 77 Am Econ Rev 176, liquidity constraints facing entrants or potential entrants can be explained by information asymmetries between firm management and creditors. If a lower-cost entrant could persevere against predation, it could reap profits in the resultant oligopolistic market; however, creditors have imperfect information about the entrant's costs. Indeed, the entrant itself may be uncertain about its production cost. Alternatively, certain theorists propose that predation may be rational in a multiproduct environment where a firm might develop a reputation for "toughness" by behaving in a "crazy" manner when faced with entrants in certain markets. See: P Milgrom & J Roberts "Predation, Reputation and Entry Deterrence" (1982) 27 J of Econ Theory 280; and D Kreps & R Wilson "Reputation and Imperfect Information" (1982) 27 J of Econ Theory 253.

[20] By acquiring a key supplier or downstream retailer, vertical integration may be used to deny a rival an essential input or increase its production cost, or to preclude access to a customer. The incumbent monopolist might be willing to pay a premium for the acquisition if it would maintain the monopoly.

[21] P Aghion & P Bolton "Contracts as a Barrier to Entry" (1987) 77 Am Econ Rev 388, provide such a model: A decentralized set of suppliers or buyers may recognize that a potential entrant has a lower cost of production than the incumbent and, if entering successfully, could reduce prices in the relevant market. However, if the potential entrant bears fixed costs for entry, it will require an adequate market share to make entry profitable. Consequently, if sufficient market share is not available for the entrant, its entry will be deterred. An incumbent could then offer customers a long-term contract at a price that is less than that which would prevail in a monopoly but greater than the competitive price.

[22] RSC 1985, c 19 (2nd Supp). The Tribunal hears matters in three-member panels comprised of both judicial and lay members, but a judicial member must chair the panel (*Ibid*, s 10). While only judicial members may determine questions of law, questions of mixed law and fact are determined by all panel members (*Ibid*, s 12).

[23] *Act*, *supra* note 2, s 79(1)-(2).

[24] *Ibid*, s 79(1).

[25] *Ibid*, s 78(1); *Canada (Director of Investigation & Research) v Nutrasweet Co* (1990), 32 CPR (3d) 1 (Comp Trib).

[26] Abuse of dominance was added as a reviewable practice when the *Act* replaced the *Combines Investigation Act*, RSC 1970, c C-23. Prior to this 1986 legislation, to knowingly assist in and form a monopoly constituted a criminal offence. The definition of "monopoly" required operation of a business "to the detriment or against the interest of the public." The criminal standard and the vague "public detriment" element made convictions difficult and the provision was largely ineffective.

[27] Predatory pricing had previously existed as a criminal offence prior to the *Act*'s 1986 enactment and was included as a criminal track offence under section 50(1)(c) of the *Act*. These provisions were removed in the 2009 amendments, following the recommendations in several reports and comments from the competition bar that the criminal track was inappropriate for such pricing practices.

[28] Direct evidence of subjective intent to lessen competition is not required and the reasonably foreseeable or objectively expected effects of the act can be used to infer intent (*Canada (Commissioner of Competition) v Canada Pipe Co*, 2006 FCA 233 at para 67 [*Canada Pipe*]). Notably, the Federal Court of Appeal in *Canada Pipe* (*ibid* at para 71, citing *Canada (Director of Investigation and Research) v Laidlaw Waste Systems Ltd* (1992), 40 C.P.R. (3d) 289 (Comp Trib) at 342) clearly links this attenuated burden of proof for subjective intent to the civil character of the reviewable practice and its remedies.

[29] The Federal Court of Appeal's determination in *Canada Pipe*, *supra* note 27 at paras 90-91, appears to impose an obligation for impugned parties to show that, prior to undertaking the practice, not only that they evaluated whether the conduct was a beneficial bargain for consumers, but that they optimized with respect to social welfare and eschewed self-interest.

[30] That is, if a pro-competitive act might be mistaken as anti-competitive but only face an injunction, a party deciding whether to undertake the conduct would likely still foresee some positive expected return. However, the "good" competition might require some upfront fixed cost and the pro-competitive act might then produce a negative expected return if the conduct could be erroneously labeled anti-competitive.

