

CANADIAN COMPETITION LAW DEVELOPMENTS

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LIDLAW LAID LOW

On January 20, 1992 the Competition Tribunal released its decision in the abuse of dominance case brought against Laidlaw Waste Systems Ltd. This is the second decision of the Tribunal under the dominance section, the first being the *NutraSweet* decision.

In the 129-page decision, Madam Justice Reed for the Tribunal concluded that Laidlaw had engaged in number of abusive practices. No final order was issued pending the parties' returning with a draft order for the Tribunal to review. The Tribunal did comment on what kind of orders it was willing to entertain.

The case involved the practices of Laidlaw with respect to certain waste collection and disposal services in four areas of Vancouver Island: the Cowichan Valley (Duncan) area, the Nanaimo area, the Courtney-Comox-Cumberland area, and the Campbell River area.

The Tribunal reviewed Laidlaw's alleged practices in these areas. In particular, it reviewed actual or attempted acquisitions of competitors, as well as restrictive covenants contained in agreements of purchase and sale. With respect to the latter, Laidlaw often obtained agreements from vendors not to compete in a geographic area up to a 500-mile radius from particular towns or municipalities.

The Tribunal also reviewed Laidlaw's contractual practices once acquisitions were made. Immediately after an acquisition, Laidlaw apparently engaged in sales blitzes to get customers to sign long-term contracts or to renew contracts long before their expiry date. The Tribunal found that in many instances signatures on contracts were obtained through misrepresentation.

The Tribunal also considered the terms of many of Laidlaw's contracts. These typically were

for a three-year term with an automatic renewal clause. Laidlaw had more liberal rights to terminate than did customers. Contracts also contained provisions allowing Laidlaw to meet a competitor's terms and conditions. On these clauses the Tribunal found:

Laidlaw therefore did not have to respond to competition by lowering prices generally. It could target price reductions only on the customer that the competitor was seeking to acquire, thereby reducing the costs of using predatory or disciplinary pricing to discourage price competition. In addition, these kinds of clauses prevent secret price-cutting which is widely recognized to be an important means of maintaining competitive markets.

In 1991 Laidlaw had dropped the use of this clause in Vancouver Island markets.

The Tribunal noted that the contracts often bound the customer to employ Laidlaw for all its garbage disposal needs. This applied even in situations where Laidlaw itself could not provide the service. In reviewing the enforcement of contracts by Laidlaw, the Tribunal noted that Laidlaw was very vigilant in enforcing all of the provisions of the contracts, even though many customers were not aware of the nature of the terms. The Tribunal found that Laidlaw's practices had a "chilling effect" on competition.

The Tribunal also noted that Laidlaw had a habit of using legal counsel to threaten legal actions against customers, although Laidlaw had not actually pursued any case against customers on Vancouver Island. The Tribunal noted, however, that in most threatening letters to customers, Laidlaw's counsel indicated that Laidlaw had pursued many actions against customers in recent years and had always been successful.

The Tribunal reviewed the evidence with respect to the geographic market involved. In

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this connection, the issue of the test in the Director's *Merger Enforcement Guidelines* (i.e., a five percent non-transitory price increase) was discussed. Two interesting issues were noted. First, the Tribunal discussed the so-called "cellophane fallacy," an issue which arose in a U.S. antitrust case against Du Pont. In relying on that case, Laidlaw's counsel had maintained that Laidlaw's price was competitive. The Tribunal seemed disinclined to accept this. Second, it also found, with respect to the "cellophane fallacy," that it could not accept or conclude that "the logic of the criticism [using prices or revenues as they exist in a non-competitive market as a surrogate for competitive prices] is invalid."

Regarding the test of a five percent non-transitory price increase as relevant for the purpose of defining markets, it is interesting to note that the Director's counsel argued that the test was not necessarily useful in an abuse of dominance case, since in such cases the respondent already had to have a dominant position in a market.

The Tribunal itself stated:

The Tribunal wishes to emphasize that the above discussion of the respondent's expert evidence should not be taken as an acceptance that the 5% price rise criterion is necessarily a useful one even in a merger case. While the test of a non-transitory significant price increase may be conceptually useful, what percentage will be significant and what period of time will satisfy the test of non-transitoriness can only be determined by reference to the facts of a particular case.

