THE 2012 ABUSE OF DOMINANCE GUIDELINES: AN ECONOMIC REVIEW

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This article examines the Competition Bureau's recently re-issued Abuse of Dominance Enforcement Guideline (2012) from an economist's perspective. In particular, the author analyzes and critiques the Guidelines' contemplated use of future market shares in establishing dominance, their use of competitors' price-cost margins in establishing predatory pricing, and addresses concerns regarding the Guidelines' treatment of joint dominance, anti-competitive intent, and the scope of conduct that may be considered abusive.

Cet article examine la nouvelle version des Lignes directrices pour l'application des dispositions sur l'abus de position dominante (2012) dans la perspective d'un économiste. En particulier, l'auteur analyse et commente l'utilisation, prévue par les lignes directrices, des parts de marché futures pour déterminer s'il y a position dominante, et l'utilisation des marges bénéficiaires des concurrents pour déterminer s'il y a pratique de prix d'éviction. Il aborde aussi des questions soulevées par la façon dont les lignes directrices traitent la notion de position dominante conjointe, l'intention anticoncurrentielle et l'éventail de comportements qui peuvent être considérés comme abusifs.

I. Introduction

In September 2012, the Bureau finalized the new Abuse of Dominance Guidelines, outlining its general approach to enforcement actions under sections 78 and 79 of the *Competition Act*.[2] The 2012 Final Guidelines are essentially unchanged from the draft version released in March 2012 and replace earlier versions including the 2009 Draft Guidelines, 2001 Final Guidelines, and several industry-specific ones.[3]

The most obvious change in the new guidelines, whether in draft or final form, is that it is substantially shorter than its 2009 predecessor and excludes much of the previous discussion on anti-competitive acts.

This and several other key aspects have led to concerns about clarity and, in some cases, the appropriateness of the Bureau's approach.

Concerns were outlined in a May 2012 memorandum by Osler, Hoskin & Harcourt LLP:[4]

A. The shorter guidelines provide less guidance on what the Bureau considers to be anti-competitive acts likely to result in a substantial lessening of competition;

B. The Bureau's approach appears to deviate from appellate case law in not requiring that anti-competitive acts be directed at a competitor;

C. The Bureau is unclear as to the strength of linkages between competitors necessary for the Bureau to consider the competitors jointly dominant;

D. The Bureau's use of future market share in establishing dominance is outside the scope of the *Competition Act*;

E. The Bureau's use of price-cost margins of a predator's competitors in predation cases is inappropriate.

This article examines the economic principles underlying these concerns. Since the purpose of competition policy is to protect competition and improve economic outcomes for consumers, understanding the economics underlying them is important in evaluating whether the Bureau's approach in these regards is appropriate. The underlying economics shed light on which types of evidence would be useful and which may be misleading in an investigation, and whether a given act under a given set of circumstances is likely to be pro- or anti-competitive.

II. Concerns about the 2012 Guidelines

A. The Bureau Provides Less Guidance on Anti-Competitive Acts

One concern is that the 2012 Guidelines, as a general matter, are substantially shorter than the previous version and exclude most of the discussion of "anti-competitive acts." The Bureau says relatively little about which acts in or beyond 78(1) it suspects can substantially lessen competition, and which business justifications might be reasonable for different acts. Absent specifics on the Bureau's view, the concern is that a lack of clear guidance can potentially chill legitimate competition.

The previous 2009 Draft Guidelines do indeed contain more detail than the 2012 Guidelines. Seven pages of text and four appendices in the previous guidelines discuss potentially anti-competitive practices such as exclusive dealing, tying, and refusals to deal, along with potential pro-competitive business justifications and potential harmful consumer effects. It further discussed how past Tribunal and Court decisions have shaped the Bureau's view. In contrast, the 2012 Guidelines relegate the entire discussion of anti-competitive acts to a few paragraphs each on exclusionary and predatory practices. Examples of specific types of acts are now mentioned only in a list, and references to case law are few.

In principle, more guidance is preferable to less, but the key point is that the additional guidance must be clear and specific to be beneficial. With clear and specific guidance, firms can better gauge which practices and circumstances will give rise to Bureau concerns, allowing them to focus on pro-competitive practices and avoid litigation risks and costs. Additional guidance that is not as clear or specific can have the opposite effect—creating a larger grey zone of enforcement and potentially causing firms to avoid certain generally pro-competitive practices for fear of litigation risk.

