The Abuse of Joint Dominance

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1. INTRODUCTION

The central purpose of antitrust law in a market economy is to align firms' incentives with the social interest by encouraging vigorous competition within markets. More competitive markets generally produce better outcomes because prices are closer to marginal cost and the appropriate qualities and product varieties are typically offered as well. Where prices remain above marginal cost because of a lack of competition in a market, the net social benefits of the market are reduced: individual units of a good that are valued more than the cost of production could be exchanged but are not, thus lowering social surplus.

Well-designed antitrust laws, apart from regulating mergers, constrain anticompetitive conduct on the part of firms. Conduct is restricted mainly in two areas. In the area of cartels or horizontal collusion, antitrust laws (in Canada, section 45 of the *Competition Act*) limit the exercise of market power through prices that are excessive as a result of explicitly coordinated action among competitors. In the Abuse of Dominance sections (mainly section 79 of the Canadian *Competition Act*) the laws constrain strategies that lessen competition by excluding rivals from a market, disadvantaging rivals by raising their costs, or inducing their exit through predatory strategies. In Canada, the Tribunal can make an order to remedy conduct that is exclusionary, disciplinary or predatory with the effect of a substantial lessening of competition.[1]

This paper analyzes the law and economic foundations of an area of antitrust law at the intersection of abuse of dominance and cartels: the abuse of joint dominance. Abuse of joint dominance refers to anti-competitive conduct not by a single dominant firm but by a group of firms with a collectively dominant

[1] *Director of Investigation and Research v. NutraSweet Co*. (1990), 32 C.P.R. (3d) 1 (Comp.Trib.)

market share. The firms in an abuse of joint dominance case are not constrained by competition within the group, perhaps because of tacit coordination; nor, perhaps because of strategic behaviour, are they constrained by competition from outside the group. An exclusionary abuse of joint dominance involves generally the same strategies as single firm abuse of dominance – exclusionary strategies, raising rivals' costs, disciplinary strategies or predation – but in joint dominance cases these strategies are adopted by firms in an oligopoly rather than a single dominant firm.

To this set of exclusionary, predatory or disciplinary strategies one can add "facilitating practices", strategies that if adopted by all firms in a cartel render the cartel more stable. Facilitating practices, as the name suggests, facilitate the exercise of market power rather than representing the abuse or exercise of market power directly. These practices can obviously be harmful and may be best dealt with under the joint abuse area of antitrust law, as we discuss.

This is an opportune time to review the law of the abuse of oint dominance and outline the economic foundations of optimal policy in this area. As we discuss in the next section of this paper, Canada, the U.S. and Europe all take different approaches to Abuse of Joint Dominance, and Canada's approach has changed between the 2001 Guidelines on Abuse of Dominance and the 2009 Draft Guidelines on Abuse of Dominance. An independently (not explicitly coordinated) but jointly adopted strategy in an oligopoly that might abuse joint dominance was not an antitrust violation in the 2001 Canadian guidelines but is in 2009; an independently but jointly adopted facilitating practice was a possible violation in the 2001 Canadian guidelines but is not in the 2009 draft guidelines. Neither independent facilitating practices nor independent abusive practices by non-individually-dominant firms are antitrust infringements in the U.S., and in Europe, independent facilitating practices are a possible infringement and there is controversy whether independent abusive practices by firms that are jointly dominant infringe the EC Treaty. The law in this area varies both across jurisdictions and over time. This variation reflects the lack of consensus on the optimal policy in this area, which arises in turn, we suggest, from the lack of a clear economic framework. The need for analysis of the variation in the law and for an economic framework as a foundation for policy is clear.

Given its position at the intersection of antitrust laws against collusion and against abuse of dominance, the design of optimal regulation on abuse of joint dominance inherits the challenges of both areas. This paper begins in the next section by reviewing these challenges. In seeking to explain exclusionary contracts, for example, an economic theory of joint abuse of dominance must explain why it is in the combined interest of seller(s) and buyers to enter into these contracts. The traditional view that a dominant firm can impose these contracts on buyers with few alternatives is wrong. Another challenge is that contracts which can be exclusionary (exclusivity contracts or simply long term contracts) are at least 99.9 percent of time adopted for efficiency reasons. A theory must provide guidance as to the type of evidence sufficient to justify an abuse case. In the second area, horizontal agreements or coordination, oligopolists successfully maintaining high prices almost never have legally binding agreements, and often have no explicit agreements at all. Each member of the oligopoly can potentially benefit from cheating on the cartel pricing, since by lowering its price the firm can sell more units at a significant profit. Why then do supra-competitive prices survive in an oligopoly? Is there anything antitrust can do about this; that is, are there meaningful remedies?

An exclusionary abuse of joint dominance case involves an oligopoly that is coordinating on prices or other dimensions of contracts, either implicitly or explicitly, in a market in which barriers to the entry by non-cartel members are not inherent or exogenous. Cartel members not only coordinate on higher prices but also implement exclusionary strategies such as exclusionary contracts or predation. An oligopoly that exercises joint dominance and adopts exclusionary strategies must deal with two kinds of "free-rider" problem. As noted above, there is a tendency for each firm to cheat on an implicit or explicit agreement on prices by cutting price and selling more (that is, each firm is tempted to free ride on the high prices of others). Additionally, it may appear that any one firm need not incur the expense of engaging in exclusionary strategies, but instead can free-ride on the exclusionary efforts of other firms. Can this additional free-rider problem be overcome? In other words, is it far-fetched to theorize that firms in an oligopoly can coordinate on both prices and entry-deterrence strategies? If not, then exclusionary abuses of joint dominance should as a matter of theory not be important. We argue that anticompetitive exclusionary or predatory strategies on the part of an oligopoly cannot be ruled out. It can be profitable even in a narrowly self-interested sense (without regard for the threat of retaliation) for individual firms to engage in exclusionary practices. And in a wider set of circumstances, a complementarity arises between strategies that facilitate the coordination of a cartel and the exclusion of potential entrants to a market that would discipline the cartel: the same strategies can be successful in both maintaining high prices and deterring entry. We provide in this paper the main insights that economic theory offers with a high-level outline of the logic. We analyze a case , *The Commissioner of Competition and Waste Services (CA) Inc. and Waste Management of Canada Corporation*, CT 2009-003. ["*Waste Services*"] based on facts that can be inferred from the consent agreement in this case, which supports the predictions of the theory.

