

## OUTSIDE THE COURTS

### OTTAWA ATTEMPTS TO BLOCK BELL CANADA'S REORGANIZATION PLAN PENDING INQUIRY

A bid by the Federal Government to block a proposed Bell Canada reorganization pending its review by the Canadian Radio-Television and Telecommunications Commission was rejected by the Quebec Superior Court on September 24. The Government has thirty days to appeal the decision. Moreover, Communications Minister Francis Fox has mentioned the possibility of legislation if the government loses in the courts and should the CRTC find that the reorganization would affect subscribers adversely. The federal action followed expressions of concern about the proposed reorganization by consumer groups, competitors of Bell, the CRTC and the Restrictive Trade Practices Commission.

The proposal, which was announced by Bell in June, was approved enthusiastically by shareholders on August 18. The plan calls for a recently incorporated Bell company, Bell Canada Enterprises Inc. (BCE), to acquire all Bell Canada shares in exchange for an equal number of BCE shares. BCE would also acquire most of Bell Canada's subsidiaries and its interest in Northern Telecom; it would accomplish that by acquiring Bell Canada's shares in those companies at their historic cost rather than current value, in exchange for which Bell Canada would receive preferred shares to be issued by BCE and which would be redeemed within five years. BCE would in future raise the equity capital to meet Bell Canada's requirements. Under the proposal, BCE would own all the shares of the following companies:

Bell Canada, which would continue to own Tele-Direct (Publications) Inc., which publishes the telephone directories, a 24.6% interest in Telesat Canada and a 30% interest in Bell-Northern Research Ltd.

The provincially regulated telephone companies now owned by Bell Canada.

Tele-Direct (Canada) Inc., Bell Communications systems Inc. and Bell Canada - International Management, Research and Consulting Ltd.

In addition, BCE would acquire Bell Canada's 55.2 per cent interest in Northern Telecom.

Thus, BCE would become the parent company of the Bell group. its subsidiaries would include federally regulated Bell Canada, some provincially regulated telephone companies and some unregulated companies; it would also have a controlling interest in unregulated Northern Telecom. The proposal constitutes Bell's solution to problems which have been faced both by Bell and

the CRTC in seeking to act fairly both to Bell subscribers and shareholders in the face of Bell's interests in functionally related but unregulated activities. This is essentially the problem to be considered in the final volume of the RTPC's report on the Bell-Northern reference. For Bell, the problem was exacerbated by CRTC decision 81-15 in 1981 that at least some of the income from Bell's unregulated activities must be treated as "other income" of the regulated activity so as to benefit subscribers. The Bell Proposal states in part:

"After the reorganization Bell Canada will no longer have any investment in any companies which the CRTC in its decision 81-15 did not consider to be integral to Bell Canada, other than its minority interests in Telesat Canada and Bell-Northern Research Ltd. Accordingly, the proposed structure responds to the concerns that Bell Canada views as being inherent in the Decision 81-15 that subscribers not be affected by the performance of subsidiaries and associated companies not considered integral to Bell Canada."

On August 12 the CRTC issued a public notice calling for comments on any aspect of the Bell proposal while specifying a number of issues. One issue of great importance to the CRTC is whether or not the proposal is subject to its review. The provisions of the Special Act incorporating Bell, along with those of the Railway Act governing its regulation, would appear to make the proposal subject to review by the CRTC. However, last April Bell obtained a certificate of continuance under the Canada Business Corporations Act (CBCA), and its articles of continuance do not contain any restrictions on the transfer of Bell's shares or on the businesses in which it may engage. There was a provision in the CBCA which expressly prohibited telegraph and telephone companies from applying for continuance under it, but the provision was repealed in 1978. Bell contends that, as a CBCA corporation, it can implement its proposal without review by the CRTC. The CRTC is also concerned about the following aspects of the proposal:

- The profits of the unregulated companies derive in part from their relations with Bell Canada, and the CRTC has been applying the regulatory principle that all net revenues from activities which are integrally related to Bell's regulated activity should be included for rate setting purposes. It is not clear that this principle could be applied after the reorganization.
- The proposal would affect the CRTC's practice of relating rates to a fair rate of return on equity, relying upon actual market data for that purpose.
- The proposal to transfer Bell Canada's investments to BCE at historic cost rather than present value would have implications for rates paid by subscribers.