Providing sufficiently clear and specific guidance on which practices are likely to be anti-competitive and under what circumstances in a few pages is a very difficult chore. The economics underlying them are complicated and every situation is unique from every other. In fact, almost every anti-competitive act in 78(1) could also be pro-competitive under different circumstances, and whether a substantial lessening of competition has occurred can only be determined by taking into account all factors unique to a case. Exclusive dealing, tying, most-favoured-nation (MFN) clauses, bundled discounting, price discrimination and refusal to deal are all examples of potentially pro-competitive acts, even by dominant firms. Predatory pricing is one example of an act typically considered anti-competitive, but many economists doubt that true predatory pricing exists except possibly in the rarest of cases.[5]

Seldom are two situations the same. As a result, bright line rules are difficult to draw. It would be convenient if one could dichotomize the acts and business justifications into clean boxes (i.e. either it "did occur" or "did not occur") and prohibit certain combinations of acts

and justifications, but allow others. In practice, however, the extent to which an act affects the marketplace and the legitimacy of a business justification for doing it is all a matter of degree. Whether competition is harmed or improved by a particular act in a particular set of circumstances ultimately comes down to an empirical question. It is not something that can be easily summarized in a set of enforcement guidelines.

The difficulty in providing clear and complete guidance is reflected in the 2009 Draft Guidelines. For example, the Bureau cautioned that exclusive dealing could anti-competitively cut off supplies to competitors; but this can often be pro-competitive too, for example, when it encourages investment by the contracting parties.[6] Tying and bundling practices could anti-competitively foreclose on a competitor, but this can often be pro-competitive too, for example, due to efficiencies or convenience reasons.[7] Most favoured nation clauses, bundled rebates, supply termination fees and long term contracts can all cause concern, but could also have potentially pro-competitive virtues. The discussion is potentially useful in thinking about issues at a very high level, but it lacks much of the specificity to reliably evaluate the risk of undertaking various practices in a specific situation.

With little case law to draw on, providing clear and specific guidelines is all the more difficult. Enforcement of the abuse of dominance provisions is a learning process. It is also an uneven learning process. Certain questions of law, such as how to interpret phrases such as "class or species of business" or "throughout Canada or any area thereof" come up in every case and the Bureau can be more confident of its general approach with respect to these. Other questions, like whether a specific act in a specific situation is likely to result in a substantial lessening of competition and whether a specific business objective justifies it arises less often. The Bureau is understandably less certain of what it will do. Over time, as new investigations, actions, and Tribunal and Court decisions add to the record, the Bureau's best practices will become clearer.

It seems prudent to include in the Guidelines those aspects of its enforcement approach which apply the most generally across cases and those about which the Bureau is most sure to follow. Guidelines, as a general matter, are intended to be long-lived documents (the last set

of comprehensive final Guidelines were in 2001). Firms should be able to rely, years out, that its text still largely represents the Bureau's view.

The 2012 Guidelines, while not uncontroversial, appear to move in this direction. It explains the Bureau's interpretation of specific phrases in the law. For example, the Bureau explains they equate "class or species of business" with product market definition and "throughout Canada or any area thereof" with geographic market definition. Both are general principles that are unlikely to change. The Bureau does not venture to discuss the many complicating factors that can arise in actually conducting the exercise.[8] The Bureau clarifies its general view that a "substantial lessening of competition" can manifest itself in lower entry or expansion, higher prices, less consumer choice or in other ways, but stops short of defining how it weighs these different outcomes or how large an effect it would consider "substantial." General principles are more likely to endure over time than discussions of specific acts and possible business justifications for those acts, especially in the absence of developed case law. Absent those extended discussions, the 2012 Guidelines is a more focused and succinct document.

However, in several places in the 2009 Draft, the Bureau did add some potentially useful specificity to its discussion of anti-competitive acts that is lost in the current guidelines. These include its view on aftermarket competition, and the specific conditions under which refusal to deals give rise to concern. It is not clear if these views have changed.[9]

Discussions of specific anti-competitive acts and possible justifications need not disappear from the record completely. While the Guidelines contain general and well established enforcement principles, there can be a second, more fluid document, discussing anti-competitive acts based on appendices II-V of the 2009 Draft. The new document could contain a history of enforcement actions and of investigations that did not lead to enforcement actions, be web-based, and updated on an ongoing basis. It could lay out the Bureau's ongoing views on matters, while not committing to them, and not diluting the main principles contained in the core Guidelines document.