We referred above to two reversals in the Competition Bureau's position on Joint Abuse in their 2009 Guidelines from the 2001 Guidelines. The new position on independent, i.e. not explicitly coordinated, abusive exclusionary practices finds support in our analysis. Explicit coordination of exclusionary practices is not necessary as there are good reasons to believe that implicit coordination of these practices is possible. The new position on facilitating practices is one to which the Bureau is constrained by the statute and precedent. But the statute and precedent are wrong on this point in that they exclude from antitrust scrutiny anticompetitive practices that the law may potentially remedy.

2. THE LAW ON JOINT ABUSE OF DOMINANCE

Canada, the US and the EU each take different positions on abuse of dominance by a group of oligopolists. There are two questions on which we focus: how does the law respond to facilitating practices? And how does the law respond to joint exclusion? Such a focus is motivated in part by recent developments in Canada, as we explain.

a. Canada

Canada has recently changed its approach to both questions. Section 79 of the *Competition Act* allows the Competition Tribunal to make an order where a dominant firm or firms engage(s) in a practice of anticompetitive acts that have the effect of substantially lessening competition. Only a handful of contested cases have been brought under this provision since its adoption in 1986, so the Competition Bureau has promulgated guidelines to give the competition community a sense of its approach to the matter. Such guidelines are not legal authority, nor are they even binding on the Bureau itself.[2] Nevertheless, the Competition Bureau plays a very important role in enforcing the law, particularly on matters such as abuse of dominance in which the Commissioner of Competition is the sole party with standing to complain before the Tribunal about a possible abuse. If the Commissioner does not consider a particular practice an abuse of dominance, this is the final say on the matter since private parties have no capacity to argue otherwise before the Tribunal or the courts. If the Commissioner does consider a particular practice by a firm or firms to be an abuse of dominance, the firm or firms in question have the choice of negotiating with the Commissioner or engaging in costly, lengthy litigation. Many choose the former; there have been only 5 contested abuse cases since 1986. If the Bureau and the parties negotiate a consent order, under s. 105 of the Act this order is as binding

[2] In *Superior Propane*, the Competition Bureau deviated from its own *Merger Enforcement Guidelines* in arguments before the Competition Tribunal.

as if it had been rendered by the Tribunal. It is thus apparent that the views of the Bureau in its guidelines are of great significance even if they do not have formal legal authority.

In *Enforcement Guidelines on the Abuse of Dominance Provisions* (2001), the Competition Bureau stated that it would potentially consider the adoption of facilitating practices under the abuse of dominance provisions of the *Competition Act*. If facilitating practices serve to support supra-competitive pricing, the Bureau took the position that they could invite an order under s. 79. In its *Draft Updated Enforcement Guidelines on the Abuse of Dominance Provisions (Sections 78 and 79 of the* Competition Act*)* (2009)*,* the Bureau rejects this approach. Building on prior case law, the Bureau's view of "anti-competitive acts" is limited to those acts which have an "exclusionary, predatory or disciplinary" negative effect on a competitor.[3] Facilitating practices have a beneficial effect on competitors and are thus omitted from the scope of s. 79.

The Bureau also reverses course on a second potential abuse of joint dominance where firms independently but in parallel adopt practices that exclude other firms from the market. In the 2001 *Guidelines*, the Bureau noted that the case law to that point had only considered exclusionary joint dominance in settings where joint dominance was obvious owing to an agreement between the parties. In *Interac*, for example, a consent order was made against a group of banks that had acted collectively through the Interac association to exclude other banks from participating in the network. The Bureau at para. 3.2.1 of the 2001 *Guidelines* analogizes to explicit agreements in cartels and concludes that "something more than mere conscious parallelism must exist before the Bureau can reach a conclusion that firms are participating in some form of coordinated activities. The ability of a group of firms to coordinate actions without entering into an explicit agreement can be addressed under the abuse provisions." Thus, it is apparent that coordination is required under the 2001 *Guidelines* to ground a

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[3] See, e.g., *NutraSweet*.

finding of joint dominance, and coordination requires something more than mere conscious parallelism.[4]

In the 2009 *Draft Guidelines*, in contrast, the Bureau makes no reference to coordinated action in assessing joint dominance. Rather the test for joint dominance is based on the firms' actions and market conditions themselves without regard to coordination. The Bureau states at para. 3.2.1(d): "[W]here these firms are each engaging in similar practices alleged to be anti-competitive, and they appear to together hold market power based on their collective share of the market, barriers to entry or expansion, and other factors…, the Bureau will consider these firms to hold a jointly dominant position."

The decision by the Bureau not to require coordination in assessing joint dominance is not simply of academic significance. It recent entered into a consent agreement with Waste Services (CA) Inc. and Waste Management of Canada Corp. that requires both firms to cease including a variety of terms, including exclusivity and high liquidated damages terms, in their contracts with customers. Neither Waste Services nor Waste Management is dominant in their own right, but together the consent agreement reports that they held 80% of the market. Nothing in the consent agreement suggests coordinated actions on the part of the firms. It is apparent that their collective market share and the exclusionary effect of their contracts were sufficient for the Bureau to make an order. We discuss this case in detail below.

