OUTSIDE THE COURTS

MACDONALD COMMISSION ENDORSES MODERATE COMBINES ACT REFORMS

The Report of the Royal Commission on The Economic Union And Development Prospects For Canada, which was released on September 5, is generally supportive of the kinds of amendments to the Combines Investigation Act which the government appears to have in mind. It also suggests an enhanced policy advocacy role for the Director of Investigation and Research, new public reporting requirements for all large firms, and a review of the price maintenance prohibition to determine if resale price maintenance should be illegal only when its detrimental effects on competition demonstrably outweigh its benefits. The Report places more emphasis, however, upon the pro-competitive effects which its proposals for freer trade would have. It also makes pro-competitive proposals respecting regulation, Crown corporations, foreign investment, and adjustment policies such as support for declining industries.

In assessing the state of competition in Canada, the Commission cites findings in a staff study by R.S. Khemani[1] that concentration at the producer level is much higher in Canada than in the United States, and has been increasing both in terms of asset shares held by the largest firms and of major industrial sectors. The study also finds that while four-fifths of the U.S. economy can be classed as competitive compared with only two-fifths in Canada, much of this difference is atrributable to the greater prominance in Canada of government-enforced price, output and entry restrictions such as in agriculture. However, another staff study[2] finds that increasing production runs are generally associated with increases in concentration, and the Commission describes increasing concentration under those circumstances as "not undesirable". Moreover, it cites a recent Economic Council of Canada Study[3] which found that concentration in terms of domestic sales including imports was much closer to U.S. levels and had been falling with increasing imports.

The Commission concludes from the foregoing findings that the two most important means of promoting competition are trade liberalization and the removal of certain regulatory restrictions on price, output and entry. It states:

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1. R.S. Khemani, "Extent and Evolution of Competition In the Canadian Economy", in Canadian Industry in Transition, Vol. 2 (Toronto, University of Toronto Press, 1985).
2. John R. Baldwin and Paul K. Gorecki, The Role of Scale in Canada-U.S. Productivity Differences, Vol. 6 (Toronto, University of Toronto Press, 1985).
3. J.R. Baldwin, P.K. Gorecki and J.S. McVey, "Imports, Secondary Output Price-Cost Margins and Measures of Concentration: Evidence For Canada", Discussion Paper 263 (Ottawa, Economic Council of Canada, 1984).

> "Competition policy in many market economies has come to reflect the thesis that the economic benefits of efficient large-scale production will often more than offset the economic costs associated with the increase in market power that is usually inherent in the development of economies of scale. In a small economy, increases in the scale of output are certain to produce met economic benefits when they occur in sectors that are subject to open international competition. It is hard to over-emphasize the central role of freer trade as a force for increased domestic competition. In Canada, the number of combines cases in which removal of trade barriers would have eliminated alleged anti-competitive activities is legion.
>
> The second important condition for greater domestic competition is the elimination of regulatory restrictions on prices, output and entry. Where these restrictions are removed, the possibility of competition from new entrants serves to discipline market participants. Recent theoretical work in industrial organization testifies to the power of potential competition to ensure both competitive pricing and efficient production, even in markets in which there are only a few firms. In Canada, the financial, transportation and professional-service sectors are obvious candidates for partial deregulation of this sort."
>
> (Vol. 2, pp. 220-1)

Turning to the Combines Investigation Act, their recommendation to which they accord greatest prominence is that the role of the Director should be recast. They state:

> "Our assessment of the major competition-policy issues leads us to conclude that the role of the Director of Investigation and Research under the Combines Investigation Act should be recast. In future, the occupant of this office should be less concerned with mergers, monopolies and vertical restrictions imposed along the supply chain and more concerned with reform of the fundamental conditions that determine the state of competition in the Canadian economy. Such reform would involve opposition to demands for continued or increased tariff, quota or equivalent protection. It would involve efforts to dismantle regulatory restrictions on entry and output, including those imposed by professional associations and marketing boards. Finally, it would involve opposition to attempts to 'guarantee' to a single producer access to the Canadian market or to a provincial market. While it is true that the Director has pursued these goals since the mid-1970's, Commissioners are suggesting that this activity be greatly intensified. Competition policy should also seek to ensure that the treatment of foreign investment in Canada is consistent with the maintenance of strong competition. Greater freedom of access to the Canadian market for foreign investment interests should help to increase the degree of competition in the Canadian economy."
>
> (Vol 2, p. 226)

And they recommend that:

