COMMENT AND ANALYSIS

CANADA'S NEW SHIPPING CONFERENCES LEGISLATION: PROVISION FOR COMPETITION WITHIN THE CARTEL SYSTEM

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Bill C-21, the *Shipping Conferences Exemption Act (SCEA), 1987*, came into force in its entirety on February 17, 1988.[1] The new *Act*, which replaces legislation enacted in 1979, entails major changes in the statutory framework for liner conferences in Canada. Conferences are cartels that regulate rates and conditions of service in liner shipping, the common carrier aspect of international ocean transport. The *SCEA 1987* narrows the conferences' exemption from the *Competition Act* and enhances the scope for price competition within the conference system through the instruments of service contracts and independent action by member lines. The legislation also establishes new procedures and remedial measures to deal with conference agreements and practices that are detrimental to users' interests. These changes, which involve increased reliance on the *Competition Act*, go a long way to balance the position of Canadian exporters and importers vis-à-vis the conferences.

The liner industry is of major importance from the standpoint of Canada's foreign trade interests. Liner shipping carries approximately two thirds of Canada's overseas trade (by value).[2] Ocean freight rates comprise 15% or more of the landed price of many Canadian exports.[3] Thus, the provisions of *SCEA* can have important implications for the price competitiveness of Canadian exporting (and importing) industries. From the competition policy perspective, the *SCEA 1987* is also of interest since it provides a model for regulatory reform which is applicable to industries in which pure competition is not a feasible alternative.

The new legislative framework for conferences has been adopted in the context of far-reaching changes in the structure and environment of the liner industry. The advent of fully integrated multimodal transport service has enhanced the availability of alternative cargo routings for exporters. The resulting competitive pressures in the liner industry have been heightened by the deregulation of surface transportation links in the U.S. and, more recently, in Canada. At the same time, the industry has been further affected by the use of larger containerships which has aggravated existing problems of excess capacity.

The issues raised in the development of the *SCEA 1987* are likely to receive increasing public attention in the future. The legislation is scheduled to undergo an in-depth review in 1992, together with the review of other national transportation deregulation legislation.[4] Even before the commencement of this review process the reforms incorporated in the *Act* will be the subject of public debate. While Canadian exporters support the legislation and have suggested even more far-reaching changes, conferences believe that the current measures go too far. In the U.S., analogous legislation to govern liner conferences, the *Shipping Act of 1984*, is scheduled to undergo review by an Advisory Commission, appointed jointly by the President and the Congress, beginning in 1989.[5] The outcome of the U.S. review process is likely to have significant implications for the policy debate in Canada.

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This article reviews the new *SCEA* legislation. Part I describes the role and environment of the conference system and the developments underlying the new legislation. Part II discusses the key provisions of the *SCEA 1987* and their rationale. Part III compares the Canadian act with the corresponding U.S. legislation, the *Shipping Act of 1984*. Part IV analyzes several issues that are expected to receive attention in the scheduled statutory review. Part V provides concluding remarks.

The Conference System, Its Changing Environment and the Need for Legislative Reform

Shipping conferences provide a rare example of functional cartels that operate openly and (in most trades) with minimal day-to-day supervision by any governmental regulatory authority. As such, they are a rich source of insight into cartel behaviour.[6] In addition to fixing rates, conferences attempt to control the types of service provided by their members, the ports from which they operate, the timing of sailings, and other conditions of service. They participate in extensive arrangements for the pooling of cargo, profits and losses. They engage in collective tying arrangements known as loyalty contracts that bind exporters to use exclusively the services of conference members. Perhaps most striking, they commonly engage the services of private policing organizations that monitor adherence to the conference tariffs and penalize members for various forms of "cheating" on their fellow conference members.

Conferences are a ubiquitous feature of international maritime shipping. They were first established in the mid-nineteenth century to regulate conditions in British imperial ocean-borne commerce. At present, there are conferences operating in all of Canada's major maritime trade routes, including the trades to and from Europe, the United Kingdom, Japan and South-East Asia. The role of conferences is sanctioned by two major international policy instruments, the OECD Council *Recommendation Concerning Common Principles of Shipping Policy for Member Countries* and the UNCTAD *Code of Conduct for Liner Conferences*.

There were approximately 34 liner conferences operating in Canadian maritime trade routes in 1987.[7] Some of the important conferences are the Canada-United Kingdom Freight Conference, the Canadian North Atlantic Freight Conference, the Canadian Continental Eastbound Freight Conference, the Japan-East Canada Freight Conference, the Eastern Canada/Australia-New Zealand Conference, the Trans-Pacific Westbound Rate Agreement (TWRA) and the Asia North America Eastbound Rate Agreement (ANERA). The latter two are "super-conferences" that regulate the carriage of both Canadian and U.S. cargo to and from various Asian countries.

The members of these conferences are major international freight shipping lines. The majority of these lines serve U.S. as well as Canadian ports. Some of the more important lines are Sea-land Services Inc., Maersk Lines, Evergreen, Atlantic Container Line, Hapag-Lloyd, CAST, Canada Maritime, Overseas Orient Container Line and Manchester Liners. Many of these lines maintain memberships in various conferences operating in different trade routes. Some of the lines also operate as non-conference carriers in particular trade routes. A few lines, such as CAST and Evergreen, commenced their operations as non-conference carriers but subsequently became involved in membership of conferences. Although there are Canadian interests in some of these lines, none of the lines operates under a Canadian flag.[8]

In terms of physical operations, in the 1970s the liner industry was transformed by the container revolution. Containers are sealed metal boxes generally twenty or forty feet in length. These boxes, which are stacked in the holds of cellular containerships, facilitate easy storage and transfer of cargo from ships to rail or motor carriers. Virtually all liner shipping operations are now undertaken in containers. Containerization has facilitated the development of fully integrated multimodal transport service in which an ocean carrier assumes responsibility for the shipment of cargo to and from inland locations. This, in turn, has enhanced the availability of alternative cargo routings.

An important characteristic of the liner industry in North America is the extensive trans-shipment of Canadian and U.S. cargo via the other country's ports. In 1985, the equivalent of approximately 148,000 twenty foot containers of U.S. cargo were shipped through Canada. Virtually all of this cargo was shipped via the Canadian east coast ports. In the same year, about 128,000 twenty foot equivalent units of Canadian cargo were shipped via U.S. ports,[9] which represented approximately 21% of total Canadian cargo.

The continental pattern of container traffic flows reflects the competitive advantages and disadvantages of Canadian and U.S. ports on the east and west coasts. On the east coast, the balance of this cargo diversion is in Canada's favour. An estimated 45% or more of the container cargo moving through Montreal originates in, or is destined for, the U.S. Midwest or New England.[10] The competitive strength of Montreal is based on natural locational advantages, superior rail links and lower labour costs.[11] On the west coast, the balance of transborder container flows is strongly in favour of the U.S. This reflects the locational advantages and superior port infrastructure of Seattle-Tacoma as well as problems related to certain longshoremen work rules in the Port of Vancouver.[12] It is expected in future, however, that in light of a recent liberalization of longshoremen work rules Vancouver may regain some Canadian origin cargo which until recently has been shipped via Seattle.[13]

The possibility of trans-shipment via each other's ports provides an important competitive "gateway" for Canadian and U.S. exporters. Canadian and U.S. conference tariffs are not binding in respect of "third country" cargo. Eastern Canadian exporters may ship their cargo with U.S. Atlantic conference member lines via New York at privately negotiated rates.[14] Similarly, U.S. exporters may ship with Canadian conference lines via Montreal at non-conference rates.[15] The possibility of obtaining more competitive rates contributes substantially to the trans-shipment of east-bound cargo via Canadian and U.S. Atlantic ports. In the North America-Asia liner trades, this possibility is limited due to the role of "joint" conferences that regulate the shipment of both Canadian and U.S. cargo.

Extensive trans-shipment of cargo via Canadian and U.S. east coast ports has prompted a number of attempts to close or limit the gateway. A number of bills have been introduced in the U.S. Congress which would require carriers moving U.S. origin or destination cargo via Canadian ports to post their tariffs with the U.S. agency responsible for maritime regulation, the Federal Maritime Commission. While these bills have received broad support form U.S. maritime interests, they have generally been opposed by major U.S. exporters based in the Midwest for whom the Canadian gateway is an important competitive alternative. The enactment of such legislation has also been opposed by the U.S. Department of Justice on the grounds that it would jeopardize an important check against the exercise of monopoly power by conferences.[16]

Legislation to govern conferences in Canada was not enacted until 1971. Prior to 1959, conference operations were tolerated under the provisions of the *Combines Investigation Act*, presumably due to the international nature of such operations. In 1959, however, certain actions by the Canada-U.K. and Canada-Continental conferences to enforce loyalty contracts (the so-called Helga Dan incident) resulted in an inquiry by the Director of Investigation and Research and hearings before the Restrictive Trade Practices Commission (RTPC).[17] In a 1965 report to the Minister of Justice, the Commission found that various agreements of the Canada-U.K. Conference fell within the jurisdiction of the *Combines Investigation Act* and had the effect of lessening competition unduly as proscribed in section 32 of the *Act*. The Commission indicated, however, that in its view conference operations generally contributed to the reliability and stability of liner services. It recommended that conference operations should continue to be permitted but that: (i) conference tariffs should be made publicly available at reasonable costs; and (ii) certain limitations should be placed on conference loyalty contracts.[18]

The first *Shipping Conferences Exemption Act* was enacted by Parliament in 1970 in response to the RTPC's recommendations.[19] The *Act* provided explicit authorization for conference members to:

(i) use collective tariffs;

(ii) implement loyalty contracts;

(iii) allocate ports of call;
(iv) regulate the timing of sailings and other conditions of service;
(v) share cargo and/or earnings and losses from the transportation of goods; and
(vi) regulate admission and expulsion of members to and from a conference.[20]

Conference agreements were permitted to cover not only ocean cargo movements, but also inter-modal (sea plus land) transportation of goods.[21] The *SCEA 1970* contained no provision for the taking of remedial measures on behalf of users, although it provided for the possibility of investigations into conference activities by the Director of Investigation and Research.[22]

In 1979, Parliament enacted new legislation, the *Shipping Conferences Exemption Act, 1979*, to replace the previous law.[23] The *SCEA 1979* retained and broadened the previous exemption for shipping agreements from the competition law. It permitted such agreements not only among conference members, but also between members of a conference and non-conference shipping companies, and between the members of different conferences.[24] In an attempt to provide protection to users, the *Act* also incorporated provisions to facilitate the conduct of investigations by the Canadian Transport Commission under section 23 of the *National Transportation Act*.[25]

The 1979 legislation also provided for the designation by the Minister of Transport of a special shipper group to represent the interests of Canadian exporters in negotiations with outbound conferences. When requested in writing the conferences were required to meet with the shipper group and to provide information "sufficient for the satisfactory conduct of the meeting."[26] Subsequent to the passage of the *Act*, the Minister of Transport designated the Canadian Shippers' Council as the shipper group for purposes of this provision.