In summary, the Canadian Competition Bureau until recently considered facilitating practices as potentially abusive of joint dominance, but now does not, and until recently required coordinated action beyond conscious parallelism among oligopolists to find joint dominance, but now does not.

[4] See Davies Ward Phillips & Vineberg LLP, "Canadian Competition Bureau Steps Up Enforcement against Joint Abuse of Dominance" (June 18, 2009) at p. 2: "[T]he Bureau's current abuse of dominance enforcement guidelines clearly indicated that some form of coordinated activities – at least more than consciously parallel conduct – would be required to establish joint control of a market."

b. U.S.

The U.S. law on facilitating practices and joint exclusionary practices is straightforward. In the absence of an agreement between the oligopolists, there will not be an order against either type of practice. While facilitating practices may form part of an unlawful agreement, "an 'agreement' on the part of the defendants to use the facilitating practice must still be proved."[5] If an agreement exists, facilitating practices may be problematic, but in the absence of an agreement, there is no basis for an order against them.

Similarly, U.S. antitrust law does not consider the possibility of an abuse of joint dominance in the absence of an agreement between the firms involved. Section 2 of the *Sherman Act* condemns monopolization, attempted monopolization and conspiracy to monopolize. Conspiracy to monopolize requires conspiracy, which requires agreement: "the failure to establish a combination or conspiracy will generally defeat a claim that the defendants conspired to monopolize in violation of Section 2."[6] The U.S. shares the Canadian approach with respect to facilitating practices, but not to joint exclusion.

c. E.U.

European law on facilitating practices is in straightforward opposition to the law in Canada and the U.S. Article 81 concerns unlawful agreements and conspiracies to fix price, but also condemns anticompetitive concerted practices. As the European Court of Justice put it in *Dyestuffs*, concerted practices are a form of coordination between undertakings which while short of agreement, substitutes "practical cooperation" for the risks of competition. In that case price announcements even if they did not result in agreements between firms were unlawful concerted practices. Thus, if a firm in an

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[5] Barry Hawk and Giorgio Motta, "Oligopolies and Collective Dominance: A Solution in Search of a Problem" November 2008 (http://ssrn.com/abstract=1301693) at 71.
[6] Section of Antitrust Law, American Bar Association, *Antitrust Law Developments (Sixth)* (2007) at 318.

oligopoly adopts a facilitating practice that has the effect of dampening competition even if it does not reflect or result in an agreement, it is subject to an order under Art. 81.[7]

European law on abuse of joint dominance through exclusion of competitors is less straightforward. The explicit treatment of high prices as a possible abuse of joint dominance in Art. 82 suggests an expansive approach generally to joint dominance, and thus would be consistent with a conclusion that firms may collectively abuse joint dominance by adopting independently exclusionary strategies. But the law is not clear. The prevailing precedent on the question in *Compagnie maritime belge* states that in order for two or more firms to be dominant for the purposes of Art. 82 on exclusionary practices, "a dominant position may be held by two or more economic entities legally independent of each other, provided that from an economic point of view they present themselves or act together on a particular market as a collective entity."[8] The question this naturally raises is what is required to reach the conclusion that the firms acted as a single collective entity. Clearly an explicit agreement is sufficient. But is independent conduct?

In its "Discussion Paper on the Application of Article 82 of the Treaty to exclusionary abuses" (1985), the European Commission suggests that independent conduct can lead to a finding of joint dominance under the *Belge transports* precedent. At para. 46, the Commission states that, "the existence of an agreement or other links in law is not indispensable to a finding of a collectively dominant position. Such a finding may be based on other connecting factors and depends on an economic assessment, and, in particular, on an assessment of the structure of the market in question." The Commission's discussion is far from crystal clear in its implications, but leaves open the possibility of a joint finding of dominance even in the absence of an agreement.

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[7] Dyestuffs

[8] *Compagnie maritime belge transports and others v. Commission*, [2000] ECR I-1365 at para. 36

Commentators such as Hawk and Motta, on the other hand, are more sceptical of independent conduct and joint dominance. They state at p. 76 that, "It should be emphasized that the presentation on the market criterion clearly does not support application of Article 82 collective dominance to mere interdependence…" They support their conclusions by canvassing cases on joint dominance. They conclude that most cases involving collective dominance involved an agreement or concerted practice between the firms in question; almost all cases involved the firms acting as a collective entity through trade associations and the like; and the residual cases involved unique circumstances, such as collective dominance between a majority shareholder and its partially owned subsidiary.[9] They conclude that something more than interdependence is required under Art. 82.

There is thus statutory clarity in Europe over the potential condemnation of facilitating practices as concerted practices that infringe Art. 81, while there is some dispute over the possible condemnation of independent exclusionary behaviour by a group of firms with possible joint dominance.

d. Summary

The law in Canada as set out in the 2001 *Guidelines* and the 2009 *Draft Guidelines*, the law in the US and the law in the EU are roughly described in the following table, with YES indicating a possible antitrust infringement, NO the opposite, and MAYBE, maybe.

	Independent Facilitating Practices	Independent Abuse of Joint Dominance
Canada 2001	YES	NO
Canada 2009	NO	YES
US	NO	NO
EU	YES	MAYBE

[9] *Irish Sugar plc v. Commission of the European Communities*, 1999, ECR II-2969.

The table reflects disagreement across time and across jurisdiction about these important questions on joint dominance. We turn in the next section to discussing the optimal policy approach.

3. ABUSE OF SINGLE-FIRM DOMINANCE

Abusive trade practices are exclusionary, predatory or disciplinary (*Nutrasweet*). Among these classes of practices, we focus here on exclusionary strategies. In the next section, we discuss facilitating practices as well.