Substantial or Complete Control

In considering the evidence necessary to establish substantial or complete control of a market the Tribunal found:

A prima facie determination as to whether a firm is likely to have market power can be made by considering the share of the relevant market held by that firm. If that share is very large the firm will very likely have market power. But other considerations must also be taken into account including: how many competitors there are in the market and their respective market shares; how much excess capacity the firms in the market have; how easily a new firm can establish itself as a competitor.

The Tribunal found that Laidlaw had very substantial market shares in the affected

geographic areas, exceeding 87 per cent in the Campbell River area as well as the Cowichan Valley (Duncan) and Nanaimo areas.

The Tribunal gave short shrift to Laidlaw's arguments that it was not abusing its market power because it was not charging excessive prices. The Tribunal conducted a review of profits being made by Laidlaw as well as fuel surcharges and other types of price increases. It concluded that although there was no firm evidence that Laidlaw was charging too high prices, there was anecdotal evidence that the firm was nevertheless exercising market power.

In discussing barriers to entry, the Tribunal found that entry barriers were typically low, but that they were higher in the affected markets because of Laidlaw's contracting practices. The Tribunal stated, "it is these contracting practices, along with other allegedly anti-competitive acts, which it is argued lead to both Laidlaw's dominant position and a substantial lessening of competition in the markets in question."

Anti-competitive Acts

The Tribunal restated, as it did in *NutraSweet*, that the list of anti-competitive acts in section 78 is not exhaustive. It also stated that the alleged anti-competitive acts of Laidlaw, namely the pattern of acquisitions and the contracting practices, were not enumerated in section 78. The Tribunal reviewed the series of acquisitions made by Laidlaw and concluded that they were for the purpose of acquiring a monopolistic position in the markets. It based this conclusion on the frequency, timing and results of the acquisitions. For example, in one area two competitors were acquired on the same day. In another, three competitors were acquired within five months of each other.

The Tribunal also found that there was evidence of subjective intent in the acquisitions made. Although the subjective intent which it found was not a required element in order to find an anti-competitive act, it found the fact that it existed in this case was significant.

Laidlaw had attempted to explain its acquisition behaviour as being in furtherance of its general corporate policy to grow through

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acquisitions. To support that position it had introduced evidence of *pro forma* financial analysis done on certain acquisitions on Vancouver Island (as they were in every other acquisition made by Laidlaw in other parts of the country). The evidence that *pro forma* analysis had been systematically used in Vancouver Island seemed less sketchy, according to the Tribunal. Also, the Tribunal found that "the fact that so much of the purchase price for these acquisitions is related to goodwill could very well be an indication that a premium might have been paid by Laidlaw for the firm being acquired."

The Tribunal also reviewed the restrictive covenants contained in the acquisitions. In doing so, it referred to the common law decisions on restraint of trade. It found that covenants stopping a vendor from operating within a 300-mile radius, when the business normally operated within an area of less than a 30-mile radius, were "clearly unreasonable."

The Tribunal also commented on a reciprocal agreement between Laidlaw and one vendor where Laidlaw agreed to stay out of a particular part of the roll-off market if the vendor agreed to stay out of the lift-on-board market. The Tribunal commented that that type of market sharing arrangement could fall under the conspiracy sections of the *Act*. It stated:

Whether or not these result in a substantial lessening of competition in the roll-off market for the purposes of section 79 is not clear from the evidence adduced in this case. Whether they result in an "undue lessening" of competition in the roll-off market for the purposes of section 45 is also not clear. While intuitively one would expect this to be so, given the small size of the markets in question, there is simply insufficient evidence with respect to the roll-off markets for the purposes of section 79 to enable the Tribunal to come to any conclusion in that regard.

It is interesting to speculate whether this comment by the Tribunal is intended to prompt the Director to conduct a criminal investigation under section 45 into the circumstances of that particular agreement.

The Tribunal also commented on whether horizontal agreements fall within the ambit of section 79. It noted that in the *NutraSweet* decision, it was reluctant to conclude that all horizontal agreements were not touched by the

dominance section. The Tribunal concluded:

The Tribunal in this case, insofar as the acquisition agreements are concerned, is dealing with horizontal arrangements between willing competitors. Extensive and detailed evidence and argument has been heard respecting the anti-competitive effects of the conduct in question. It is not seriously in dispute, as the Tribunal noted in the *NutraSweet* decision, that the enumeration in section 78 is not controlling with respect to the scope of section 79. The Tribunal in this case has no difficulty classifying the acquisitions as acts constituting an anti-competitive practice.

