

## COMMENT AND ANALYSIS

### AN INTRODUCTION TO THE NATIONAL TRANSPORTATION AGENCY OF CANADA

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National Transportation Agency

Canadian transportation entered a new era in 1988 with implementation of the *National Transportation Act, 1987*, the *Motor Vehicle Act, 1987*, and the *Shipping Exemption Act, 1987*. Transportation regulation has changed dramatically with enactment of this new legislative framework. The legislation's new orientation dictated the creation of a new regulatory authority removed from the old regulatory approach and structured to serve Canada's transportation community in a manner consistent with the objectives of the new legislation.

The National Transportation Agency, established under the provisions of the *National Transportation Act, 1987*, assumed responsibility for federal regulation of Canadian transportation on January 1, 1988. Proclamation of provisions establishing the Agency itself came into force on October 2, 1987, while the remaining sections of the *Act* became effective January 1, 1988. The Agency replaced the Canadian Transport Commission (CTC) which had regulated transportation in Canada for over twenty years under the *National Transportation Act, 1967*.

This article offers a basic introduction to the National Transportation Agency. First, the evolution of Canada's new legislative framework provides a background to the formation of the Agency. The article then describes the Agency, its structure and role in Canadian transportation.

#### A Changed Regulatory Environment

It had been almost 25 years since the last substantive review of Canada's transportation legislation. The MacPherson Royal Commission Report, issued in 1961, became the basis for the *National Transportation Act* of 1967. Canadian transportation, however, witnessed significant change and development in the last twenty years. Transportation markets matured and carriers no longer needed extensive protection. Regulation became unnecessarily detailed, with authorities setting terms and conditions on which business could be done. The old regulatory regime restricted competition and enterprise often leading to excessive transportation costs and limited service options. Clearly, Canada's method of regulation was dated. It had not kept pace with change and was no longer responsive to the needs of shippers, passengers, and carriers. A new approach, characterized by less regulation and greater reliance on competition and market forces was required.

The federal government worked cooperatively with the transportation community to develop a new national transportation policy and legislative framework. Transportation reform began on February 21, 1985, when the Honourable Don Mazankowski, then Minister of Transport, speaking at the annual meeting of the Canadian Industrial Transportation League, extended a general invitation to all to participate. It culminated with proclamation of new legislation close to three years later. The Office of Economic Regulatory Reform, a special unit reporting directly to the Minister of Transport, was the government's key operative in the consultative and legislative development process. This office dealt with over 500 transportation interests to formulate new legislative provisions which met particular needs while respecting the principles of regulatory reform.

Developed through consultation, the transportation bills were subjected to extensive study and comment through the Parliamentary process. Parliamentarians, both during committee deliberations and in debates on the floor, played an important role in refining the provisions to best meet the requirements of the transportation community, and the general public. Throughout the legislative process, consultation between the federal government and interested parties were open and frank.

### **The Agency's Role**

The legislative framework established by the *National Transportation Act, 1987*, provides the National Transportation Agency with a new approach for regulation and new tools with which to do the job. The Agency has all the powers, rights and privileges of a superior court in Canada. However, in contrast to the CTC, which was more interventionist, the Agency is service-oriented, the focus being problem solving and protecting the public interest. The Agency understands the importance of maintaining a constructive working relationship with Canada's transportation community in order to effectively meet its objectives in this new environment.

The Agency's legal mandate is determined by the provisions of several pieces of transportation legislation, including the *National Transportation Act, Railway Act, Western Grain Transportation Act, Canada Shipping Act, Shipping Conferences Exemption Act, Pilotage Act, Maritime Freight Rates Act, Atlantic Regional Freight Assistance Act, Motor Vehicle Transport Act* and the *Aeronautics Act*. These acts, and any ensuing regulations, determine what the Agency does - and how it does it.

The new legislation clearly distinguishes the Agency (which implements and administers transportation legislation) from the government (which establishes policy). Agency decisions and orders are bound by policy direction from the Government of Canada. Regulations are prepared by the Agency, but require approval by the Governor in Council.

The Agency's role is also distinct from that of Transport Canada. The Agency is responsible for the economic regulation of transportation. Transport Canada performs a policy development role in support of the Minister of Transport, is responsible for the regulation of transportation safety (except rail), and provides certain transportation services (for example, airports, port and harbours, Coast Guard services).

The Agency's regulatory mandate is substantially different from that of its predecessor, the Canadian Transport Commission. Although some programs were inherited intact from the CTC, the new *National Transportation Act* and *Shipping Conferences Exemption Act* also provide for new Agency services and programs and establish a new attitude towards the economic regulation of transport. The Agency has undertaken to provide a more dynamic and responsive approach to transportation regulation to ensure the objectives of the new legislation are realized.

Section 3(1) of the *National Transportation Act*, in declaring Canada's National Transportation Policy, provides a clear understanding of the objectives of the legislation. The fundamental objective of Canada's transportation system is to serve shippers and travellers, and to maintain the economic well-being of the country and its regions. The best use of all modes is to be made at the lowest total cost. The *NTA's* policy statement also recognized, for the first time in legislation, that safety of the transportation system is the first priority. Indeed, major reforms of safety regulation and enforcement have recently been implemented in all transport modes.

Under the new *National Transportation Act*, the concept of competition has been expanded, from competition among modes, to include competition among carriers within each mode. The old *National Transportation Act* emphasized competition among modes. However, economic legislation covering the individual modes often constrained competition and protected carriers at the expense of consumers. Potential new entrants had to prove that the market required and could support another service (public convenience and necessity). Under the new legislation the situation has changed: competition will be encouraged as the best way to meet the needs of users and the economy as a whole and regulation will

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be implemented only where necessary, primarily where market forces are too weak to ensure effective competition.