The need for reform of the legislative framework for shipping conferences in Canada emerged from several developments. First, in the early 1980s there was growing evidence of dissatisfaction with conference arrangements among the users of liner shipping services. In 1982, a survey of more than 300 Canadian exporters, importers and freight forwarders sponsored by Consumer and Corporate Affairs Canada found that only 20% of those interviewed favoured continuation of the legislation in its existing form.[27] The largest single group (42%) favoured outright repeal of the *SCEA* legislation. A related development was the emergence of shippers' councils, in Canada and other maritime countries, as an organized vehicle for the expression of users' concerns. In public hearings of the Canadian Transport Commission (Water Transport Committee) into the *SCEA* in 1982, the Canadian Shippers' Council voiced concerns about the inadequacy of the existing legislative framework and a perceived lack of responsiveness by conferences to exporters' needs.[28]

The second major development leading to reform of the legislative framework for shipping conferences was the general realization in Canada and abroad of the potential benefits of deregulation in all transportation modes. As in the airline, trucking and rail transportation industries, studies found that cartelization of the liner industry had contributed to higher-than-competitive rate levels, excess capacity and an inefficient emphasis on service quality competition.[29] It was believed that enhanced reliance on competitive market forces would lead to a wider range of price-quality options for users. This view was endorsed in the Minister of Transport's 1985 Discussion Paper on reform of transportation regulation, *Freedom to Move*, which indicated that "Canadian shippers require greater freedom of action with respect to shipping conferences."[30]

A third development leading to the overhaul of *SCEA* which coincided with the movement toward deregulation was the enactment of new legislation the *Shipping Act of 1984* to govern shipping conferences in the U.S.[31] The U.S. act incorporated a number of innovative provisions to make the conference system more responsive to users, notably the provisions relating to independent action and service contracts. As elaborated below, several provisions of the *SCEA 1987* are modelled on these corresponding provisions of the U.S. legislation. Nevertheless, the *SCEA 1987* differs from the U.S. act in many other respects.

Design and Key Elements of the *SCEA 1987*

The *SCEA 1987*, like its predecessor legislation, is based on the important premise that shipping conferences are an international institution which Canada alone cannot abolish.[32] In this respect, the treatment of shipping conferences differs markedly from the approach taken in concurrent legislation respecting the airline, rail and trucking modes.[33] While curtailment of collective rate making was an essential element of regulatory reform in the other modes, in the *SCEA* exercise it was understood from the outset that, for reasons of international comity, basic conference operations would continue to be exempted from the *Competition Act*.

Within this framework, the *SCEA 1987* has three basic thrusts. First, it clarifies and narrows the exemption that conferences receive from the *Competition Act*, extending the range of conference practices that are subject to the *Act*. Second, it introduces two important new measures to facilitate price competition within the conferences, viz., service contracts and the right of independent action by conference members. Third, it incorporates a new procedure for the review of complaints and the taking of remedial measures in situations where users are adversely affected by conference practices. These developments are discussed in the following three subsections.

Clarification and Narrowing of the Conferences' Exemption from the *Competition Act*

The *SCEA 1987* retains the exemption for shipping agreements in the *SCEA 1979* but restricts it in several respects. First, it deletes the previous exemption for collusive agreements between conference members and non-conference carriers. Competition from non-conference carriers, which operate in most trade routes not subject to foreign government-imposed entry barriers, is generally regarded as the most important source of protection for users against the charging of excessive rates by conferences. Deletion of this aspect of the exemption was considered important to ensure that non-conference carriers serve as a genuine competitive alternative to conference lines.

Second, the *SCEA 1987* clarifies that the exemption does not apply to conference members who engage, or who conspire to engage, in predatory pricing.[34] Liner shipping is an industry which appears to be characterized by a greater incidence of predatory conduct than most other industries. This may be due to the traditional scope for collective operations in the industry and the protection against new entry that has been afforded by conference loyalty contracts.[35] The clarification that predatory pricing remains subject to the *Competition Act* should not in any way deter healthy price competition in the industry. The standards applied under the predatory pricing provisions of the *Act* leave broad scope for pro-competitive price cutting.[36]

Third, the *SCEA 1987* removes a potential loophole in the *SCEA 1979* by clarifying that the conferences' exemption from the *Competition Act* does not apply to agreements that have not been duly filed as required by the *Act*.[37] Finally, the *1987 Act* specifically provides that the exemption does not apply to conference members who engage in collective negotiations with inland carriers. The intent of this provision, which is modelled on a similar provision of the U.S. *Shipping Act of 1984*, is to ensure that conference members must negotiate with truck or rail carriers on an individual basis.[38] The provision does not prevent conference members from offering combined multimodal rates to exporters, nor does it prevent them from setting such rates collectively.

New Measures to Facilitate Rate Competition within the Conferences

Among the most important provisions of the *SCEA 1987* are the new provisions dealing with independent action (I/A) and service contracts. Independent action means the offering of rates by individual conference members that are different from those agreed to in the conference tariffs. The I/A rates are also published in the conference tariffs and are available to all users shipping the specified

cargo. Like the U.S. *Shipping Act*, the *SCEA 1987* provides conference members with a statutory right to take independent action on all published rates and service items. The right of independent action is an essential requirement for a conference agreement to receive an exemption from the *Competition Act* under the *SCEA 1987*.[39] The effect of this right is to legitimize and facilitate a form of price competition within the conference. The U.S. experience suggests that the right of independent action will be extensively utilized by conference members and will serve as an important check against the possibility of excessive pricing by the cartels.[40]

The notice procedures for independent action are an important determinant of its overall effectiveness. In the U.S., the *Shipping Act of 1984* permits conference members to take I/A upon a maximum of 10 days notice to the other conference members, who may subsequently opt for the independent action rate.[41] In Canada, the notice period is not fixed in the *SCEA 1987* but is set by the Governor in Council under the legislation. Although conference representatives favoured a longer period, exporters argued that a period of 10 days or less, as in the U.S., was important for them to be able to compete effectively in overseas markets. In a *Shipping Conferences Independent Action Order* which took effect on February 17, 1988, the Governor in Council established a notice period of fifteen days for independent action under the *Act*.

A second pro-competitive element incorporated in the *SCEA 1987* is the provision for confidential service contracts between users and conference members. Service contracts are private arrangements for the transportation of designated amounts of cargo at negotiated rates, outside the conference tariffs. Such contracts can, in principle, be long term arrangements or "one shot" deals for the transportation of a specified number of containers. The provision for service contracts was an important element of the U.S. *Shipping Act of 1984*, which was intended to help balance the pro-carrier features of that legislation.[42] In Canada, the promotion of the use of service contracts was a major thrust of the government's deregulation program in the rail as well as the marine transportation mode.[43]

The terms of the provision for service contracts in the *SCEA 1987* require some clarification. Like the U.S. *Shipping Act of 1984*, the *SCEA 1987* permits the conferences to collectively establish terms and conditions respecting the use of service contracts by their individual members.[44] Presumably these terms include provisions respecting rates to be charged and minimum volume commitments. As a result, the conferences retain a significant measure of control over the use of such contracts.

As proposed in Bill C-21 at the time the legislation was introduced in Parliament, the conferences' right to establish terms and conditions respecting the use of service contracts was subject to a right of opting out by individual members of the conference, who could then offer such contracts on their own terms and conditions.[45] In effect, this gave conference members a right of independent action on confidential service contracts as well as the above-noted right of independent action on published rates. This feature of the bill, as introduced in Parliament, went significantly further than the corresponding provisions of the U.S. legislation, but was considered necessary to fulfil the intent of the proposals put forward in *Freedom to Move*.[46]

During the hearings of the legislative committee on Bill C-21, representatives of Canadian exporters strongly supported the right of individual conference members to take independent action respecting the use of service contracts. In their view, this right would greatly facilitate the exporters' ability to negotiate competitive rates from conference members. The conferences argued, however, that the right of independent action on such contracts would seriously undermine their viability and would put Canada out of step with the U.S. on this matter. Following consultation with the Minister of Transport and the Cabinet, the legislative committee recommended deletion of the right of individual conference members to take independent action respecting the use of service contracts.[47]

Notwithstanding the changes implemented by the legislative committee, service contracts are expected to generate important benefits for users. In the U.S., service contracts have been extensively utilized and have resulted in substantial rate cuts. In May, 1986, approximately two years after passage of the U.S. legislation, the Federal Maritime Commission had 5,272 service contracts on file

and was receiving more than 100 new contracts every week.[48] In taking into consideration the U.S. experience, however, it is important to note certain differences in the two countries' provisions governing service contracts. These are discussed below:

As an additional measure to make conferences more responsive to users, the *SCEA 1987* has incorporated a change in the treatment of conference loyalty contracts under the *Act*. The legislation stipulates that such contracts may not contain standard form requirements for users to ship 100% of their goods with members of the conference. A commitment covering all the user's goods may, however, be obtained by negotiation. This amendment is intended to respond to exporter complaints that conferences in the past have routinely insisted on "all or nothing" loyalty commitments, although its practical effect in this regard may be limited.

New Procedures for Review of Complaints and Remedial Measures

A major focus of concern on the part of Canadian exporters regarding the *SCEA 1979* was the inadequacy of dispute settlement and complaint handling procedures under the *Act*. In response to this concern, the *SCEA 1987* establishes a new procedure for review of complaints and issuance of cease and desist orders respecting conference agreements and practices that are technically within the *SCEA* exemption but are nevertheless found to be harmful to exporters. The new procedure is applicable in circumstances where any person, including the Director of Investigation and Research, has reason to believe that a conference agreement or practice "has, or is likely to have, by a reduction in competition, the effect of producing an unreasonable reduction in transportation service or an unreasonable increase in transportation costs."[49] In such circumstances the *Act* authorizes the complainant to make application for remedial measures to the Canadian Transport Commission (an amendment is needed to *SCEA 1987* to transfer this function to the new National Transportation Agency).[50] Following such investigation as, in the Agency's opinion, is warranted (including, where appropriate, a public hearing), it will be empowered to issue an order requiring the removal of an offending feature of an agreement, or the cessation of any conference practice, or requiring such other action as, in its opinion, is warranted.

The test used in the complaint review process is taken from the corresponding provisions of the U.S. *Shipping Act of 1984*.[51] The institutional framework for administration of the process under the *SCEA* is, however, different from the U.S. act. While in Canada the process is to be administered by an expert body dedicated to speedy resolution of complaints, the U.S. legislation relies on formal judicial processes. In particular, the U.S. act designates the District Court for the District of Columbia as the body responsible for taking remedial measures, and specifies that application to the court can be made only by the Federal Maritime Commission.[52] At the time of its passage, the review standard was considered as an essential element of the U.S. *Shipping Act*.[53] In practice, however, it has not been extensively used.