Laidlaw argued that since mergers were dealt with in section 91 of the *Act*, it should not be subject to orders with respect to acquisitions or mergers under the dominance section. It also relied on the fact that section 78(b) covers a particular type of merger or acquisition, but not the type at issue in the case before the Tribunal. On this point the Tribunal found:

Laidlaw's *expressio unius* argument is not convincing. Firstly, paragraph 78(b) is explicitly non-exhaustive. The fact that an act is not listed in paragraph 78(b), even if it is listed elsewhere in the statute, is no reason to conclude that it is excluded as an anti-competitive act. Secondly, while section 91 does state that the acquisition of a competitor is a merger, it does not necessarily follow that such an acquisition *exclusively* falls under the merger provisions.

In reaching this conclusion the Tribunal also relied on the provisions of subsection 79(7) of the *Act*, which states that concurrent proceedings cannot take place on the same facts under the dominance section and the merger section. The Tribunal found that the inclusion of this subsection contemplated that an application could be made under either section on the basis of substantially the same facts.

The Tribunal analyzed the terms of the typical contracts from a supplier's point of view. It found that:

There is no credible explanation for many of the provisions of these contracts other than to create barriers to entry for would-be competitors by making customer purchase decisions inflexible. The tying of the customers to Laidlaw operates to exclude other competitors from the market.

In analyzing the contracts from a purchaser's point of view, the Tribunal found that they were contracts of adhesion and that the evidence showed the customer derived virtually no benefit

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from them.

The Tribunal also considered the argument advanced by Laidlaw's counsel that subjective intent was necessary under the section. It found that:

Proof of subjective intention on the part of a respondent is not necessary in order to find that a practice of anti-competitive acts has occurred. Such intention is almost impossible of proof in many cases involving corporate entities unless one stumbles upon what is known as a "smoking gun". Section 79 of the Act provides for a civil proceeding and civil remedies. In that context corporate actors and individuals are deemed to intend the effects of their actions.

Perhaps one of the stronger statements by the Tribunal in the decision was with respect to Laidlaw's questionable litigation practices:

No one can read the evidence concerning the use Laidlaw made of litigation and the threat of litigation in this case without a sense of outrage. The respondent used its vastly larger size and economic resources together with the threat of litigation to prevent customers from switching to competitors. It commenced spurious litigation and threatened litigation against its competitors to drive or attempt to drive them out of business by raising their costs of doing business. This is certainly predatory behaviour.

The Tribunal also commented:

It would be hoped that when courts become aware of this kind of oppressive use of the legal system they would at the very least be prepared to award costs to the defendant on a full indemnity basis.

Substantial Lessening of Competition

In analyzing the effect on competition, the Tribunal first dealt with market concentration. Here it found that Laidlaw's practice of acquiring competitors, at times to monopoly levels, created a *prima facie* substantial lessening of competition.

The Tribunal also found that Laidlaw had created artificial barriers to entry. It stated:

In this case the linchpin of Laidlaw's maintenance of its dominant position is the standard form contracts of adhesion which it uses to lock in a customer base. In this regard, the substantial lessening which is to be assessed need not necessarily be proved by weighing the competitiveness of the market in the past with its competitiveness at present. Substantial lessening can also be assessed by reference to the competitiveness of the market in the presence of

the anti-competitive acts and its likely competitiveness in their absence.

On the overall question of substantial lessening, the Tribunal concluded:

There is no reason to doubt that based solely on the economics of lift-on-board service these should be highly competitive markets. The evidence shows, however, that the effect of the contracts is to make entry sufficiently difficult so that it no longer effectively polices the market. The evidence demonstrates that a new firm can acquire a certain number of customers but that it cannot establish a customer base with sufficient rapidity to make entry attractive. In the markets in question there is no doubt that acquisition practices of Laidlaw buttressed by the creation of artificial barriers to entry through the contracts have resulted in a substantial lessening of competition.