Transportation has long been recognized as a key to regional development and has played an important role in the development of this country. The prerequisite for lasting economic development in all regions of Canada is an efficient, effective, and competitive transportation system. The *National Transportation Act, 1987*, creates the framework necessary to achieve such a system. Furthermore, the new *Act* recognizes in law, for the first time, that transportation has an important role to play in regional economic development. This is one of the elements of the national transportation policy that will guide the Agency in its decisions over the coming years.

The Agency's constituent legislation broadly defines the policy to be reflected in Agency orders and decisions. In circumstances where the constituent acts give broad discretion to the Agency, there may be a need to attach greater precision to policy objectives. The new *National Transportation Act* allows the federal government to issue binding policy guidelines to the Agency. These guidelines must be made public by being tabled in Parliament and must not affect specific cases which are currently before the Agency.

### The Agency's Structure

The legislation enacting the government's reform of transportation regulation contains new services, powers and functions specifically tailored to the new regulatory philosophy. To ensure effective administration, corresponding changes were made to the regulatory body which were consistent with the practices and perspectives of the new regulatory environment. To meet these objectives, the Agency has been structured:

- to be less cumbersome, smaller, and more accessible to the public;
- to encourage a multimodal approach to transportation issues;
- to place greater emphasis on proceeding in a timely and less costly manner; and
- to reduce the administrative burden on shippers and carriers alike.

The Chief Executive Officer of the Agency is the Chairman who is charged with responsibility for the supervision and direction of the work of the Agency members and staff. A Vice-Chairman and a maximum of seven other members are appointed for renewable terms not exceeding five years. At least one member must represent each of five regions of Canada: Pacific, Prairies, Ontario, Québec and Atlantic Canada. Up to six additional members may be temporarily appointed to the Agency to meet extraordinary demands or provide special expertise for limited periods.

The Honourable Erik Nielsen, P.C., Q.C., is Chairman of the Agency - his previous position as President of the CTC provided continuity during the transitional period establishing the new Agency. Mr. Nielsen brings to the Agency his many years of public service to Canada including a lengthy association with the aviation industry. He also brings his experience of over 28 years of active law practice during which he acted as counsel for several client organizations engaged in all modes of transportation.

To date, four members have been appointed to join Mr. Nielsen at the Agency: Ed Weinberg, Jim Mutch, Craig Dickson and Ed O'Brien. The Honourable Marcel Lambert has been appointed as a temporary member under that provision of the *Act* allowing for appointment of temporary members.

Ed Weinberg, a former director of freight studies at the CTC, was a key member of the Office of Economic Regulatory Reform. He played an instrumental role in formulating the legislation through his extensive consultations with Canadian industry. Jim Mutch came to the Agency directly from a senior position with Canadian Airlines International. He has had a long involvement with domestic and international aviation, tourism and northern transport.

Craig Dickson worked for 34 years with the Atlantic Province Transportation Commission. He has had extensive experience with transportation user groups such as the Canadian Shippers Council. Ed

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O'Brien has been Director of Transportation for the Province of Newfoundland since 1973, and prior to that held positions with Quebecair and Canadair Limited.

Marcel Lambert was a Commissioner with the Canadian Transport Commission for the past three years. Before that, Mr. Lambert was a Member of Parliament, serving as Speaker of the House from 1962 to 1963 and as Minister of Veterans Affairs.

The Chief Operating Office of the Agency is the Executive Director. The Executive Director reports to the Chairman and is responsible to that office for the management of the Agency and its staff. Keith Thompson, Q.C., is Executive Director of the Agency. Mr. Thompson headed up the Office of Economic Regulatory Reform - the federal office directly responsible for developing the new legislation. Previously, Mr. Thompson was employed by the CTC.

A clear distinction exists between Agency members and Agency staff. Members make Agency decisions; staff advise the Agency's members.

The CTC was made up of modal committees - the Railway Transport Committee, the Air Transport Committee and so forth. The Agency, by contrast, is structured along functional lines emphasizing intermodal and market orientation objectives. The staff of the Agency is organized into four transportation program branches, two administrative support branches, and Legal Services. Branch heads report to the Executive Director. Program branches are: Dispute Resolution, Market Entry and Analysis, Transportation Subsidies and Rail Safety. The Agency currently retains responsibility for rail safety pending legislation that will sever and transfer this function to Transport Canada and a new Transport Accident Investigation Board. Once the transition is complete, the Agency's staff will be substantially less than that of the CTC's - down to about 470 person-years from 830. The CTC had seventeen commissioners, the Agency will have nine members.

The Agency's headquarters are in the National Capital Region (Hull, Québec). Section 20(2) of the *National Transportation Act* allows the Agency to establish regional offices. The Act specifies that if regional offices are established, one is to be in Atlantic Canada and one in Western Canada. The Agency's Western Regional Office in Saskatoon is now fully operational, while the Atlantic Regional Office in Moncton will officially open soon.

Regional offices bring the services of the Agency closer to the people using them. They provide direct access to the Agency on matters of local and regional concern. This arrangement facilitates communication with communities, and other interested persons and groups interacting with the Agency.

