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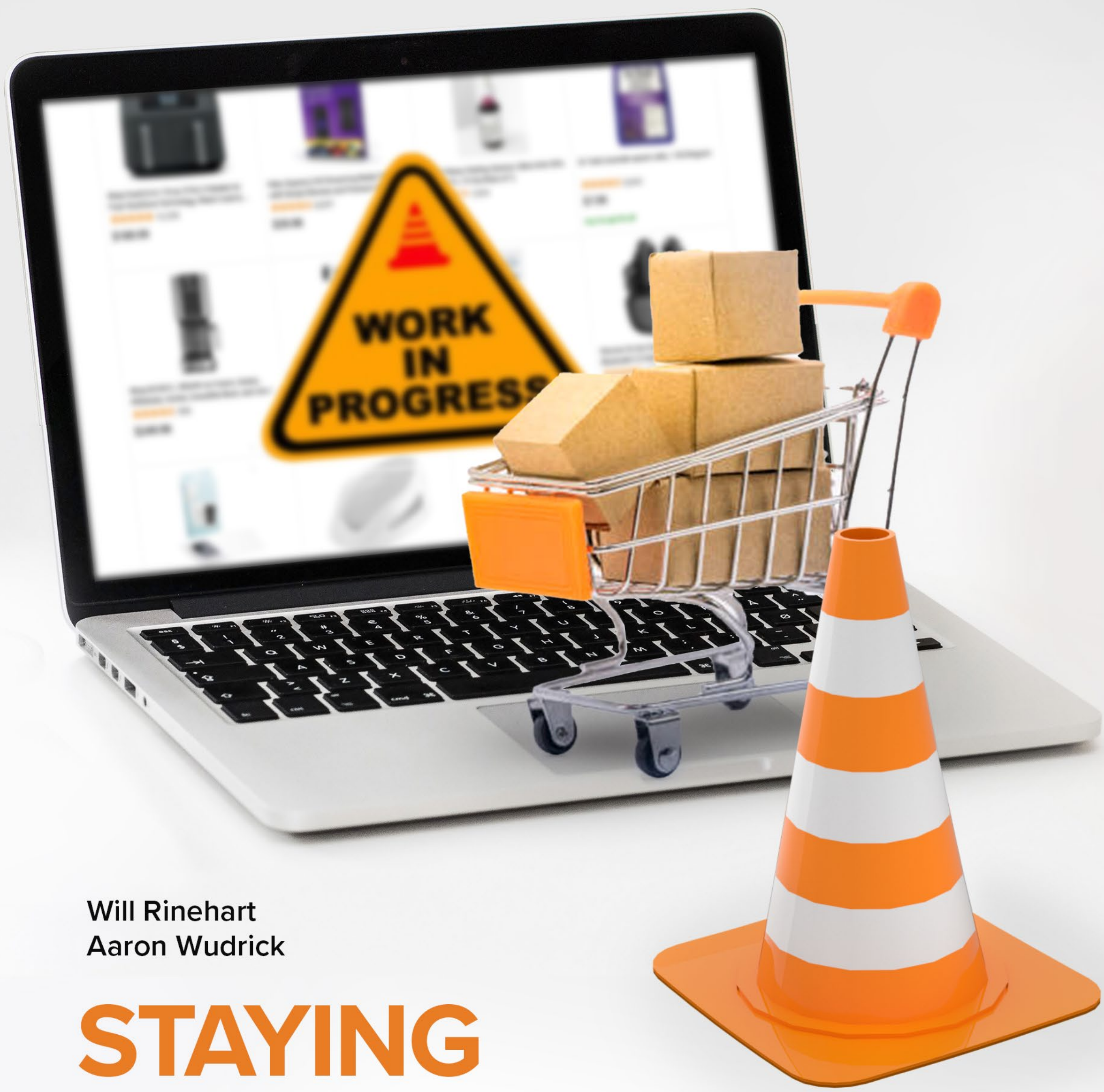

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STAYING THE COURSE

Why competition law should remain focused on consumer welfare standards, not radical change

May 2023

TRUE NORTH IN CANADIAN PUBLIC POLICY

TRUE NORTH
IN CANADIAN PUBLIC POLICY

Contents

Executive summary | sommaire

Digital commerce has revolutionized how Canadians interact, do business, and consume products, giving rise to new and important digital firms. In November 2022, the federal Minister of Innovation, Science and Industry launched a public consultation to determine whether some aspects of the Competition Act need to be amended and/or updated to reflect this new digital economy. Commissioned to lay out proposed changes to the Act, the Competition Bureau's discussion paper suggests that it is concerned that the power of digital firms has grown far beyond the reach of the competition law in its present form.

But Canada must guard against overreaction and avoid following the same path as several peer nations, in particular the United States. Far too many of the critical citations in the discussion paper – including those that do some of the heaviest lifting to support proposed changes – rely on unjustified assumptions that American analyses can be effectively substituted into the Canadian context, even when there are significant differences in our respective economies and business cultures.

Clearly, the government has a role to play in fostering competition. The question is whether it risks inadvertently hampering robust competition by intervening too aggressively in areas where dynamic forces are evolving rapidly and are not well understood. The bureau must resist the temptation to view the status quo in any given market as static.

Much of the current discussion over reforms to competition law grapple with the question as to whether competition law should be harnessed to address other pressing social concerns, such as inequality. Our view is that competition law is a surgical tool that should remain focused on the consumer welfare standard – and that the government should address any other important challenges with more appropriate tools.

The digital world certainly operates in novel and unique ways, such that the usual markers of anti-competitive behaviour in traditional business operations can in digital businesses be signals of healthy market competition that benefits consumers. Better analysis of how digital platforms work in practice is needed to parse the good from the bad.

The current competition regime has a proven track record of promoting competition and protecting consumers. To take one example among many, the Act has prevented monopolies from dominating markets, which has encouraged innovation and generally ensured low costs for consumers. The Act does not need a fundamental overhaul of its mandate. Rather, it needs more resources so that organs of government, such as the bureau, can properly administer the existing regime.

Assuming that the framing of the bureau's discussion paper reflects its intended direction for competition policy, we are headed down a perilous path. Toying with dramatic changes to the Act, based on dubious evidence, would substantially alter how business is conducted and is likely to trigger significant unintended consequences, with negative repercussions for our economy. We urge the bureau to ensure the Act remains focused on promoting the "efficiency and adaptability of the Canadian economy." The consumer welfare standard remains the proper tool for this task. MLI

***Le commerce numérique a révolutionné** les modes d'interaction, d'affaires et de consommation de la population canadienne, ce qui a favorisé l'entrée sur le marché de nouvelles et importantes entreprises numériques. En novembre 2022, le ministre fédéral de l'Innovation, des Sciences et de l'Industrie a lancé une consultation publique afin de déterminer si certains aspects de la Loi sur la concurrence devaient être modifiés ou adaptés à cette nouvelle économie numérique. Dans son document de travail, le Bureau de la concurrence, qui a été chargé de proposer des changements à la loi, a indiqué avec préoccupation que le pouvoir des entreprises numériques avait dépassé de loin la portée de la Loi sur la concurrence sous sa forme actuelle.*

Toutefois, le Canada doit se garder de toute réaction disproportionnée et éviter de suivre les pas de ses pairs, en particulier des États-Unis. Les citations critiques dans le document de travail sont trop nombreuses – y compris les plus porteuses en faveur des changements proposés – à reposer sur l'irréaliste supposition que les analyses américaines peuvent être efficacement substituées au contexte canadien, même si nos économies et nos cultures d'entreprise respectives diffèrent notablement.