Remedies

Perhaps the most interesting part of the Tribunal's decision is its discussion of the remedies it was willing to entertain. It may be recalled that the Director had sought a long and extensive list of remedies, some of them very regulatory in nature. In considering the appropriate remedies it could impose, the Tribunal indicated that it could only go as far as it considers necessary "in order to restore competition in the relevant markets." It also agreed that it was not its function to impose penalties or punitive measures.

With respect to future acquisitions and restrictive covenants by Laidlaw, the Tribunal indicated that it was willing to prohibit Laidlaw from acquiring any competitor in the affected markets for a period of three years. On the question of declaring the restrictive covenants in the acquisition agreements null and void, as the Director had requested, counsel for Laidlaw argued that this remedy was not within the Tribunal's jurisdiction since it was a blatant interference with the property and civil rights of the parties. Laidlaw argued this was a matter of provincial jurisdiction. Laidlaw also argued that the Tribunal was not a court of inherent jurisdiction and therefore could not grant the remedies sought.

On this point the Tribunal concluded:

There is no doubt that the Tribunal is not a court of inherent jurisdiction and is a creature of statute. At the same time, it is clear from the types of remedies which are expressly *included*

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within the Tribunal's mandate (ordering sales of shares and assets) that the Tribunal was given broad jurisdiction to interfere with property rights not only of the party or parties before it but also of third parties who have contracts with the respondent. This is clear not only from the remedies expressly described but also from the types of activity which the Tribunal is mandated to restrain: pre-emption of scarce resources; buying up products to prevent erosion of existing price levels; adoption of product specifications; requiring or ordering a seller to sell only or primarily to certain customers.

The Tribunal then proceeded to state that five particular covenants in various acquisition agreements were "wildly overly broad" and void.

In considering all of these restrictive covenants, the Tribunal seemed to be guided by the common law principles of unreasonable restraint of trade. This raises two interesting issues. The first is whether the Tribunal needs to be guided by common law rules in furthering its statutory obligations and mandate. The second is the ease with which the Tribunal found that the clauses in this case were unreasonable. It generally has been extremely difficult under the common law to have a court declare restrictive covenants "unreasonable."

With respect to terms, the Tribunal indicated that Laidlaw would be prohibited from including right of first refusal and right to compete clauses in future contracts. The Tribunal noted as well that Laidlaw had undertaken not to enforce such clauses in existing contracts and to notify its customers of this position. It had also undertaken to remove liquidated damages clauses from its standard term contracts.

With respect to the three-year renewal clause found in the contract, Laidlaw proposed to make renewals for one year only. The Tribunal found this insufficient, stating:

The Tribunal is prepared to grant an order that the contracts, both present and future, shall have no longer initial term than one year. An automatic right of renewal is appropriate but only for a one-year period. At the expiration of the initial one-year term, cancellation of the contract may occur on one-month's notice by either party. It would seem preferable that the existing contracts expire on their anniversary dates within a year of the Tribunal's order rather than all on one day.

The Tribunal also indicated that it would grant an order prohibiting Laidlaw from obtaining

exclusive service contracts with customers.

The Tribunal recognized that it was tying Laidlaw's hands when other competitors in the market would not be so constrained. On this point it stated:

While the situation created by such orders would seem to be unbalanced, the Tribunal is aware that if customers are faced with a choice between a three-year lock-in type contract such as that which Laidlaw now uses and a one-year contract from which the anti-competitive clauses have been removed, it seems likely that they would choose the less onerous version.

With respect to other remedies, the Director had sought a remedy prohibiting Laidlaw from exiting any of the markets. The Tribunal indicated it was not willing to grant such an order. However, it did indicate that if the Director could provide a fairly precise definition of "exiting", it would be prepared to include in an order a provision that Laidlaw must give the Director sixty days' notice of any such intended exit.

The Tribunal also indicated that it would consider exit from the market as a circumstance giving rise to an application to amend or vary the order. It did so in spite of the provisions of section 106 of the Act, which states that applications to vary can only arise when there has been a change of circumstances.

The Director had sought various pricing remedies such as a prohibition against Laidlaw charging a price which would undercut a competitor's price, unless it was offered to all customers, and requiring Laidlaw to circulate price lists to all its customers for five years. The Tribunal had difficulty in agreeing to such orders.

In conclusion, the Tribunal asked that counsel for the Director, in consultation with counsel for the respondent, draft an order for issuance by the Tribunal, which draft was to be submitted within ten days of the reasons being filed. On February 4, counsel for both parties submitted draft orders which differed in some material respects. Obviously, they could not agree on all the terms.