To further assist firms in managing litigation risk, it may also be useful to consider implementing a pre-clearance program in which

the Bureau, upon voluntary request by a firm, conducts a preliminary review of a particular act or practice. It would offer a preliminary, non-binding opinion on its potential legality specific to the circumstances. To the extent it contained non-confidential information, the general issues involved could be made widely available.[10]

B. The Bureau Does Not Require Anti-Competitive Acts to Be Directed at a Competitor

The Bureau states in the 2012 Guidelines that "[w]hile many types of anti-competitive conduct may be intended to harm competitors, the Bureau considers that certain acts not directed at competitors could still be considered to have an anti-competitive purpose."[11] This appears to contradict the Federal Court of Appeal which ruled in *Canada Pipe* that "an anti-competitive act is one whose purpose is an intended negative effect on a competitor that is predatory, exclusionary or disciplinary."[12] In a May 2012 roundtable discussion, a Bureau official explained it did not want to restrict attention solely to acts directed at a competitor so the Bureau might pursue abuse of dominance cases against firms using facilitating practices to maintain a dominant position.[13]

If the goal of competition law is to promote efficiency and economic welfare, as economists widely agree it should, there is no reason in principle to limit anti-competitive acts to those directed at a competitor.[14] Any such act that harms consumer outcomes, whether or not beneficial to other firms, should be prohibited. Indeed, neither the U.S. nor the E.U. have a requirement that acts be directed at a competitor. Even in Canada, the FCA noted that 78(1)(f) is potentially an exception to that rule (it is unclear whether other exceptions to the rule, including those considered by the Bureau, are possible).[15]

The relevant question is—does requiring anti-competitive acts to be those directed at a competitor create a loophole that allows dominant firms to harm competition? What anti-competitive acts would harm competition and consumers, but not harm competitors? Except for collusive activity, mergers to monopoly, and ignoring excessive pricing (which is an abuse in the E.U., but not in Canada or the U.S.), virtually all anti-competitive methods of maintaining market power involve

harming other firms to some degree. At first glance, it would seem the requirement that acts be directed at a competitor may lose little in terms of protecting consumers and competition.

Collusive price or quantity fixing is an example of a practice that does not harm competitors, but does harm consumers and competition. It is obviously a serious matter and presumably would be dealt with under sections 45 or 90.1. Merger to monopoly is another example of an "abuse" that does not harm competitors, but it is a reviewable matter unlikely to be permitted.[16] In the E.U., "excessive pricing" is a prohibited abuse because it harms consumers even though it actually helps competing firms by weakening price competition. Canada and the U.S. do not prohibit "excessive pricing" since monopoly pricing by a monopolist is considered normal economic use of market power rather than an abuse of it.

The potential exception the FCA gives to the competitor harm rule in Canada is 78(1)(f) which prohibits "buying up products to prevent the erosion of existing price levels." This is unlikely to be an exception in practice. If the product in question is an input, and a dominant downstream firm buys up the input beyond its needs in order to prevent competitors from gaining access to it, this clearly hurts its competitors and falls within the definition of an anti-competitive act given the FCA. If, on the other hand, the product in question is an output that the dominant firm sells, inflating the price of its own product by buying it makes no economic sense. Buying up that product solely to increase its own selling price, though it helps competitors, is a money losing proposition for the dominant firm. If the point is to benefit its competitors, some type of consideration must flow in reverse.

The debate of what constitutes an anti-competitive act arises in part because section 78(1), entitled "Definition of anti-competitive act" is not actually a definition at all. Rather 78(1) is just a non-exhaustive list of examples of acts deemed anti-competitive.[17] All but one, 78(1)(f), are examples of acts directed at competitors.

If an economist is asked how to define an "anti-competitive act," as stated in 79(1)(b), a reasonable definition might be "an act that is anti-competitive," or using other language, an "act that substantially lessens competition"; however, this is the exact language of 79(1)(c), so

that under such a definition, 79(1)(b) would be redundant. Any act that satisfies 79(1)(c) would automatically satisfy 79(1)(b).

In *Canada Pipe*, the Tribunal used a similar definition of an anti-competitive act by basing it on whether the act led to a substantial lessening of competition, essentially co-mingling 78(1)(b) and 78(1)(c).[18] On appeal, the FCA ruled the Tribunal erred in doing so, and in keeping three distinct prongs of the three prong test, defined an act as one that had an intended negative effect on a competitor. The FCA's ruling would appear to pre-empt the Bureau's effort to use a broader definition, although the potential for other exceptions to that definition, like 78(1)(f), makes it less clear.

The restriction is a legal distinction. From an economics point of view, an act that substantially lessens competition, whether directed at competitors or not, whether intended to harm them or not, should be prohibited in one section or another of the law. The question remains what facilitating practices the Bureau has in mind that it would challenge under sections 78 and 79 that would not harm competitors. If such acts exist, there should be a mechanism to bring enforcement actions against it.