The explicit designation of the Director of Investigation and Research as a person with authority to apply for remedial measures is one of the innovative features of the *SCEA 1987*. It recognizes that specific conference agreements and practices, while technically within the *SCEA* exemption, may nevertheless be harmful to Canadian exporters' interests. It should be noted that the Director's authority to apply for remedial action under the *SCEA* is intended to supplement rather than supplant his recourse to the provisions of the *Competition Act*, which remain applicable in respect of all matters that are not explicitly exempted in section 4 of the *SCEA 1987*.[54]

The *SCEA 1987* incorporates a small but potentially significant change in the provision relating to meetings between conferences and users' representatives. The reference in the previous act to "the designated shippers' group" has been changed to "any designated shippers' group," making it possible for the Minister of Transport to designate multiple shipper groups to meet with users. The revised provision does not, however, impose any additional obligations on conferences beyond the previous

requirements to meet with the shippers' group when reasonably requested and to provide information sufficient for the satisfactory conduct of the meeting. In this respect, the *SCEA 1987* does not respond to the request by the Canadian Shippers' Council for stronger measures to require good faith negotiations by conferences. As discussed in the following section, the *SCEA 1987* also does not go as far as the U.S. *Shipping Act of 1984* in promoting the role of shippers' associations in freight consolidation.

Finally, during the clause-by-clause review, the legislative committee deleted the sunset clause from Bill C-21. As introduced in Parliament, the bill was scheduled to expire 5 years after coming into force unless renewed by an Order in Council. A similar clause was also contained in the *SCEA 1979*. The sunset clause was considered to be an important feature of the *SCEA* legislation in view of its unusual nature as an exemption from competition legislation. Members of the committee reasoned, however, that the comprehensive review of transportation legislation, which is macdated in section 266 of the *National Transportation Act, 1987*, would ensure adequate scrutiny of the *SCEA 1987*.

Comparison of the *SCEA 1987* and the U.S. *Shipping Act of 1984*

The *SCEA 1987* and the U.S. *Shipping Act of 1984* are similar in important respects. As noted, both acts incorporate the right of independent action by conference members on published rate and service items as a key check against the setting of excessive rates by the cartels. Both authorize the use of negotiated service contracts between conference members and individual exporters, while permitting conferences to collectively set terms and conditions for such use. Both acts apply the same test to agreements and practices that are technically within the conferences' antitrust exemption but may be harmful to users.

The Canadian and U.S. acts, nevertheless, have substantial differences in their overall design and specific provisions. While *SCEA* is primarily an exemption act, which imposes some related conditions on the liner conferences, the U.S. *Shipping Act* is a comprehensive regulatory statute. The greater degree of government involvement in regulating the liner shipping industry in the U.S. reflects the greater importance of carrier interests in that country. Whereas Canada has essentially no deep sea liner fleet of its own, the U.S. has an extensive merchant marine which is historically linked to U.S. strategic interests.[55] The purpose clause of the U.S. act indicates that its objectives encompass the development of an "economically sound and efficient U.S. flag liner fleet" as well as the promotion of an efficient and economic ocean transportation system.[56] In contrast, Canadian government policy statements regarding *SCEA* have emphasized the need to protect Canadian exporters' interests vis-à-vis the conferences.[57]

The greater government regulatory involvement in the U.S. is evident in the provision for policing of conference tariffs by the Federal Maritime Commission (FMC). Section 10(b) of the U.S. act explicitly prohibits carriers from offering secret rebates or charging rates different from those set out in their published tariffs. This prohibition applies to both conference members and non-conference carriers. This provision is actively enforced by the FMC in periodic investigations of rate discounting activities.[58]

In Canada, the *SCEA 1987* requires filing of conference tariffs but contains no provision for government supervision of the tariff rates. Furthermore, there is no requirement for filing of tariffs by non-conference carriers. In this way, the Canadian legislation avoids involving the government in policing the conference-cartel arrangements. This feature of the act was reflected in the previous legislation and is not affected by passage of the *SCEA 1987*.

There are also major differences in the treatment of service contracts in the Canadian and U.S. acts. Unlike Canada, the U.S. legislation requires that the "essential terms" of all service contracts be publicly filed with the FMC and that the same terms must be made available to all "similarly situated" users.[59] In Canada, service contracts are essentially treated as private commercial arrangements.

They are to be filed with the regulatory agency on a confidential basis.[60] Furthermore, *SCEA 1987* contains no requirement for service contracts to be made available to similarly situated users on the same terms.

The U.S. public filing and non-discrimination requirements relating to service contracts represent an attempt to retain an element of the common carrier philosophy in what is essentially a private contractual arrangement. The mixed private and public regime for service contracts has been the source of extensive problems for U.S. conference members. These problems, which have been the subject of investigation by the FMC during the past year, involve the use of certain clauses in the service contracts that are considered by the conferences to be unduly favourable to users.[61] These include:

(i) most favoured buyer clauses, which provide that a shipper who has signed a service contract is automatically entitled to any lower rate that is subsequently offered to another shipper by the same carrier;

(ii) "Crazy Eddie" clauses, which provide that a shipper with a service contract is automatically entitled to any lower rate that is subsequently offered by any other carrier;[62] and

(iii) clauses providing for *de minimis* amounts of liquidated damages in the event that shippers fail to ship the full amount of cargo committed under a service contract.

These clauses are not required under the U.S. legislation but have been accepted by conference members under pressures resulting from the public disclosure and non-discrimination requirements.

The widespread use of these clauses has generated extensive discussion in the U.S. shipping community and led numerous participants to suggest that service contracts are unworkable in the liner industry. In November, 1987, the FMC moved to limit the use of Crazy Eddie clauses and define other terms for the use of service contracts.[63] At the same time, however, U.S. carrier as well as shipper representatives have suggested that the source of the problems lies not in the use of service contracts but in the public filing and non-discrimination requirements.[64] Removal of these requirements would bring the treatment of service contracts in the U.S. legislation closer to their treatment in Canada.

The U.S. *Shipping Act* contains a stricter provision than the *SCEA 1987* respecting conference loyalty contracts, the collective tying arrangements that are used by conferences to ensure the exclusive patronage of individual users. In particular, the U.S. act prohibits such contracts except when they are "in conformity with the antitrust laws."[65] This provision has effectively ended the use of collective loyalty contracts, since the concerted use of tying arrangements is prohibited under section 1 of the *Sherman Act*.[66] In Canada, the *SCEA 1987* permits the use of conference loyalty contracts subject to the requirement that they do not, in a standard form, require the commitment of 100% of a user's cargo.

A significant underlying difference between the U.S. *Shipping Act* and the *SCEA 1987* is that, while the former requires conferences to be "open", the latter permits open or closed conferences. That is, while the U.S. legislation requires conferences to admit to membership all carriers that meet basic minimum service requirements, the Canadian act permits conferences to regulate the admission or expulsion of members at their own discretion. The U.S. requirement of open conferences should not necessarily be seen as efficiency-enhancing.[67] From the competition policy perspective, it may be preferable to have new entrants enter a trade route as non-conference members. Historically, the policy of open conferences is associated with the objective of supporting expansion of the U.S. merchant marine.

In a similar vein, the U.S. *Shipping Act*, unlike the *SCEA 1987*, contains "defensive" provisions to facilitate retaliation against foreign countries that impede the access of U.S. national flag carriers to their ocean commerce. Section 13(b)(5) of the U.S. act authorizes the Federal Maritime Commission, where it finds that any common carrier or foreign government has "unduly impaired" the access of a U.S. vessel to ocean trade between foreign ports, to take any action it considers appropriate, including suspension of foreign carriers' U.S. tariffs. This provision is in response to the growing trend among the non-OECD countries toward cargo reservation and other forms of government intervention to promote their national shipping lines. This trend was encouraged by the adoption of the UNCTAD *Code*

of Conduct for Liner Conferences, which sanctions the conference system and the principle of government reservation of cargo to national shipping lines.[68] The U.S. regards the *Code* as protectionist and anti-competitive.[69] Canada has no similar statutory provision for retaliation against foreign government intervention in shipping markets, although the need for such measures has been considered from time to time.[70]

Finally, while both the Canadian and U.S. acts contain provisions to facilitate negotiations between conferences and users, the scope and intent of these provisions differ significantly. The Canadian provisions refer only to the general role of the designated shipper group(s) in representing the interests of shippers. The Canadian Shippers' Council meets with conferences to discuss matters of interest to broad classes of users (e.g. general rate increases or surcharges) but does not participate in individual rate disputes. Conference representatives have expressed frustration with the general nature of the Council's mandate and its apparent inability to make commitments on behalf of users.[71]

In contrast, the U.S. *Shipping Act* is concerned with shippers' associations that are actively involved in consolidation or distribution of freight for the purpose of negotiating special rates or service contracts for particular users.[72] The *Act* prohibits conferences from refusing to negotiate with such associations.[73] It does not, however, provide any exemption for such associations from the antitrust laws.

Since the passage of the U.S. act, shippers' associations have been organized in a number of industries to take advantage of these provisions of the legislation. The U.S. Department of Justice has issued public statements regarding the treatment of shipper associations under the antitrust laws. These guidelines have recognized the efficiency enhancing potential of shippers' associations and provided broad scope for their activities.[74]

Issues Likely to be Addressed in the Planned Review of the *SCEA 1987*

As noted in the introduction, the *SCEA 1987* is slated to undergo an in-depth review beginning in January, 1992, together with other national transportation deregulation initiatives. The U.S. *Shipping Act of 1984* is also scheduled to undergo an elaborate public review, to commence in 1989.[75] The policy reviews are likely to focus on matters such as the impact of independent action on published rates and the appropriate notice period for such action, the role of service contracts and their implications for large and small shippers, the need for conference loyalty contracts, the role of shippers' associations and the adequacy of dispute resolution and remedial powers and processes.