Visiblement, le gouvernement a un rôle à jouer pour promouvoir la concurrence. Or, nous devons établir s'il ne risque pas d'entraver involontairement une concurrence robuste en intervenant de manière trop agressive dans des domaines où les forces vives évoluent rapidement et ne sont pas bien comprises. Le Bureau doit résister à la tentation de présumer du statisme des marchés.

Une bonne partie de la discussion actuelle sur les réformes du droit de la concurrence s'attache énergiquement à la question de savoir si ce droit ne devrait pas être exploité pour répondre à d'autres préoccupations sociales urgentes comme les inégalités. Nous pensons que le droit de la concurrence est un instrument « chirurgical » *qui doit demeurer axé sur la norme en matière de bien-être du consommateur – et que le gouvernement doit surmonter tout autre défi important au moyen d'outils plus appropriés.*

Le monde numérique fonctionne certainement de manière nouvelle et unique, si bien que les indices habituels de comportement anticoncurrentiel dans les opérations traditionnelles des entreprises peuvent, dans les entreprises numériques, signaler une saine concurrence à l'avantage des consommateurs. Pour distinguer le bon du mauvais, il faut mieux analyser comment fonctionnent concrètement les plateformes numériques.

Le régime de concurrence actuel a fait ses preuves en matière de promotion de la concurrence et de protection des consommateurs. Pour ne citer qu'un exemple parmi d'autres, la loi a empêché les monopoles de dominer les marchés, ce qui a favorisé l'innovation et généralement assuré des coûts peu élevés pour les consommateurs. La loi n'a pas besoin d'être révisée en profondeur en ce qui a trait à son mandat. Elle a plutôt besoin de ressources accrues pour permettre aux organes du gouvernement, comme le Bureau, d'administrer correctement le régime existant.

Si le document de travail traduit l'orientation que le Bureau entend donner à la politique de concurrence, nous nous engageons sur une voie périlleuse. Badiner avec la loi en imposant des changements radicaux, sur la foi de preuves douteuses, modifierait substantiellement les modes d'affaires et pourrait avoir d'importantes conséquences imprévues, négatives pour notre économie. Nous demandons instamment au Bureau de veiller à ce que la loi demeure axée sur la promotion de « l'efficacité et la capacité d'adaptation de l'économie canadienne ». La norme en matière de bien-être du consommateur demeure l'outil de choix pour cette mission. **MLI**

Introduction

The government's consultation document, *The Future of Competition Policy in Canada*, comes at an important time (ISED 2022a). It has been 20 years since the first high-speed Internet connections were built and almost 20 years since social media platforms were founded. A little more than 16 years ago the first iPhone went on sale. The rise of these new technologies – and their adoption by the commanding heights of the economy – has had a rapid and dramatic impact on society.

The digital revolution has reshaped our economy in ways that were unimaginable when the *Competition Act* was first enacted. The question before the government is whether "there are clear signs that more must be done to ensure that Canada's competition law, policy and tools are optimized and sufficiently agile to keep pace with a rapidly evolving economy" (ISED 2022a). As this submission will argue, many of the "clear signs" of competitive decline are in fact evidence of robust market competition.

Digital industries are unique because they upend commonly held notions about how markets should behave. Zero priced goods or services, which are products that are costly to produce but are ostensibly offered free of charge to consumers can sometimes signal anticompetitive behaviour in traditional markets. In digital platforms, however, zero prices often indicate the market is competitive. Section 2 provides a fuller explanation of these forces, and the underlying lesson is critically important for this consultation. Analysing multi-sided platforms, which support interactions and exchanges between two or more groups, require key modifications to the standard models (Evans and Schmalensee 2022). As such, using the frameworks developed for traditional businesses in the context of digital platforms will often lead to incorrect analysis and, ultimately, result in consumer harm.

Defining new standards for mergers, raising notification standards, and amending the abuse of dominance threshold in the revised *Competition Act* would be significant changes. Abuse of dominance is a key concept within competition law, as it defines when a dominant business or group of businesses has conducted in such a way as to stop or substantially reduce competition in a market. These changes would mark a radical departure from longstanding tradition.

The Act should be responsive where overwhelming evidence suggests that it needs to be changed – as it has already proven to be; the Act has not been static throughout its history. For example, the government made significant changes to it in 2009 (Hutton 2009). In the present case, however, the government has not marshalled sufficient evidence to justify radical change, particularly because the same amended rules would apply to all markets and market actors despite the fact that the bureau's case refers only to tech firms.

> *Changing the law in response to perceived threats from a small clutch of "digital tech" firms would be unprecedented.*

Changing the law in response to perceived threats from a small clutch of "digital tech" firms would be unprecedented, as the discussion paper readily admits. Indeed, it goes on to concede that "the Act's framework of general application is its strength." It is "sufficiently dynamic to address emerging competition law issues regardless of the changing context" (ISED 2022a, 8). Previous reforms of Canadian competition law, including the passage of the Act in 1986 and the amendments enacted in 2009, have created a legal regime that reflects the best practices of integrating economics into competition law (Boyer, Ross, and Winter 2017). Already, Parliament has ushered in reforms that are set to take effect in summer 2023 (Baker McKenzie 2022).

This consultation mistakenly calls for significant legal reform. And while some minor changes might be appropriate, the fundamental character of the Act itself should be left intact.

The one-size-fits-all approach proposed in the discussion paper means that, for example, retailers would be subject to treatment and remedial attention developed for vastly different business models such as social networks, search engines, and other fundamentally distinct platforms.

Canada should not be seduced by the so-called anti-monopoly, or "hipster antitrust" movement coalescing in the United States. While it is correct that our peers are "already well down the road towards re-examining their frameworks and approaches to competition policy in light of the digital economy," the discussion paper is riddled with references to US-based arguments that are not neatly transplanted to the Canadian context.

The European Union (EU), United States, United Kingdom, and Australia have all aggressively deployed regulatory tools against so-called "Big Tech." But those cases have been missteps, resulting in ambiguous outcomes at best or consumer harm at worst. Understanding why these cases failed to help consumers can help to inform this consultation.