- There are legal questions relating to the fields of application of the Canada Business Corporations Act, the Railway Act relating to regulation, the Special Act under which Bell Canada was incorporated as they affect the jurisdiction of the CRTC and the position of competing producers of telecommunication equipment.

On August 17 Consumer and Corporate Affairs Minister André Ouellet released a report on the matter by the Restrictive Trade Practices Commission. The report, which had obviously been prepared in great haste, was issued as Part II of the Commission's report on its telecommunications inquiry. The final volume will not be ready for some months and it would have appeared too late to affect the immediate issue of the Bell proposal. The Commission stated that while it was not in a position to make specific recommendations,

"We feel, however, that the public interest requires that a reorganization should not take place unless there has been a full public consideration of the probable effects of the proposal, with respect to both subscribers and the telecommunication industry."

The Commission indicated its concern about a number of aspects of the proposal. Noting that the current value of Bell's investments exceeds the historic cost by more than half a billion dollars, much of it derived from Northern Telecom shares, the Commission states:

"A strong case can be made that most of the increase in the value of Northern's shares held by Bell should accrue to the subscribers who, in a rate-of-return regulatory environment, were the real, if unknowing, risk takers in Bell's reliance on Northern as its principal supplier."

With regard to Bell's purchasing arrangements with Northern, the Commission points out that while dividends from Northern now help to reduce telephone rate increases, they would go directly to shareholders under the proposal. The Commission states:

"A dichotomy would thus be created between the interests of Bell shareholders and its subscribers which does not now exist. Inappropriate equipment purchases would harm subscribers and benefit Bell shareholders. Regardless of management's competence and interest in operating efficiently, it should not be placed in a position where the interests of shareholders and subscribers is so divergent."

The Commission also expresses concern about the proposed separation of regulated from unregulated income where joint costs are involved, especially Bell's unregulated overseas consulting services such as in Saudi Arabia. It states:

"...it must be assumed that what Bell has to sell overseas is derived from its experience gained in operating its own telecommunications networks. It is difficult to see how a subsidiary operating at arm's length could be established or why anyone would want to insist on such a relationship. It is assumed that the resources essential to providing the service reside in Bell Canada and are called upon as needed. The removal of all income derived from the sale of overseas telecommunications consulting services from the flow of revenue used in determining the revenue needs of Bell Canada, as would result from the proposed reorganization, raises a serious question of fairness as between shareholders and subscribers."

### COMBINES DIRECTOR PROPOSES NARROWER EXEMPTION FOR SHIPPING CONFERENCES

Mr. Lawson Hunter, Director of Investigation and Research under the Combines Investigation Act, appearing before the Water Transport Committee of the Canadian Transport Commission, warned that international ocean liner shipping conferences are cartels which may be adversely affecting Canadian foreign trade. He argued that provisions of the present Shipping Conferences Exemption Act, 1979, (SCEA), which extends broad immunity for conferences from attack under the Combines Investigation Act, must be changed to ensure that the users of liner services are protected from abuse of conference market power. Shippers also proposed changes, while ship owners and agents expressed general satisfaction with the present law.

The SCEA expires in 1984 unless it is renewed, and the CTC has conducted public hearings across the country as part of an interdepartmental review. The Act was first passed in 1971 following publication in 1965 of a report on shipping conferences by the Restrictive Trade Practices Commission. The Act, which contains a five year "sunset clause", was reenacted in 1979 with minor amendments. Essentially, it exempts from the Combines Investigation Act a broad range of conference practices, including collective rate fixing through common tariffs; use of dual rate exclusive patronage contracts; allocation of ports among conference members; regulation of carrier schedules and other service characteristics; pooling of cargo and revenue, and conference control over admission of new members.

The exemption does not apply to certain extreme monopolistic practices, such as predatory conduct toward independent carriers. Conference members must file with the CTC their tariffs and descriptions of arrangements falling within the exempted categories. The Act also specifies that conference practices that restrict competition excessively, beyond what is necessary for rate or service stability, are prejudicial to the public interest for the purposes of section 23 of the National Transportation Act. Under this provision, the CTC may intervene, hold hearings, and issue reports and/or remedial orders

respecting prejudicial practices of ocean carriers and other transport modes under federal jurisdiction. The Director of Investigation and Research is also authorized by the SCEA to conduct inquiries into certain conference activities.