> "...Parliament empower the Director of Investigation of the Combines Investigation Act to report on all developments that impede competition in Canada, including trade protection and regulatory provisions."
>
> (Vol. 3, p. 429)

The Commission favours civil law remedies for horizontal and vertical mergers that are contrary to the public interest and for flagrant abuses of monopolistic power, stating:

> "In our judgement, the vast majority of corporate mergers that are concluded in response to the dynamics of the market-place should not be of concern from the perspective of public policy, particularly not where the inflow of trade from abroad can be relied on to maintain a healty degree of competition. At the same time, however, a modern nation with an open market economy should have available to it, under civil law, the means to prohibit horizontal or vertical mergers that are contrary to the public interest. By the same token, we believe that means should also be available for dealing on a civil-law basis with flagrant abuses of monopolistic power. Such an abuse might occur, for example, where a firm that occupies a dominant position in the market-place sells a product at an exceptionally low price in an effort to drive an emerging competitor out of business."
>
> (Vol. 2, pp 222-3)

With regard to the means of adjudication of such matters, the Commission associates itself with those who prefer an administrative tribunal with rights of appeal to the courts only on grounds of law, jurisdiction and natural justice:

> "...we are well aware of the difficulty of developing criteria for determining whether or not certain types of mergers serve the public interest. We also recognize the difficulty of distinguishing between corporate behaviour that is abusive and predatory in its intent and effect, and behaviour that is innocent in intent and in keeping with acceptable competitive practices. Because it is so difficult to make such distinctions, we conclude that it would be better to call on an administrative tribunal to exercise its best economic judgement in the resolution of merger and monopoly cases than to fall back on adjudication by the courts, which are quite unequipped to exercise economic judgement.
>
> "We must also emphasize our view that the proposed administrative tribunal should review mergers, alleged monopolistic behaviour, and related matters such as specialization agreements

> aimed at industrial rationalization only if they appear to offer a serious threat to competition in the domestic market. While the tribunal must be able to exercise its judgement on the basis of the circumstances surrounding each case brought before it, the law and the regulations under which the tribunal is created should carefully define the tribunal's mandate and provide clear guidelines on the manner in which it is to carry out its proceedings."
>
> (Vol. 2, p. 223)

The Commission supports the conclusion of the 1978 report of the Royal Commission on Corporate Concentration that mergers and acquisitions involving conglomerates should be dealt with on an individual basis by the federal government and Parliament.

With regard to the conspiracy provisions, the Commission favours amendments to remove the enforcement difficulties which have resulted from recent decisions by the Supreme Court of Canada, and it would retain the exemptions pertaining to export activities. In addition, they call for amendments to overcome the apparent exemption of conduct by the self-regulated professions which is pursuant to authority delegated to them by provincial legislation.

The one area in which the Commission appears to lean towards some relaxation of the existing law is that of price maintenance. They state that a staff study by Mathewson and Winter[1] contends that there are circumstances in which resale price maintenance could provide significant economic benefits, and the Commission adds:

> "While Commissioners are not in a position to reach any conclusion on this issue, we do recommend a review of the provision making it illegal in any circumstances to require compliance with resale prices. It might be determined that resale-price maintenance should be illegal only when its detrimental effects on competition demonstrably outweigh its benefits. Alternatively, resale-price maintenance could be made a matter for review by an administrative tribunal, just as exclusive dealing and tied selling are now reviewed by the Restrictive Trade Practices Commission."
>
> (Vol. 2, p. 224)

In point of fact, while the ban on price maintenance has been extremely effective in promoting competition at the retail level, it does not, as the Commission states, make resale price maintenance "illegal in any circumstances". Ss. 38(5) permits a price to be affixed or applied to a product or container. Ss. 38(9) provides a number of defences against a charge of refusal to supply because of the low pricing policy of the person involved. The defences include loss leader selling, so-called bait and switch selling, misleading advertising of the product and inadequate servicing of the product. A seller who has a legal defence against a charge of refusal to supply is in a strong position to police resale prices.

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1. F. Mathewson and R. Winter, Competition Policy and Vertical Exchange, Vol. 7, forthcoming (Toronto: University of Toronto Press, 1985).