To take one recent example, the UK's Competition and Markets Authority (CMA) successfully halted the merger between Meta and Giphy, the latter of which is a company that compiles short videos without audio and gifs for online users to share. But in the time it took the CMA to stop the merger, consumer preferences had changed. TikTok is now a leader in social media and Instagram is playing catchup. Consumers interacting in a market, not government intervention, provided the ultimate competitive check.

The government has set itself important task: to "identify the best ways to modernize Canada's competition law framework, and address the above challenges in a way that creates the greatest benefit for the greatest number of Canadians." But it needs to heed its own words and understand how "the nature of competition itself is changing as firms increasingly compete for consumers in dynamic ways and on features other than price, challenging some of the traditional methods of analysis" (ISED 2022a, 9). The bureau's consultation begs for better analysis of what is changing and what prices represent, which the following sections help to illustrate.

First, we review the literature on productivity and large firms, explaining why traditional measures of competition often don't adequately capture complex markets. Then, we follows with an explanation for why digital competition often looks different from competition among traditional businesses. Next, we explain the context of this consultation and separates the good proposals from the bad. Finally, we offer some concluding comments.

Economics of large firms

One of Nobel Laureate Robert Lucas's most important contributions to economic theory, *On the Size Distribution of Business Firms*, seems to have been sparked by a trip to Canada. He wrote,

> On a recent vacation in Quebec, my family and I stopped for lunch at a small, inexpensive restaurant on the St. Lawrence River. The decor, the menu, and the service in this family-run place were unique to it, and reflected a large number of managerial decisions, all solved in a way reflecting both the tastes of the owners and local prices of food and other materials. Even politics was involved: the flags of Canada and the United States flew out front; the flag of Quebec was absent. The Quebec economy is developing rapidly, however, and should we return in ten years we shall find, I imagine, a Poulet Frit Kentucky outlet in its place, with decor, menu, services, and politics identical to its twins in Montreal or Quebec City. This will occur, according to the theory developed above, because rising real wages will make working for some one else more lucrative than the return to making managerial decisions for a single, small restaurant. (Lucas 1978, 522-23)

Lucas' theory was simple, and has largely been borne out by the historical record. As productivity and wages inch up over time, the decision to become an entrepreneur becomes less attractive to young people entering the workforce (Lucas 1978; Eeckhout and Jovanovic 2012). As a result, the supply of entrepreneurs declines, leading to bigger and more productive firms. Wherever you find productive people, you also tend to find higher wages and larger companies (Poschke 2013). Canada, the US, the EU, and Japan are all home to large, productive companies in a variety of industries including retail, manufacturing, mining, services, and telecommunications (Poschke 2014).

Higher incomes are usually accompanied by higher productivity, and higher productivity usually means bigger firms. In other words, there are natural trends that lead to firms getting bigger. Rob Atkinson's *Big is Beautiful:*

Strengthening Growth and Competitiveness in the Canadian Economy is a full-length treatise on these trends within Canada (Atkinson 2021). In Canada, as in other places, large companies pay their workers higher wages, invest more in research and development, and are more productive. Rather than always being the result of insufficient competition, large firms are often the result of increased productivity.

None of this is to say that large firms are all made equally. Rather, it supports what antitrust scholar Jonathan Baker calls the "benign alternative" (Federal Trade Commission 2018; see also Baker 2019, 23). It can best be summarized this way: the combination of information technology (IT) use, a better educated and more productive workforce, along with a relative slowdown in the labour force, has led to firm sorting (Kozeniauskas 2022; Karahan, Pugsley, and Sahin 2019). Across industries, geographic regions, and firm sizes, pay differences *within* a company have only changed slightly.

Even still, some sorting should be expected as a result of increasing productivity. Productive firms pay their employees more, skewing the top end of the income scale. Widening worker pay gaps have tended to be a result of a widening gap *between* firms in the composition of their workers.

The bureau is right to see addressing "inequality and inclusive growth" (ISED 2022a, 7) as an important focus. But the news in Canada is actually mostly good: relative to its peers, Canada continues to maintain low-income inequality, as it has for decades (Conference Board of Canada Undated). This means that at least some of what is driving the conversation in the United States is thus not present to the same degree here.

Firm sorting also means that one of the key indicators of market concentration, the Herfindahl–Hirschman Index (HHI), is likely to increase over time.[1] More productivity by the top firms means more production, which means the HHI is likely to increase. Here again, much of the conversation simply assumes the American situation applies here, even though the United States is unique among countries because it has seen some of the biggest shifts in market concentration. And yet, even there, that "increase is not a dramatic one" (Grullon, Larkin, and Michaely 2019; Directorate for Financial and Enterprise Affairs Competition Committee 2018).

Canada has seen some increase in concentration but it has not been as dramatic as elsewhere. According to research from Crépeau and Duhamel (2008) conducted for Industry Canada, the average HHI of Canadian industries increased by about 9 percent from 1997 to 2002 (Crépeau and Marc Duhamel 2008). While some might cite these statistics as cause for alarm, these numbers put Canada's overall concentration well below that in Austria, Belgium, Finland, Italy, Sweden, France, and the United States.

The past two years have been banner years for start-ups and so-called "unicorns" in Canada (Simpson 2022). Companies like Hopper, Dapper Labs, and Blockstream have all been breakout stars. Something is going right and it needs to be nurtured. Startup investment rose from $2.1 billion in 2016 to $13.7 billion in 2021 (Thorne 2022).

Likewise, the Canadian information and communications technologies (ICT) sector has contributed significantly to Canada's GDP, amounting to $104.5 billion (in 2012 constant dollars) in 2021. This sector comprises 5.3 percent of national GDP and 15.3 percent of national GDP growth from 2016 to 2021 (ISED 2022b, 3).

In spite of these clear successes, there is still a worry that firms are getting too big.

Despite the pandemic's effects, the sector has demonstrated impressive growth in output, employment, and innovation compared to the overall Canadian economy (ISED 2022b). Since 2016, the ICT sector has posted a stronger annual growth than the total economy. On average, the compound annual growth rate in this sector has been 5.0 percent over a five-year period, compared to 1.6 percent for the overall economy.

In spite of these clear successes, there is still a worry that firms are getting too big. Research from Bawania and Larkin (2019) found that Canadian firms have followed the trend of other countries and are exhibiting some signs of consolidation. Large firms have become more dominant, and the number of Toronto Stock Exchange (TSX) publicly traded firms has dropped. Meanwhile, firms in industries with large market concentration have seemingly generated higher profit margins. All the while, mergers and other deals have seen an uptick (Bawania and Larkin 2019).

Classical economic theory suggests that concentration increases are causes for concern because they should lead to price hikes, output reductions, and consumer welfare decreases. As market concentration increases, the number of firms competing in the market decreases, giving the remaining firms greater market power. With greater market power, these firms can raise prices above the competitive level, reducing consumer surplus and leading to a deadweight loss in the market. Additionally, with fewer competitors, firms may reduce output in order to maintain their market power, further reducing consumer welfare.