Mr. Hunter characterized conferences as cartels, whose purpose is to exercise market power for the benefit of carriers. He considered that the primary economic rationale put forward in defence of conferences - the prevention of "destructive competition" - can be seriously questioned. Moreover, while some form of exemption for conferences may be necessary, because of their pervasiveness as an international institution, significant limits on conference power are both desirable and reasonable in view of U.S. shipping policy, which enforces important constraints on conferences, and generally requires balancing the interest of service stability with the traditional goals of antitrust policy. (Antitrust immunity for conferences operating in U.S. trades may be strengthened soon, but significant constraints are likely to remain - see article above).

In the course of his presentation, the Director revealed preliminary results of (i) an economic study of liner conferences by the Bureau of Competition Policy; and (ii) a survey of Canadian shippers, commissioned by the Bureau. Key findings include:

(a) Structure of Liner Shipping

- In 1981, over 30% of the value of Canadian exports was transported by water - over half of this by liner;
- The limited evidence available suggests that international transport costs are "very significant", and these may operate as a barrier to trade, like tariffs or other restraints;
- Competition between "naturally competitive" conferences, and from independent (non-conference) carriers, offer insufficient protection for Canadian shippers. An increasing percentage of conference lines have memberships in three or more conferences, and on more than half of all Canadian routes, conferences have one regular, year round independent rival or none.

(b) Loyalty Contracts

More than half of the conferences operating in Canada employ dual rate loyalty contracts, whereby shippers receive discounts for promising to ship up to 100% of their traffic by conference carriers. The purpose of these contracts is to preserve conference market shares and minimize the threat of new entry by independent carriers. Mr. Hunter noted that of the

64 shippers surveyed as of the date of his submission, 98% believed they should not apply to shippers' total traffic. He characterized the contracts as "anti-competitive exclusive dealing arrangements."

(c) Preferential Rates for U.S. Shippers

The Director reported that his office had encountered some limited evidence of a conference member offering to ship products of United States origin through a Canadian port at a rate significantly lower than the loyalty rate offered to Canadian shippers. He described this as intolerable and called upon the inter-departmental SCEA review committee to determine if the practice is widespread. (It is known that over 60% of the outbound traffic through Montreal originates in the U.S.)

(d) Conference Rate Surcharges

Mr. Hunter noted that the greater proportion of effective rate increases over a recent period was attributable to Bunker Adjustment Factors (BAFs) and Currency Adjustment Factors (CAFs), not to increases in 'base' rates. Since such surcharges are imposed unilaterally and on short notice, he said this makes a mockery of the extensive negotiations with shippers over base rates.

(e) Multi-modal Transport Issues

The Director noted the increasing incidence of "door to door" multi-modal transport service, frequently offered by ocean carriers, that provide one segment of service directly, and the other segments through sub-contracting with railroads or trucking firms. He noted that multi-modal service entails significant efficiency gains and convenience to shippers in the form of "one stop shopping." However, he saw possible dangers, especially given the increasing trend toward multi-modal ownership as the vehicle for integration. Potential dangers include cross-subsidization of inland freight movement with ocean revenues, and generally heightened entry barriers, through preferential treatment of affiliated carriers.

Policy Recommendations

While recognizing the potential usefulness of the Canadian Shippers Council as a means of expressing shipper concerns, Mr. Hunter considered that only more rate competition could ensure adequate protection for Canadian

users of liner services. While noting that current liner rates and profitability may be temporarily depressed by the worldwide economic downturn, he submitted that Canada's future policy toward conferences must be based on the assumption of a post-recessionary resurgence of foreign trade demand, with consequent strengthening of conference market power. The Director's core recommendations were:

- (i) Outright prohibition of loyalty contracts, to encourage independent competition. More traditional, less restrictive volume discounts might still be allowed.
- (ii) A mandatory right of independent action for conference members, allowing individual members to depart from tariff rates under prescribed conditions. This provision would inject limited rate competition within the conferences and reduce the influence of inefficient carriers on joint rates. Mr. Hunter noted that a form of this right was implicit in the existing U.S. policy of "open" (penalty-free) entry and exit from conferences, and would be explicit for conferences using loyalty contracts under bills pending before Congress.