In general, the regional offices will be concerned with applications for authority to operate air services and the investigations of applications and complaints on service and rate matters, including mediation assistance. Also, the regional offices will be involved with rail branch line abandonment applications and will conduct special field investigations. In addition to these general functions the Western regional office will assist with *Western Grain Transportation Act* matters. These include rate appeals, general complaints and field audits.

The Atlantic regional office will conduct certain field audits for the subsidy programs of the *Atlantic Region Freight Assistance Act* and the *Maritime Freight Rates Act*. Under these acts, subsidy payments are made to designated carriers for freight transported within and out of the Atlantic region. Other responsibilities related to these subsidy programs will be assigned to the Atlantic regional office in the future.

### Agency Service

The Agency is structured to provide improved service to Canada's transportation community. A description of the services provided by each of the Agency's four transportation program branches follows.

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The **Dispute Resolution Branch** provides various services to resolve rates and service disputes between carriers and shippers/travellers. These include informal and formal investigation, mediation and final offer arbitration. This branch's other areas of responsibility include acquisitions and mergers involving Canadian transportation undertakings; competitive line rates; interswitching and the regulation of transportation services for disabled Canadians.

The **Market Entry and Analysis Branch** is responsible for the licensing of Canadian and foreign carriers in respect of their operations in Canada, and the enforcement of licensing requirements. This section also monitors the economic impact of regulatory reform and participates in the negotiation of international air agreements.

The **Transportation Subsidies Branch** is responsible for the determination of rates and payment of subsidies in support of transportation services. It also evaluates rail network rationalization proposals.

The **Rail Safety Branch** is responsible for compliance with Agency regulation dealing with the safety of railway operations, infrastructure and rolling stock. Other responsibilities include investigations into railway accidents and compliance with regulations for the transportation of dangerous commodities by rail.

## Legislative Review - A Statutory Requirement

In accordance with requirements established in the new *National Transportation Act*, transportation in Canada will be monitored over the first four years of the legislation to assess its effectiveness on a continuing basis. The Agency will conduct annual reviews for each of the four years - 1988, 1989, 1990 and 1991. In January, 1992, a comprehensive review will be undertaken by one or more individuals appointed by the Governor in Council.

## Continuing the Dialogue

Canada's new transportation legislation was developed through extensive consultation with all elements of the transportation community. These parties made an invaluable contribution to the structuring of new legislation to best serve Canada's transportation needs.

The National Transportation Agency's work will be complemented by maintaining effective communications with the transportation industry. The Agency is prepared to work closely with industry to continue the dialogue established in developing the legislation. A co-operative effort will contribute to Canada's legislative framework reaching its full potential.

The National Transportation Agency has prepared a series of pamphlets outlining the key features of the new federal transportation legislation. These pamphlets can be obtained, at no charge, by contacting:

Hearings and Publications Distribution Centre  
National Transportation Agency  
Ottawa, Ontario  
K1A 0N9

Telephone: (819) 997-0019  
Telex: 053-4254 or 053-3615  
Facsimile: (819) 997-6727

## THE MERGER REVIEW PROCESS\*

By: Howard I. Wetston

### Introduction

This paper provides an overview of the Bureau of Competition Policy internal practice and procedure - the "nuts and bolts" of merger review. It outlines the types of issues with which the Bureau deals daily, and the steps that can be taken to expedite the Director's process of merger review.

The principal objective is to discuss the various stages involved in this process, ranging from information gathering and assessments to settlement proposals and applications to the Tribunal. In addition, the process of prenotification, the mechanics of obtaining Advance Ruling Certificates (ARC), and the nature of the Bureau's relationship with Investment Canada will be addressed.

### The Merger Review Process

The *Competition Act* applies to all mergers in Canada including all direct and indirect foreign acquisitions of Canadian companies. The implication of this is perhaps only fully grasped by looking at the figures. From the time of the enactment of the amended merger law in June, 1986, to the end of April, 1988, there were 1,895 publicly reported mergers in Canada, of which 1,134, or 60 percent, were foreign acquisitions. Of these, 199 have been subjected to a "significant" review (i.e. the Bureau has opened a file and reviewed the matter for at least two person days, or 15 officer hours) of which only three have resulted in an application to the Competition Tribunal. In addition, an application for an interim injunction was recently made in relation to the proposed acquisition by Institut Merieux of CDC Life Sciences Inc. Of the 199 mergers for which files were opened, only 37 were the subject of a review involving 10 person days or more. (This figure drops to 22 if the U.S. "significant review" threshold of 30 person days is employed.)

In the Institut Merieux case the Director of Investigation and Research proceeded to the Tribunal under s.72 of the *Competition Act* for two reasons:

- (i) because, on the basis of the facts available, he was of the opinion that the proposed transaction was reasonably likely to prevent or lessen competition substantially; and
- (ii) because the parties had failed to prenotify pursuant to s. 86 of the Act.

Of the other three mergers that were brought before the Competition Tribunal, one (Palm Dairies) was abandoned when the Tribunal declined to endorse the proposed consent order, one (Sanimal) has been held in abeyance pending the resolution of a constitutional challenge, and the other (Gemini) is currently proceeding through the discovery stage.

With respect to the balance of the mergers that have been examined in a "significant fashion," 33 have concluded with the issuance of Advance Ruling Certificates and 29 have been processed by providing advisory opinions. Of the latter 29, 15 were permitted to proceed under the monitoring program. The Bureau is aware of five mergers that have been abandoned as a result of the Director's position.