But as early as the 1880s, economists recognized that the way in which firms compete in the real world is much more complex. Even duopolies might arrive at prices that approximate competitive markets (Dixon 2001, 126). This subtlety was largely adopted by antitrust scholars in the 1980s and integrated into competition law worldwide. Broadly speaking, the empirical change has shifted competition law away from concentration and towards concerns about market power.

Market power typically takes one of two forms: (1) traditional market power, and (2) exclusionary market power. Traditional market power is the ability to raise the price of a good above the competitive level by restricting output or cutting quality. Traditional market power is distinct from the latter type, exclusionary market power, which involves denying competitors or potential competitors' inputs or access to markets or raising their costs.

Empirical studies tend to find complex relationships between concentration and market power. To take one example, market power is often directly measured by markups. A markup is the difference between the selling price of a good or service and cost that goes into producing it. As the reasoning goes, the greater the market power, the higher the company is able to set the markup. Indeed, a driving argument behind the anti-monopoly movement is that markups are rising dramatically. And while early research found rising markups, more detailed studies using slightly different measures for markups have found only negligible increases which are largely explained by changing preferences in the use of technology, rather than market composition (Foster, Haltiwanger, and Tuttle 2021, 2).

Absent Canadian research to rely upon, in the United States, manufacturing concentration increases have indeed correlated with slightly higher prices (Foster, Haltiwanger, and Tuttle 2021). Even more importantly, concentration increases are correlated with increases in productivity, offsetting a large portion of the price increase. In contrast, non-manufacturing concentration increases over the last 20 years are not correlated with observable price changes, but are correlated with increases in output (Ganapati 2018). In other words, yes, prices went up – but so did production, negating any worries about rising markups.

Another seemingly paradoxical relationship is the one that exists between national concentration measures and local concentration measures. As one long-time scholar of this space noted, "[n]ational concentration measures can be particularly misleading for geographically localized markets" because the trends reverse when data is restricted to just a local analysis (Syverson 2019). So even as more national measures show that concentration is increasing, local markets have seemingly become more competitive in a number of industries (Rossi-Hansberg, Sarte, and Trachter 2019).

Additionally, the long tail of the market structure matters. A market involving a handful of large-scale firms and many small-scale businesses may give rise to different types of market structure, ranging from monopoly or oligopoly to monopolistic competition through new types of market structure. This largely depends on the conditions under which the free entry and exit of small firms incentivizes big firms to sell their product varieties (Kokvin, Parenti, Thisse, and Ushchev 2017).

The central concern laid out in this consultation is the recent development of what the discussion paper calls "market concentration and the enormous influence of new economic giants." The discussion paper worryingly skips over this literature and the nuance it demands. Market power is mentioned countless times, but a thorough discussion of markups is absent. Worries about rising concentration are peppered throughout the paper, even though it acknowledges that "increasing concentration could signal a smoothly functioning market environment rewarding the most efficient producers."

Better research is needed to understand how Canada stacks up to other countries. If anything, this consultation confirms that the government needs to collect more data and create the conditions for better local analysis to occur before concluding that the Act needs to change. It draws too many conclusions based on research coming from the United States or Europe. Canada needs reforms based on a homegrown analysis.

The government should be careful in distinguishing between "natural" and "market-power-driven" increases in concentration. As the government readily admits, "Even without mergers, concentration can increase when businesses exit, or when some businesses gain share from others by offering better products and services, a natural and expected result of the competitive process. (ISED 2022a, 19). Even still, "[c]oncerns have been raised with respect to the reach of the Act's remedial framework, given the potentially harmful effects of concentration" (ISED 2022a, 19).

As the next section argues, the unique economics of digital platforms doesn't mean they need a different remedial framework. Instead, the unique economics of digital platforms calls for analysis specific to the digital industry, while the application of the governing principles of efficiency and the protection of consumer welfare remain consistent.

Economics of software and digital platforms

Major digital platforms, such as Facebook or Amazon, operate using a business model that is fundamentally different from the traditional one-sided company business model. As a result, traditional competition analysis that does not account for these differences misrepresents their economic realities and risks becoming the basis for policy decisions that will ultimately harm consumers.

Digital platforms can be distinguished from one-sided companies in two ways: (1) digital platforms meld the cost structure of software with the scaling of networks, and (2) platforms serve multiple groups of consumers rather than a single set of consumers.

Digital platforms like Twitter and Instagram as well as software businesses like Adobe require significant upfront investment in research and development, infrastructure, and personnel, much like a traditional brick-and-mortar business. However, once the program or platform is established, the marginal cost of adding new users, producing additional units of the digital product, or updating and maintaining these products is typically negligible compared to other businesses.

The cost structure of software, as Martin Casado and Matt Bornstein explain, "creates a number of compelling business benefits, including recurring revenue streams, high (60-80%+) gross margins, and – in relatively rare cases when network effects or scale effects take hold – super-linear scaling" (Casado and Bornstein 2020). Network-driven scaling is what separates digital platforms from all other digital firms.

Platforms create value by bringing together distinct customer groups, such as advertisers, content creators or other types of "users" of the platform service. Such platforms uniting different types of users are not new. They have been around for decades in industries that create and support products like video games, credit cards, newspapers, and radio stations (Rochet and Tirole 2003).

By their very structure, networks have effects that can drive growth. Facebook is a good example in which network effects increase the value of the product: as more people join and interact with the platform, the more useful and indispensable the service becomes. This helps the network expand, which makes it more likely that still others will join. The network effect is thus a positive feedback loop of increased membership that can lead to highly-valued super-linear scaling. Due to the digital nature of the product, there are very low marginal costs for adding each new member, whose presence can then be harnessed to yield high gross margins.

A one-sided business, like a laundromat, a mining company, or even a software company, has one customer, so analyzing demand and pricing is fairly straightforward. However, platforms are more complex since value is generated by the interaction of the multiple participants who use the platform, and the users themselves (the "customers") are part of the value of the network to other users. For example, advertisers find more value in a social media platform the more users that platform has, particularly if they are sharing images and scrolling through a feed, since that means that more users will view the ads.

Advertisers are on platforms because the platforms help them reach users. So, in response to a decline in the number of users, advertiser demand will drop as well. The result echoes back to become a negative feedback loop. When advertisers drop out, the platform's total value also recedes and user demand falls because the platform is less valuable to them.

Economic analysis of "demand interdependencies" in digital platforms

Traditionally, regulators have regarded low or negative prices as a signal of anticompetitive behaviour. However, in the context of multi-sided digital platforms (i.e., those that support interactions and exchanges between two or more groups), this is not an accurate metric by which to capture the underlying economic reality.