Summary

The impact of this decision in the continuing development of jurisprudence under the dominance section is significant. Once again, the Tribunal has had little difficulty in finding a

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violation of the provisions of the *Act*. In fact, it used very strong language in condemning many of the practices used by Laidlaw. It also clarified the scope of the law in a few important respects. First, it is clear that in an appropriate case, horizontal agreements can be caught by the dominance section. Second, the treatment of restrictive covenants as an aspect of abuse is noteworthy and interesting. The Tribunal also appears to take a very tough view on what "unreasonable" restraints are. Finally, the Tribunal had no difficulty turning aside the argument that interference with contracts was not within its jurisdiction. And its comments on harassing litigation may be raised in other cases where dominant suppliers make frivolous or vexatious attempts to threaten competition. The precedent presumably would apply to regulatory harassment in addition to court actions.

L.A.W.H.

ONTARIO MEAT RENDERING MERGER: COMPETITION TRIBUNAL TURNS DOWN DIR DIVESTITURE APPLICATION

On March 9, 1992 the Competition Tribunal issued its reasons with respect to the Director's application for an order directing Hillsgown (Canada) Ltd. (Hillsgown) to divest itself of the business operated by Ontario Rendering Company Limited (Orenco). This marks the first occasion on which the Director has lost a contested application to the Tribunal since the 1986 revision of the *Competition Act*.

Hillsgown obtained control of Orenco when it acquired fifty percent of the common shares of Canada Packers Inc. in July 1990. Hillsgown already controlled the Rothsay rendering business through its acquisition of Maple Leaf Mills Ltd.

The Tribunal's denial of the Director's application was based on:

- (1) insufficient evidence that the merger resulted in a substantial lessening of competition; and
- (2) the probable ineffectiveness of the proposed divestiture order in the circumstances of the case.

Meat Rendering Business

Meat renderers process the waste products of meat slaughterhouses and other animal carcasses. The two primary products are tallow, which is used for soaps, feeds, cosmetics and paints; and protein meal, which is used for fertilizers and pet foods. There are many grades of each rendered product, with grades depending in part on whether the source was red meat animals or poultry. Both rendered products compete with vegetable oils and meals. The Tribunal found that, to a large extent, renderers are price takers as a result of the availability and competitiveness of substitutes for their products.

Relevant Market

The Tribunal's market analysis focussed on the possible market power of the renderers as tellers of the rendering service to suppliers of the rendering material. The Tribunal found that because of different equipment requirements for rendering red meat animals and poultry, and the different product characteristics of each such rendered material, red meat renderable material comprised a distinct product market. In addition, the Tribunal narrowed the product market definition to rendering services for "non-captive" material, i.e. material obtained from third parties as opposed to material obtained from vertically integrated slaughtering operations. The Tribunal found that the dimensions of the relevant geographic market were more uncertain, due to instability in the boundaries of the sources of renderable material around particular plants and changes in the market since the merger had occurred. For the purposes of analysis of the impact of the merger, the Tribunal accepted a plant market boundary of approximately 200 to 250 miles. Significantly, the Tribunal rejected the Director's position that the Canada/U.S. border created a geographical market boundary. Rather, it found that existing regulatory constraints did not create a significant impediment to transborder movements in renderable material. As a result, the impact of operations of a major multi-plant U.S. rendering company with facilities in Detroit were regarded as relevant to the Tribunal's

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assessment of the impact on competition of the merger. As well, the Tribunal did not accept that there was a clear boundary between plants which served the captive and the non-captive red meat material markets.

Substantial Lessening of Competition

The Tribunal accepted the capacity of the merged supplier to maintain prices above competitive levels for a considerable period of time, as a primary test of the impact of the merger on competition. Applying this test, the Tribunal considered market concentration, the presence of access capacity, the overall market environment, barriers to entry and the fact that rendered products are not homogeneous.

Market Concentration

The Tribunal assessed market concentration before and after the merger in terms of historical output in a relevant market and productive plant capacity. On the basis of both established quantitative concentration measures (the Herfindahl-Hirschman Index and the four-firm concentration ratio), and of an examination of the capacity of equipment used by market participants in red meat rendering, the Tribunal concluded that the merger had increased the market share of the merged companies considerably in an already concentrated industry. However, the Tribunal emphasized that this finding did not carry considerable weight in its overall assessment of the impact on competition. It stated that its finding did no more than "give rise to at least an initial concern that the merger will likely substantially lessen competition in the active market."