Exclusionary strategies on the part of a single firm with a dominant market share generally involve contracts with either downstream buyers or upstream suppliers. If a dominant firm signs long term exclusive contracts with downstream buyers, for example, then an entrant into the industry must rely on finding buyers at the end of their contracts or buyers whose need for the product is new. If the entrant bears fixed costs in entering the market or maintaining a flow of production, then the scarcity of available buyers will make entry less profitable. The entrant will have to incur a longer time of below-profit operations while it gathers sufficient buyers as their contracts end. Where buyers purchase only one unit at a time or there are other technical efficiencies from dealing with only one seller at a time, a simple long term contract with liquidated damages can have the same effect.

Other contracts have similar effects. Consider, as another example, a contract with the requirement of notification of any offer received by the buyer, combined with a right of first refusal on the part of the seller to match the offer. This contract can deter entry because it provides an automatic, immediate and contractually-guaranteed response by the incumbent to any attempt by the entrant to establish a presence in the industry by undercutting the incumbents' current prices. The entrant, knowing that such contracts are in place would be deterred from entering the market.

Is the potential exclusionary benefit of these contracts to the incumbent an adequate explanation of the contracts? Is it an adequate basis on which to base antitrust policy (keeping, for now, within the simple context of single-firm dominance)? The traditional, or pre-Chicago, view was yes. A monopolist in a market has market power – including the power to impose contracts on consumers that are not in consumers' interest. If a set of contracts can help the incumbent maintain a monopoly in the industry and serve no other purpose then of course the contracts are profitable and anticompetitive.

This traditional view is wrong. Any contract is entered into voluntarily by both the seller and buyers. More significantly, in virtually any commercial contract there is the opportunity for the buyer and seller in any contract to transfer lump-sums of wealth between them. A contract, apart from the price itself, must therefore be explained in terms of maximizing the *sum* of the payoffs to the contractual parties. (If another contract offered a higher sum of payoffs, then the parties could move to that contract, sharing the gain in total payoffs.) The terms of a contract, apart from the price, must be explained in terms of the maximization of total payoffs, not in terms of the power of one party to impose the contract on another.

The Chicago School concluded that since contracts maximize joint surplus between buyer and seller, the fact that a buyer agrees to an exclusive contract implies that it is not anticompetitive.[10] But the fact that contracts maximize the payoffs to contractual parties does not mean that contracts are efficient. A contract can have a negative impact on parties outside the contract. This is the basis for the modern economic theory of anticompetitive, exclusionary contracts (sometimes referred to as the post-Chicago theory). The seminal article in this literature is Aghion and Bolton (1987). Aghion and Bolton offered two specific theories of why exclusionary contracts might be entered into by a dominant seller and (voluntarily) by buyers.

[10] Bork, *The Antitrust Paradox* 1978.

The more important of these theories involves a collective action problem across buyers, in terms of their decisions to accept the contract offer by the incumbent. Suppose that an incumbent monopolist, selling to a number of buyers who each demand only one unit of a product, faces the threat of entry by a new firm. Suppose further that, as is common, the entrant faces a sunk cost of entry into the industry or a fixed cost that must be incurred continuously as long as the entrant is in the industry. Then the entrant will not enter unless there are enough buyers available that its fixed costs can be covered or its investment in entry costs into the industry can be justified. Suppose that the number of free buyers required is 15, for example. The incumbent, knowing this, can offer long term contracts – exclusive contracts or contracts with liquidated damages – to enough buyers that the remaining number of "free buyers" is too small to justify the entrant's investment. The incumbent seller, having the first-mover advantage in offering contracts, can offer contracts to all but 13 of the buyers and if the buyers accept, the entrant is shut out.

Why would buyers accept such contracts? The old Chicago argument is that the incumbent supplier must compensate the buyers fully for the cost to them of exclusivity – the cost to them of the loss in competition when the entrant is excluded – because otherwise the buyers would reject the contract. But consider the decisions of buyers to accept the contract. If all other buyers accept the contract, then the decision by a particular buyer has no effect on the entry decision; a decision to reject the contract by a particular buyer would leave only 14 free buyers, not enough to justify entry. Each buyer is in the same position. If the seller offers even a small "bribe" in terms of a reduction in price for entering the long term contract, then acceptance by all buyers is a Nash equilibrium in the "sub-game" of simultaneous buyer acceptance decisions.[11] The seller can achieve exclusion with only a small bribe to each buyer by exploiting the buyers' collective action problem: buyers individually are better off by

[11] The bribe is not necessary for the outcome to be a Nash equilibrium; but it does ensure a Nash equilibrium in which acceptance is a strictly best response by each buyer.

accepting the contract but collectively they would be better off if all rejected the contract. Contracts can be exclusionary and anticompetitive even when entered into voluntarily by all market participants because each buyer ignores the impact of its decision on other buyers.

The use of exclusionary contracts is illustrated by *Nielsen*, which involved contracts by an incumbent monopolist in the Canadian market for scanner-based market information. This case involved both contracts with upstream suppliers (suppliers of raw data) and contracts with downstream buyers (producers of grocery products). The downstream contracts are the more useful illustration here. Initially, Nielsen's contracts with buyers were short-term, with commitments of less than 1 year. As soon as the plans for entry into the Canada became clear, Nielsen struck longer term contracts, of up to 5 years, with the 30 or so buyers that it was most vulnerable to losing to the potential entrant. These new long term contracts had liquidated damages and offered the buyers some discount in prices to enter the long term contract, but the necessary discount would have been small. In *Nielsen* , the long term contracts were struck down as part of the remedy imposed by the Tribunal.