[31] Ralph A Winter, "Presidential Address: Antitrust restrictions on single-firm strategies" (2009) 42 Can J of Econ 1207-1239.

[32] *Ibid* at 1222, exhibits the practical difficulties with price-cost comparisons, citing *Canada (Commissioner of Competition) v Air Canada* (2003), 26 CPR (4th) 476 (Comp Trib). Here, Air Canada contested that many of the cost categories corresponded to avoidable costs on routes for which below-cost pricing was alleged, contending that many costs were offset on connecting routes. The matter concluded without a final decision when Air Canada filed for restructuring.

[33] Winter, *supra* note 31 at 1221-22, argues *R v Hoffman-La Roche*, (1980) 28 OR (2d) 164 (HCJ), aff'd (1981), 33 OR (2d) 694 (CA), illustrates this problem. Here, the court found predation under the now-rescinded section 50(1).

Winter contends there is an efficient explanation for the impugned conduct: to increase its market share of prescription purchases, the incumbent pharmaceutical company rationally lowered the price to hospitals of its brand-name drug, recognizing the low probability of patients switching to generics if prescribed the brand-name product in the hospital.

[34] Winter, *supra* note 31 at 1230.

[35] Albeit a challenge to a merger under s.92 of the *Act*, the role of probabilistic econometric estimations in identifying the relevant market and determining the prevention of competition is exemplified in the recent tribunal decision in *Commissioner of Competition v CCS Corporation*, 2012 Comp Trib 14, online: Competition Tribunal <http://www.ct-tc.gc.ca/>.

[36] William M Landes, "Optimal Sanctions for Antitrust Violations" (1983) 50 U Chi L Rev 652; and Gary Becker "Crime and Punishment: An Economic Approach" (1968) 76 J of Pol Econ 169.

[37] Monopolistic pricing imposes a social cost in the form of deadweight loss to the market. For optimal behaviour, the party must internalize the social cost of its behaviour. However, if the penalty is set only according to this deadweight loss, an incentive to act anti-competitively would remain where the expected economic profits exceed the deadweight loss. An incumbent monopolist would still behave inefficiently. In order to provide an effective deterrent to anti-competitive conduct *ex ante*, the party must anticipate that any economic profits will be disgorged. Moreover, extracting part of the counterfactual consumer surplus, these profits represent harm to consumers. As well, in a realistic scenario where the probability of detection is less than one and there are positive enforcement costs, the optimal deterrent would be increased inversely to the probability of avoiding detection.

[38] Landes, *supra* note 36 at 655-57. Landes' approach, following Becker, *supra* note 36, recognizes that the purpose of such penalties "is to deter inefficient offenses, not efficient ones."

[39] Indeed, in this example, a penalty of $2 million should fully offset any expected private benefit from undertaking the conduct. However, imposing a penalty equal to the reduction in consumer surplus (incorporating both the economic profits and deadweight loss) compels the party to bear the full social costs of its conduct. It might be justified as deterrence since forcing the party to internalize the resulting social costs corrects any incentive for inefficient anti-competitive conduct that reduces social surplus. Notably, following Landes, *supra* note 36, facing such a penalty, a party would still have incentive for efficient – even if anticompetitive – conduct.

[40] The $10 million and $15 million upper-bounds for the AMP quantum cannot cleanse its denunciatory basis. While it is entirely conceivable that actual past and future market impacts might exceed the $10 million threshold, an AMP determined on a basis that is not rationally connected to a market participant's incentives for acting anti-competitively would nonetheless serve to denounce, not simply deter, such conduct.