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\*This article is condensed from a speech given by Howard I. Wetston, Senior Deputy Director of Investigation and Research, Bureau of Competition Policy, Department of Consumer and Corporate Affairs. The speech was presented at a luncheon address to the Insight Seminar on the Impact of Competition Policy on Mergers and Acquisitions.

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Given this volume of activity, and the potential impact that the Director's decision may have on a transaction, it is essential that he obtain knowledge of mergers on a timely basis. Most mergers are brought to the attention of the Director from a variety of private and public sources. In terms of public sources, press and media reports relating to potential or actual mergers are most useful. A merger register is maintained in the Bureau of all such public merger announcements. With respect to private sources of information, the Director often becomes aware of a merger by contact with the merging parties themselves, either through voluntary disclosure or through prenotification. Voluntary disclosure of significant mergers that are not subject to the prenotification provisions is becoming the norm, as is informal and early contact with respect to large mergers that meet the notifiable transaction thresholds of Part VIII.

Another important source of information in relation to foreign takeovers is Investment Canada. As a matter of course, Investment Canada sends a copy of applications it receives to the Director for his assessment of the likely competitive impact. In addition, the Director's staff have, in the process of examining various industries over the years, developed industry contacts which can be used to keep up-to-date on developments and merger activity in particular industries. Finally, the Director receives, from time to time, complaints from customers, suppliers or competitors of the merging parties, and, of course, from firms who are the subject of a hostile takeover attempt.

There are, of course, mergers that will go undetected. However, in Canada it is likely the Director will eventually find out about a merger, particularly if there is a competition problem, because a complaint is likely to be received from an apprehensive customer, supplier or competitor. While it is possible that the Director may never become aware of a merger, he does have up to three years from the time the merger is substantially completed to challenge it before the Competition Tribunal. The business implications of this provision explain, in part, the high incidence of voluntary disclosure of mergers that fall below prenotification thresholds.

The statutory standard for review is whether the merger is likely to prevent or lessen competition substantially. In assessing whether this anticompetitive threshold is likely to be contravened, Bureau staff attempt to determine the likely impact of the merger on each competitive dimension in which the firm competes, such as price, level of service, quality, product choice and innovation. To develop this assessment clearly requires an in-depth understanding of the business and competitive dynamics of a particular industry, and can require considerable detail relating to both the market and the parties.

The categories of questions asked by the Director's staff cover matters internal to the firm, such as product lines, customers, suppliers and market share; and matters external to the firm, such as the relevant market, competitors and their market share, the availability of substitutes, the role of foreign and other potential competition, the nature of innovation and change in the market, the extent of government regulation and other barriers to entry.

For example, in relation to product lines, the extent to which product lines of the merging firms are competing or complementary must be determined. If product lines are competing, what will be the combined share of the new company in these product markets? Will the combined market share be less than the sum of the parties' pre-merger shares as a result of lost customers, or will it be greater by virtue of the parties' enhanced competitive position? Will parts of certain product lines be dropped? If so, does this create efficiencies in production and/or reduce choice for customers? One line of inquiry can lead to a host of other more detailed questions.

The assessment process determines the nature of the information that is required by the Bureau. The first step is the identification of the relevant market, which has product and geographic dimensions. In relation to the relevant product market, staff examine the products produced by the parties and their degree of substitutability, or reasonable interchangeability, with other products that may be available. In economic terms, degree of cross-elasticity of demand between these products is assessed - that is, the extent to which a significant price increase of the products of the parties would cause buyers to switch to a substitute product. If there is a low cross-elasticity of demand between

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the product or products manufactured by the parties to the merger and products that are said to be substitutable, then these latter products would be considered to be poor substitutes and would therefore not be considered to be within the relevant product market.

In addition, it is necessary to determine the cross-elasticity of supply, that is, the extent to which a price increase of the product of the parties in question would cause suppliers of other products to adjust their processes in order to be able to make a reasonably substitutable product. If suppliers in another market could easily alter their production process and make a product that is competitive with the product of the merged parties, then they could be included in the relevant market.

Clearly, measurements of cross-elasticity of demand and cross-elasticity of supply are rarely available. Moreover, even when data may be available permitting such computations, there are several methodological and statistical issues that are not always easy to resolve. Certainly, to make such computations under tight time constraints is generally not possible.

Accordingly, proxies of these measures, such as actual patterns of competitive behaviour, price differentials, industry opinion, consumer opinion, end use, product characteristics, whether the products to be compared are purchased by different consumers, whether different distribution channels are used and what the parties themselves appear to consider to be the market in which they compete are relied upon. This gives a notional understanding of the market - its dimensions and its dynamics.

With respect to the geographic market, it is necessary to determine the extent of the field of rivalry faced by the merged parties. In other words, it is important to know the extent to which firms located in progressively distant areas would be able to constrain the ability of the merged parties to raise prices, reduce output or otherwise behave anticompetitively. Key elements in this analysis include transportation costs, tariffs, import quotas and customer preferences. Consumers, for example, may be unwilling to purchase from distant firms, even if they are price competitive, because of considerations such as inconvenience, longer lead times, larger shipping or inventory requirements, lower level of customer service or additional information costs in locating distant sources of supply. Similarly, transportation costs or tariffs may render it unprofitable for distant firms to respond to a price increase by entering the market of the merged parties. By assessing these types of considerations together with actual observations and the opinions of industry participants and experts, a fairly informed view of the relevant geographic market can be obtained.

Several of the more important factors in s. 65 are also crucial to a determination of the relevant market. These include barriers to entry, foreign competition and substitutes.