A final component in the definition of an anti-competitive act is that there must be an intent to harm. From an economics standpoint, the distinction has little meaning since almost everything a firm does is intended to harm its competitors, whether pro-competitive or anti-competitive. Ultimately competition and consumer outcomes matter, and these do not depend on intent. Nonetheless, intent is certainly important in criminal matters and also for monetary penalties if set with behaviour deterrence in mind.

C. The Bureau is Unclear about the Required Linkages to Establish Joint Dominance

Another concern in the 2012 Guidelines is a lack of clarity in the Bureau's approach to abuse of joint dominance. Joint dominance is based on the idea that several firms, collectively, may share market power and act to maintain that collective market power through anti-competitive means. The *Act* allows for joint dominance in 79(1)(a) which states that where "one *or more* persons substantially or completely

control...a class or species of business," those persons are considered dominant [emphasis added].

In its 2001 Guidelines, the Bureau stated that "something more than mere conscious parallelism must exist" for it to establish joint dominance.[19] In the 2009 Draft Guidelines, it more broadly stated "[w] here these firms are each engaging in similar practices alleged to be anti-competitive...the Bureau will consider these firms to hold a jointly dominant position."[20] In the 2012 Guidelines, the Bureau steps back and states that "parallel conduct by firms is not sufficient, on its own" and that it will consider factors such as the combined market shares of the firms, barriers to entry, and the extent of competition between firms in its determination.[21] The concern is the lack of clarity as to the degree of coordination or parallel conduct among potentially jointly dominant firms necessary to give rise to Bureau action.

Joint dominance is not a well-established concept as a matter of economics. Underlying it is the idea that large oligopolistic firms may refrain from competing with one another and instead combine efforts to exclude other firms from the market, yet not necessarily colluding to do so. It can be thought of as "collusion but not collusion."

Except in cases where oligopolists are found to be explicitly colluding, joint dominance enforcement runs a substantial risk of doing more harm than good. Parallel pricing and other parallel behaviours have often been cited as evidence that oligopolists are acting in concert and that, if engaged in potentially anti-competitive acts, joint dominance provisions should apply. However, in reality, parallel behaviours are fully consistent with competitive oligopolistic markets and limiting the types of acts competing oligopolists can undertake has the potential to chill legitimate competition.

Parallel pricing is a well known outcome of oligopolistic competition, and the economics of oligopolistic competition is well established.[22] Oligopolistic industries differ from others in that they consist of just a few large firms, and perhaps a fringe of much smaller ones. Because there are few, actions taken by a single oligopolist—pricing, output, R&D, for example—impact not only on its own profits, but also the profits of every other oligopolist. Therefore each must pay attention to what its competitors in the market are doing—to do otherwise would

be irrational. Each anticipates the actions of others, and responds to those actions when they occur. This interdependence gives rise to consciously parallel behaviour through competition. In fact, if an oligopolist were to make prices and output decisions ignorant of other firms in the market, it would likely fail in time. Parallel behaviours should not, by itself, give rise to joint dominance concerns.

At the other extreme, where there is actual evidence that firms are explicitly colluding, joint dominance would apply but enforcement under Sections 78 and 79 would seem unnecessary. Explicit collusion is condemned the world over for its anti-competitive effects, and is an offense under section 45 and subject to civil provisions under section 90.1. If colluding firms have a collectively dominant market share, they could surely replicate the harm done by a single dominant firm and would be jointly dominant. However, joint dominance is the secondary problem here, and presumably the cartel would be the first target of Bureau activity. Once dismantled, issues of abuse of joint dominance under Sections 78 and 79 become moot.

Finally there is the "in-between" case when there is no evidence of explicit collusion, but the parallel behaviours are so pervasive that "tacit collusion" between firms is suspected. "Tacit collusion" is the idea that oligopolists can replicate the outcome of an explicit collusive agreement without an explicit agreement at all, but rather through repeated market interaction, price signaling, and other types of cooperative signaling.[23] If several large firms are tacitly colluding, even if not illegal in its own right, they could then be jointly dominant.

As a matter of economics, tacit collusion sufficient to replicate an explicit agreement is likely rare. Even explicit collusive agreements, with terms clearly laid out, are difficult to maintain. "Tacit" agreements, in contrast, must be arrived at through indirect, imprecise, and often very public communication. If it were to occur, it may take a leader-follower form, where a single leader initiates price movements and others avoid known retaliation by quickly following, so that actions are parallel. However, it is more likely that one confuses legitimate oligopoly competition and parallel behaviours with the notion of tacit collusion.