The analysis in this paper sheds light on a number of issues which are likely to be considered in the review process. First, the statutory review will inevitably confront the basic issue of whether there is any continuing need for conferences in Canadian maritime commerce. The existence of any valid economic rationale for conferences was questioned by user representatives appearing before the legislative committee on Bill C-21.[76] The termination of the exemption for conferences from the *Competition Act* is noted as an option to be considered in the statutory review provisions contained in the *National Transportation Act*.[77] The question of whether conferences should continue to be permitted is also noted as a specific issue for consideration in the statutory review provisions of the U.S. *Shipping Act of 1984*.[78] A recent survey of U.S. shippers conducted by the Federal Maritime Commission in preparation for the coming review of the U.S. legislation found that, among the shippers who expressed an opinion, 50% favoured prohibition of liner conferences in U.S. trades.[79]

Academic commentators have reached varying conclusions regarding the economic utility of conferences. A significant segment of opinion maintains that conferences serve a useful function in providing greater stability of rates and services than would otherwise prevail.[80] In this view, the structural characteristics of the liner industry necessitate the use of cartels to prevent "cut-throat competition." The opposing segment of opinion believes, however, that the economic justification for conferences is weak and that the cartels have tended to promote higher-than-competitive rates and an inefficient emphasis on service quality competition.[81] In this connection, it has been argued that the

conferences have themselves contributed to the perennial problem of excess capacity in the liner industry.[82]

It is apparent that, regardless of their original rationale, the ability of conferences to regulate service conditions in the liner trades has been significantly eroded by natural market forces. The container revolution and the development of door-to-door multimodal service, as well as the increased efficiency of the surface transportation industries in the recent past, have generated enhanced competition through the availability of alternative cargo routings.[83] Of course, as in the past, the need to exempt conferences from the full force of the *Competition Act* may depend partly on considerations of international comity as well as economic policy.

Assuming that the role of conferences continues to be accepted in some form, a second major issue that will likely be reconsidered in the policy review is the matter of independent action on service contracts. As noted, in the original version of Bill C-21 the right of conferences to set terms and conditions for the use of service contracts was subject to a 15 day right of opting out by individual conference members. This right was deleted from the bill by the legislative committee at the urging of the conferences. Representatives of Canadian exporters, however, strongly supported retention of this right as a major pro-competitive feature of the bill.[84]

The concept of confidential service contracts originated in the U.S. rail sector, where the use of such contracts is at the discretion of individual users and carriers. As in the liner shipping mode, the rail carriers initially resisted the incorporation of this requirement in the U.S. *Staggers Rail Act* in 1980. A 1985 report by the U.S. Interstate Commerce Commission found, however, that the use of individual service contracts has generated important benefits for both users and rail carriers by making possible a closer tailoring of services to user needs.

It is recognized that the use of service contracts in the U.S. ocean liner trades since the passage of the *Shipping Act of 1984* has generated extensive concerns on the part of carrier interests. It should be emphasized, however, that the concept of service contracts under the U.S. legislation is very different from the concept as used in the *SCEA 1987*. In the U.S., the essential terms of these contracts are filed publicly and must be made available to all similarly situated users. In our view, it is this mixing of private contracts and common carrier obligations and not the use of service contracts *per se* which has created the most serious problems for the U.S. liner industry. The *SCEA 1987* avoids many of the problems experienced in the U.S. by treating service contracts as private commercial arrangements not subject to public filing. This is superior to the U.S. legislation both in principle and workability.

A third issue that may receive consideration in the review of the *SCEA 1987* concerns the role of conferences in multimodal rate setting. The *SCEA 1987* (like the U.S. legislation) permits conference members to set such rates collectively, although the conference members must negotiate their arrangements with rail or other inland carriers individually. The 1985 discussion paper on national transportation policy, *Freedom to Move*, contained a proposal which seemed to suggest that conferences would be prohibited from continuing to set such rates collectively.[85] Multimodal rates could still be offered to users, provided they were not set collusively.

It is essential that liner carriers continue to offer multimodal rates, since these are the rates that are desired by most users. Conferences as an institution, however, were originally intended to cover only ocean cargo movements. The expansion of the scope of their operations to control aspects of inland transport may conflict with surface transportation objectives of competition and efficiency. Thus, as implied in *Freedom to Move*, there is a case to be made for requiring conference lines to offer multimodal rates on an individual basis. It should be recognized, however, that this would entail a major limitation on the role of conferences since most liner cargo is now shipped on a door-to-door basis.

A fourth issue that will likely receive further consideration in the upcoming review of *SCEA* concerns the treatment of conference loyalty contracts. It may be recalled that these are collective tying arrangements (between a user and the conference as a whole) in contrast to service contracts which may be with individual carriers. As pointed out above, under the U.S. legislation such contracts are prohibited except to the extent that they are in conformity with the antitrust laws.

It is sometimes argued that loyalty contracts are important to small users in that they generally provide a uniform 15% rate discount to all users. With the new provision for service contracts, however, small users should be able to obtain volume discounts through freight consolidation. The existing system of loyalty contracts, while apparently providing an additional option for users, can affect them adversely by inhibiting the expansion of non-conference lines. It may be noted, however, that in many trade routes the use of loyalty contracts has been voluntarily curtailed by conferences.

A fifth issue which may be raised in the context of the review of the *SCEA 1987* concerns the need for enactment of defensive measures along the lines of the retaliatory powers that have been adopted in the U.S. The purpose of such powers is to provide the government with a means of responding to restrictive foreign government policies that inhibit free and fair competition in shipping markets. The enactment of such measures by OECD-member countries is contemplated in the *Recommendation Concerning Common Principles of Shipping Policy for Member Countries* which was approved by the OECD Council in February, 1987. Canada supported the recommendation but indicated that it would treat it as non-binding.

A final and more general issue that may surface, particularly in light of the recent Canada-U.S. Free Trade Agreement, concerns the trans-shipment of container cargo between Canada and the U.S. In the course of the legislative committee hearings on Bill C-21, conference representatives asserted that various measures contained in the bill could increase the diversion of Canadian cargo through the U.S., eroding the economic basis of Canadian maritime ports. In fact, the opposite seems likely to occur. As was pointed out by members of the Canadian Shippers' Council, by making available similar opportunities in Canada as are currently available in the U.S., service contracts and the right of independent action should actually reduce the incentive for further trans-shipment of cargo by Canadian exporters. Indeed, during the legislative committee hearings representatives of Canadian exporters suggested that the measures contained in the *SCEA 1987* would result in some re-patriation of Canadian cargo currently flowing through the U.S.[86]

Concluding Remarks

The *SCEA 1987* has implemented major changes in the legislative framework for shipping conferences in Canada. These reforms build effectively on the recommendations of *Freedom to Move* and its assessment that Canadian exporters require greater "freedom of action" with respect to shipping conferences. The new legislation narrows the conferences' exemption from the *Competition Act*, provides enhanced scope for price competition within conferences through service contracts and independent action by member lines, and establishes new procedures to deal with conference agreements and practices that are detrimental to users' interests. These changes strengthen the position of Canadian exporters and importers vis-à-vis the conferences.

The *SCEA 1987* has borrowed several features from the corresponding U.S. legislation, the *Shipping Act of 1984*. These include the right of independent action on published rates and service items, the use of service contracts subject to terms and conditions to be established by the conferences, and the new review standard for conference agreements and practices. Nevertheless, the Canadian and U.S. acts differ in important respects. Unlike the U.S. legislation, the *SCEA 1987* does not involve the government in enforcing the conference tariffs. In addition, the *SCEA 1987* avoids the problems experienced with service contracts in the U.S., by treating such contracts as private commercial arrangements. In our view, it is the mixing of private contracts and common carrier obligations in the U.S. legislation rather than the use of service contracts *per se* which has generated the most serious problems for the U.S. liner industry in this area.

The issues raised in the development of the *SCEA 1987* are likely to receive increasing public attention in the future in connection with the broader review of national transportation deregulation initiatives. The public debate in Canada will be influenced by the outcome of the upcoming

comprehensive review of the U.S. *Shipping Act of 1984*, which is scheduled to begin in 1989, more than two years earlier than the Canadian review. Some of the issues that will likely receive consideration include the economic justification for conferences, the viability of independent action on service contracts, the treatment of multimodal rate-setting, the role of conference loyalty contracts and the need for defensive measures to respond to protectionist foreign government shipping policies.

In approaching these issues, it is important to recall the nature of Canadian interests in ocean shipping policy. Unlike the U.S., Canada has no significant national flag deep sea fleet. It is, however, highly dependent, more than most other industrial countries, on exports as a source of national income and growth. In these circumstances, Canada should continue to be selective in adopting aspects of U.S. shipping policy and should consider carefully the implications of conference practices from the standpoint of users.

In both Canada and the U.S., regulatory reform in the ocean shipping industry has lagged behind other transportation modes in subjecting collective rate making to the full force of competition legislation. This reflects the pervasiveness of shipping conferences as an international institution as well as their perceived role in promoting stability of service. The conferences' ability to control rates and conditions of service in the liner industry has, however, been eroded by natural market forces such as containerization and the growth of alternative (multimodal) cargo routings. In addition, the recent legislative reforms to permit service contracts and independent action by member lines have injected substantial scope for rate competition within the conferences. It remains to be seen whether further changes will be needed in liner conference shipping policies in the 1990s.[87]

NOTES

1. Bill C-21, An act to exempt certain shipping conference practices from the provisions of the *Competition Act*, to repeal the *Shipping Conferences Exemption Act*, 1979, and to amend other acts in consequence thereof, was introduced in the House of Commons by the Minister of Transport on November 6, 1986. The bill was passed by the House of Commons on June 29, 1987. It was passed by the Senate and received royal assent on June 30, 1987. The *Act* came into force in its entirety on February 17, 1988, in conjunction with the *Shipping Conferences Independent Action Order*, S.O.R./88-69, which established the notice period for independent action under the *Act*.

   An earlier version of Bill C-21, namely Bill C-122, was introduced in Parliament in May, 1986, but died on the order paper when Parliament was prorogued. A previous bill to amend the *SCEA 1979*, Bill S-12, was introduced in the Senate in 1984, but also died on the order paper following hearings by the Senate Committee on Banking, Trade and Commerce. Bill S-12 differed significantly from Bill C-21 in its design and content. For background, see S.D. Khosla and R.D. Anderson, "New Canadian and U.S. Legislation to Govern Shipping Conferences," *Canadian Competition Policy Record*, vol. 5, no. 2, June 1984, pp. 13-23.

2. Transport Canada, Review of the *Shipping Conferences Exemption Act* (Ottawa: February 1984), p.7.

3. Testimony of Mr. A.H. Hall (Chairman, Canadian Shippers' Council), in Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21, Issue No. 1, April 28, 1987, p. 36. See also J.M. Finger and A.J. Yeats, "Effective Protection by Transportation Costs and Tariffs," *Quarterly Journal of Economics*, vol. XC, February 1976, pp. 169-76.

4. Bill C-18, the *National Transportation Act*, 1987, section 266. Paragraph 1(b) of the section indicates that the review is to consider the need for retaining, modifying or terminating any or all of the shipping conference practices that are exempt from the *Competition Act*.

5. U.S. *Shipping Act of 1984*, P.L. 98-237 [Reprinted in H.R. Rep. 98-600, 98th Cong., 2nd Sess., February 23, 1984], section 18.