The Commission's final recommendation in the sphere of competition policy is that "All large corporations, public and private, Canadian owned and foreign owned, should be required to file annual reports with the government." (Vol. 3, p. 429). Elsewhere, they expand upon that recommendation in the following terms:

> "In order better to formulate and administer appropriate competition policy, the governments should consider requiring all large corporations and corporate groups -- public and private, foreign-owned and Canadian-owned -- to make available to the public information relevant to their operations. Given the relatively small size of Canada's domestic market, a high degree of concentration is necessary in certain industries if Canadian participants in these industries are to compete effectively against foreign enterprises at home and abroad. Yet a high degree of concentration may be considerably less acceptable in domestic industries that are largely sheltered from competition with foreign firms. Lack of domestic competition might make the goods and services produced by such industries excessively costly to Canadian firms which must buy from them. Consequently, these firms might find that their ability to compete against foreign firms is reduced. Given this situation, it is clearly important that Canadian competition policy be capable of responding to a variety of conditions and circumstances. The availability of extensive information concerning the functioning of all large-scale enterprises is a prerequisite for exercising a properly balanced competition policy."
>
> (Vol. 2, p. 227)

In connection with their proposals or freer Canada-U.S. trade, the Commission recommends an intergovernmental institution to provide basic executive and administrative decisions, technical staff services, adjudication of complaints and appeals (Vol. 3, p. 421). There is no specific discussion as to whether the existing Canada-U.S. antitrust cooperative arrangements would need to be supplemented in order to deal with private restrictions on international trade which might follow the reduction of official trade barriers.

Turning to the regulatory framework, the Commission, while not calling simply for less regulation, states that in many areas "a reduction in regulation, and a concomitant increase in competition, would substantially increase economic efficiency". (Vol. 3, p. 429). They also suggest a new role, possibly for the Director of Investigation and Research, in monitoring regulatory redistribution of incomes. They state:

> "many regulatory bodies sanction or require redistribution of costs and, thus, of incomes, often through cross-subdization among various users of a particular service. Each case needs examination on its own merits. Such transfers, however, are often hidden or

> obscure. Without full knowledge of the extent of such redistribution, it is, of course, impossible to consider whether the redistribution is warranted. To make such assessment possible, we suggest that Parliament require regulatory bodies, or perhaps the Director of Investigation and Research, to report regularly to Parliament and the public on the full extent of all redistribution of costs and income sanctioned by regulatory provisions."
>
> (Vol. 2, p. 216)

The Commission calls for phasing out or privatizing Crown corporations whose functions or objectives could be met more effectively by other means.

With regard to restrictions on foreign investment, the Commission sees the recent replacement of F.I.R.A. by Investment Canada as a step in the right direction, but they would go further to ensure full public disclosure and political accountability.

With regard to adjustment policies, they make proposals which, inter alia, would make it more difficult for governments to resort to protection of declining industries.

ONTARIO GOVERNMENT INTRODUCES BILLS TO STOP RETAIL DRUG PRICE GOUGING

Ontario Health Minister Murray Elston introduced two bills on November 7 that are designed primarily to stop long-standing abuses in the retail pricing of multiple-source prescription drugs including those obtained through the Ontario Drug Benefit Plan. He estimated that Ontario taxpayers and consumers are now paying at least three to four millions of dollars monthly in excess drug costs.

One bill, the Ontario Drug Benefit Act, confirms the authority of the Minister to determine what drugs will be listed in the Ontario Drug Benefit Formulary and to set realistic prices for them. The Formulary sets the amounts which pharmacists may claim in addition to a five dollar dispensing fee for filling prescriptions under the Ontario Drug Benefit Plan. The Bill recognizes that small pharmacies may buy in smaller quantities and higher prices than large ones, and it provides that reimbursement will not be lower than actual acquisition costs. The Minister announced plans in September to set realistic prices in the Formulary, but his power to do so under existing legislation was challenged by Apotex Inc., a manufacturer of generic drugs. The Supreme Court of Ontario issued an Order on September 12 prohibiting the government from publishing a revised Formulary until the case is heard.

The other Bill, the Prescription Drug Cost Regulation Act, will make it mandatory for pharmacies, except where a physician has specifically

written "no substitution" on a prescription, to inform consumers about their right to request an interchangeable drug and to dispense according to the customer's choice. It will also require pharmacies to dispense drugs in the entire quantity prescribed except in special circumstances. This will abolish the one-month supply limit that now exists under the Ontario Drug Benefit Plan and which enables a pharmacist to claim more than one dispensing fee during the life of a prescription.