A challenge in any case where long term contracts are at issue as an abuse of dominance is distinguishing empirically between the hypothesis of an anticompetitive role and the hypothesis of an efficiency role of these contracts. Long term contracts are an efficient way to organize economic activity whenever they are needed to protect the returns to specific investment by one party or the other in a contract and when the coordination of such investment and planning is necessary because of uncertainty in the evolution of the economic environment.[12] Obviously, 99.9% of long term contracts are efficient, so clear evidence must be available to reject the efficiency hypothesis.

[12] See Joskow, P.L., 1987. Contract duration and relationship-specific investment: empirical evidence from coal markets. *American Economic Review* 77(1), March, and Oliver Williamson, *Markets and Hierarchies*, Free Press 1975.

4. HORIZONTAL COORDINATION: THE OLIGOPOLY PROBLEM

The second strand of antitrust economics that joint dominance draws upon is the area of oligopoly pricing – specifically the coordination by firms in a tight oligopoly to maintain supra-competitive prices. There is a basic tension for the firms in an oligopoly. Collectively they are better off if they suppress competition, but individually they may be better off by competing vigorously. There is a danger that such firms would explicitly commit to one another not to compete vigorously and thus realize greater profits for the collective. It is a core matter for antitrust law to deter such explicit agreements. The law makes it illegal, indeed criminal, for competitors to explicitly agree on price. Aside from deterring covert agreements in "smoke-filled rooms" which would help oligopolists coordinate their behaviour, such anti-conspiracy rules prevent firms from entering into overt contracts to keep prices high. This is significant in itself, because in the absence of such enforceable agreements there will be incentives for each oligopolist to cheat on the agreement – a successful cartel raises marginal revenue above marginal cost and thus each firm individually is better off it can raise output. Unenforceable agreements require informal punishment for deviations, including price wars or a permanent return to competitive pricing. Since informal punishment may or may not be effective, the law against explicit agreements is effective in deterring a range of anticompetitive behaviour.

There is, however, wide scope for parallel behaviour across firms that falls short of an explicit agreement. The difficulties in regulating this behaviour are illustrated by the *Atlantic Sugar* case. In that case, three collectively dominant sugar companies had maintained similar relative market shares for decades, with each firm realizing the same market share as they had been allocated during a World War II quota program. The firms were charged with conspiracy. At trial it became clear that the competitors relied on two pieces of information to maintain parallel, less than aggressively competitive behaviour: their historical market shares; and the posted prices in the lobby of one firm, Redpath, that its competitors could view. The applicable law then, as now, prohibits agreements between competitors to reduce competition. Did the conduct in *Atlantic Sugar* amount to an unlawful agreement?

At trial, the court found that the conduct with respect to the price list was simply parallel behaviour, while there was a tacit agreement, and hence breach of the law, over historical market shares. The Supreme Court held that merely parallel behaviour was not a basis for a conviction for conspiracy, and thus agreed with the trial judge's holding with respect to the price list. The Court also rejected the conviction with respect to historical market shares, recasting the trial judge's finding of a tacit agreement as "parallelism by tacit agreement." It further held that to ground a finding of tacit agreement there must be evidence of communication of an offer and tacit acceptance of that offer.

While doing violence to the concept of a "tacit agreement" both in its recharacterization of the trial judge's finding and in its description of a communicated offer, the Supreme Court reached an entirely defensible outcome from a policy perspective: merely parallel behaviour is not subject to antitrust punishment, but rather some kind of explicit agreement is necessary. There are two reasons to support the Court's approach. First, and most fundamentally, there is no practical remedy for purely parallel behaviour. Suppose that the Court had found that the historical market shares supported an unlawful agreement. How would the three sugar firms behave going forward? Would they ignore their historical shares and collective interest in maintaining them? Asking profit-maximizing entities not to behave in a profit-maximizing way is not a successful policy strategy. In the end, the only possibly effective remedy for parallel behaviour among oligopolists is price regulation. Unless the state is willing to assume responsibility for setting prices in a vast range of industries with possibly oligopolistic tendencies, the law should refrain from intervention in almost all cases of purely parallel behaviour.[13]

[13] There is only one context in which antitrust law can and does address purely independent but parallel behaviour (the so-called oligopoly problem): competition policy can take steps to ensure that an oligopoly structure that gives rise to the threat of parallel behaviour does not emerge in the first place. While breaking up existing oligopolies is

A variety of practices exist that do not reflect or encourage explicitly collusive behaviour between would-be competitors, but rather discourage vigorous competition between the competitors even if adopted unilaterally. "Facilitating practices" are strategies adopted by oligopolists that facilitate supra-competitive prices in an industry. There is no exhaustive list of such practices, but the following are some examples. In a market with otherwise difficult to detect prices, sellers may adopt policies that publicize prices. Atlantic Sugar's posting of a price list in its lobby, for example, rendered pricing more transparent which facilitated more cooperative pricing outcomes among the oligopolists. Sellers might also offer price-matching guarantees. These serve two purposes. One, they enlist buyers as monitors of rivals' prices, and two, they commit the seller to punish the rival for dropping price by responding with an equally low price. The latter effect is even stronger if the seller commits to beat the rival's price by some percentage. Sellers might also offer most-favoured-nation clauses to buyers which guarantee to the buyer that it receives as low a price as that paid by any other customer even on a going forward basis. Such clauses reduce the seller's incentive to lower prices to future buyers: the seller must sell at lower prices not only to the future buyer, but also must rebate the past buyer with the MFN clause. By raising the cost of price cuts, MFN clauses collectively adopted by an oligopoly can stabilize high prices.

It is important to appreciate that practices such as these and others are not always, or even often, used to facilitate supra-competitive prices. Rather, they all have efficiency motivations, in particular, reducing the buyer's risk of overpaying relative to market conditions, that make them unobjectionable in most cases. But facilitating practices can dampen competition and raise prices in oligopolies in some circumstances.