Regarding the issue of multi-modal integration, the Director noted the need to resolve the ambiguity in the present SCEA as to the scope of the exemption for joint rate making; he considered that Parliament had intended to create only an (Ocean) Shipping Conferences Exemption Act, not a multi-modal transport conference act. he also saw a need for an eventual strengthening of National Transportation Act provisions respecting multi-modal acquisitions.

Throughout his submission, Mr. Hunter emphasized the need for more extensive carrier information disclosure, to create a solid base for public policy making. Finally, he suggested that the SCEA might be replaced by more positive legislation, embodying his basic policy recommendations and more general provisions respecting ownership and information disclosure by conference and independent carriers.

### Views of Shippers

The submissions by shippers' interests also expressed some dissatisfaction with the conference system. The Canadian Manufacturers' Association criticized the one hundred per cent loyalty contracts and the "arbitrary" assessment of surcharges by the conferences; and it called for some degree of negotiating freedom for individual conference members. The Canadian Shippers' Council, which has been designated by the Minister of Transport under the Act as the shippers' group with which conferences must meet, also submitted a brief. it called for access to more information on such matters as BAFs and CAFs, legislative support for more meaningful negotiations with the conferences, a dispute settlement procedure and a requirement for a reduced loyalty pledge. Ship owners and agents generally supported the SCEA as it now stands.

## ONTARIO AND QUEBEC TO TERMINATE STOCK EXCHANGE RATE FIXING

The Ontario and Quebec securities commissions have both decided to terminate the fixing of stock exchange brokerage fees in their respective jurisdictions effective April 1, 1983. Alberta has no present plans for such a change and British Columbia is still considering the matter.

At the present time the Toronto Stock Exchange sets a sliding scale of minimum commissions on all transactions up to \$500,000.00 as approved by the Ontario Securities Commission (OSC). In its decision to abolish fixed rates, which is dated June 25, the OSC stated in part:

"We have concluded, on all the evidence, that we can no longer continue to sanction a practice, no matter how long it has been in existence, which is contrary to the aspect of the public interest identified in section 32 of the Combines Investigation Act...We are mindful that the brokerage community, as the rest of the economy, is presently in a cyclical trough with restructuring taking place even with the perceived protection of the regulated fixed minimum rate structure. This same regulated fixed minimum rate structure acts as a constraint on any firm wishing to increase its rates as well as a prohibition against a firm that wishes to reduce them. In the end result the small investor may pay a larger commission if he uses the services of the so-called 'full service' broker. The so-called 'discount broker' may emerge, as indeed it has in Toronto in the commodities field, for the investor not needing the advice or the range of services now routinely available through most brokerage firms."

Other factors noted by the Commission included the favourable experience in the United States since the abolition of fixed rates there in 1974, and the existence of a substantial and growing minority of larger Ontario brokers who have favoured a move to flexible rates.

The Director of Investigation and Research, Combines Investigation Act, urged the abolition of fixed rates at hearings of the OSC in the autumn of 1981. Officials of the Quebec, Alberta and British Columbia securities regulatory bodies were present at those hearings.

Rules respecting institutional ownership of securities dealers and diversification and are now under consideration, and the OSC held hearings on those subjects in July, 1982. Interest by stock brokers in public ownership and diversification are of fairly recent origin and the OSC is just in the process of developing firm rules in those areas. There is concern within the industry about possible adverse effects of permitting outside control, especially where other financial institutions are involved, and about permitting securities dealers to

engage in other financial services. In his submission at the July hearings, the Director of Investigation and Research recommended removal of all restrictions on the flow of capital into and out of the brokerage industry. He stated:

"Restricting the flow of capital into, or out of any industry is tantamount to creating a barrier to entry or exit. The effect is undistinguishable from that of not allowing firms to enter the industry, an action which is well understood to be anti-competitive."

### **AIR FARE DISCOUNTS RESTRICTED BY CANADIAN TRANSPORT COMMISSION**

The Air Transport Committee of the Canadian Transport Commission, in a decision announced on August 19, has placed a number of restrictions on air fare discounts effective November 1, 1982.

Offers of discounts as high as fifty per cent or more had become widespread since CP Air introduced its Skybus no-frills service in 1979. The industry is now suffering heavy losses and has been seeking the intervention of the Commission to contain the discounts.