In addition, this act will ensure that all interchangeable drugs dispensed to cash-paying customers will be sold at or below prices set by regulation plus a dispensing fee. Pharmacies will still be free to establish their own dispensing fee for interchangeable drugs in the cash market, but it will have to be registered with the Ontario College of Pharmacists and be posted in the drug store. For all prescription sales including those in the Ontario Drug Benefit Plan, pharmacies will be obliged to itemize on the prescription label or on the customer's receipt the cost of the drug and the dispensing fee.

The bills are the new Ontario government's response to a public outcry that followed articles by Ann Silversides in the Globe and Mail on August 22 and 24 of this year. She drew attention to an almost unnoticed report by Dean J.R.M. Gordon of Queen's University School of Business that was realeased about a year ago by the Ontario government (Report of the Commission on the Pricing of Multiple-Source Drug Products in Ontario). The Commission had been established by the Ministry of Health, the Ontario Pharmacists' Association, the Canadian Drug Manufacturers Association and the Pharmaceutical Manufacturers Association of Canada. The report, like several other publications which have appeared since the early 1970's, was highly critical of some of the practices of the Ministry, the manufacturers and the pharmacists in the pricing of multiple-source prescription drugs. Dean Gordon concluded that there was "a singular lack of competition", that prices were excessive, and that unnecessary costs variously estimated at up to $50 millions annually were borne by taxpayers through the Ontario Drug Benefit Plan, by subscribers to private drug payment plans and by cash-paying customers.

The problems at issue arose following the 1969 amendment to the Patent Act[1] providing for the compulsory licensing of prescription drug patents. That amendment led to a substantial increase in the number of multiple-source prescription drugs on the market, with the same generic product often differing widely in price according to its source of supply. The existence of different prices for the same generic drug meant that the Ministry of Health had to decide the level or levels at which to reimburse pharmacists for the multiple-source drugs dispensed under the Ontario Drug Benefit Plan.

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1. In reasons rendered on November 18, 1985, Mr. Justice Strayer of the Federal Court, Trial Division, dismissed an action by Smith, Kline & French Laboratories Limited et al. challenging the 1969 amendment as being ultra vires, inconsistent with the Canadian Bill of Rights and contrary to the Canadian Charter of Rights and Freedoms.

Under the Plan, all persons over 65 as well as disadvantaged groups such as those on welfare obtain prescription drugs free of charge, the retail pharmacist being reimbursed by the Province. About 45 percent of the total value of prescription drugs sold in Ontario come under the Plan. The pharmacist is reimbursed on the basis of a relatively modest dispensing fee of five dollars plus an amount which is listed for each drug in the Ontario Drug Benefit Formularly. The amounts listed for multiple-source drugs are those provided periodically to the Ministry by the manufacturers, and are supposed to be the wholesale cost to pharmacists. In filling prescriptions under the Plan, the pharmacist is required to supply the lowest priced of the multiple-source drugs.

A number of abuses have, however, crept into the system. In filling prescriptions for customers not under the Plan, pharmacists tend to charge the Formulary prices but they are not required to supply the lowest-priced of the multiple source drugs. Rather, they have an incentive to use the make of drug which brings them the highest margin. The drug manufacturers, each seeking to maintain or increase market share, have responded by reporting fictitiously high prices to the Ministry for inclusion in the Formulary. The result is that the Ministry pays the pharmacist the dispensing fee of five dollars plus an amount for the drug which may be double or more the actual acquisition cost. In addition, pharmacists are not required under the Plan to dispense more than one month's supply at a time even though the prescription permits a larger supply.

These abuses have also brought higher drug prices in the market not covered by the Ontario Drug Benefit Plan. Of the 7.6 million Ontario residents outside the Plan, some 6.4 million are covered by private plans. According to Dean Gordon, operators of the private plans have been pressured by the Ontario Pharmacists Association to reimburse pharmacists at the same rates as those under the provincial Plan (see also evidence of this in the acquittal of the Metropolitan Toronto Pharmacists Association on a conspiracy charge, Canadian Competition Policy Record, March, 1985). In addition, while retail prices are not uniform, Gordon found that cash-paying customers tend to be charged the Formulary prices.

The Globe and Mail of September 24 reported on a survey it conducted of the costs of having a generically written prescription for amoxillin filled by 19 pharmacies in the Toronto area. Most pharmacies charged for the drug according to the amounts listed in the Formulary, which varied from $7.20 to $8.04 depending upon the brand. Those figures, according to the Globe and Mail, are more than double actual acquisition costs, and several pharmacies charged less than $4.00. The dispensing fee ranged from $3.50 to $6.30, although a fee of more than $5.00 for a generically written prescription is illegal in Ontario under the Health Disciplines Act. All five pharmacies in the survey that were run by elected members of the 19 member Ontario College of Pharmacists charged more than the legal fee; the College is responsible for enforcing the Act by virtue of the pharmacists' status as a self-governing profession.