In work fundamental to his being awarded the Nobel Prize, economist Jean Tirole (2003) proved an essential point in platform analysis: that an increase in marginal cost on one side of the platform does not necessarily increase prices on that side. Thus, the profit-maximizing price for one side may be below the marginal cost or even negative (Rysman 2009, 125). This is particularly due to the fact that the value of the platform lies in the volume of users it attracts, and this is where the bulk of the revenue actually comes from.

If traditional one-sided market businesses are pricing below or at marginal cost, this is a likely indicator of predatory pricing. However, in the case of multi-sided businesses such as many of the digital platforms, these low prices are part of the cost structure; a part of the initial investment is then recuperated as the network expands, and it is therefore inaccurate to assume this is evidence of predatory pricing.

Demand is thus tightly integrated between the different users of the platform. Changes in user and advertiser preferences, for example, have an outsized effect on platforms because each side responds to changes in the other. As a result, small changes in price or quality tend to have far more of an impact on platforms than on more traditional, one-sided markets because such changes chase off both advertisers and users from platforms. These changes reverberate through the platform and in so doing have a much larger effect on consumers than pricing or quality changes in one-sided markets. These are called "demand interdependencies" and are a species of indirect network effect. Research on magazine price changes confirms this theory (Song 2021). The demand on one side of the market is interdependent with demand on the other. To see this in action, one only need to see how a decrease in ad quality resulting from Apple's 14.5 "App Tracking Transparency" update wiped out US$10 billion from Meta's bottom line (Newman 2022).

Economists David Evans and Richard Schmalensee (2022) explain the importance of the integration of platform economics into competition analysis: "The key point is that it is wrong as a matter of economics to ignore significant demand interdependencies among the multiple platform sides" when defining markets. If they are ignored, then the typical analytical tools will yield incorrect assessments. Evans and Schmalensee broadly "demonstrate that a number of results for single-sided firms, which are the focus of much of the applied antitrust economics literature, do not apply directly to multi-sided platforms" (2022).

In the European Commission's (EC) case against Google, we can see the disastrous effect of applying single-sided firm economics to multi-sided digital platforms. The EC sued Google in 2018 because the company "required manufacturers to pre-install the Google Search app and browser app (Chrome), as a condition for licensing Google's app store (the Play Store)" (European Commission 2018). But Chrome and the Search app were the valued products being bundled with the Play Store so that users could have free access to the latter.

Not surprisingly, when the network was torn apart, the true prices could be seen. As *Vice* reported, Android manufacturers now have to pay Google a surprisingly high price in Europe in order to include Google's Play Store and other mobile apps on their devices. The fee schedule shows costs as high as $40 per device to install these apps because the EC didn't understand the network value being exchanged (Kastrenakes and Brandom 2018). While this case was about bundling, it emphasizes what happens when traditional analysis is applied to a network. Consumer welfare suffered when the EC failed to recognize the value of the network and pulled it apart.

The Competition and Markets Authority's termination of the Meta deal with Giphy in the UK is another example of misapplied analysis. The agency intervened to prevent additional concentration in Meta's platforms since via the merger, "Meta would be able to increase its already significant market power by denying or limiting other social media platforms' access to Giphy GIFs, thereby pushing people to Meta-owned sites, which already make up 73% of user time spent on social media in the UK" (Competition and Markets Authority 2022).

In two short years, however, TikTok overtook Facebook in the UK and rendered the CMA's argument against the merger moot (Fisher 2022). When the case began in 2020, it was fairly evident that Giphy didn't improve Facebook's market power, suggesting that the CMA's case was flimsy to begin with. But by 2022, when the courts finally agreed and Facebook stopped pursuing

Giphy, it was impossible to deny that consumer preferences had already shifted dramatically.

What happened? The market for online content and attention shifted away from gifs and static videos, Giphy's primary product offering, and towards TikTok's form of video content. In response, Meta moved away from relying on Giphy's product, introduced Reels, which essentially copied TikTok's short video format, and revamped its overall platform interface (Malik 2022). Giphy shed at least $200 million as the deal with Facebook was progressing, a clear sign that the company's value was evaporating quickly (Hern 2002). In the end, changing consumer preferences did a better job of ensuring competition than the CMA's action, as TikTok's ascendance and the resulting change in the market's composition of digital players can not be attributed to their intervention.

One of the most common arguments against platform power is the worry that they will start excluding producers, retailers, advertisers, and app developers (Rolnik [2018]). Platforms, however, have a strong incentive to include all users because the effects reverberate through both sides of the platform. That being said, predation *can* occur in a two-sided market. This is uncontroversial and actions to counter it should be enforced accordingly, but doing so doesn't require a change in the law. Rather, it just needs a better analysis of specific cases.

Certain free services like TikTok and Facebook can create "zero-price equilibriums" where the most efficient price for consumers is zero (Gans 2020). While efforts to inject competition into these markets might seem like they are helping, they "can be welfare reducing." As one of the top economists in this field summarized it, "The conclusion is that zero can be a 'special zone' with respect to policy analysis such as in antitrust" (Gans 2020). These sorts of considerations also need to be carefully integrated into consumer welfare analysis in order to represent the economic realities accurately and then generate effective policies.

Zero pricing in digital platforms is unique and requires special consideration. Policies designed to promote competition in digital platform markets should be carefully evaluated to avoid potential harm to consumer welfare. That lesson is critical to understanding why the changes proposed by Canada's federal government could be so harmful.

Changes to the law

On November 17, 2022, the federal Minister of Innovation, Science and Industry formally announced a comprehensive review of the *Competition Act*. Just as the consultation was announced, other alterations were made to the Act to respond to the economics of digital firms. These reforms have resulted in at least three significant changes that were consolidated by the introduction of Bill C-27, the Digital Charter Implementation Act, and the establishment of the Personal Information and Data Protection Tribunal (ISED 2022, 13). Thus, the current consultation isn't without precedent; it is the latest in a string of changes that began in 2021.

The 2021 Budget allocated new monies "to enhance the Competition Bureau's enforcement capacity and ensure it is equipped with the necessary digital tools for today's economy." Following this, in February 2022, the minister announced an intention to undertake a review of the Act, and shortly thereafter the Act was amended through the Budget Implementation Act, specifically, the BIA Amendments (BIA). These changes, which will take effect in the summer of 2023, have already greatly restricted the scope of competition (Wait and Hersh 2022).

Under the changes to the Act, price fixing and other anticipative agreements could be met with a discretionary fine with no limitation on the amount to be paid. The move was met with skepticism in the legal community, especially with respect to so-called "abuse of dominance" cases because little evidence exists that this conduct is widespread. Simply put, the Commissioner of Competition has very rarely sought to impose fines in abuse of dominance cases, because this conduct is presumptively legal until it is proven otherwise (Wait and Hersh 2022).