6. For an early but insightful analysis, see John S. McGee, "Ocean Freight Rate Conferences and the American Merchant Marine," *University of Chicago Law Review*, vol. 27, 1960, pp. 191-314. See also Daniel Marx, Jr., *International Shipping Cartels* (Princeton, N.J.: Princeton University Press, 1953), and B.M. Deakin and T. Seward, *Shipping Conferences: A Study of their Origins, Development and Economic Practices* (Cambridge, U.K.: Cambridge University Press, 1973).

7. Testimony of Mr. Martin Brennan [Associate Assistant Deputy Minister, Policy and Coordination, Transport Canada], in *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 1, April 28, 1987, p. 20.

8. A substantial Canadian-flag merchant marine that was accumulated by the federal government for strategic reasons during World War II was privatized and converted to flags of convenience following the war. Task Force on Deep-Sea Shipping [Gunnar Sletmo, Chairman], *Report to the Minister of Transport* (Ottawa: Supply and Services Canada, 1985), pp. 11-17. It should be noted that the Minister of Transport has recently proposed enactment of tax incentives to facilitate development of Canadian shipping lines. "Shipping lines may be allowed tax avoidance," *Globe and Mail*, March 28, 1988, p. B5.

9. "Life is good at the Port of Montreal," *American Shipper*, January 1987, pp. 28-30. For earlier data, see Transport Canada, *supra* note 2.

10. "Life is good at the Port of Montreal," *id.*

11. The average cost of dockworker labour in Montreal is $26 Cdn. (wages plus benefits) as compared to $34 U.S. in the port of New York. "Life is good at the Port of Montreal," *id.* See also "Montreal's Competitive Edge," *Lloyd's Shipping Economist*, December 1987, pp. 18-20. The latter indicates that "The port of Montreal's ability to compete with the likes of New York, Baltimore and, latterly, Hampton Roads for U.S. Midwest cargoes is based firmly on the port's strategic 'back door' location." It suggests that the greater flexibility in the negotiation of rail freight contracts which has been made possible under the new *National Transportation Act*, 1987, will help to sustain this advantage into the 1990s.

12. Arbitration report by Joseph Weiler, discussed in "Vancouver's Container Clause Discarded," *American Shipper*, September 1987, pp. 76-78.

13. "Vancouver Terminals Seek Local Work After Box Rule Ends," *Journal of Commerce*, January 27, 1988, p. B1.

14. "U.S. legislation governing American shippers using U.S. ports does not apply to Canadian shippers using conferences out of U.S. ports. This is why we get confidential service contracts through U.S. ports." Remarks of J. Moore (Secretary, Canadian Shippers' Council), in *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 1, April 28, 1987, p. 47. See also Testimony of the Canadian Retail Shippers' Association, in *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 3, May 5, 1987.

15. For discussion, see Lawson A.W. Hunter (then Director of Investigation and Research), *The Shipping Conferences Exemption Act: Implications and the Need for Change* (Submission to the Canadian Transport Commission Hearings into the *Shipping Conferences Exemption Act*, Vancouver, B.C., June 29, 1982), p. 20. Liner rates applicable to U.S. cargo trans-shipped via Canadian ports have traditionally been exempted from regulation pursuant to U.S. shipping legislation. See *Austasia Intermodal Lines v. FMC*, 580 F. 2d 642 (D.C. Cir. 1978).

16. See "The Diversion of U.S. Ocean Cargo Through Canadian Ports: An Evaluation of the Need for Regulation," *George Washington Journal of International Law and Economics*, vol. 17, 1982, pp. 167-204, especially pp. 191-194 and excerpt from letter by the U.S. Department of Justice quoted in note 119. See also "The Canadian Landbridge Controversy," in L.T. Thuong and F.M. Collison, "In Search of a Coherent Policy on International Intermodal Transportation," *Journal of Maritime Law and Commerce*, Vol. 16, No. 3, July 1985, pp. 397-421.

17. The Helga Dan incident involved an attempt to enforce a conference loyalty contract against Canadian exporters seeking to patronize a non-conference line which provided special winter service to the port of Quebec during the period when the conference lines did not undertake winter operations in the St. Lawrence River. Restrictive Trade Practices Commission, *Shipping Conference Arrangements and Practices* (Ottawa: Department of Justice, 1965), p. 1.

18. Restrictive Trade Practices Commission, *id.*, pp. 98-99.

19. *Shipping Conferences Exemption Act*, R.S.C. 1970, Chapter 39 (1st. Supp.).

20. *SCEA 1970*, section 3(1). In the 1970 legislation, the exemption for loyalty contracts was made subject to three conditions:
    (i) provision for termination by either party upon 90 days' notice;
    (ii) a 15% maximum spread between loyalty contract rates and tariff rates applicable to non-signees; and
    (iii) no provision for payment of deferred rebates as an *ex post* reward for a shipper's loyalty.

21. See the definitions of a "tariff" and the "transportation of goods" in *SCEA 1970*, section 2.

22. *SCEA 1970*, section 11.

23. *Shipping Conferences Exemption Act, 1979*, S.C. 1978-79, c. 15.

24. See the opening words of *SCEA 1979*, section 5.

25. See *SCEA 1979*, section 4.

26. *SCEA 1979*, section 15.

27. E.M. Ludwick and Associates, *Shipping Conferences: Survey of Users' Views* (Ottawa: Consumer and Corporate Affairs Canada, 1983).

28. Canadian Shippers' Council, *Submission to the Water Transport Committee of the Canadian Transport Commission* (1982).

29. See, e.g. J. Devanney et al, "Conference Rate Making and the West Coast of South America," *Journal of Transport Economics and Policy*, vol. 9, May 1975, pp. 154-77; A.A. Walters, "Gains from Deregulation of Ocean Shipping," in *Proceedings: In Search of a Rational Liner Shipping Policy* (Northwestern University Transportation Research Centre Forum, March 13 and 14, 1978); and Robert Larner, "Public Policy in the Ocean Freight Industry," in Almarin Phillips, ed., *Promoting Competition in Regulated Markets* (Washington, D.C.: Brookings Institution, 1975). See also U.S. Department of Justice, *The Regulated Ocean Shipping Industry* (Washington, D.C., 1977).

30. Minister of Transport, *Freedom to Move: A Framework for Transportation Reform* (Ottawa: Supply and Services Canada, 1985), p.2.

31. U.S. *Shipping Act of 1984*, *supra* note 5. The U.S. legislation embodies a complex mix of policy objectives. From the carriers' perspective, the legislation was important to:

(i) streamline the burdensome regulatory procedures applicable under the previous (1916) legislation; and
(ii) clarify and broaden the immunity for shipping conference agreements from the U.S. antitrust laws, which had been eroded by various federal court decisions.

At the same time, the legislation was designed to protect the interests of users, through the new provisions relating to independent actions, service contracts and shippers associations as well as an extensive list of prohibited acts. The result was "an entirely new approach to maritime regulation." See C. Jonathan Benner, "The *Shipping Act of 1984*," in *Papers and Proceedings of the Western Transportation Law Seminar*, 1984.

32. *Freedom to Move*, *supra* note 30, at p. 44.

33. For a useful overview, see "The New *National Transportation Act* from the Shippers' Perspective," *Canadian Competition Policy Record*, vol. 8, No. 4, December 1987, pp. 24-27.

34. *SCEA 1987*, section 4(4). In addition to the new exception for predatory pricing, a separate provision of *SCEA* stipulates that the exemption does not apply if any or all of the parties to an agreement conspire, combine, agree or arrange to "use a vessel for the purpose of preventing or lessening, unduly, competition in the transportation of goods by an ocean carrier that is not a member of that conference." This apparently refers to the use of "fighting ships" - a legendary practice in the shipping industry whereby conferences would send a ship into port to offer carriage at low rates for a limited period prior to the scheduled loading of a non-conference vessel. See Deakin and Seward, *supra* note 6.

35. The liner industry provided one of the classic examples of predatory pricing in the law and economics literature. See *Mogul Steamship Co. v. McGregor, Gow & Co.* [1892] A.C. 25. For relevant discussion, see Basil Yamey, "Predatory Price-cutting: Notes and Comments," *Journal of Law and Economics*, vol. IX, 1966, pp. 259-77. On the role of conference loyalty contracts in limiting entry, see McGee, *supra* note 6.

36. R.D. Anderson and S.D. Khosla, "Recent Developments in the Competition Policy Treatment of Predatory Pricing," *Canadian Competition Policy Record*, vol. 6, no. 3, September 1985, pp. 1-16, and R.D. Anderson and S.D. Khosla, "Review of McFetridge and Wong on Predatory Pricing in Canada," *Canadian Competition Policy Record*, vol. 7, no. 1, March 1986, pp. 16-21.

37. The possibility that the *SCEA 1979* could have been interpreted as exempting from the *Competition Act* agreements that had not been duly filed with the Canadian Transport Commission arose from the broad wording of the exempting provision (section 5), which did not refer to the filing requirement.

38. For the corresponding U.S. provision, see the U.S. *Shipping Act of 1984*, section 10(c)(4). The U.S. provision clarifies that "this paragraph does not prohibit the setting and publishing of a joint through rate by a conference, joint venture, or an association of ocean common carriers."

39. *SCEA 1987*, section 4(3).

40. The right of independent action has been an important factor in limiting rate increases in the U.S. Pacific liner trades. "Explosive mix prompts 40% capacity growth," *Lloyd's Shipping Economist*, March 1987, pp. 6-10. The inclusion of this right in the 1984 legislation was strongly supported by the U.S. antitrust authorities. James C. Miller III [then Chairman of the U.S. Federal Trade Commission], *Prepared Statement on H.R. 1878*, (before the House of Representatives' Committee on the Judiciary, 1983). In Canada, the adoption of a right of independent action in the *SCEA* legislation was initially proposed in a submission to the Canadian Transport Commission by the Director of Investigation and Research under the *Combines Investigation Act* in 1982, before the enactment of the U.S. legislation. Lawson A.W. Hunter, *supra* note 15.

41. U.S. *Shipping Act of 1984*, section 5(b)(8).

42. P.A. Friedmann and J.A. Devierno, "The *Shipping Act of 1984*: The Shift from Government Regulation to Shipper 'Regulation'," *Journal of Maritime Law and Economics*, vol. 15, no. 3, July 1984, pp. 311-51.

43. *Freedom to Move*, *supra* note 30, pp. 33-34 and 44-45. See also Canadian Transport Commission, *Inquiry into Whether Canadian Domestic and Import/Export Rail Traffic Should be Given Treatment Similar to International (Transborder) Traffic* (1985).

44. *SCEA 1987*, section 4(1)(c).

45. Bill C-21, (First reading, November 6, 1986), section 4(1)(c).

46. *Freedom to Move* had proposed that "Shippers will be able to negotiate confidential service contracts with individual conference members." *Supra* note 30, pp. 44-45.

47. *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 7, June 23, 1987, p. 11.

48. "Service Contracts: Boon or Bane?" *Journal of Commerce*, June 12, 1986, pp. 1A, 6A-7A.