The Consumers Association of Canada and the Director of Investigation and Research under the Combines Investigation Act have opposed action by the Commission. The Director's representative stated at hearings in June:

"...the Committee's proposal, if implemented as policy, would be an unwarranted limitation on competition among domestic air carriers and, rather than helping to improve the financial performance of domestic air carriers in 1982 and 1983 may well cause a reduction in domestic air carrier revenues and profitability."

The new rule bans discounts of more than 25 per cent on one way fares, and the same applies to return fares not booked fourteen or more days in advance.

### **FOOD PROCESSORS PROPOSE SUBSTANTIAL CHANGES IN FARM INCOME SUPPORTS**

The Grocery Products Manufacturers of Canada (GPMC), an association representing some 140 food processors, has proposed a substantial reduction in the powers of agricultural marketing boards with supply management functions and the introduction of a contributory insurance scheme for producers of crops not under supply management which would guarantee them one hundred per cent of producers' average cash costs.

The proposals are contained in a report, which was released in June, 1982. In an earlier report which was released in October, 1981, GPMC emphasized the high cost of supply management boards in terms of consumer prices, productivity, lost production and the balance of Canadian international trade in raw and processed foods. Among the recommendations in that report was the placing of a moratorium on the creation of additional supply management boards.

The report issued in June presents proposals to curb the powers of supply management boards whose activities affect inter-provincial and international trade and to provide more income security for producers of nationally traded farm products which are not covered by supply management boards. At the present time there are over one hundred provincial marketing boards, of which thirty-nine have supply management powers. Some of the latter operate under federal-provincial agreements which enable them to restrict inter-provincial and international trade; while many of these boards are subject to the authority of supervisory boards, farm interests generally predominate. At the federal level, the Canadian Dairy Commission and boards dealing with eggs, chickens and turkeys all have supply management powers. The latter three are loosely supervised by the National Farm Products Marketing Council (NFPMC) which by statute is dominated by farm interests. Altogether, products accounting for about one quarter of all farm receipts are governed by supply management boards. Essentially, CPMC proposes that the NFPMC be transformed into a quasi-judicial body which would be capable of protecting the public interest. It would have broad powers over all federal supply management boards and over restrictions by provincial boards on inter-provincial and international trade. Specifically CPMC recommends:

1. All existing supply management marketing boards in Canada, including the Canadian Dairy Commission, the national agencies for eggs, chicken and poultry, and any provincial board whose product is sold outside the province, should be regulated by the National Farm Products marketing Council (NFPMC).
2. The powers of the NFPMC should be strengthened through legislative amendments to make it a bona fide regulatory agency with quasi-judicial powers to subpoena information, call witnesses, and approve or disapprove specific pricing or supply decisions of its regulated agencies.
3. Full-time membership in the NFPMC should be expanded to ensure all partners in the food system are fairly represented in all of its executive decisions.
4. Each partner in the food system should have representation on supply management boards regulated by the NFPMC.

5. The NFPMC and every agency regulated by it should publish an annual report on their operations.
6. No supply management marketing board should have the power to restrict interprovincial trade or imports without the explicit approval of the NFPMC after appropriate hearings and the acceptance of its recommendations by Order-in-Council."

GPMC has expressed concern about pressures to establish supply management boards for a number of additional products including beef and potatoes. As an alternative, it proposes an "income security package", many elements of which already exist in whole or in part. For example, it favours marketing boards to negotiate prices and encourage sales, and existing income stabilization measures such as crop insurance. In addition, it proposes a contributory insurance scheme whereby producers of such products as beef, pork and potatoes which are not under supply management would be guaranteed one hundred per cent of producers' average cash costs. CPMC states:

"The foundation for this new program would be a single level Stabilization Fund that would encompass all national commodities excluding the grains that are adequately covered now by the Western Grain Stabilization Fund. Most importantly, the Fund would provide improved security to beef, hog and potato producers, whose incomes currently are subject to serious cyclical fluctuations. In practice, the Stabilization Fund would be based on the principles already tested and well established by the very effective Western Grain Stabilization Fund."

GPMC estimates that the cost of the proposed "security package" to the government would be only about half those which would be incurred by supply management schemes for the same products. Moreover, it states:

"The income stabilization mechanism described here provides an incentive for producers to increase their productivity and leaves the marketing system free to promote consumption in all parts of Canada, and to seek and enhance export potential not only for the raw product, but also for processed products."