Once the relevant market is defined, the Director's staff evaluate the structural and behavioural characteristics of this market. One of the more important structural considerations is the market share of the various market participants and how their shares have changed over time. Depending upon the circumstances, this measurement normally is made on the basis of the firms' sales or their productive capacity.

Another important structural consideration is the extent to which barriers to entry affect the ability of potential competitors to enter the market in response to increases in the price levels of the product or products of the remaining firms, thereby providing an effective constraint on the exercise of market power that may result from the merger. Generally speaking, barriers to entry may be defined as a cost of production which must be borne by a firm seeking to enter an industry but is not borne by firms already in the industry. This may include such things as start up and operating costs or the scale of production. However, other considerations such as brand loyalty, the cost of capital, advertising expenditures, patent protection of essential technology, government regulation, and control of distribution channels, or of necessary and scarce inputs by vertically-integrated firms, may be considered as significant barriers to entry.

Other qualitative factors that are enumerated in s. 65, and that have not already been considered, are then examined. For example, regard must be had to whether a failing firm is involved, to the extent

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of effective competition remaining and to whether a particularly vigorous and effective competitor is likely to be eliminated. Other factors that are not specifically mentioned in s. 65 that can often be of relevance under s. 65(h) are:

- countervailing market power held by buyers;
- a prior history of anticompetitive conduct in the industry which makes an exercise of market power more likely; and
- the extent to which products in the market are homogeneous.

At the end of the analysis, all of the qualitative and quantitative factors are considered to determine whether the merger is likely to prevent or lessen competition substantially. If the answer is affirmative, the Bureau evaluates whether any real efficiency gains will be derived from the merger, and if so, whether they are likely to be greater than and will offset the effects of any prevention or lessening of competition that is likely to flow from the merger. In this regard, it is important to note that if certain of the gains claimed can reasonably be expected to be attained by the parties in a less restrictive fashion than by merger, then they will not be considered. This is because the last clause of ss. 68(1) restricts the assessment to those gains in efficiency that "would not likely be attained if the order were made."

A real efficiency gain is a saving that results when the unit costs of output are reduced or a better product is produced without a proportionate increase in costs. Normally, this would include all non-redistributive qualitative and quantitative gains that are reasonably ascertainable. Gains that are redistributive in nature are those that result solely from a redistribution of income between two or more persons. Savings falling into this class would include reduced labour costs or purchasing discounts brought about solely as a result of the exercise of increased market power or bargaining leverage. However, where such purchasing discounts are expected to be granted by the merged firm's suppliers because, for example, the merged firm's increased orders will bring about cost savings to the supplier of the merged firm, that will be recognized as a legitimate efficiency gain. Also in the class of pure pecuniary gains would be tax savings, the acquisition of a production facility at a lower cost than would have been required to build a comparable plant, and savings that are associated with decreases in non-price competitive dimensions such as quality or variety in the post-merger environment.

By contrast, gains that are typically accepted arise from production related efficiencies such as economies of scale and scope. Scale efficiency refers to the reduction in unit costs incurred by a firm to produce a given product as it moves toward its optimal plant size or production run. Economies of scope are associated with multiproduct production, and arise when the total cost of producing multiple products together is less than the sum of the costs that would be associated with producing each product separately.

Other efficiency gains that are recognized in the context of a horizontal merger assessment are derived from specialization in product lines, the elimination of excess capacity or duplication, and reduction in service, transportation and other distribution costs. Likewise, conglomerate mergers of firms that sell their products through similar distribution channels or that have similar technological processes can give rise to significant economies of scope or distribution and other types of marketing efficiencies. With respect to vertical mergers, quantifiable gains usually relate to better integration of production facilities and transaction cost considerations, such as overcoming problems associated with information flow and contracting with third parties. It should be added that qualitative efficiencies that cannot be quantified, such as Research and Development (R & D) synergies or enhanced ability to respond dynamically to developments in the market, are also given due weight in the balancing process when reasonably ascertainable.

The Director will soon be releasing an information bulletin on the subject of efficiency gains. However, recent Bureau experience with various efficiency claims, particularly with regard to the causal relationship that is contemplated in ss. 68(2) between efficiency gains and increased exports or import substitution, requires comment. Subsection 68(2) specifically states that anticipated efficiency gains will generate increased exports or import substitution, and not the other way around. In this regard, parties should be able to substantiate not only their cost claims but also the

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reasonableness of their sales projections. The figure that should be claimed as an efficiency gain is not the total value of the increased exports or import substitution but only the cost saving that will enable the merged firm to become more competitive, multiplied by the number of units expected to be sold. In addition, to the extent that increased sales abroad enable the firm to move even further down its long run average cost curve, this additional cost saving would be recognized.

It is often argued that an acquirer who has been losing market share is in a better position to exploit potential efficiencies than the acquiree who is a vigorous competitor. Similarly, parties sometimes claim non-recurring gains, which are essentially asset redistributions, under ss. 68(1) such as proceeds from the sale of a plant. So far, not much weight has been given to these types of efficiency arguments.

Another important issue that often arises is that of confidentiality. Subsection 27(1)(a) of the *Act* protects the identity of parties who have provided information but not the fact that the Director is examining a particular matter. In addition, ss. 27(1)(c) prohibits the Director from disclosing the fact that the parties have prenotified, and from divulging information obtained from the parties pursuant to a request for an Advance Ruling Certificate. However, the protection of s. 27 does not extend to information that is already public, that is obtained from sources other than the parties applying for the ARC, or to information communicated for the purposes of the administration or enforcement of the *Act*.