There are several problems in applying joint dominance provisions to suspected tacitly collusive firms. First, and most obviously, there is no discrete distinction between consciously parallel behaviour and tacit collusion. Typically they are indistinguishable. Applying joint dominance to suspected tacitly collusive firms, which may be speculative to begin with, necessarily means applying joint dominance to other oligopolistic competitive industries where parallel pricing is competition based. There is a high potential for chilling legitimate competition.

The second problem is that 79(1)(a) can always be satisfied by including enough parallel behaving firms into the jointly dominant group until the requisite market share is reached. As such, firms in many industries that practice "anti-competitive acts" could in principle be subject to litigation risk under joint dominance in spite of having no real market power at all.

By restricting the types of actions firms can independently undertake when competing for customers, the Bureau's actions may in fact weaken competition among the largest, most efficient firms, in order to provide protection for smaller, less efficient ones.[24] If the goal of competition law were to promote small business participation, this would be consistent with that, but where the goal is to improve consumer prices and outcomes, there is a significant risk of dampening competition among the strongest competitors.[25] Which would be more competitive: three large and aggressively competing oligopolists with no other competitors or three weakly competing oligopolists and a fringe of small and inefficient competitors? Often it will be the former. This concern was echoed in a 2007 speech by Gerald Masoudi, then Deputy Assistant Attorney General at the DOJ, in discouraging the Chinese from adopting a joint dominance provision. He recommended restricting joint dominance for cases of explicit collusion, but then handling such matters under appropriate anti-collusion statutes.[26]

Given the economically weak notion of joint dominance, U.S. courts have rejected the idea and agencies no longer pursue joint dominance cases. In the E.U., TFEU Article 102 contains similar language to the *Competition Act* prohibiting abuse of a dominant position by "one or more undertakings."[27] The ECJ has stated that firms must act as a "collective entity" to be jointly dominant.[28] Although it is unclear exactly how strong the links must be to qualify, it is beyond mere parallel

behaviour and something closer to tacit collusion.[29] In Canada, case law is undeveloped adding to the uncertainty in enforcement in this area.[30]

D. The Bureau's Use of Future Market Share is Outside the Scope of the *Act*

Another concern in the 2012 Guidelines is that the Bureau may use future market share instead of current market share in establishing dominance. As section 79(1)(a) is written in the present tense, the Bureau's enforcement plan would seem broader than that permitted by law.

Putting aside the letter of the law and considering the economic merits, if the goal is to prohibit anti-competitive behaviours resulting in a substantial lessening of competition, taking into consideration future market shares as well as current market shares would *prima facie* seem reasonable. In some cases, when market shares change little over time, the issue is moot. In other cases, following mergers or bankruptcies especially, future market shares may differ markedly and the Bureau would be able to pre-empt acts by soon-to-be dominant firms. Given the administrative lag between initiation of an action and its resolution, this could prevent the harm that would otherwise occur by a newly dominant firm while enforcement proceedings were in progress.

In practice, however, two problematic issues can arise. First, there is considerable uncertainty in predicting and using the future market share of a potentially dominant firm. Given the difficulties and disputes inherent in determining current market shares, which are dependent on imprecise market definition exercises, predicting future market shares is that much more speculative. If used, there should be little uncertainty how future market shares would compare to current ones.

Second, and more importantly, the use of future market shares creates a potentially undesirable double standard of enforcement. It creates one dominance threshold for stable or entrenched firms and a lower one for growing or more innovative firms.

To see this, dominance under 79(1)(a) occurs when a firm "substantially or completely controls...a class or species of business," where the term "substantially" is left undefined. The Bureau generally uses (current) market shares to measure control and, in contested abuse cases, a market share of at least 65% or more is typical.[31] Invariably, market shares are estimated very noisily to begin with, and the cut-off threshold for when a firm is large enough to be considered dominant is necessarily an arbitrary distinction.

Imagine the Bureau takes the simple view that "substantially controls" means 65% or more of the market share. If a firm has a 45% market share currently, which is expected to rise to 65%, the Bureau may take action. For another firm, whose share is stable and equal to 60%, no action is taken. The result is that an identical act in an identical current situation would be potentially challenged for a firm with a market share of 45%, but not for a firm with 60%—a different *de facto* standard for growing firms than for stable firms. Demonstrated by their growth, the former group is often the strongest source of competition and innovation and caution must be taken not to apply a tougher standard to these firms, especially when its growth is organic.