49. *SCEA 1987*, section 13.

50. During the hearings of the Legislative Committee on Bill C-21, an amendment was proposed to reflect the replacement of the Canadian Transport Commission by the National Transportation Agency under Bill C-18, but the amendment was ruled out of order on procedural grounds. See *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 6, May 14, 1987.

51. See U.S. *Shipping Act of 1984*, sections 6(g) and 6(h).

52. U.S. *Shipping Act of 1984*, section 6(h).

53. The legislative report to accompany the U.S. act indicated that the analysis to be carried out under the review standard would include traditional antitrust considerations (e.g. market share of the parties to the agreement), efficiency benefits (e.g. control of excess capacity) and implications for U.S. foreign policy and international comity. See H.R. Rep. 98-600, *supra* note 5, pp. 31-37.

54. *SCEA 1987*, section 13(6) indicates specifically that:

    (6) Nothing in this section affects the operation of the *Competition Act* in respect of its application to:

    (a) any conference agreement or inter-conference agreement that is not exempt from the application of that *Act* by virtue of section 4; or
    (b) any practice of a conference or of any member thereof.

    Section 13(6) was inserted in Bill C-21 by the legislative committee during the clause-by-clause review. This provision clarifies that the remedial powers invested in the CTC under section 13 of the *SCEA 1987* were not intended to limit the application of the *Competition Act* in respect of non-exempt activities. The legislative committee also deleted from the bill a reference to the forwarding of reports to the Minister of Consumer and Corporate Affairs by the Director of Investigation and Research pursuant to his investigatory powers under *SCEA*. The committee inserted in the bill a subsection to clarify that evidence obtained by the Director in an inquiry under the *SCEA* may be used in a complaint filed with the CTC pursuant to section 13, or may be used in proceedings under the *Competition Act*, as appropriate. See the *SCEA 1987*, section 16(3) and the testimony of M.P. O'Farrell (Deputy Director of Investigation and

Research), in *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 7, June 23, 1987, pp. 15-17.

55. For discussion, see Robert A. Ellsworth, "Competition or Rationalization in the Liner Industry," *Journal of Maritime Law and Commerce*, vol. 10, no. 4, July 1979, pp. 497-517.

56. U.S. *Shipping Act of 1984*, section 2.

57. For example, *Freedom to Move* indicated that "The government recognizes that it is not feasible to eliminate the conference system. Rather, it is necessary to find the best means of regulating conference operations so as to produce the greatest benefit for shippers." *Supra* note 30, at p. 44.

58. See "FMC Cracks Down on Illegal Rebating by Ocean Carriers," *Journal of Commerce*, October 28, 1987, p. 1A.

59. U.S. *Shipping Act of 1984*, sections 10(b)(1), (2), (3) and (4).

60. See *SCEA 1987*, sections 6 and 11.

61. "29 Lines Plead with FMC to Stop Contract Abuses," *American Shipper*, February 1987, pp. 34-37.

62. The term "Crazy Eddie" as applied to service contracts in the liner industry is understood to have been derived from a discount store in New York City of the same name which reportedly "refuses to be undersold."

63. "Crazy Eddie Gets the Boot From FMC," *American Shipper*, January 1988, p. 12. Essentially, the Commission has proposed to prohibit the use of Crazy Eddie clauses and establish minimum standards for liquidated damages in service contracts.

64. "If the contracts can be made confidential, they will become a real benefit for the carriers." Statement of Daniel Kerrigan [President of Atlantic Container Line], quoted in "30-Day Wait Might Solve IA Problems," *American Shipper*, February 1987, pp. 20-22.

65. U.S. *Shipping Act of 1984*, section 10(b)(9).

66. Without antitrust immunity, conference loyalty contracts would be viewed as horizontal agreements among competitors to fix prices and would, thus, be illegal *per se* under section 1 of the *Sherman Act*. U.S. Department of Justice, *Filing of Tariffs and Dual Rate Contract Systems in the Foreign Commerce of the United States* (comments before the Federal Maritime Commission on Docket 84-23). The U.S. Department of Justice has subsequently clarified that loyalty contracts remain acceptable under the antitrust laws where they are entered into with individual shipping lines rather than with a conference as a whole. "Loyalty contracts make a comeback," *American Shipper*, August 1987, p. 22.

67. There is a near-consensus among both advocates and critics of the role of conferences that open conferences are less efficient than closed ones. See, e.g. Gunnar K. Sletmo and Ernest W. Williams, *Liner Conferences in the Container Age* (New York: MacMillan, 1981) and Devanney et al, *supra* note 29. See also U.S. General Accounting Office, *Changes in Federal Maritime Regulation Can Increase Efficiency and Reduce Costs in the Ocean Liner Industry* (Washington, D.C.: July 2, 1982).

68. UNCTAD, *Code of Conduct for Liner Conferences*. For discussion, see Transport Canada and Canadian Transport Commission, *Canadian Perspectives on the UNCTAD Code of Conduct for Liner Conferences: Proceedings* (Ottawa: 1982).

69. Paul B. Larsen and Valerie Vetterick, "The UNCTAD Code for Liner Conferences: Reservations, Reactions and U.S. Alternatives," *Law and Policy in International Business*, vol. 13, 1981, pp. 223-280.

70. See Task Force on Deep Sea Shipping, *supra* note 8.

71. Testimony of Ronald Gottshall [Chairman, Trans-Pacific Westbound Rate Agreement], in *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 1, April 28, 1987.

72. U.S. *Shipping Act of 1984*, section 3.

73. U.S. *Shipping Act of 1984*, section 10(b)(9).

74. Charles F. Rule [then Deputy Assistant Attorney General, Antitrust Division, Department of Justice], *The Antitrust Division's Approach to Shippers' Associations* (remarks before the Chemical Manufacturers Association, October 21, 1985). Essentially, Mr. Rule suggests that shippers associations will be permitted under the antitrust laws except where they: (i) facilitate the exercise of monopsony power; or (ii) facilitate the lessening of competition among an association's members in regard to a final product.

75. U.S. *Shipping Act of 1984*, section 18.

76. Testimony of representatives of the Canadian Shippers' Council, in *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 1, April 28, 1987.

77. *National Transportation Act, 1987*, section 266(3)(h).

78. U.S. *Shipping Act of 1984*, section 18 (f) indicates in part that the study of the Advisory Commission on Conferences in Ocean Shipping "shall specifically address whether the nation would be best served by prohibiting conferences..."

79. "Shippers Evenly Divided," *American Shipper*, August 1987, pp. 35-38. During the hearings of the Legislative Committee on Bill C-21, representatives of the Canadian Shippers' Council indicated that a majority of the Council's members would support repeal of the *SCEA exemption. Supra note 76.*

80. See, e.g., Sletmo and Williams, *supra* note 67.

81. See, e.g., Devanney *et al*, *supra* note 29, and Walters, *supra* note 29.

82. Devanney *et al*, *supra* note 29.

83. To some extent, the emergence of super-conferences represents an attempt to counter this development.

84. Testimony of the Canadian Shippers' Council, *supra* note 76.

85. "Shipping conferences will be allowed to quote multimodal rates, but safeguards against collusion in the setting of such rates will be implemented..." *Freedom to Move*, *supra* note 30, p. 8.

86. Testimony of the Canadian Retail Shippers Federation, *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-21*, Issue No. 3, May 5, 1987.

87. James R. Weiss [Chief of Transportation, Energy and Agriculture Section, Antitrust Division, U.S. Department of Justice], *The Future of Competition in U.S. Ocean Trades — More or Less?* (Remarks Before a Symposium Sponsored by the Federal Maritime Commission, Long Beach, CA, February 18, 1988.)

TOWARD A REALISTIC POLICY ON MERGERS *

By: William Macdonald and William Rowley
McMillan, Binch, Toronto

It took about 19 years after the request of Prime Minister Lester Pearson to the Economic Council of Canada to assess the then combines law to get the comprehensive changes that were enacted in 1986. Eighteen months later, enough has happened under the new law to warrant a preliminary look at how well served Canada is likely to be by it in a highly competitive world and in light of the Canada-U.S. trade agreement.

The 1986 law represented a vast improvement over all earlier proposals. Nonetheless, three major concerns remained at the same time:

- While public faith in government intervention had declined over the years, this was not matched by strong government faith in markets. In the end, Ottawa retained extensive powers of intervention, primarily in the important area of mergers.
- The government reversed the decision of the previous Liberal government to rely on the courts for adjudication under known and established rules of law. Instead, discretionary power was granted to a new, untried Competition Tribunal.
- None of the parties that would be most affected – the government, the courts, the tribunal or the private sector – were well equipped to deal with a law that was highly dependent for satisfactory results on sound knowledge about the structure of markets and the competitive behaviour of industrial organizations. This meant that a considerable educational process would be essential.

A year and a half later the tribunal is still on trial and the economic learning has just begun. On the merger front the really dirty question is the fundamental one which has never been satisfactorily answered in Canada. It is: "What merger has ever taken place in Canada since the first combines laws were enacted, which over any reasonable length of time has had any significant or lasting anti-competitive effects?"

This question goes to the root of the new merger law and how it is now being administered. The lack of a good answer suggests that today's merger law owes far more to perceived political, than to economic, requirements.

Moreover, the world for Canadian business now and in the future is far more competitive than at any time this century, due to the globalization of industry. This is quite apart from the competitive injection Canada will receive by becoming part of a market more than 10 times its size under the new free trade agreement with the U.S.

The principal policy mistake, which was identified at the time, was the adoption of a merger threshold test (based on a substantial lessening of competition) that was far too low for the competitive and market-size realities of the Canadian economy. As each month passes, this initial assessment is being reinforced in administrative practices.

The key question now is whether a cure can quickly be found on the administrative side, or whether there will have to be recourse to legislative amendment. It does seem reasonably certain that neither the tribunal nor the courts can be turned to for a timely solution.

At the administrative level, the comparison with the U.S. is striking and depressing. In Canada, in the first 18 months since the passage of the new law in July 1986, 1,300-1,400 mergers have been reported. Of these, more than 1/3 have been reviewed in the director's office. One hundred and thirty-three, or more than 1/3 of this number, have received significant scrutiny.

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* (this article originally appeared in the *Financial Post*, January 11, 1988)

By contrast, in the much larger American economy in roughly the same period, at least 10 times as many mergers occurred. Nonetheless, fewer than 100 of these received significant scrutiny from either the Antitrust Division of the U.S. Department of Justice or the Federal Trade Commission.

It is obvious that the office of the competition law director needs to cut back severely the number of cases it reviews. It is equally obvious that a more realistic policy posture is urgently needed that is reflected in a publicly known means for restricting director scrutiny to only the most significant cases for the national economy. What is not yet certain is whether the current legal test will prove to be completely unworkable.