Dean Gordon devoted seven pages to the lack of competition in Ontario's prescription market, stating:

> "...the fundamental structural problems of the current programs and policies are the singular lack of effective competition throughout the retail prescription market and, in those instances where some competition exists, the barriers preventing the benefits of such competition from being passed on to consumers. In short, while some elements of the present structure promote competition, other elements hinder it. The elements which hinder it are stronger than those which promote it - thus the overriding objective of reasonable prices for prescription and drug products and services is not achieved to an acceptable level.
>
> "Competition in this context does not necessarily mean complete absence of regulation. Rather, it means structures which encourage suppliers of services to provide those services at the lowest possible cost."

He found the Ministry at fault, not only for accepting unrealistic prices for the Formulary, but more generally for not exercising its strong position in the market in the interest of consumers. He pointed out that physicians could be helpful by adopting the practice of writing their prescriptions in generic terms. He noted the pressure placed on operators of private drug plans by the pharmacists and their Association to accept the Formulary prices. He underlined the paucity of information available to consumers and said that pharmacists could do much to correct that.

COMMONS COMMITTEE OPTS FOR MORE COMPETITION IN FINANCIAL SECTOR

The House of Commons Standing Committee on Finance, Trade and Economic Affairs' report on the regulation of Canadian financial institutions was tabled on November 6. The Report examines the Green Paper on financial institutions which was published by the Department of Finance last April (Canadian Competition Policy Record, June, 1985) and makes its own proposals for restructuring those intitutions. The Report also deals at length with the supervisory reforms that are needed in the light of the recent failures among banks and other financial institutions and recommends the creation of a wide-ranging National Financial Administration Agency.

The Committee rejects many of the principal recommendations in the Green Paper including the proposed financial holding company structure, the creation of Schedule "C" banks, the ownership rules and the banning of self-dealing. Its proposals include the following:

- Eliminate all distinctions between the Canadian widely held (Schedule A) banks and the foreign and narrowly held Canadian (Schedule B) banks.

- "That the chartering, acquisition or merger of a financial institution involving a foreign-owned entity be considered for approval by the Minister of Finance on the principle of reciprocity".

- "That domestic ownership limits for all Canadian incorporated financial institutions and holding companies controlling affiliated financial institutions be established on the basis of domestic asset size as follows:"

Under $10 billion	100%
$10-$20 billion	75%
$20-$30 billion	50%
$30-$40 billion	25%
Over $40 billion	10%

Foreign-owned Canadian financial institutions would be made subject to similar ownership limits based upon Canadian domestic asset size.

- Instead of the mandatory form of financial holding company proposed for financial conglomerates in the Green Paper, the Committee recommends:

> "That non-bank financial institutions be allowed to diversify flexibly through upstream holding companies and affiliated institutions, downstream holding companies and subsidiaries, together with some limited expansion of in-house powers and networking arrangements"

- Permit trust companies to expand their commercial lending from the present seven percent to fifteen percent of their total assets.

- Instead of a ban on self-dealing as proposed in the Green Paper, the Committee recommends a multi-faceted approach which would avoid the competition and efficiency losses flowing from a general ban. There would be a selective ban on self-dealing of kinds likely to affect solvency. A new National Financial Administrative Agency with wide supervisory authority over all financial institutions would be empowered to grant exemptions. These measures would be complemented by increased corporate self-regulation and the use of specialized board committees to monitor self-dealing issues.

The Green Paper proposal to permit networking was among those which the Committee endorsed. Networking refers to arrangements among financial institutions whereby one institution provides the public with access to an investment, contract or service offered by another institution, whether affiliated or not. The Committee also endorsed a Green Paper proposal for the creation of so-called Chinese Walls as one of a number of ways of preventing conflicts of interest which can arise when a financial institution has to choose between its own corporate interests and those of a customer. A Chinese Wall is a combination of corporate policies, structures and procedures to prevent a flow of information between divisions of a company or between related companies.

According to an article by Sonita Horvitch in the Financial Post of November 16, the proposed new ownership rules would mean no change in the present ten percent single ownership limit for the three largest Scedule A banks but would permit higher single ownership for the others. Trilon, the largest of the non-bank financial conglomerates, would come under the 75 percent rule.