This consultation wants to go further and "optimize the functioning of this framework." Specifically, the discussion paper laments that there is a "high bar for intervention: the Bureau may not be able to take action against potentially harmful forms of conduct because of the specific legal tests to be met. While over-enforcement is not desired, the field cannot be tilted too steeply against necessary intervention if an effective watchdog is to function" (ISED 2022a, 15).

The risk of over-enforcement

While it is not directly cited, antitrust scholarship has rightly been preoccupied with determining the costs of under- and over-enforcement. This stems from Easterbrook's (1984) pioneering work on the error-cost framework. The framework was based on the idea that the cost of an error is not just the cost of fixing the error, but also includes the cost of detecting the error and the cost of any consequences resulting from the error.

There are two types of error. False positives or Type I errors are errors that condemn and deter beneficial conduct. These are the errors incurred in over-deterrence. False negatives or Type II errors are the opposite, those that allow harmful conduct. These are the errors of under-deterrence. Each type of error comes with a cost and there is an additional cost that comes with administering the system.

Easterbrook was quick to point out that the cost structure has a specific shape in the real world. False negatives or under-deterrence can be ameliorated by market competition. On the other hand, the market cannot undo false positives or over-deterrence. As a result, the cost of over-deterrence is far more significant than under-deterrence.

Easterbrook's research is a warning that this consultation should heed. The bureau should be careful that its changes don't lead to over-deterrence, and indeed, many of the suggestions contemplated in the discussion paper increase the likelihood of it.

Productive changes to the Act

When taken as a whole, the discussion paper charts out a new path that could seriously harm consumers. While the digital economy presents new challenges for competition enforcement, the overall effect of many of the contemplated changes would be to lower the standard of harm and make it easier to bring a case – even though the available literature and research suggests that what is actually needed is more caution and more evidence before proceeding to do so.

The discussion paper reviews a number of possible changes to many areas of Canadian competition law that can be broadly separated into (1) merger review, (2) abuse of dominance, (3) competitor collaborations, (4) deceptive marketing, and (5) administration and enforcement. Each of the changes is discussed below.

Merger review

The discussion paper has singled out the merger review process for reform. One of the biggest changes offered up in the consultation would reform the "efficiencies defence." A range of options have been floated, but none of the evidence presented is fully convincing that a dramatic change is needed.

Since the 2015 *Tervita* decision, there have been calls to alter "Canada's unusual approach" in merger challenges, effectively doing away with the efficiencies defence, which accepts that a merger that might have anti-competitive effects can proceed if those effects are to be outweighed by economic efficiency gains. The efficiencies defence means that competition law strikes a balance and it helps to promote innovation and economic growth by allowing firms to merge and achieve economies of scale that might not be possible otherwise.

But rather than presenting a list of ways that this challenge could be harmful to consumers, this aspect of the law is being highlighted because "Canada's approach is relatively unique in terms of how the efficiencies are measured and weighted against anti-competitive effects when the defence is invoked – the so-called 'welfare standard'" (ISED 2022a, 26).

The discussion paper omits some of the most important aspects of that case. The real impact of *Tervita* was that it demanded more of the government when it brought a challenge. If it wanted to show a price effect, then it needed to present evidence of a price effect. As is clearly noted in the decision:

> the Commissioner did not quantify quantifiable anti-competitive effects and therefore failed to meet her burden under s. 96. Specifically, there is no price elasticity information which means that the possible range of deadweight loss resulting from the merger is unknown. To permit the Tribunal to consider the price decrease evidence without the rest of the information necessary to quantify deadweight loss admits far too much subjectivity into the analysis, with no guarantee that the Tribunal will have enough information to ensure that a subjective assessment would align with what would actually be observed if the effect were properly quantified. As a result, those quantifiable anti-competitive effects should be assigned zero weight. ((*Tervita Corp v Canada (Commissioner of Competition)* 2015 SCC 3 at para 165)

Tervita did not, as the ISED discussion paper implies, simply place "a tremendous emphasis on quantification of efficiency considerations, noting that qualitative effects would 'assume a lesser role in the analysis in most cases'" (ISED 2022a, 26). It demanded that government actually prove a price effect if it claimed one would occur, and made it clear that, "Proven efficiency gains of any magnitude will therefore outweigh the anti-competitive effects" (*Tervita Corp v Canada,* para 151).

This is not a bug that needs correcting; it is a feature. The government should be bringing hard evidence of a clear consumer harm if it wants to stop firms from merging. Competition law demands highly technical and complex economic analysis if it is to parse out the good deals from the bad ones. Forward-looking merger analysis is highly speculative and the burden should be on the government to prove clear consumer harm is imminent.

So yes, it is technically true that, "With the added importance of non-price competition in the digital economy, the burden of litigating an efficiencies claim is likely to become even more of a significant challenge for both firms and the Bureau, particularly with more abstract concepts such as privacy or innovation" (ISED 2022a, 27). If the bureau wants to properly litigate, it will need to bear these costs. Of course, it is already the case that the bureau is staffing up to deal with this problem.

Moreover, the government should be careful in how uniquely it frames this defence. The United States, for example, has a dramatically different process of adjudication in competition cases, but the effect on consumer welfare is often very similar. On the other hand, the United Kingdom has a much lower threshold to bring a challenge to a deal, which is what allowed it to stop Facebook from merging with Giphy with the limited evidence that the deal was going to firmly establish Facebook's market power. Indeed, the Giphy-Facebook merger shows what happens when there are low thresholds for bringing a case.

Notification thresholds have also been slated for reform in Canada. It has been reasoned that, since digital companies buy so many startups below merger notification thresholds, they are likely poaching small companies and trying to stifle potential competitors. Despite the fact that most founders want to sell their company and attribute a sale to a sign of success, the government has argued for changing merger notification guidelines because "the likelihood that such acquisitions will fall below pre-merger notification thresholds, or otherwise avoid sufficient scrutiny, is particularly acute in this realm" (ISED 2022a, 21).

Yet again, to make its case, the bureau has cited statistics based on American markets. But properly structured empirical studies have just recently been published. Contrary to what many have thought, the first study to look at venture capital (VC) deals from 2010 to 2019 "found a persistent positive impact of the big tech start-up acquisitions on the appetite of VCs to also invest in start-ups of similar industry segments" (Prado and Bauer 2022).

To add to this, the bureau has only challenged nine of 3,000 reviewed mergers since 2009, and, therefore, this amendment would result in wasted resources (Kilby 2022). Only a small proportion of mergers are problematic for competition, as Edward Iacobucci has noted (2021). Efficiency is cited as the primary goal of Act, but the amendment would result in an extraneous review of lawful mergers that would otherwise likely go unchallenged.