Excess Capacity

The Tribunal noted that there was clear available capacity from the multi-plant U.S. operation at its Detroit facility, and that Schneider's rendering plant would be available for processing non-captive material as a result of the closing down of its Ontario cattle slaughtering operations. On the whole, the Tribunal found that it would be relatively easy for competitors to

increase capacity or to shift material around in a multi-plant firm situation to open up capacity where needed in this industry. In fact, the Tribunal found that larger firms actually planned their plant capacities in order to be able to free up plants close to market opportunities. Accordingly, it noted that there was significant excess capacity in the industry in general and that the merged firm itself was not capacity-constrained. These factors alone, the Tribunal noted, would restrain to a considerable extent the ability of the merged firm to raise prices.

Market Environment

The Tribunal also found that demand for red meat rendering services in the relevant Ontario-centered market was going through a period of structural decline which was not expected to level off. This change in structural demand was the result of both a movement of consumers away from red meat products and a decline of cattle rearing in Ontario. The reduction in Ontario cattle production reflects an overall shift in production to larger and more efficient herds in western Canada. The Tribunal noted that slaughter operations, the principal source of renderable meat, were relocating closer to these expanding western herds. It concluded that this trend will continue, noting that since 1970 the number of U.S. renderers had decreased from 650 to 300, with the most notable decline being in urban areas. The Tribunal also noted that in addition to structural demand shifts and industry relocation, increasing environmental costs to rendering operations, and relatively depressed prices for tallow and meal due to the increased availability of substitute products, have also led to increased consolidation in the industry.

Barriers to Entry

The Director submitted that there were three significant barriers to entry in the rendering business: land use restraints, lack of sufficient supplies and sunk costs. On reviewing the evidence with respect to land use constraints, the Tribunal noted that some new sites were available for rendering operations, and that zoning rules permitted expansion of a number of existing sites.

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With respect to the availability of sufficient supplies, the Tribunal noted that this issue turned on the scale of plant under consideration. There appeared to be various efficient plant sizes in the relevant market. Thus, the security of large supplies did not appear to be a prerequisite for efficient operation. As well, the Tribunal noted that further supplies may be available through forward integration of slaughtering operations. Finally, the Tribunal concluded that there was little evidence of the proportion of total costs represented by sunk costs. Overall, it found that the barriers to entry were moderately high for *de novo* entrance but that, given the state of the market, this form of entry would not be expected. On the other hand, the Tribunal noted that barriers to entry were low for established firms and that in the circumstances, they would be likely to respond to any price increase by freeing up or adding capacity.

Non-homogeneous Products

Finally, the Tribunal noted that the fact that rendering process products are highly non-homogeneous worked against the Director's theory that the merged firm could become a dominant supplier of tallow and meal.

Conclusion: Lessening of Competition from Merger not Substantial

The Tribunal accepted that there would be a lessening of competition in the relevant market as a result of the merger. However, it also noted that whether this lessening of competition would be "substantial" within the meaning of the *Act* would depend upon the circumstances of the case. Specifically, it rejected applying a rigid quantitative test to this determination, such as the "five percent price increase over two years" test that is referred to in the Bureau's *Merger Guidelines*. The Tribunal noted that its assessment was complicated by the fact that there would have been a lessening of competition in the market in any event for other reasons. The Toronto area had been the most competitive rendering market in North America up to the period around the merger. The Tribunal found that this situation would not be re-established under any circumstances. The

Tribunal also emphasized that its competition impact analysis must proceed from the new market situation brought about by structural demand changes and productive capacity overhangs independent of the merger.

The Tribunal concluded that it had not been persuaded on a balance of probabilities that a substantial lessening of competition was likely to arise as a result of the merger of the two rendering businesses. However, it emphasized that this decision is "very much a border line one and the difficulty relates to the dynamic changes which are occurring in the market." The Tribunal's principal reasons for this finding were:

While market share statistics are high and barriers to *de novo* entry are moderately high, the Tribunal cannot ignore the fact that a significant source of competitive discipline will exist from those firms which border geographically on the relevant market and which would be prepared to expand their area of collection in the face of a price rise by the merged firm. Indeed, such firms may find it necessary to do so in any event in order to obtain sufficient volumes for themselves. The fact that there is excess capacity everywhere in the relevant market and in the rendering plants approximate thereto means that constraints will exist on the merged firm's ability to raise prices.