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wholly impractical, merger review allows the authorities to prevent a merger that would allow a significantly greater risk of anti-competitive parallel behaviour. Merger review is not without its challenges, in that it is anything but straightforward to determine the likely competitive impact of a merger, but offers one practical remedy for the oligopoly problem in those cases where a concentrated market would, the absence of antitrust regulation, come about through mergers.

Facilitating practices raise policy questions that are distinct from those engendered by the basic problem of parallel but non-collusive oligopoly behaviour. The crucial difference between policy towards facilitating practices and policy towards high pricing directly is that there is a clear remedial choice with the former: the authorities can order a practice to stop, or not. In the case of prices, it is obvious that the remedy is not a binary matter. Firms need to set prices; the question is what price is too high. This effectively requires the constant monitoring and industry expertise associated with price regulation. Just as authorities can order a single dominant firm to cease to impose exclusionary clauses in its contracts (see, e.g., *Nielsen*), the authorities have a clear remedial target with facilitating practices. As a consequence, there is reason for antitrust law to restrict adoption of facilitating practices where they lessen competition, recognizing that authorities should be cautious in reaching such a conclusion.

There is a caveat. The fact that remedies are available with respect to facilitating practices does not ensure a solution to the oligopoly problem. Parallel pricing can survive even in the absence of any given facilitating practice. The point of the remedy, however, is to make the probability of an uncompetitive outcome smaller. This is a perfectly valid basis on which to order a remedy, and is consistent with other antitrust areas. Exclusive contracts, for example, may be sufficient to deter entry, but may not be necessary, yet antitrust authorities make orders against them nevertheless.[14]

[14] The *Nielsen* case illustrates this point. In that case Nielsen entered into exclusive supply contracts for a key input, scanner based data from supermarkets, and this was itself sufficient to ensure that a rival, Information Resources Inc., could not enter the market. In response to this exclusionary behaviour, the Competition Tribunal found an abuse of dominance and, *inter alia*, ordered Nielsen to stop agreeing to exclusive supply contracts with the supermarkets. While the contracts Nielsen had with the supermarkets were no longer exclusive, the supermarkets did not sell to IRI and thus facilitate competition downstream. Collectively the supermarkets were likely better off continuing to realize a share, perhaps the larger share, of Nielsen's downstream monopoly profits than to facilitate a duopoly downstream that would have lower total profits to share. Thus, while the remedy in *Nielsen* allowed the possibility of competition, it could not guarantee it. This was not a reason not to make the order in that case, and it is not a reason not to make orders against facilitating practices where they are determined to increase the probability of uncompetitive behaviour.

5. JOINT DOMINANCE: OLIGOPOLY AND EXCLUSION

We know from our discussion above there is a basis for regulating exclusionary contracts entered into by a single dominant firm and buyers (alternatively, suppliers) that are, from case evidence, exclusionary and anticompetitive. We also know from traditional theory discussed above that within a tight oligopoly high prices can be stable, as a result of explicit or tacit coordination among firms in circumstances where there are exogenous or inherent barriers to entry.

An exclusionary abuse of joint dominance case arises where oligopoly members both keep prices high <u>and</u> are able to establish and maintain entry barriers via exclusionary contracts or other devices to protect their supra-competitive profits. A theory of an exclusionary abuse of joint dominance is a theory of oligopoly with endogenous entry barriers. This theory is relevant where inherent barriers to entry are not sufficient to deter entry, so jointly dominant firms exert some effort to raise barriers to entry or to induce the exit of firms outside the jointly dominant group.

Joint abuse of dominance would appear, then, to introduce an additional dimension beyond price that requires oligopoly coordination: member firms must jointly establish contracts that would not otherwise be struck, i.e. that would not otherwise be efficient for the contracting members. The additional dimension of coordination needed for joint abuse would appear to invite an additional dimension of free-riding by cartel members,and therefore reduced stability of the cartel.

The key question in this area is the same for both positive economics and antitrust policy: does the additional dimension of coordination needed for joint abuse by an oligopoly, in the form of erection of contractual barriers, diminish the probability of success to the extent where joint dominance should not be an important policy concern? Or can the dynamics of oligopoly coordination sustain cooperative behaviour in both the dimension of pricing within the market and the establishment of contractual barriers to entry? Judging by the variation in joint abuse law across jurisdictions discussed in section 2, there is not agreement on these questions.

In this section and the next, we bring both theory and case evidence to bear on the questions. The key theoretical finding is that the additional dimension of free-riding is minimal and therefore that joint abuse of dominance is plausible.

Two specific propositions capture this general point. Our first proposition is that under some circumstances, the best response by any individual cartel member to the adoption of exclusionary contracts by other cartel members will be to adopt the same contracts. By "best response" here we mean the response that maximizes immediate profits. The dynamics, in particular the threat of reversion to intense competition that supports the coordinated equilibrium in a classic tacitly coordinated oligopoly, are not necessary.

To develop this proposition, consider the example of section 3 in which an entrant needs at least 15 free buyers to cover the fixed costs of production, and the single incumbent firm signs up all but 13 buyers (or even more buyers) to long term contracts at the cost of only a small bribe to each. Replace the single firm in this explanation by two incumbents who are successful at (tacitly[15]) coordinating their pricing within the market. The entry of an additional firm would at a minimum require the two incumbents to share the profits from coordinated pricing, and would also jeopardize the stability of supra-competitive pricing. The offer of long term contracts by each incumbent, with the total of such long term contracts being sufficient to deter entry, is a Nash equilibrium because it is in the individual interest of each incumbent to deter entry. The costs of deterring entry via long term contracts are small in this example of exclusionary contracts because of the collective action problem across buyers: a free-

[15] We focus on tacit coordination because explicit coordination is a clear violation of conspiracy laws, rendering the question of joint abuse less relevant.

rider problem among buyers induces buyers to accept exclusivity in exchange for a trivial benefit. The free-rider problem related to the establishment of barriers to entry can be small or non-existent.