This is not only of academic interest. Now that for most practical purposes there is to be a continental market in North America, can Canada as the smaller partner with the smaller market afford this kind of a merger regime?

If Canada has a real merger policy interest in the new world of a Canada-U.S. trade agreement, it would be for a merger regime that was more repressive in the U.S. than in Canada. Given their smaller size in almost every case, Canadian-owned or based firms are going to need every size and other advantage they can get from the very beginning. There is no time to allow for the normal 10-20 years process of judicial interpretation and development of a new law.

One of the issues at the heart of the long competition law reform saga concerned the role of a specialized economic tribunal with discretionary powers. This issue was not clearly resolved in the 1986 changes.

On the one hand, a new body called the Competition Tribunal – with the provision for membership of so-called lay experts – was established. On the other hand, the appointees were to include federal court judges and the powers granted appeared to be more adjudicative based on law than discretionary based on a particular policy view reflecting not known rules but so-called economic expertise.

Another key issue related to constitutionality of the tribunal and the powers granted to it: the only two tribunal cases to date – the *Palm Dairy* case and the *Sanimal Industries* case – together raise these issues squarely. (*Palm Dairy* involved the merger of a substantial part of the dairy industry in Western Canada; *Sanimal Industries* involved the merger of a substantial part of the animal byproduct rendering business in Quebec.)

The tribunal's *Palm Dairy* decision came as a complete surprise. The reasons upon which it was based raise the spectre beyond anyone's expectation of an approach colored by policy intervention, which goes beyond the simple adjudication of the issues placed before it by the parties.

There are several causes for concern. First, the tribunal refused a consent order that presumably met the commercial requirements of the companies and the legal and public policy requirements of the director as the officer established by Parliament as its legislative enforcement instrument.

Second, the tribunal saw itself as having an independent obligation, going beyond adjudication based on evidence and argument, to ensure any order it approved would be effective to accomplish its perception of the competition policy objectives of the law.

The *Sanimal* case raises the issue of the constitutionality of the tribunal.

To date, with proceedings ordered to a halt by the Quebec Court of Appeal, the results are not encouraging. At least in Quebec, this means the tribunal will be without work until the courts have decided the issue of its constitutionality.

The result of the uncertainties overhanging the tribunal is a large practical increase in the regulatory role of the director which probably goes well beyond anything contemplated by the legislators.

Some early conclusions are clear, the law itself may well need revision. And there is an urgency for the government in general and the director in particular to think through and make available for public comment a realistic merger policy approach that recognizes international competitive and Canada-U.S. trade agreement realities.

REPLY TO MACDONALD AND ROWLEY ON MERGER POLICY

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In a recent issue of the *Financial Post* (January 11, 1988, p. 14), William Macdonald and William Rowley offered a critique of Canada's merger policy since the new *Competition Act* came into force in June 1986.[1] I believe their analysis is seriously defective on a number of points.

At the outset they state three major concerns existed at the time the new legislation was passed:

- Ottawa still had extensive powers of intervention with respect to mergers;
- adjudication of merger cases is by a Tribunal rather than the courts operating "under known and established rules of law;" and
- a considerable educational process is essential if the new law is to produce satisfactory results.

In reply, first I would say, it is true the merger provisions are more restrictive than before, but they were previously a nullity because the government was using the wrong tool (criminal law) for the job. Less than ten cases were prosecuted between 1910 and 1986, and in only one was a conviction obtained and there the accused pleaded guilty.[2] It should be emphasized that Ottawa's new powers of intervention with respect to mergers are no more extensive than those of antitrust authorities in the U.S.[3] or the EEC. Indeed, it is more difficult to prohibit a proposed merger in Canada that is likely to lessen competition substantially because an efficiency gains defence is provided in the new legislation.

Second, the panels of the Competition Tribunal that now adjudicate merger cases are chaired by a judge of the Federal Court of Canada. Questions of law must be decided only by judicial members of the Tribunal. Moreover, the Tribunal is subject to essentially the same procedural rules as a court dealing with civil matters.[4] If merger cases were adjudicated by the courts, the judges would face the same problem of interpreting the words of the new merger law as does the Tribunal. It is wrong, therefore, to say that if mergers were adjudicated by the courts they would be subject to "known and established rules of law" as far as the substantive elements of the new legislation is concerned.

Third, the participants <u>are</u> learning how to deal with proposed mergers under the new legislation. The quality of the new analysis done by firms proposing mergers and by the Bureau of Competition Policy has improved greatly in the 18 months the new law has been in place.[5] Some participants, however, deeply resent any process that attempts to identify and stop mergers that are likely to lessen competition substantially without providing any offsetting real gains in efficiency.

Underlying MacDonald & Rowley's basic argument that merger policy ought to be less restrictive is the proposition that the world of Canadian business is now and will become more competitive due to the globalization of industry. In reply I would note, first that this is an over generalization. A large fraction of the economy is not subject to the benefits of international trade nor will it be once the agreement with the U..S. is in operation. Moreover, even if all parts of the economy were subject to international trade, this would not mean we should alter Canada's <u>functional</u> approach to mergers. The core of the policy is a proposed merger's likely effect on competition, whether domestic or foreign. If the effect of free trade is to increase competition in Canada, that fact will be fully reflected in the future <u>application</u> of the existing legislation.

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* An abridged version of this account was published in the Financial Post, February 8, 1988, p. 16.

Second, the free trade agreement with the U.S. will not begin until 1989 and in some sectors it will be phased in over 10 years.[6] While free trade is generally pro-competitive in its impact, it is not a panacea nor is it a substitute for a merger policy as MacDonald & Rowley seem to imply.

Third, while industry-level concentration in manufacturing industries in Canada is high, it has remained stable over the past two decades. However, aggregate concentration has increased substantially as recent Statistics Canada data make clear.[7] Unfortunately, the present law cannot address pure conglomerate mergers, no matter how large. It should be noted that in 1986 and 1987 there were 90 mergers in Canada in which the value of the transaction exceeded $100 million.[8] Many were conglomerate mergers.

MacDonald & Rowley argue that "the principal policy mistake was the adoption of a merger threshold test (based on a substantial lessening of competition) that was far too low for the competition and market-size realities of the Canadian economy." This is erroneous for several reasons. First, the basic test is really in two parts. The Tribunal must determine:

- is the proposed merger likely to lessen competition substantially?
- if so, is there likely to be real gains in efficiency that will be greater than and offset the lessening of competition?

It should be noted that U.S. policy - which the two authors profess to admire - does not provide for an efficiency gains defence as does the new *Competition Act*. This defence, of course, makes it more difficult to stop an anti-competition merger.

Second, MacDonald & Rowley, without saying so, are apparently continuing to push for their preferred test which is based on the amount of competition remaining after the proposed merger. As an advisor of BCNI, the leading member of the "Gang of Five" associations that had such a large impact on the drafting of the new legislation, Mr. Rowley fails to note that the "competition remaining" idea was incorporated into the legislation as one of the factors to be considered by the Tribunal in determining if a proposed merger is likely to "lessen competition substantially."

The authors state that more than one-third of the 1300-1400[9] mergers in Canada have been "reviewed" by the Director's office in the past 18 months and some 133 have received "significant scrutiny" - whereas in the U.S., with "at least 10 times as many mergers, fewer than 100 of these have received significant scrutiny" by the antitrust authorities. They later use this point to propose that fewer mergers in Canada be subject to detailed scrutiny. This argument is fatally flawed for several reasons. First, the number of mergers in the U.S. in recent years is less than four times the number in Canada. For example, there were 3200 merger announcements in the U.S. in 1986 in which the value of the proposed transaction exceeded $1 million.[10] Another source puts the number at 4022, of which 352 had a transaction value greater than $100 million.[11] In Canada, there were 938 mergers in 1986 and 948 in 1987.[12] Therefore, it is quite wrong to say there were at least 10 times as many mergers in the U.S. as Canada in recent years.

Second, the Director reports that his office "reviews" a merger if two or more person-days are spent on the file. Most of the 400-odd mergers examined by the Bureau of Competition Policy stemmed from filings with Investment Canada and required very little staff time. In the U.S., 30 days must be spent on a merger before it is counted as having been subject to a preliminary review.[13] The antitrust authorities in the U.S. received 2400 pre-merger notification filings in 1986 and 2256 in 1987 as required by law.[14]

Third, the U.S. authorities can dispose of cases more quickly because their pre-merger notification requirements have both a much lower size threshold than Canada's and the amount of information that must be filed is much greater in the U.S. In the U.S. only 94 of the 2400 filings in 1986 required a second request for information which is indicative of a more extensive review by the authorities.[15] In general, therefore, it requires fewer person days to assess the likely consequences of a proposed merger in the U.S. than Canada.

Fourth, because of their much longer experience (38) years with a workable merger law, the U.S. authorities have published detailed guidelines from time to time (1968, 1982, 1984) specifying how they analyze proposed mergers and interpret the words of the statute.[16] The Director has indicated in his recent speeches he will publish shortly a series of statements outlining his position on the important elements of the legislation.

Fifth, unlike their U.S. counterparts, Canadian authorities have to address the efficiency defence question in scrutinizing proposed mergers. This is a difficult task as virtually all of the essential information is in the hands of the parties to the merger. This increases the time needed to review a proposed merger.

MacDonald & Rowley argue that "[i]t is obvious that the office of the competition law director needs to cut back severely the number of cases it reviews." In reply I would make the following points. First, no evidence is offered to support this conclusion other than an erroneous comparison of Canadian and U.S. merger review processes discussed above. Second the authors' conclusion might make sense if a large proportion of the proposed mergers challenged by the Director were subsequently found by the Tribunal not to be against the public interest. In fact, only two cases have been brought before the Tribunal since it was created in June, 1986. Only one decision has been rendered (*Palm Dairies*), and it amounted to a rejection of a draft consent order under rather unusual circumstances.[17]

Data provided by the Director of Investigation and Research for the period June 19, 1986, and January 8, 1988, indicates 151 mergers out of a total of over 1600 were "examined in a significant fashion," i.e. the assessment involved 30-person days or more. The 121 investigations that were completed were resolved as follows:

- 23 proceeded under the Program of Compliance including 11 with subsequent monitoring by the Director;
- 22 resulted in an Advance Ruling Certificate including one with monitoring;
- 70 were held to pose not issue under the *Act*;
- 4 proposed mergers were abandoned during the review process; and
- 2 applications were made to the Tribunal.