Efficiency Defence

Section 96 of the *Competition Act* provides that the Tribunal may refrain from making a remedial order with respect to a merger if it finds that the merger is likely to bring out gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result, and if the gains in efficiency would not likely be obtained if the order were made. Strictly speaking, the Tribunal's finding of no substantial lessening of competition made it unnecessary for it to consider the *Act's* efficiency defence in this case. Nonetheless, the issue had been argued extensively and the Tribunal took the opportunity to present its interpretation of this defence. Its interpretation is significant since it differs considerably from the positions advanced by the Director and the respondent in this case and from the general approach taken by the Director in the *Merger Guidelines* (see page 45 of the *Guidelines*).

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The respondent had argued that efficiencies were disclosed by its evidence of administrative, transportation and manufacturing cost savings. The Tribunal concluded that this evidence was problematical, and it could not be proven that, to the extent cost savings arose, they had arisen from the merger itself. The principal difficulty with the cost saving evidence, the Tribunal noted, was that it must be based on "unstable assumptions on the likely structure of the market absent the merger in question." Finally, the Tribunal noted that the onus to establish the efficiency defence lay throughout the case on the respondent. It was not sufficient for a respondent simply to establish a *prima facie* efficiency defence, upon which the onus to rebut the defence would shift to the Director.

Significantly, the Tribunal rejected the Director's position that proven efficiency gains should be balanced only against allocative inefficiencies (often referred to as deadweight losses) that would arise from the inefficient substitution by consumers away from the products of the merged firm to their second-choice products as a result of the higher prices charged by the merged firm. This position implicitly rejects the possibility of losses to society or the relevant industry resulting from redistribution of wealth between consumers of the products of the merged firm and the firm's owners, arising from the merged firm's higher prices in a post-merger environment.

The Tribunal noted that it did not consider that the phrase "the effects of any prevention or lessening of competition that will result or is likely to result" from the merger or proposed merger (in section 96 of the Act) should be read restrictively as referring only to allocative inefficiency. It concluded that, had this been Parliament's intention, it would have drafted section 96 in a different and narrower fashion. As well, the Tribunal noted that the general purpose clause of the Act refers both to the promotion of efficiency and adaptability in the Canadian economy and to providing consumers with competitive prices. Adopting the Director's approach to the efficiency defence, the Tribunal noted, would mean that the efficiency promotion objective would effectively be regarded as paramount to the competitive

consumer price objective of the Act. The Tribunal found no basis for this paramountcy.

Accordingly, the Tribunal found, and gave notice to the Director and interested parties, that it would not exclude wealth or distribution effects from its assessment of the impact of a merger in the context of the application of the efficiency defence. Nor, the Tribunal concluded, would it assume that wealth or distributional effects should be regarded as neutral to the Canadian economy, noting that the re-distribution of wealth from Canadian consumers to foreign owners of the supplier may well not have a neutral effect on the Canadian economy as a whole.

Remedial Order Impact

In November 1990, Rothsay's Toronto facility was expropriated and Rothsay moved this business throughout the corporate group. The Tribunal noted that "the interaction of the expropriation and the merger is a major complicating factor in this case" since the Tribunal's interim hold-separate order was issued only after the expropriation-induced integration of Rothsay (Toronto) and Orenco had been under way for some time.

This initial lawful and continuing business integration, coupled with declining demand for red meat rendering, would, in the Tribunal's view, have made the divestiture order ineffective in increasing competition. Clearly, the order could not put Rothsay and Orenco back into a pre-merger situation. Given the expropriation of the Rothsay facility, Rothsay would either have to expand its existing Moorefield facilities or build a new one to absorb the former Rothsay (Toronto) business. A possible site for the latter had not been pursued after the merger. The Tribunal's finding of a contracting market meant that the order would either force investment in excess capacity or result in Rothsay concentrating on poultry rendering and withdrawing from the red meat rendering market. The Tribunal also noted that Orenco had modified its business to accommodate the transfer of Rothsay's Toronto business which had already occurred prior to the hold-separate order. As a result, a divestiture order would not likely return the market to the

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pre-merger level of competition. Rather, it might create more excess capacity.