As a matter of policy, the Director respects the confidentiality requests of parties where a merger is not yet public. The fact that parties have communicated with the Director about a proposed transaction, asked for a written opinion or requested an ARC, will not be revealed. Nevertheless, in these circumstances, the Director must rely exclusively on the parties themselves for much crucial information and will be unable to test that information with knowledgeable industry participants. Therefore, it is quite possible that a negative advisory opinion will be provided. In any event, if the information should prove to be inaccurate or incomplete at a later stage, the parties will be exposed to the risk that the Director will decide to take a second look at the merger within the three-year review period allowed under the *Act*. Also, it is most unlikely that an ARC would be provided in circumstances such as these, particularly where a horizontal merger is involved.

In addition to the provisions of s. 27, when a formal inquiry is commenced by the Director, ss. 8(3) provides that all such inquiries are to be conducted in private. The practical effect of this provision is that the Director will not comment on a question with respect to whether a s. 8 inquiry has been initiated, unless the parties themselves have made this fact public.

Although the need for confidentiality in particularly sensitive circumstances can significantly reduce the scope of an investigation or constrain the Bureau's ability to provide useful input to the potential merging parties, it does seem to be beneficial, where appropriate, to discuss proposals with the Director at an early stage before the transaction is made public. These discussions often provide parties with a helpful indication of the Director's likely concerns.

When parties voluntarily approach the Director regarding a proposed merger, the first point of contact is usually a meeting with the staff of the Merger Branch. In appropriate circumstances, a useful vehicle for advancing discussion in merger cases is the preparation and delivery of a brief memorandum, prepared by the acquirer, alone or in conjunction with the acquiree. This memorandum should outline the details of the transaction including the reasons for the merger, the product lines of the merging companies, the relevant geographic market, market share data, a description of the remaining competitors, their products, location and price competitiveness. In addition, it is useful to provide information with respect to other relevant considerations, such as the extent of regulation or other barriers to entry, the potential for efficiencies, and the countervailing market power of customers or suppliers. This information helps the Bureau understand the transaction and the comparative position of the parties in the market. It also serves as an excellent basis for discussion with company officials and counsel.

If after the initial meeting there appear to be no competition problems, the Director will inform the parties of this, either formally or informally, depending on what the parties request. Of course,

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prenotification may still be required. Two avenues that are available for a more formal response are the Advance Ruling Certificate or an opinion letter under the Director's Program of Advisory Opinions. (ARCs will be discussed later in the paper.)

If there appear to be competition issues raised, then further information will be required. At this stage, and depending on the degree of confidentiality of the transaction, the Bureau relies on the parties to provide the required information. Every effort is made to request relevant information and to avoid asking for information that is not essential to the assessment. However, it must be kept in mind that the industry analysis and evaluation of the potential impact of a merger is complex. To this end, full and frank discussion has been proven to serve the interests of both the Director and the parties in achieving an expeditious merger review.

The length of the information-gathering stage depends on a host of factors, such as the number and complexity of the competition issues raised, the nature of the industry and the availability and quality of information. Clearly, the Bureau's ability to expedite matters is a function of timing considerations and the quality of information provided by the parties.

In cases where substantive competition issues arise, Bureau staff normally communicate with the parties within three to four weeks. During this period, parties will often be contacted on several occasions for additional information and clarification. The Director's staff will usually be seeking, simultaneously, input from customers, suppliers, and competitors. In addition, industry experts are often retained to assist with the technical understanding of the industry and to provide an opinion on the dynamics of industry behaviour.

The findings of the Merger Branch staff will then be communicated to the parties. The Director is also briefed throughout this process. With major cases, an additional period of up to four weeks has typically been required in order to consider new information and additional submissions of the parties, seek the views of outside consultants and obtain additional information from the industry. This new information is used to revise the initial assessment of the merger.

On the basis of the information gathered from the parties and other sources, the Director's staff finalize the assessment document. This document typically includes a summary of the position of the parties, the views of interested industry participants, and experts retained by the Director, together with an analysis of the s. 65 factors and other considerations relevant to the assessment of the likely competitive impact of the merger. The views of other interested bodies, such as government departments, will also be highlighted.

This assessment document forms the basis upon which the Merger Branch staff, through the office of the Senior Deputy Director of Investigation and Research, provides a recommendation to the Director with respect to the transaction. This recommendation and the principal reasons for it are normally discussed with the parties prior to the Director finalizing his position, thereby providing parties an additional opportunity to present arguments prior to a final decision by the Director.

Staff recommendations vary from suggesting that no further action be taken or that the impact of the transaction be monitored for three years to recommending that the merger be challenged. It should be kept in mind that if the Director is of the view that grounds exist for the making of an order under s. 64 of the Act, he is obliged to commence an inquiry pursuant to ss. 8(1)(ii) of the Act.

Once the Director forms the view that the merger is likely to prevent or lessen competition substantially, the parties may have some difficult decisions to make. Between the extreme choices of abandoning or litigating the transaction in question, the parties should consider whether there are ways to restructure the deal in a way that might alleviate the Director's competition concerns.

The frequent communication between the Director's staff and the parties will normally have provided a clear picture of the areas of concern. For example, if only one division or product line is the focus of objection, the parties may consider divesting the troublesome division or product line to third parties. This solution, in fact, has already been successfully employed in a number of cases.

The Director will consider settlement proposals, and in this regard will often seek the views of outside economic and industry experts, together with the input of various other industry participants,

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to test the practicality and viability of particular proposals. Experience to date has shown the proposals that work best are structurally oriented and do not require extensive monitoring.