The Committee, in its introductory remarks, emphasized the need for competition as a a public policy objective along with the paramount need for solvency and stability. It stated:

> "...the number of recent failures and the need for adequate regulation and supervision must not unduly overshadow the need for competition as a public policy objective. Canada is a country of diversity with varying regional and local needs. It is also a major player in world financial markets. Therefore, it is imperative that legislation governing financial institutions and the system of regulation and supervision should provide a framework for new institutions to be created and small regional ones to be viable. This is because regionally based institutions may often be more sensitive to local community needs. The growth of the credit union movement in Western Canada and that of the caises populaires in Quebec is proof that small and regional institutions can be viable.
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> "The financial institution failures and the rapid development of financial innovations precipitated by technology have pointed to the need for re-regulation and deregulation. Straddled between the two seemingly opposing trends are the public policy objectives of stability and competition. While most observers acknowledge that trade-offs are inevitable between these two policy objectives, it is the view of the Committee that re-regulation and deregulation are not incompatible goals. The Committee believes its conclusions and recommendations contained in this report reflect this attempt to strike a balance between the two public policy objectives while concomitantly improving prudential safeguards (re-regulation) and providing greater diversification of corporate powers to non-bank institutions (deregulation)".

The Director of Investigation and Research, Combines Investigation Act, made a submission to the Committee in July. After noting the necessity of regulation to ensure public confidence in the solvency of financial institutions, he emphasized that its form should be the least restrictive of competition so as to allow fainancial markets to operate as freely and efficiently as possible. He took the position that large conglomerates or high levels of concentration do not necessarily preclude high levels of performance, stating:

> "High levels of concentration should become a matter of concern only when markets are not contestable. Concerns about future concentration can best be dealt with by the implementation of regulatory policies which allow freedom of entry by new firms into different market segments. The freedom of entry is the most powerful device for ensuring competition, increasing efficiency, and preventing abuses by incumbent firms. As long as entry is not impeded, potential new firms will be able to exploit profitable business opportunities as they arise, thus discouraging inefficient behaviour by existing firms. Successful market penetration by new entrants will only be dependent upon the exercise of superior skills, management strategies, and innovative behaviour. As such, the question of whether or not new firms do in fact enter and hence lower measurable concentration levels is not critically important. Rather, what is important in terms of a disciplining device on incumbent firm behaviour is a credible prospect of competitive entry".

He questioned the Green Paper proposal to solve the self-dealing problem by an outright ban, and presented his views on less restrictive solutions. The Committee has adopted a number of his proposals in that regard as well as some of his suggestions for preventing conflict of interest abuses.

CRTC PONDERS STRUCTURAL SEPARATION TO ENSURE FAIR COMPETITION AMONG TERMINAL EQUIPMENT SUPPLIERS

All submissions had been received by the Canadian Radio-Television and Telecommunications Commission by the end of October in its current proceeding to examine the feasibility of implementing structural separation of the multiline and data terminal equipment businesses of Bell Canada and British Columbia Telephone Company. The Commission will study the submissions, after which it is expected either to make a decision or call public hearings.

The crux of the issue is how best to ensure that the companies do not exploit their monopolies as telecommunications carriers by subsidizing their terminal equipment businesses to the disadvantage of competing suppliers who are not carriers. CRTC decisions in 1979 and 1980 permitted customers to attach their own equipment to the Bell Canada and B.C. Tel. lines. Well over

one hundred independent suppliers now compete with the carriers in the Canadian multiline and data terminal equipment markets which are valued at well over $200 millions annually. The independents now have about one-third of the markets in Bell Canada and B.C. Tel. territories.

While both carriers now offer some of their terminal equipment through separate subsidiaries, an increasing amount of the CRTC's resources are being devoted to the carriers' rates for such equipment. Moreover, neither the Commission nor the independents are satisifed with the results. Figures recently supplied by B.C. Tel. to the Commission indicated that costs under the former's own classification of terminal gear exceeded revenues. Following a complaint by the Association of Competitive Telecommunications Suppliers this year, the Commission found that, in Ontario, Bell Canada's schedule for providing network services to subscribers with their own terminal equipment was five business days longer than for subscribers with equipment supplied by Bell. In Quebec, there was no schedule for subscribers with their own equipment and it was a matter of negotiation on a case by case basis.