Throughout, one must always bear in mind that what ultimately matters from an economics point of view is whether the act substantially lessens competition. Therefore appropriate action should have less to do with rough measures of market shares (and inferences of market power) under 79(1)(a) and more to do with whether a practice results in a substantial lessening of competition under 79(1)(c). Having said that, in spite of the inherently imprecise nature of market share calculations, 79(1)(a) can still be of some value as a simple safe harbor screen.

E. The Bureau's Use of Price-Cost Margins of a Predator's Competitors is Inappropriate

In the Guidelines, the Bureau states that in predation cases it will examine, in addition to the alleged predator's price-cost margins, "whether the alleged predatory price can be matched by competitors without occurring losses."[32] The concern raised is that evaluation of the price-cost margins of competitors, rather than just the predator, is contrary to standard tests of predatory pricing. The economics on this

point is clear—whether the alleged predatory price can be effectively matched by competitors is not sufficient for determining predation.

The theory of predatory pricing is one that receives more legal attention than economic attention.[33] In fact, most economists doubt the existence of predatory pricing strategies in practice except, if at all, in very rare cases.[34] As the theory goes, a predator with deep pockets sets its prices below its own costs and suffers losses in the short run. It squeezes competitors' margins until they eventually leave the marketplace. In the long run, assuming there are barriers to entry preventing previously existing competitors from re-entering the market, a strong assumption, the predator recoups its short run losses and now earns monopoly (or near-monopoly) profits to the detriment of consumers.

The anti-competitive nature of predatory pricing is based on the fact that a predator acts against its own short run interest by pricing below (marginal) cost and taking losses in order to eliminate competition in the long run. Losing money in the short run is not a rational strategy without the expectation of long run recovery after the competition is anti-competitively eliminated.

A predatory pricing test generally has two prongs. The first is a test of the price-cost margin of the alleged predator. These costs are necessarily the costs of the alleged predator, not of the competitor. It generally needs to be shown that the alleged predator is pricing below its own marginal cost, or a related measure.[35] The second prong is either to establish that the predation was successful in eliminating competition and generating more than compensatory long run profits, or, before that happens, that market conditions and barriers to entry are such the predator is likely to eliminate competition, keep it out, and reap long run profits.[36]

It is both rational and perfectly pro-competitive for an alleged predator to undercut the price of its competitor down to and even below its competitor's cost, providing it is not itself pricing below its own cost. The competitor could lose money and go out of business, but this is still not predatory. Rather, this is the very competition that competition law is designed to encourage.

For example, imagine the alleged predator's costs are below the competitor's costs. If predation were ever a profitable strategy in the long term, this would be the more likely scenario. In this case, pricing below the competitor's cost (but above its own) drives that competitor out of business, but only because the competitor is less efficient and cannot compete in its own right under fair terms. Rather than being anti-competitive, this is the purest example of meeting and beating the competition and should not be confused with predation. The alleged predator has attained the position of a dominant firm by being the most efficient, the most innovative, or both. The fact that the competitor cannot match the alleged predatory price is immaterial.

Now imagine the alleged predator's cost above that of the competitor. In this more unlikely scenario, the predator would have to price further below its own cost in order to price below its competitor's cost as well. Because the predator prices below its own cost, it already satisfies the first prong of the predatory pricing test regardless of the competitor's cost.

Whether a high cost predator could satisfy the second prong of the test—that it could force an exit and recoup its short term losses in the long run—is more complex. Here, the Bureau could potentially use the competitor's price-cost margins in a limited way—as a rough secondary screen to possibly rule out predatory pricing. If, following the alleged predation, the predator makes losses, but the competitor's price-cost margin is still sufficiently high that it is unlikely to exit the market, the alleged predation strategy is unlikely to have been predation at all. However, the test has limited power—even if costs could be measured well, the competitor's price-cost margins need not go negative to induce its exit. Competitor margins and profits need be decreased only by as much as necessary to make the competitor exit this particular market and choose to reinvest its capital in a better alternative. Moreover, in differentiated goods markets, or where the qualities of the firms' products differ, prices among the firms will naturally differ, and the question of whether a competitor can match the alleged predator's price is not as relevant.

As a general matter, predatory pricing actions must proceed with extreme caution. First, as is well known, marginal costs and corresponding margins can be difficult to estimate with accuracy and competitive

pricing can potentially be mistaken as predatory. The more competitive a market and the closer prices are to costs, the greater the potential for error. Second, even if costs were known, prices are often below cost for promotional reasons, as loss leaders, or for other reasons that do not cause competitive harm. Third, even where predation is suspected, the question of whether a predator could realistically recover its losses in the long run is often very speculative.