In fact, under some conditions the incentive to deter entry can be stronger when there are multiple incumbents. The stability of a cartel or tacit agreement is decreasing in the number, n, of members of the cartel or agreement, since the incentives to cheat on the agreement are higher with increasing n: the percentage increase in market share that can be captured by cheating is higher, and in addition the chance that other firms will want to disrupt the market by punishing the cheater is greater. It may well be, for example, that a tacit agreement could be sustained between two firms but not three. In this case, the prospect of a third firm entering the market is therefore particularly costly to the incumbents and the incentive to deter entry via abusive practices is stronger with two incumbents than with only one.

Our second proposition is that in a broader range of circumstances, contracts or strategies that are adopted by cartel members as facilitating devices, to aid in sustaining the cartel price, can serve simultaneously to deter entry. As one example, consider, a right-of-first refusal clause in which seller has the opportunity to match any offer a buyer receives from a rival seller. Such clauses tend to keep prices high by informing each oligopolist of price cuts by rivals, and by allowing sellers to match their rivals and thus punish any attempt to steal business. Moreover, the clauses tend to exclude new entrants: incumbents have the right to match prices and exclude competitors, which discourages attempts at entry in the first place. There is no cost to an individual seller from adopting such a clause, and thus there is no free-rider problem among firms in exercising joint dominance in this manner. There is, however, a collective action problem for buyers: each may accept the right-of-first refusal clause, despite its anticompetitive effects, reasoning that its individual acceptance will have little effect either on market prices or on entrants.

A second example of practice that combines cartel facilitation and entry deterrence is the staggering of contracts. Staggered contracts refer to the design of *some* contracts as long term with the effect that not all contracts terminate on or near the same dates. Staggered contracts enhance the stability of a cartel because a cheater on the cartel cannot capture the entire market in the short run by reducing price. It can capture only those consumers free of long term contractual obligations. The share of consumers captured by cheating before the cheating is detected may be small when contracts are staggered.[16] Staggered contracts can also act as a barrier to entry. If all contracts ended at or near the same dates, then an entrant could capture a substantial market share in a short time through a low price offer, justifying the investment in entry costs; but when contracts are staggered the entrant may be forced to wait a longer time to accumulate enough customers to cover its fixed cost. The staggering of contracts was an issue in *Nielsen* (although in this case in was the upstream contracts with suppliers, not the downstream contracts with buyers, that were staggered). Note that the staggering of contracts would potentially be remedied not through a requirement that all contracts end on the same date, but by a prohibition of long term contracts.

We have found that exclusionary abuse of joint dominance is, as a matter of theory, possible in any market that meets both (1) the conditions allowing tacit coordination of prices; and (2) the conditions that would allow exclusionary strategies in the hypothetical case of a single firm. That is the "jointness" of the dominance does not necessarily introduce an important new free-rider problem or source of discipline on the oligopoly – beyond, that is, the necessity to coordinate *within* the market in order to achieve higher profits. The 2009 Draft Guidelines recognize this additional factor in setting out as a condition for dominance incorporate the consideration of competition within the market, not just competition from potential entrants.

[16] The game-theoretic basis for this claim is provided in a recent working paper , Long-Lived Consumers, Intertemporal Bundling, and Tacit Collusion, James Dana and Yuk-fai Fong, Northwestern University, October 2008.

As we discuss in the conclusion our analysis supports the new Canadian Guidelines' approach to joint dominance: evidence of explicit coordination among jointly dominant firms on the abusive practices is not necessary.

6. **CASE STUDY**

Based on facts that can be inferred from the consent agreement in *Waste Services*, this case supports the predictions of the theory. Under the Commissioner's theory, two firms, operating in a market in which a single firm had historically been found liable of abuse of dominance (*Laidlaw*), were dominant in several markets for commercial waste services.[17] The firms were ordered in the consent order to refrain from various contractual practices such as setting contract terms greater than 2 years, renewal terms greater than 1 year; requiring lengthy and limited termination notice periods for buyers; rights of first refusal; requirements to divulge information about offers from third parties; requirements for substantial liquidated damages; and requirements by the parties to provide notice of and reasons for any increase in price.

The contractual terms that were in place, as inferred from the agreement, can potentially serve as both facilitating devices and exclusionary devices, in terms of preventing significant entry or growth by firms other than the two dominant firms. The right of first refusal protects each firm against undercutting both from its rival within the market and from other, smaller firms or new entrants. The obligation to inform a supplier about offers from other parties both enhances the stability of the within-market coordination (by shortening the time for detection of "cheating") and also frustrates any attempt to enter or expand on the part of a small firm. The longer term contracts serve to ensure the staggering of contracts, which can serve to dampen the competition between the two incumbent firms

[17] None of the Directors' conclusions were admitted to by the parties in the Consent Agreement.

in the market by lessening the incentive for each to undercut the other as the short term gains from undercutting are reduced by the limited number of free buyers. And the staggered contracts limit the ability of entrants and small firms to achieve a significant market share even when these firms have costs no higher than the incumbents.

7. CONCLUSION: EVALUATING THE LAW AND THE 2009 GUIDELINES

Canadian enforcement policy has moved in inconsistent directions with respect to regulation of the oligopoly problem. It has sensibly stayed the course by continuing to reject the idea of regulating high prices in either a monopoly market or an oligopoly. But the 2009 *Draft Guidelines* reversed course with respect to non-exclusionary facilitating practices, removing them from scrutiny as a potential abuse of a jointly dominant position. The 2009 *Draft Guidelines* also reversed course with respect to joint exclusionary practices, holding that merely parallel behaviour is sufficient to attract a remedial order where the practices substantially lessen competition. The second reversal is appropriate. Firms may have incentives independently to adopt strategies that deter entry or otherwise harm rivals and competition, and these strategies, such as exclusive contracts, are susceptible of remedies. These contentions are illustrated by the B.C. waste case and the consent agreement that resulted. Canada has sensibly departed from the U.S. requirement of explicit coordination among oligopolists, and has also avoided the ambiguity and lack of clarity of the E.U. approach.