MacDonald & Rowley assert that "[i]t is equally obvious that a more realistic policy posture is urgently needed that is reflected in a publicly known means for restricting director scrutiny to only the most significant cases for the national economy." Again no evidence is provided to show that the Director is acting in any way inconsistent with the mandate given by Parliament in the June 1986 legislation. The Tribunal has not rejected the Director's interpretation of the law in a respectable number of cases (only one case has resulted in a judgment). More importantly, if counsel for proposed acquirors feel the Director is demanding too much in negotiating a settlement they are free to reject the Director's terms and thereby challenge him to take the case to the Tribunal. This has occurred in only one case, *Sanimal Industries*.[18] Finally, if MacDonald & Rowley's advice were taken and the Director established new criteria for the assessment of proposed mergers that were less restrictive than those in the statute he would be flouting the express will of Parliament. Surely the authors are not advocating that this be done.

MacDonald & Rowley argue that "[t]here is no time to allow for the normal 10-20 years process of judicial interpretation and development of a new law." This is a gross - perhaps grotesque - exaggeration. It should be noted that in his presentation at a seminar on merger policy in Toronto on December 15, 1987, Mr. Rowley said it would take 7-10 years for merger law to evolve to a reasonably predictable state. Even this is an exaggeration. One has only to think of the rapid development of case law concerning the 1982 *Charter of Rights and Freedoms*. In order to determine the meaning of the words of the new merger legislation what we need is more cases brought to the Tribunal, not encouragement for the Director to raise the threshold in his assessment of proposed mergers because some members of the bar dislike having to justify proposed mergers according to new legislation.

MacDonald & Rowley state that the reasons given by the Competition Tribunal in the *Palm Dairies* case "raise the spectre beyond anyone's expectation of an approach colored by policy intervention, which goes beyond the simple adjudication of the issues placed before it by the parties." Again, the authors are being unjustified alarmists. The Tribunal properly exercised the discretion granted to it by Parliament. S. 77 of the *Competition Act* states that the Tribunal "may" grant a consent order on the terms proposed by the Director and the respondents. It does not say that it shall do so. Second, the Tribunal raised very real concerns about the character of the proposed order which it summarized as follows:

> ... the Tribunal is asked to issue a consent order which was developed through a process of negotiation between the Director and the respondents. That order would establish a highly detailed, complex and, in parts, vaguely defined arrangement between the respondents. It would require perpetual monitoring by the Director and, probably, frequent reassessment by the Tribunal. There is no evidence before the Tribunal that this complex arrangement, as opposed to a more simple, straightforward remedy such as allowing another (completely independent) purchaser to acquire Palm Dairies, is necessary to meet the objectives of the *Act*. Also, there is reason to doubt the effectiveness of the arrangement which it is sought to impose and consequently issuing the order could possibly lead to a substantial reduction in competition. Although the terms of the order are designed to maintain Palm as a separate competitive force in the market there is considerable doubt that they would, over the long term have that result.[19]

MacDonald & Rowley fail to point out that the *Palm Dairies* case is a peculiar one. The underlying issue in the case was whether or not the merger had been "substantially completed" prior to the date the new legislation went into effect. Evidently both sides were sufficiently uncertain of their new positions on this issue that they preferred to negotiate an awkward compromise (in the form of the draft consent order) on the substance of the merger rather than fight the procedural issue before the Tribunal and possibly the courts.

It should be noted that in its final judgment the Tribunal did not deal with the issue of whether, in fact, it had jurisdiction over the merger. That is, whether the merger was "substantially completed" prior to the time the new legislation came into force. The counsel it appointed to argue the issue asserted that the Tribunal did have jurisdiction as the merger had not been substantially completed prior to June 19, 1986. The Tribunal's idea that there was a more straightforward remedy was to prove correct. In mid-1987 Peter Pocklington bought Palm Dairies for $52.5 million.[20]

Lawson Hunter, the previous Director of Investigation and Research, has stated that in *Palm Dairies* the Tribunal "has exercised its jurisdiction and authority in an aggressive and independent fashion....They have implicitly provided an indication of the manner and seriousness with which they will view competition issues. They also provided some guidance as to the nature of orders, whether consent or otherwise, they believe it appropriate for the Tribunal to issue."[21] Mr. Hunter emphasized that "this case had unique circumstances relating to its transitional features, and...it will obviously take some time...to obtain more specific guidance from the Tribunal as to the manner in which it will administer the law."

MacDonald & Rowley argue that the "really dirty" but fundamental question that has never been satisfactorily answered is, "What merger has ever taken place in Canada since the first combines laws were enacted, which over any reasonable length of time has had any significant or lasting anti-competitive effects?" With respect, this is not the fundamental question. It is this. Until June 19, 1986, Canada had no legislation capable of restraining the wide ranging restructuring of the Canadian economy in the interests of either efficiency or market power. One need only review the sad history of the few prosecutions, e.g. *Canadian Breweries* (1960), *B.C. Sugar* (1960), *K.C. Irving* (1976) and *Thomson-Southam* (1983).[22] Yet in this salutary environment in which the supposedly relentless forces of the capital market in terms of the purchase and sale of control of corporations were virtually unrestrained, what evidence do we have that the performance of the Canadian economy was beneficially affected? Where is the evidence that it has been made more efficient? Has the absence of almost any restraint on mergers - even those among direct competitors in highly concentrated

industries - increased the nation's growth rate in real terms? Has the absence of restraints on mergers stimulated technological change and innovation in Canadian industry? Without any restrictions on mergers have firms in Canada combined so as to become more effective in foreign markets and increase our exports? Conversely, has the ability to merge freely made Canadian firms better able to compete against imports?

In summary, where is the evidence of the cornucopia of benefits Canadians will be giving up if they insist that the new legislation, able to prevent mergers that are likely to lessen competition substantially without providing offsetting gains in efficiency, be left as it is?

Conclusion

It is too early to state categorically that major changes are necessary in the merger provisions effective June 19, 1986. However, in both his speeches and in his behaviour the Director has indicated a marked preference for negotiated settlements over litigation before the Competition Tribunal. While this approach probably economizes on transactions costs, it greatly reduces the amount of information in the public domain because:

(a) the full text of the settlement is very seldom made public; and

(b) no detailed statement of facts is made public.

Both would occur if more merger cases were taken before the Tribunal. With more information in the public domain, all interested parties would be able to learn more about the actual application of the new legislation. Alternatively, the Director could require as a term of any negotiated settlement that the agreement and a fairly detailed statement of facts be made public shortly after the settlement has been reached.

It may well be that the Director is performing too large a "regulatory" role with respect to mergers, by negotiating settlements rather than having the Competition Tribunal adjudicate in those cases he believes violate the new law. However, the lawyers for firms involved in proposed mergers - such as Macdonald and Rowley - have one solution to this dilemma in their own hands. They can refuse to accept the Director's interpretation of the new legislation and thereby invite him to challenge the proposed merger by making an application to the Competition Tribunal for an order prohibiting it. In short, they can bypass the Director and let the adjudicators do the job Parliament intended, namely interpret the words in the new merger sections of the *Competition Act*.

NOTES

1. For a general review of the new legislation, see W.T. Stanbury "The New *Competition Act* and *Competition Tribunal Act*: 'Not With a Bang, Bit a Whimper'," *Canadian Business Law Journal* Vol. 12(1), October 1986, pp. 2-42.

2. See *R.* v. *Electric Reduction Co. of Canada Ltd.* (1970) 61 C.P.R. 235. (Ontario High Court of Justice). A review of the merger cases to the end of 1976 is presented in G.B. Reschenthaler & W.T. Stanbury, "Benign Monopoly: Canadian Merger Policy and the K.C. Irving Case," *Canadian Business Law Journal*, Vol. 2(2), August 1977, pp. 135-168. The only significant merger case since that time was *Thomson-Southam*. See "Five of Eight Charges Against Newspaper Chains Dismissed on Motion of Non-Suit," *Canadian Competition Policy Record*, Vol. 4(4), December 1983, pp. 39-41; "Newspaper Chains Acquitted," *Canadian Competition Policy Record*, Vol. 5(1), March 1984, pp. 1-8.

3. See, for example, R.D. Anderson and S.D. Khosla, "Recent Developments in Canadian and U.S. Merger Policy," *Canadian Competition Policy Record*, Vol. 7(3), September 1986, pp. 46-65.

4. See Randy Hughes, "Proposed Rules for Regulating the Practice and Procedure of the Competition Tribunal," *Canadian Competition Policy Record* Vol. 7(4), December 1986, pp. 10-13; "Competition Tribunal Rules," SOR/87-373, June 25, 1987, pp. 1-17.

5. This conclusion is based on statements by officials of the Bureau of Competition Policy and legal counsel involved in merger cases.

6. See *The Canada-U.S. Free Trade Agreement* (Ottawa: Department of External Affairs, 1987).

7. See Globe and Mail, January 14, 1988, p. A8. For a more detailed review of these and related data, see R.S. Khemani, D.S. Shapiro and W.T. Stanbury (eds.) *Mergers, Corporate Concentration and Power in Canada (Montreal:* The Institute for Research on Public Policy, forthcoming), Ch. 1, 3.

8. Data compiled by the author and reported in Khemani, Shapiro & Stanbury, *op. cit.*, Appendix 1.

9. The Bureau of Competition Policy indicates there were 1630 proposed mergers between June 19, 1986, and January 15, 1988.

10. See W. T. Grimm & Co., *Mergerstat Review, 1986.*

11. *Mergers & Acquisitions* (Philadelphia: MLR Enterprises). Based on completed transactions at year end with a value of $1 million or more and which involved transfer of at least 5% of a firm's assets or equity.

12. Data provided by the Bureau of Competition Policy.

13. Information provided by Dr. David Scheffman of the FTC at a conference on merger policy at the University of Toronto, December 15, 1987.

14. Data provided by Dr. David Scheffman of the Federal Trade Commission, and the U.S. Department of Justice.

15. *Ibid.*

16. See "Merger Guidelines 1968" in CCH *Trade Regulations Reports*, July 9, 1982; U.S. Department of Justice, *Merger Guidelines* (Washington, D.C., 1982); U.S. Department of Justice, *Merger Guidelines Issue June 14, 1984 and Accompanying Policy Statement,* BNA *Antitrust and Trade Regulation Report,* No. 1169 Special Supplement.

17. See Lawson A.W. Hunter, "Competition Tribunal Weighs In on First Merger Case", *Canadian Competition Policy Record,* Vol. 7(4), December, 1986.

18. See John Blakney, "Merger Application: Quebec Meat Rendering Industry," *Canadian Competition Policy Record,* Vol. 8(2), June 1987, pp. 10-11; Lawson A.W. Hunter, "Constitutional Validity of *Competition Tribunal Act* and *Competition Act* Challenged," Canadian Competition Policy Record, Vol. 8(2), June 1987, p. 11.

19. *Director of Investigation and Research* v. *Palm Dairies Limited et al.*, (Unpublished judgment of the Competition Tribunal, Ottawa, November 27, 1986) pp. 15-16.

20. "Pocklington betting on milk shakeup," *Vancouver Sun*, June 18, 1987, p. E9.

21. *Supra* note 17, p.4.

22. See the references in note 1.

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