[41] As observed in *R v M(CA)*, [1996] 1 SCR 500 at para 81: "The objective of denunciation mandates that a sentence should also communicate society's condemnation of that particular offender's conduct. In short, a sentence with a denunciatory element represents a symbolic, collective statement that the offender's conduct should be punished for encroaching on our society's basic code of values as enshrined within our substantive criminal law."
[42] *Cartaway Resources Corp (Re)*, 2004 SCC 26 at para 52: "Deterrent penalties work on two levels. They may target society generally, including potential wrongdoers, in an effort to demonstrate the negative consequences of wrongdoing. They may also target the individual wrongdoer in an attempt to show the unprofitability of repeated wrongdoing. The first is general deterrence; the second is specific or individual deterrence ... In both cases deterrence is prospective in orientation and aims at preventing future conduct."
[43] *Ibid* at paras 60 and 64.
[44] *R v Cotton Felt Ltd* (1982), 2 CCC (3d) 287 (Ont CA) at para 10, indicates how a deterrent penalty should be calibrated: "Without being harsh, the fine must be substantial enough to warn others that the offence will not be tolerated. It must not appear to be a mere licence fee for illegal activity."
[45] [2004] 3 SCR 737.
[46] *Ibid* at para 62.
[47] 2010 FCA 200 [*U.S. Steel*], leave to appeal to SCC refused, 34389 (November 24, 2011).
[48] *Ibid* at paras 76-77.
[49] *Ibid* at para 74: "The case law has consistently drawn a distinction between penalties that aim to punish or denounce (penal) and penalties that aim to deter (non-penal)."
[50] RSC 1985, c 28 (1st Supp).
[51] In *U.S. Steel*, the penalties in question were imposed to compel compliance with specific undertakings under that particular statute (*supra* note 47 at para 53) and these penalties only accrued during the time that U.S. Steel was knowingly not complying with those undertakings (*ibid* at para 77).
[52] *Rowan v Ontario Securities Commission*, 2012 ONCA 208 [*Rowan*].
[53] *Ibid* at paras 54-55.
[54] *Ibid* at para 53. Sharpe JA then further emphasized the constitutional threshold from *Martineau*, stating that the key question is whether the fine "by its magnitude, is imposed for the purpose of *redressing a wrong done to society at large*."
[55] 2006 Comp Trib 32 [*Gestion Lekski*].
[56] *Ibid* at para 63.
[57] This was the maximum at the time of the decision. The 2009 amendments to the *Act* increased the potential AMP quantum for a corporation to $10 million for a first order and $15 million for a second order.
[58] *Ibid* at para 65.
[59] Stikeman Elliot, "Rogers Communications claims misleading

advertising case, AMPs violate Canadian Constitution" (2 March 2012), online: <http://www.thecompetitor.ca/2012/03/articles/competition/deceptive-marketing-practices/rogers-communications-claims-misleading-advertising-case-amps-violate-canadian-constitution/>; and Competition Bureau, "Competition Bureau Takes Action Against Rogers Over Misleading Advertising" (19 November 2010), online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03316.html>.

[60] As well, *Gestion Lebski* was decided before the addition of additional aggravating or mitigating factors in the 2009 amendments to the *Act*. These additional factors included " the gross revenue from sales affected by the conduct" and "the financial position of the person against whom the order is made." As argued above, gross revenue is not equivalent to the economic damage from anti-competitive conduct. Notably, an AMP for deceptive marketing practices was recently imposed in *Commissioner of Competition v Yellow Page Marketing*, 2012 ONSC 927. While the constitutionality of the AMP was evidently not challenged in that decision, rather than expressly calibrate the AMP to the damage, the trial judge applied the factors in a fragmented fashion to determine that the AMP "should be at the high end of the range" (see paras 65-59).

[61] However, where data around consumer behaviour is available, it is certainly conceivable that the economic impact from deceptive marketing practices could be more directly quantified (i.e. from estimation of consumer behaviour in a counterfactual without the practice). For instance, in *Commissioner of Competition v Sears Canada Inc*, 2005 Comp Trib 2, the Tribunal's decision records (and the expert witnesses provided) relatively extensive evidence about consumer behaviour in the relevant market for all-season tires (*ibid* at paras 195-220). This evidence concerned the nature of consumers' search for the product and consumers' perception of value. Although the respondent was "given leave to present evidence and make submissions at a future hearing relating to the factors to be taken into account" (*ibid* at para 387), the Tribunal ultimately imposed an AMP quantum of $100,000 (the then maximum for a first order against a corporation under the *Act*). However, the reasons for the AMP order do not disclose the application of the factors in order to determine the quantum (*Commissioner of Competition v Sears Canada Inc*, 2005 Comp Trib 13).