Importantly, complaints of predatory pricing are often brought by firms whose margins are being squeezed by other stronger, more efficient firms, and are seeking a legal prohibition protecting them from their competition. To prohibit any firm from pricing below the costs of another competitor, but above its own costs, is essentially to prohibit that firm from competing. More than most anti-competitive acts, actions against suspected predators based on noisy measures of price-cost margins have a substantial risk of misdiagnosis and, by ordering higher prices, a very real possibility of harming competition.

III. Conclusion

The 2012 Abuse of Dominance Guidelines represent an important tool in assisting firms and their counsel to forecast the Bureau's enforcement approach and better comply with the provisions of the *Act*. In many ways it improves and updates the 2009 Draft Guidelines, but many questions remain. The brevity of the 2012 Guidelines relative to its predecessor, in particular the exclusion of the detailed discussion of types of anti-competitive acts likely to substantially lessen competition, have caused some concerns about the clarity of the Bureau's approach going forward. Other questions have arisen with regards to its approach to anti-competitive acts, joint dominance, future market shares in establishing dominance, and tests for predatory behaviour.

This article discussed the economics underlying these questions. As competition law is rooted in economic principles, understanding the economics can help us understand which types of acts are likely to harm competition and those which, under different circumstances, will not. It helps us understand the types of evidence that are appropriate and not appropriate for determining whether a particular abuse has occurred.

One of the greatest challenges in assembling a meaningful set of Abuse of Dominance Guidelines, and a source of contention here, is how much guidance is valuable and meaningful going forward and how much remains on the speculative side, especially given the lack of case law in the area. The 2012 Guidelines, relative to its predecessors, is a more succinct document that focuses on established enforcement principles and shies away from more controversial or speculative questions. Those questions still need to be answered, of course, but cannot be answered well today. Only with additional economic analysis of specific acts and additional case law in the area will the uncertainty over appropriate enforcement under sections 78 and 79 of the *Act* gradually decrease over time.

Endnotes

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[2] Competition Bureau Canada. "Abuse of Dominance Provisions (Sections 78 and 79 of the *Competition Act*)," September 2012. ("*2012 Guidelines*")

[3] Competition Bureau Canada. "Abuse of Dominance Provisions (Sections 78 and 79 of the *Competition Act*)," Draft, March 2012. ("*2012 Draft Guidelines*"); Competition Bureau Canada. "Abuse of Dominance Provisions (Sections 78 and 79 of the *Competition Act*)," Draft, January 2009. ("*2009 Draft Guidelines*"); Competition Bureau Canada. "Abuse of Dominance Provisions (Sections 78 and 79 of the *Competition Act*)," 2001 ("*2001 Guidelines*")

[4] Osler, Hoskin & Harcourt. "Comments on the Competition Bureau's 2012 Draft Updated Abuse of Dominance Guidelines," memorandum, May 2012. ("*Osler*")

[5] DiLorenzo, T. "The Myth of Predatory Pricing," CATO Policy Analysis Paper 169, 1992. ("*DiLorenzo*")

[6] 2009 Draft Guidelines, *Supra* note 3, at 32.

[7] *Ibid* at 35 (noting that cars are generally sold with four tires included).

[8] 2012 Guidelines, *supra* note 2 at 3. The Bureau cites use of the hypothetical monopoly test (HMT) for market definition. The test has fallen out of favor by agencies in the U.S. and in some other jurisdictions. In practice, the test is rarely performed empirically, and market definition is often based on qualitative rather than quantitative argument.

[9] The Bureau stated aftermarket competition was of little concern since a relevant market cannot contain a single product. 2009 Draft Guidelines, *supra* note 3 at 36. It also stated that only when vertically integrated suppliers refused to deal with potential downstream competitors was it concerned with refusal to deal practices. 2009 Draft Guidelines, *supra* note 3 at 39.