Two alternative methods have been proposed for ensuring that the carriers do not use revenues from their monopolies as carriers to subsidize their terminal equipment businesses. One is improved methods of costing for regulatory purposes and the other is structural separation of the carriers' monopoly activities from their competitive activities. The Commission has now concluded that the completion of Phase III of its Cost Inquiry and the adoption of an improved costing method will take a considerable amount of time. Moreover, the carriers have been complaining about delays in regulatory approvals and the independents have been calling for action to ensure that there is no cross-subsidization. In consequence, the Commission decided to initiate the proceeding on structural separation without delay.

The submissions of the Bureau of Competition Policy, the Independent suppliers and the Canadian Manufacturers Association favour structural separation, while those of the carriers and the trade unions do not.

The Bureau of Competition Policy's Director of Investigation and Research takes the position that structural separation is the appropriate means of preventing cross-subsidization in the particular cases of Bell Canada and B.C. Tel. He notes that structural separation does restrain management freedom as do other regulatory policies, but he emphasizes the monopoly positions of the two carriers and contends that they have a strong incentive to cross-subsidize. He argues that the alternative of regulatory costing techniques can at best only provide aporoximations of costs of a particular group of services and that they involve expensive and detailed regulatory intervention.

Bell Canada states that it is prepared to implement structural separation voluntarily subject to certain conditions if the Commission finds it to be in the public interest. Bell does not, however, regard structural separation as an appropriate course. They deny engaging in cross-subsidization

of terminal equipment or the existence of any incentive to do so. They contend that structural separation would result in an efficiency loss for their overall operations and reduce consumer choice. Moreover, they take the position that satisfactory costing controls are available to counter any ability to cross-subsidize. They state in their concluding remarks:

> "Given the impact on customers; the additional costs; the maturity of the market in terms of the type and number of participants; its five year life under current conditions of distribution and regulation and the significantly reduced size of the replacement market; the current changes recognized as necessary in the U.S.; the continuously changing nature of technology; and the availability of a costing solution, the Company cannot support structural separation as a solution to either a regulatory, or a perceived market, dilemma."

There are, in addition, differences in the positions taken as to how structural separation should be achieved if that option is chosen. Bell Canada proposes that "the fixed assets to be transferred to the affiliate be valued on the basis of their original costs, as capitalized and recorded on the Company's asset accounts, reduced by an appropriate amount which would be calculated based on the estimated remaining lives of the assets as reflected by survivor curves currently determined to be appropriate for use with the associated asset accounts". The Director of Investigation and Research and the independents, on the other hand, take the position that the affiliate be valued according to its market value as an ongoing business or, in the words of the Director, "according to generally accepted business valuation principles in order to most closely approximate the value that would be attached to the business in an open-market or arms-legnth transaction".

COMMONS SUB-COMMITTEE FAVOURS MORE PROTECTIVE COPYRIGHT LAW

The House of Commons Sub-Committee on Revision of Copyright, Standing Committee On Communications and Culture, released its report, A Charter of Rights For Creators, on October 10. The Report deals with the 1984 White Paper on copyright, From Gutenberg to Telidon (see Canadian Competition Policy Record, September, 1985). The Sub-Committee's Report recommends substantially increased protection for creators including establishment of additional copyright societies, expansion of the range of rights attaching to copyrighted works and extension of copyright protection to new types of works. It emphasizes the perceived need to protect the private property rights of creators and to provide increased rewards for creative activity.

Copyright Societies

Copyright societies are collective organizations to which copyright holders may assign or license their rights for purposes of exploitation and enforcement. The existing Copyright Act provides for musical and dramatico-musical copyright societies, subject to regulation by the Copyright Appeal Board. Like the White Paper on Copyright, the Report of the Sub-committee recommends that the collective exercise of copyright by such societies be encouraged. It states that:

> "The collective exercise of copyright has several advantages. For users it permits quick and easy access to a large volume of copyright material. For creators it permits the exercise of rights which cannot be effectively administered individually. For example, a composer cannot monitor the use of every musical work on radioa and television all across the country. However, the same monitoring done on behalf of several thousand composers at the same time is an effective way to monitor and enforce what otherwise would be unenforceable rights. The same principles can also be applied to photocopying in schools and libraries, to the taping of broadcasts by schools, and to other multiple uses."

> The Sub-committee recognizes, however, that:

> "There is a danger that the unregulated collective exercise of rights could lead to abusive practices. If the only practical access is through a collective then there is a potential that a collective, because of its dominant position, could occupy too strong a bargaining position vis-à-vis users."