In the preclosing period, it is more likely that undertakings to divest will be accepted rather than other settlement alternatives. To date, it has not been required that undertakings to divest be embodied from the outset within the terms of a Consent Order for post-closure situations. In general, the transaction is permitted to proceed without a Consent Order, subject to a written agreement that if an undertaking is not fulfilled, a Consent Order from the Competition Tribunal will be sought. However, the longer the period required for divestiture, the greater the likelihood the Director will require that divestiture terms be embodied from the outset in a Consent Order. Undertakings that are primarily behavioural in nature will not usually be given as favourable consideration as those which are essentially structural in nature.

Normally, if divestitures are to take place, they should be carried out as quickly as possible. This is because commercial, labour and market conditions can often change rapidly. Moreover, the economic or competitive viability of a product line or a company can be quickly dissipated without active or secure management. Where a compliance-oriented settlement is not possible and the parties pursue the merger, the Director will not hesitate to apply to the Competition Tribunal for relief.

The Director will, in the near future, release an information bulletin on compliance. Negotiated settlements will be discussed in this bulletin.

### Prenotification

Seventy-two prenotification filings have been received since the Part VIII provisions came into force on July 15, 1987. Most filings have been satisfactory, and in fact only one has been rejected. The majority of filings take place after some consultation with the Director's staff.

In the course of discussing particular notification requirements, several areas of uncertainty have been raised. For example, parties are often unsure whether they should proceed by way of short form or long form filing. When deciding between short form and long form filing (21 days), a long form is usually required where significant competition issues are likely to arise because it gives the Bureau additional time and information with which to assess the competition implications of the transaction. In the event of uncertainty, the matter can be discussed with the prenotification unit of the Merger Branch.

A second area where questions commonly arise is in relation to the reporting of information required with respect to affiliates. The Act defines affiliates in the context of *de jure* control which, for the most part, is reasonably ascertainable. The difficulty lies in providing information in relation to affiliates that operate in markets unrelated to those affected by the transaction. In these circumstances, parties can normally look to ss. 88(2) of the Act, which sets out the way in which information not relevant to the competition assessment can be omitted. However, the revenues and assets of these affiliates must be taken into account in the determination of whether the \$400 million threshold of ss. 81(1) is exceeded. Similarly, parties may use ss. 88(2) to omit submitting the complete file of proxy solicitation and prospectus filings for the past two years if the pertinent information contained therein is repetitive of other material included with the prenotification.

Another common area of uncertainty relates to determining who is a principal customer or supplier, particularly where the party has many customers, none of which account for any significant percentage of the total volume of business. Rather than filing computer printouts listing thousands of customers or suppliers, the Director's staff will assist parties by narrowing the filing requirements to principal customers or suppliers, or classes of customers or suppliers.

With respect to parties that have previously notified in relation to other transactions a subsequent prenotification must be treated as a completely new filing. That is, while the parties may have already sent in much of the information relating to their company required under Part VIII, if the Bureau were to accept only "incremental information" pertaining to the particular aspects of any new transaction

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not dealt with in the previous filing, major administrative problems would arise. The exceptions to this relate to annual reports, securities filings and 10Ks.

When a prenotification filing is received, it is reviewed for completeness. The parties are then sent a letter indicating whether the prenotification is complete and, if so, what the date will be for expiry of the s. 95 period. A telex is sent at the end of this period to confirm that the prenotification responsibilities of the parties have been fulfilled. Technically, the parties can then close. However, if the competition issues have not been resolved, the companies will be closing at their own risk. In these circumstances, parties might consider extending the closing date.

Although the purpose of prenotification is to alert the Bureau to particular mergers and to provide the staff with time to assess their competitive implications, the information included in a s. 93 or s. 94 filing is usually insufficient to enable them to fulfill their responsibilities with respect to the substantive merger provisions of Part VII of the Act within the seven or 21 day period. Parties therefore often include, with their prenotification filing, a competition brief which provides the Director's staff with sufficient information to determine if there are issues raised that would require additional study. The advantage of this procedure is that the Director is often in a position at the end of the prenotification period not only to advise the parties that the period has passed, but also to indicate, based on the information provided to him, that he does not have grounds upon which to challenge the merger.

### Advance Ruling Certificates (ARC)

One of the more common questions asked is whether prenotification or an ARC is the best route to follow in a given situation. Pursuant to s. 74 of the Act, the issuance of an ARC is a discretionary decision and follows a thorough analysis and the complete co-operation of the parties in terms of providing relevant information. It also takes a significant amount of the Merger Branch's time. In some cases, it is necessary to seek external expertise.

If parties desire a high degree of comfort that the Director will not challenge their proposed transaction, they can apply to the Director for an Advance Ruling Certificate. The effect of such a certificate is that if the transaction for which it was issued is substantially completed within one year after it has been granted, the Director is barred from applying to the Tribunal solely on the basis of information that is substantially the same as that upon which the issuance of the certificate was based. Accordingly, the Director is cautious about granting ARCs. Nevertheless, 33 ARCs have been issued.

Parties who wish to apply for an ARC should send a comprehensive written request to the Director. The letter should address the details of the transaction and the reasons why the merger is not likely to raise significant competition concerns for the Director. In this regard, reference should be made to the factors set forth in s. 65. Staff of the Merger Branch are available to provide assistance or guidance.