[10] Such a program would likely require substantial resources to implement.
[11] 2012 Guidelines, *supra* note 2 at 11.
[12] *Commissioner of Competition v. Canada Pipe Company Ltd./Tuyauteries Canada Ltée,* 2006 FCA 233 at para 77 ("*Canada Pipe").*
[13] Osler, *supra* note 4 at 5.
[14] If the goal of competition policy were solely to protect competitors, then such a rule is clearly consistent with that goal.
[15] Most abuse of dominance provisions in the U.S. are covered under Section 2 of the *Sherman Act* (1890) (monopolization and attempted monopolization), the *Clayton Act* (1914) (mergers, exclusive dealing, tying/bundling, mergers, price discrimination), and the *Robinson-Patman Act* (1936) (price discrimination). In the E.U., it is covered under Article 102 of the Treaty for the Functioning of the European Union (TFEU).
[16] In *Laidlaw*, the Tribunal considered Laidlaw's practice of buying up competitors an anti-competitive act and dismissed its claim that its merger activity should be evaluated under Section 91 of the *Act. Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.) ("*Laidlaw")*
[17] The Competition Tribunal confirmed in *Nutrasweet* the list of acts in 78(1) are not exhaustive. *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) ("*NutraSweet").* A list of acts considered potentially anti-competitive by the Tribunal is given by Goldman, S. "Abuse of Dominant Position – The Canadian Approach," European University Institute, 2003 EU Competition Law and Policy Workshop/Proceedings, 2003.
[18] The FCA also ruled in *Canada Pipe* that the Tribunal erred in its evaluation of 79(1)(c). "It is not the absolute value of competition in a market which must be substantial, but rather the preventing or lessening of competition that results from the impugned practice must be substantial." *Canada Pipe, supra* note 12 at para. 36 An economic comparison of real world outcomes to the but-for outcomes, absent the anti-competitive act, is necessary to evaluate the effect of the act on competition.
[19] 2001 Guidelines, *supra* note 3.
[20] 2009 Draft Guidelines, *supra* note 3 at 15.
[21] 2012 Guidelines, *supra* note 2 at 10.
[22] See, for example, Carlton, D. & Perloff, J. Modern Industrial Organization, 4th ed., Prentice Hall, 2005 and Tirole, J. The Theory of Industrial Organization, Cambridge, MA: MIT Press, 1988.
[23] Vitzilaiou, L. & Lambadarios C., "The Slippery Slope of Addressing Collective Dominance Under Article 82 EC" *The Antitrust Chronicle* (October 2009), at 8.
[24] A distinction could be made if the acts harm firms outside the jointly dominant group but do not harm those within the jointly dominant group.
[25] Section 1.1 of the *Competition Act* explicitly sets as one of its goals "that

small and medium sized enterprises have an equitable opportunity to participate in the Canadian economy."

[26] Masoudi, Gerald. "Some Comments on the Abuse-of-Dominance Provisions of China's Draft Antimonopoly Law," UIBE Competition Law Center Conference on Abuse of Dominance: Theory and Practice, Beijing, China, July 21, 2007, transcript of speech.

[27] TFEU, Article 102.

[28] Joined cases C-395/96P and C-296/96P, *Compagnie maritime belge transports SA (C-395/96P), Compagnie maritime belge transports* SA (C-396P) and Dafra-Lines A/S (C-396/96P) v. Commission of the European Communities, 2000, ECR, I-1365 ("*Compagnie Maritime Belge*");

[29] Gudofsky, J., Kriaris, E.L., and Vital, L. "Abuse of Joint Dominance: Is the Cure Worst than the Disease?," Canadian Bar Association 2010 Annual Competition Law Conference, at 16.

[30] Several joint dominance matters were settled with the Bureau. *Bank of Montreal et al v. The Director of Investigation and Research (CT-1995-002) ("Interac"); Canada (Director of Investigation and Research) v. AGT Directory Ltd. (CT-1994-002) ("AGT"); Waste Services (CA) Inc. and Waste Management of Canada Corporation (formerly Laidlaw Waste Systems Ltd.) v. The Commissioner of Competition (formerly the Director of Investigation and Research) (CT-2009-003) ("Waste Management")*

[31] In the Guidelines, the Bureau states that market share is "one of the most important determinants of market power" and that "a market share of 50 percent or more will generally prompt further examination." 2012 Guidelines *supra* note 2 at 9. The Bureau considers other factors as well including the distribution of market shares across other firms.

[32] 2012 Guidelines, *supra* note 2 at 13.

[33] The theory was popularized in McGee, J. "Predatory Price Cutting: The Standard Oil (N.J.) Case," *Journal of Law and Economics* 1: pp. 137-169.

[34] DiLorenzo *supra* note 5.

[35] Marginal cost is a superior measure to average variable costs or average total costs for this purpose, and the average avoidable cost measure often used by the Bureau is closely related to marginal costs.

[36] Joskow, P. & A. Klevorick, A. "A Framework for Analyzing Predatory Pricing," *Yale Law Journal* 89: 213, 1979.