To deal with this issue the Report recommends regulation of copyright societies' rates by a revised Copyright Appeal Board (to be re-named the Copyright Board). The Board's jurisdiction would be limited to setting rates and to hearing evidence only where the society and its users are unable to reach voluntary agreement. This is in contrast to the proposal in the White Paper to give the Board broader powers to intervene in the societies' internal administration.

One important issue raised in the submission of the Director of Investigation and Research to the Sub-committee was the use of exclusive licensing arrangements between copyright societies and their members. The existing musical performing rights societies normally require their members to make an exclusive assignment of their rights to the societies for a period of 5 years. In the U.S., the American Society of Composers, Authors and Publishers (ASCAP) is prohibited from using such exclusive arrangements under the terms of a 1950 antitrust consent decrees. In their interventions before the Sub-committee the Director as well as the Canadian Society of Copyright Consumers and several other user representatives suggested that the Sub-

committee consider recommending similar treatment of copyright societies in Canada. However, the Sub-commitee declined to recommend such limitation of the role of copyright societies.

Compulsory Licensing of Sound Recordings

A system of compulsory licensing for the mechanical reproduction of sound recordings in Canada has been in effect under the Copyright Act since 1924. Section 19 of the Act provides that once any work has been recorded in Canada, it may be re-recorded by any person upon payment of statutory royalty fee. A recent study found[1] that the system of compulsory licensing has fostered the growth of a competitive recording industry in Canada. Removal of the system would place Canadian record companies at a "serous disadvantage," since their major foreign competitors benefit from similar provisions under their domestic copyright legislation.

However, the Report of the Sub-committee recommends abolition of compulsory licensing for sound recordings. It states that:

> In its approach to this issue, as with the other exceptions to copyright that it has considered, the sub-commitee returns to its basic philosophy: copyright law is a matter of the property rights of creators and any derogation from those rights must be for strong public policy reasons.
>
> There is no question that the compulsory licence constitutes such a derogation. It takes away a copyright owner's right to control who will record a work and under what circumstances. It takes away the right to negotiate the most favourable terms possible.

Right to Control Rental of Copyrighted Materials

The Sub-committee Report recommends the establishment of a separate new right of copyright holders to control the public rental of all copyrighted works, even following their sale (for due consideration) to independent distributors. The White Paper recommended the establishment of this right for films, video-cassettes and sound recordings. Under the existing Copyright Act, buyers are at liberty to rent unless there is an agreement to the contrary with the copyright holder.

In his submission to the Sub-committee, the Director of Investigation and Research noted a concern that the establishment of a rental right could facilitate exclusive dealing and tied selling by the major film-makers. Although the rental right is actively supported by the U.S.-based motion picture industry, the U.S. has so far declined to establish such a right in respect of films and video-cassettes.

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1. Mike Berthiaume and Jim Keon, The Mechanical Reproduction of Musical Works in Canada (Consumer and Corporate Affairs Canada, Copyright Revision Studies, 1980).

Home Copying and Fair Dealing

The Sub-commiteee expressed concern over the growing incidence of home taping of audio and video recordings. To deal with the issue of home taping, the Sub-committee recommended the enactment of a new levy on blank tapes and recording equipment, with the proceeds to be distributed to creators by collective societies. The Sub-committee explicitly rejected a broadening of the concept of "fair dealing" under the existing Copyright Act to accommodate home taping and other forms of personal reprography. In the U.S., the corresponding but broader concept of fair use was held to permit home taping for purposes of time-shifting by the U.S. Supreme Court in the 1984 Betamax case.

Other Recommendations

The Report of the Sub-committee further recommends that:

- Computer programs should receive full copyright protection for the life of the creator plus 50 years;

- Copyright holders should retain the right to bar the importation of competing duly authorized foreign versions of their works;

- A new right of compensation for copyright holders for cable re-transmission of their works be established;

- The maximum level of fines for criminal infringement of copyright be increased substantially to $1 million.

Consumer Interests

The Report of the Sub-committee contains little analysis of the impact of the proposed strengthening of copyright protection on consumers. In a dissenting opinion to the Report, Lynn McDonald, the N.D.P. member, stated:

> No estimates have been made as to the probable costs, or outflow of funds, from the recognition of these new rights, although for all of them, the majority of funds up to 90% in some categories would leave the country. I believe that estimates should be made and considered before implementation of costly items.

The Sub-committee has requested that the government table a response to the report early in the new year.