The decision to exclude non-exclusionary facilitating practices from joint abuse scrutiny, on the other hand, does not have a sound basis in policy. If facilitating practices are not reviewed under abuse of dominance, there is no legal justification for making an order against them. Section 45 concerns conspiracies and agreements, and facilitating practices need not manifest an agreement, nor do they necessarily facilitate an agreement within the meaning of that section and the case law (see, e.g., *Atlantic Sugar*). But facilitating practices may lessen competition, are plausible in practice, and are remediable. It therefore does not make sense for antitrust authorities never to consider them. The U.S. has this wrong from a policy perspective, while the E.U. has this right, with its focus not only on agreements in its conspiracy provision in Art. 81 but also "concerted practices." Canada used to get it right in its abuse guidelines by considering facilitating practices as a possible abuse of joint dominance, and now gets it wrong.

It is important, however, to recognize the source of the problem. The Competition Bureau is bound by its statute and by precedent. Section 45 and precedent such as *Atlantic Sugar* suggest that facilitating practices cannot be considered under the conspiracy provision, at least without an accompanying explicit agreement. There is thus no legal room in Canada for the authorities to address facilitating practices under s. 45.

Moreover, precedent also renders facilitating practices outside the ambit of s. 79. Section 78 lists a non-exhaustive, illustrative list of practices that could amount to an abuse of dominance. The Competition Tribunal in interpreting ss. 78 and 79 together concluded that the common features of the enumerated practices in s.78 are that they have an intended effect on rivals that is exclusionary, predatory or disciplinary.[18] The Tribunal moves from this observation to a conclusion that any act unenumerated in s. 78 that is alleged to be an abuse of dominance pursuant to s. 79 must also have an effect on rivals that is exclusionary, predatory or disciplinary.

The problem with the Tribunal's approach is that it potentially excludes anticompetitive behaviour that benefits a group of potential rivals collectively at the expense of their customers. That is, behaviour that is collusive or otherwise dampening of price competition is outside the scope of s. 79 on the Tribunal's approach. For example, in *NutraSweet*, there was a complaint that NutraSweet, which had a clearly dominant position in the artificial sweetener aspartame market, had abused its dominant

[18] See, e.g., *NutraSweet*.

position by entering into an agreement with a potential rival, Ajinomoto, according to which Ajinomoto would not enter the Canadian market. The Tribunal rejected the complaint, noting that cooperative behaviour is outside the scope of the abuse provisions since it does not have an intended negative exclusionary, disciplinary or predatory effect on a rival. Under this interpretation of ss. 78 and 79, there is no room for the Competition Bureau to bring a complaint against facilitating practices adopted by a group of firms, since facilitating practices have a beneficial, not a negative, effect on rivals. The Bureau's reversal on facilitating practices in the 2009 *Draft Guidelines* is therefore not justified on a policy basis, but is consistent with prevailing case law.

The Tribunal's approach is by no means dictated by ss. 78 and 79. Section 78 provides only a non-exhaustive list of potential abuses of dominance, so does not on its face exclude facilitating practices as a potential abuse of dominance. Given that s. 79 is a catch-all provision that explicitly contemplates conduct by jointly dominant firms, that there is no other provision that addresses facilitating practices, and that facilitating practices can allow jointly dominant firms to substantially lessen competition, it would be preferable to interpret s. 79 in a more purposeful, substantive way that would address facilitating practices.

It is apparent, however, that the Tribunal and the courts are unlikely to deviate from this narrow approach to s. 79 at this point. *Canada Pipe* illustrates the formalistic approach that dominates s. 79 jurisprudence. In that case, the Federal Court of Appeal carefully parsed each subsection of s. 79, coming to some remarkable conclusions. For example, s. 79(1)(b) asks whether a dominant firm (or firms) has committed a practice of anticompetitive acts, while s. 79(1)(c) contemplates an order by the Tribunal wherever the practice lessens competition substantially. In *Canada Pipe*, a dominant firm argued that its marketing scheme that had been alleged to be abusive of dominance was designed to bring efficiency benefits to its customers. The Federal Court of Appeal held that an anti-competitive act under s. 79(1)(b) need not decrease competition; in addition, it held that a positive effect on consumers does not negate a finding of an anti-competitive act under s. 79(1)(b). Neither of these considerations negate an intended exclusionary, predatory or disciplinary effect of that practice, which is the subject of investigation under s. 79(1)(b). Efficiency motivations are considered only under the substantial lessening of competition analysis which arises under s. 79(1)(c). By parsing the language of the statute in such a formalistic way, the Federal Court of Appeal established a precedent that allows a finding of a practice of anticompetitive acts under s. 79(1)(b) that is beneficial to consumers and does not lessen competition under s. 79(1)(c). As Trebilcock forcefully argues, this is wrong-headed.[19]

With such a formalistic precedential backdrop to s. 79 interpretation, it was appropriate for the Bureau to have excised facilitating practices as a potential abuse of joint dominance in its 2009 *Draft Guidelines*. But this does not imply that such a move has a strong basis in policy. Either through a rethinking by the courts of their jurisprudence, or through a statutory amendment, the law should evolve in a manner that allows it to address facilitating practices. As of the moment, there is an unfortunate lacuna that reform should address.

[19] Trebilcock, Michael, "Abuse of Dominance: A Critique of Canada Pipe," *Canadian Competition Record*, Summer 2007: 1-13.