The result of even lower thresholds would lead to uncertainty for buyers and for businesses that intend to merge or acquire another firm. Moreover, this amendment would represent a significant impediment to start-ups that intend to be acquired, particularly in the tech industry. Without the capital to achieve economies of scale, acquisition may be the only exit strategy for these entrepreneurs and venture capitalists. If the limitation period is extended, buyers will have an incentive to delay the acquisition or to forego it altogether, which may be harmful for the start-up itself and to the Canadian economy as a whole.

Further, the paper *Highlights from the Competition Bureau's Data Forum* noted that the UK's Digital Competition Expert Panel examined hundreds of acquisitions that went unreviewed and concluded that few problematic mergers were missed. This stands in line with the fact that the bureau challenges very few mergers. If the primary goal of the Act is efficiency and adaptability of the Canadian market, this amendment should not be pursued.

As will be explained later in Section 4, if the bureau is permitted to compel information for market studies, it could better monitor and detect anti-competitive killer acquisitions, particularly in the tech industry.

The discussion paper also considers "whether amendments to the *Act* could give labour a more central role in competition analyses." But again, much of this section is backed up by research from US academics that are hoping to solve concerns in that country.

The government needs to be comfortable with the new digital world. In fact, the discussion paper acknowledges that even if "mergers are reviewed by the Bureau on a case-by-case basis and competitive threats addressed, lawful concentration can continue to occur in the economy" (ISED 2022a, 19). The importance of this observation needs to be highlighted. The government could make its reforms and concentration may increase regardless.

Abuse of dominance

The Act grants the bureau a wide remit in addressing unilateral conduct that may distort markets in a variety of ways. While recent case law has broadened the interpretation of abuse, the Act still imposes, according to the discussion paper, "a relatively onerous burden on the Competition Bureau, and this may limit the Bureau's ability to consider seeking remedies in cases where competition appears to be threatened" (ISED 2022a, 34). In effect, the bureau seeks wider latitude to police "uncertain competitive harm before it happens" (ISED 2022a, 22).

Much like the changes being contemplated for merger review, the proposed changes to abuse of dominance would be extraordinary. The government needs to marshal exceptional evidence to support the change, but gives none. Instead, the discussion paper proposes that so long as "firm actions are able to limit competition," those actions should fall under the scrutiny of section 79.

Re-defining what should and should not be captured by the abuse of dominance provisions pervades recent competition law literature. Advocates have argued, apparently persuasively to the bureau, that there are harms to competition that are going unsanctioned because the dominance threshold is too high. However, neither the discussion paper nor other publications explain what those harms are.

For example, a recent *Policy Options* article that was part of a series on competition law reform singled out protection of small- and medium-sized enterprises (SMEs) from abuses of dominance as an under-addressed and under-enforced area of the Act but gave no evidence that SMEs are being harmed by dominant firms (Hearn 2022).

The current definition of "dominance" is well-established and has been uniformly interpreted by courts and regulatory agencies in Canada. Similar to merger review changes, redefining "dominance" or joint dominance could have unintended consequences and potentially discourage investment and innovation. If companies are uncertain about whether their actions may be considered anti-competitive, they may be hesitant to invest in new markets or pursue innovative business strategies. This could harm Canadian businesses and consumers by reducing competition and stifling innovation.

Both the discussion paper and the *Abuse of Dominance: Enforcement Guidelines* note that the Act already contemplates joint dominance (Canadian Competition Bureau 2019, 16-17). The difference between the existing law and the above proposal is that similar or parallel conduct is currently insufficient on its own to ground a finding of dominance. The firms must still meet the dominance threshold. Eliminating this requirement makes little sense.

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Certain EU jurisdictions have opted for an alternative type of abuse of dominance to address specific types of anti-competitive conduct in situations where a single firm (or group of firms) do not meet the dominance threshold. France and Germany, in particular, have enacted abuse of economic dependence provisions (Baumann, Mutschler-Siebert, Marsh, et al. 2021). This allows competition law to intervene where firms engage in conduct that harms dependent firms.[2] Abuse of economic dependence still requires the same substantial lessening of competition requirement as abuse of dominance, but contemplates a different relationship between the relevant parties. It would be a minor shift in the types of single-firm conduct captured by the Act.

The bureau also seems intent on creating well-defined rules and presumptions of illegality for some kinds of behaviour. However, some have argued that a range of conduct from single firms should be sanctioned irrespective of how big the firm is or what the anticompetitive effects may be.

The bureau should resist the temptation to simply ban behaviour without properly studying the effects of the behaviour in question. As Nobel Prize winning economist Ronald Coase warned decades ago:

> [I]f an economist finds something—a business practice of one sort or other—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a

> monopoly explanation, frequent. (Williamson, 2002, citing Coase in Fuchs 1972, 67)

The bureau should resist codifying this error of knowledge in law.

Competitor collaborations

Modifying the law to deem or infer horizontal coordination without a buy-side agreement would represent a significant shift in competition law enforcement in Canada. Currently, the Act's conspiracy and bidrigging provisions require an agreement between competitors as well as an intention to rig prices. It is an open question, and an active area of research, to understand how algorithms set prices automatically. Before modifying these provisions to target price algorithms, negative effects on consumers need to be firmly established in the real world. Moreover, it could lead to serious chilling effects on pro-competitive conduct (such as price monitoring, price matching, etc.) that is highly beneficial to the Canadian economy.

Additional analysis is needed to assess the extent to which monetary penalties affect commercial decision-making. Substantial fines in jurisdictions such as the EU (a much larger market) have not always led to the desired outcome. Monetary penalties could have a chilling effect on business creativity and on a company's willingness to take pro-competitive risks.

If monetary penalties are introduced, the law should be clear so that businesses can make assessments *ex ante* and relatively easily determine whether the proposed conduct is compliant with the Act.

To date, the bureau has made minimal use of the civil competitor collaboration provisions of the Act (i.e., there have been few cases where penalties even could have been awarded). The fact that the civil competitor collaborations provision only applies to ongoing and future conduct is both appropriate and desirable. This is consistent with the governing philosophy of the Act; namely, that the civil provisions are designed to protect competitive markets rather than to discipline market participants.

In the 2009 amendment to the Act, Parliament intentionally excluded buy-side agreements from the criminal conspiracy provisions. This followed nearly a decade of consultation aimed at narrowing the categories of conduct that attract criminal liability to those which are *per se* anticompetitive (i.e., those that can have no pro-competitive effect). These consultations considered at length including buy-side agreements as part of the criminal conspiracy provisions and deliberately rejected that option in favour of treating them as a reviewable practice where competitive effects are necessarily considered.

Moreover, the fact that buy-side agreements are often pro-competitive militates against even implementing a rigid civil *per se* approach. The bureau effectively acknowledges this in its *Competitor Collaboration Guidelines*:

> The Bureau recognizes that small- and medium-sized firms often enter into joint purchasing agreements to achieve discounts similar to those obtained by larger competitors. Such agreements can be pro-competitive and are not deserving of condemnation without a detailed inquiry into their actual competitive effects. (Competition Bureau 2021, 21)

A joint purchasing arrangement is an agreement between firms to purchase all or some of their requirements for a product from one or more suppliers. Such arrangements are often pro-competitive, as they permit firms to combine their purchases to achieve greater discounts from suppliers and share delivery and distribution costs.