Situations such as management buy-outs, internal corporate reorganizations and takeovers by companies outside of the industry of the target company are generally considered to be more obvious candidates for an ARC. However, to the extent that these or other situations are likely to give rise to some lessening of competition, albeit not substantial, the Director is more likely to issue a non-binding advisory opinion than an ARC. When parties request an opinion on a proposed transaction without allowing the Bureau an opportunity to seek external expert opinions or to talk to competitors or customers in the industry, the Director will not normally issue an ARC unless the transaction is very unlikely to have anticompetitive implications. A detailed information bulletin on Advance Ruling Certificates will be available shortly from the Bureau of Competition Policy.

### Investment Canada

Investment Canada's mandate is to review certain acquisitions in Canada by non-Canadians under the general "net benefit to Canada" test. One of the six factors to be considered in the Investment

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Canada process is the effect of the merger on competition. Accordingly, there is clearly some degree of overlap between the *Investment Canada Act* and the *Competition Act*. As a result, close contacts have been cultivated between the Bureau of Competition Policy and the Investment Canada Agency. As a matter of practice, Investment Canada seeks the Director's input and assessment of the competition factor.

Investment Canada is subject to a 45-day time limit to complete their assessment. However, as a matter of practice, the Agency attempts to complete this process in 30 days. Therefore, the Bureau tries to complete its competition evaluation of Investment Canada cases within 15 days of first receiving notice of the matter. Normally the assessment is made on the basis of information provided in the Investment Canada application. Nevertheless, where documentation is insufficient to carry out a proper assessment under the *Competition Act*, the companies involved are approached directly. The information that passes between the Bureau and Investment Canada complies with the confidentiality provisions of the respective statutes.

The Merger Branch corresponds with Investment Canada on a weekly basis, telexing to Investment Canada all matters that present no competition issue. Often, in urgent cases, notice is given to Investment Canada by telephone, followed by a written confirmation. The Director will normally indicate whether, in his view, the competition factor should be given a positive, neutral or negative weight in the overall net benefit assessment. In most cases, the Director has given a neutral weight. However, where he has concerns, he will write to Investment Canada outlining his reasons. Investment Canada may still decide that the merger is of net benefit to Canada even if the competition factor is negative.

Although the same merger is often examined by both Investment Canada and the Director, the Director's assessment is independent of Investment Canada's. Therefore, the fact that Investment Canada has decided that a merger is of net benefit to Canada does not in any way remove or reduce the Director's jurisdiction to review, challenge, or otherwise resolve a merger transaction.

It is important to note that, notwithstanding the *Canada-U.S. Free Trade Agreement (FTA)*, the provisions of the *Competition Act* continue to apply with equal force to foreign and domestic mergers. If the *FTA* is implemented, the review threshold of Investment Canada will be raised over a period of a few years from their current levels to \$150 million. However, the applicability of the *Competition Act* to all mergers, regardless of size, will remain unaffected.

## Conclusion

The merger review process involves a number of important stages and factors. This paper has examined the Bureau's assessment of some of the more important substantive considerations in merger analysis, such as the relevant market, barriers to entry, foreign competition, efficiencies and various other structural and qualitative criteria. It has also covered matters of process such as confidentiality, the nature of the compliance process and compliance alternatives, how and when to approach the Director, and various other significant timing considerations.

This information should assist those in the business and legal communities to determine whether and how to prenotify, apply for ARCs or advisory opinion letters and how the Investment Canada provisions interact with competition policy questions.

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## HIGHLIGHTS

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REAL ESTATE INDUSTRY GETS NEW CODE OF CONDUCT  
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### FEATURE ARTICLE:

ANTITRUST AND TRADE POLICY: A PEACEFUL CO-EXISTENCE

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## COMPETITION ACT SECTION NUMBERS CHANGED

The Revised Statutes of Canada, 1985, came into effect on December 12, 1988. As of that date all references to federal statutes included in the revision, including the *Competition Act*, should be to this new version. Many section numbers of a large number of federal statutes have changed as the result of the coming into force of the 1985 Revised Statutes. The *Competition Act* should now be cited as R.S. 1985 c. C-34. The 1986 revision to the *Combines Investigation Act* is contained in the Second Supplement of the revision as Chapter 19.

A Table of Concordance matching the previous section numbers of the *Competition Act* with those of the *Act* in the 1985 Revised Statutes is attached.



Table of Concordance

Competition Act R.S., 1970, c. C-23 as amended	Competition Act R.S., 1985, c. C-34 as amended
article/section	article/section
1	1
1.1	1.1
2	2
2.1	2.1
3	3
4	4
4.1	5
4.2	6
5	7
6	8
7	9
8	10
9	11
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24	26
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26	28
27	29
27.1 Repealed	30 Repealed
28	31
29	32
29.1	33
30	34
31	35
31.1	36
31.2 - 31.9 Repealed	37 - 44 Repealed
32(1)	45(1)
32(1.1)	45(2)
32(1.2)	45(2.1)
32(1.3)	45(2.2)
32(2) (6)	45(3)-45(7)
32(6.1)	45(7.1)
32(7)	45(8)
32.01	45.1
32.1	46
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32.3	48
33	49
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35	51
36	52
36.1	53
36.2	54
36.3	55
36.4	56
37	57
37.1	58
37.2	59
37.3	60
38	61
38(7.1) Repealed	61(8) Repealed

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39	62
40 Repealed	63 Repealed
41	64
42	65
43 Repealed	66 Repealed
44(1)	67(1) & (2)
44(2)-(5)	67(3)-(6)
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45.3	72
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