Given that buy-side agreements can have negative, neutral, or positive effects on competition, the current reviewable practice provision in section 90.1 is an appropriate framework. This provision has been drafted to allow the commissioner to take enforcement action for agreements that lead to a substantial lessening or prevention of competition but, at the same time, to cultivate an environment where businesses will explore collaborative pro-competitive agreements.

Deceptive marketing

Given the wide ambit of the Act's existing deceptive marketing provisions, reformulating deceptive marketing is not necessary, but enhanced enforcement could ensure that marketing practices are properly policed. As the discussion paper notes, "the Act's deceptive marketing provisions have been interpreted broadly and apply to all manner of business promotion in Canada, and in this sense can serve as a powerful tool in the digital economy" (ISED 2022a, 48).

Deceptive marketing covers a wide range of anticompetitive acts. Generally speaking, this Part of the Act prevents false or misleading practices that can (1) harm consumers, (2) harm businesses engaging in honest practices, and (3) negatively impact the economy (Competition Bureau Canada 2022). These objectives are consistent with the existing purposes of the Act, outlined in section 1.1. In that way, expanding enforcement of deceptive marketing is in the interest of all competition law stakeholders.

Greater enforcement will also contribute to increased efficiency in the Canadian economy. The integrity of the market is put at risk when actors engage in deceptive practices. For example, Reebok-CCM claimed that its hockey helmets protected against both skull fractures and brain injuries, despite only testing the helmets for protection against skull fractures (Competition Bureau Canada 2015). Consumers who are concerned about brain injury in sport could be induced to purchase Reebok-CCM helmets instead of a competitor's based on a performance claim that was not founded in adequate and proper testing. If left unchecked, this type of deceptive act has repercussions across the entire market. Allowing these deceptive acts to stand serves as a disincentive to companies to actually conduct the requisite testing, ultimately leading to lower quality (and potentially unsafe) products being sold to consumers. Drip pricing, the focus of the BIA amendment, is the same. It is the practice of advertising a product at a certain price, but then increasing the price gradually during the purchase process by adding additional fees, taxes, or other charges to the initial price. Unaddressed, it creates an incentive for sellers to hide the true price in order to appear more attractive to consumers than competitors.[3]

Administration and enforcement of the law

The discussion paper notes that current enforcement mechanisms "do not generally provide a rapid response to urgent marketplace issues." In an increasingly fast-paced and digitized economy, the discussion paper argues that lethargic enforcement could lead to irreversible harm.

Meanwhile, other jurisdictions have given their respective competition authorities greater latitude to act ahead of formal decisions through interim and remedial measures.[4] While the Competition Tribunal has taken some steps to expedite hearing procedures and decision deadlines, this fails to address the relative toothlessness of the bureau to ensure compliance outside of the formal hearing process (Competition Tribunal 2019). As the discussion paper notes, the bureau acts as a pure litigator, not a regulator.

A more efficient bureau would introduce greater certainty into the economy, particularly on pressing and urgent issues. Giving the bureau greater investigatory latitude could lead to more voluntary compliance or negotiated settlements. This would resolve more cases without going to the tribunal, freeing up the latter's time to handle only the more serious and complex matters. Additionally, deferring matters more often from the criminal law to the civil enforcement track allows meaningful action to be taken more quickly, thereby benefitting all parties involved.

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Through market studies, the bureau is able "to take a more holistic approach to analyzing a sector than other forms of advocacy, where the Bureau may be limited to providing advice on discrete issues, such as that relevant to a specific federal or provincial regulatory proceeding" (Competition Bureau Canada 2018). For the purpose of market studies, proponents of traditional competition law policy should be able to support an expansion of information collection outside of the enforcement context. Proponents of traditional competition law can get behind the "hipsters" on this area of reform.

With respect to the burden placed on parties and the costs associated with performing market studies, the *Market Studies Information Bulletin* notes that, "[a]s market studies are generally resource-intensive projects, the Bureau takes considerable care in selecting and scoping a market study to ensure that it will examine issues that are of critical importance to Canadians and the Canadian economy" (Competition Bureau Canada 2018). In addition, the bureau "tries to minimize the cost for stakeholders to respond to information requests or otherwise participate in a market study" (Canadian Press 2022).

Moreover, unlike Canada's major trading partners, the bureau does not have formal investigative powers to compel information for the purpose of market studies. With an expanded toolkit, "businesses would be compelled to co-operate and provide information that illuminates market trends that are potentially anti-competitive" (Bednar, Qarri, and Shaban 2022, 20). Additional data may enable the bureau to identify "new or emerging trends in sectors where potential competition concerns have yet to be studied or addressed by regulators and other stakeholders" (Bednar, Qarri, and Shaban 2022).

However, Statistics Canada still collects and produces very little data. Indeed, only two reports can be found under the "industry concentration" tag compared with over 100 for the United States (Statistics Canada Undated). If the bureau wants to better police all industries, it should be working first to understand them. Market studies are critical to this.

Conclusion

The Competition Bureau should be cautious about introducing sweeping changes to the *Competition Act* since the evidence suggests the status quo is, on the whole, working effectively. The consumer welfare standard has served Canadians well and should not be replaced or diluted by tasking competition law with more amorphous goals, particularly because the justification for doing so is based on inaccurate assumptions about the Canadian economic context. At the end of the day, dramatic changes to the ways that competition law are practiced will not provide consumers with more competitive prices and even greater choice. The best protection for consumers is the proper enforcement of the consumer welfare standard, along with up-to-date economic analysis that enables regulators to respond to the real ways in which digital businesses operate. MLI

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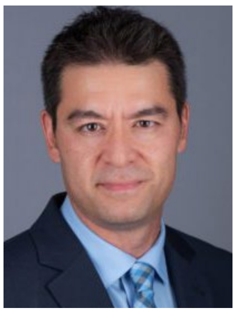

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Endnotes

1 The most common measure to determine market competitiveness is the Herfindahl-Hirschman Index. Market shares are squared and then summed for each firm that competes in a market. The resulting index is typically cited to illustrate the competitiveness of the industry.

2 For example, Apple licenses certain resellers and authorized repair facilities. The French Competition Authority fined Apple €1.1 billion after it restricted the prices that an authorized reseller could charge (in effect, vertical price fixing) (McGeown and Navea 2020).

3 See, for example, Erik Holmstrom's analysis of drip pricing and Ticketmaster (Holmstrom 2019).

4 See the EU's Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, articles 7-10, 17-24; the Australian Competition and Consumer Commission 2022; and, in the US, Federal Trade Commission 2021.

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