The Tribunal concluded this part of its decision by carefully noting that business planners should not draw much general guidance from this basis for denying the order:

If there had been no expropriation of the Toronto plant the question of the effectiveness of a divestiture order would not have arisen. In the particular circumstances of this case, however, the Tribunal doubts that an order for divestiture would be effective to preserve a significant degree of competition in the relevant market for a sufficient period of time to justify its issuance. The Tribunal does not want to leave the impression that merely because the respondents have changed their positions in response to the merger before the application for an interim order was brought by the Director, the Tribunal is reluctant to order divestiture. That is clearly not the case. The Tribunal's comments on the likely ineffectiveness of a divestiture order pertain only to the particular facts of this case including the particular market conditions. The Tribunal is not convinced that issuing an order which depends for its effectiveness on one of the parties constructing additional facilities in a market where there is already excess capacity and shrinking volumes would accomplish a pro-competitive result.

There may, however, be a general lesson to be drawn after all. It is that merging parties will stand a better chance of rationalizing resources if they move quickly to shift business and to close or liquidate excess capacity before the Director can obtain a standstill or hold-separate order. If successful, this will mean that the order cannot necessarily have the effect of maintaining the market in its pre-merger condition. Finally, as perhaps was already evident from the Molson/Canadian Breweries and Esso/Texaco mergers, the divestiture remedy of merger law is particularly difficult to pursue in markets characterized by structural demand reductions and firms which are heavily dependent on immobile, single-function assets.

J.F.B.

SUPREME COURT UPDATE

At least three cases concerning the *Competition Act* are now pending before the Supreme Court of Canada.

The appeal from the Nova Scotia Court of Appeal decision in *R. v. Nova Scotia Pharmaceutical Society*¹ was argued before the Court on December 4, 1991. Judgment was reserved. The case concerns the constitutionality of the conspiracy provisions of the *Competition Act*.²

The appeal of *Chrysler Canada Ltd. v. Canada (Competition Tribunal)*,³ a decision of the Federal Court of Appeal concerning the power of the Competition Tribunal to enforce its final orders through contempt proceedings,⁴ was heard on January 31, 1992. Judgment was also reserved.

The documents concerning the application for leave to appeal the decision of the Québec Court of Appeal in *Procureur général du Canada c. Alex Couture Inc.*⁵ were sent to the Judges by the Registry on February 3, 1992 (applications for leave to appeal no longer require an oral hearing). The case principally concerns the constitutional validity of the merger provisions of the *Competition Act*, in terms of both the *Charter* and the division of powers.⁶

P.K.L.

Notes

¹ (1991), 80 D.L.R. (4th) 206.

² For a casenote, see (1991), 12:2 C.C.P.R., pp. 1-3.

³ [1990] 2 F.C. 565 (F.C.A.).

⁴ See (1990), 11:3 C.C.P.R., pp. 5-7.

⁵ [1991] A.Q. No. 1604, reported in translation as *Alex Couture Inc. v. Canada (Attorney-General)* (1991), 83 D.L.R. (4th) 577.

⁶ See (1991), 12:4 C.C.P.R., pp. 5-8.

PRICE DISCRIMINATION GUIDELINES
NEAR FINAL STRETCH

In January 1992 Howard Wetston, the Director of Investigation and Research, released a second version of the Bureau of Competition Policy's proposed enforcement guidelines on price discrimination. Since then, the Bureau has been seeking views from interested parties. It is expected that the final guidelines will be out in the spring.

CANADIAN COMPETITION POLICY RECORD

The new version is a substantial improvement over the first draft. However, it retains most of the liberalizing and positive features of the initial version. It should encourage vigorous price competition and ensure the section does not have an anti-competitive effect.

The principal thrusts of the initial draft are not altered. In particular, great reliance is placed on the use of the word "available" in the section. The Director would interpret that provision to allow the granting of functional discounts, growth bonuses and exclusive dealing discounts, provided they were made "available" to all competing purchasers of like quantity.

However, the second draft continues to be somewhat vague on the meaning of the word "available." In particular, it is unclear what the distinction is between "available", as used in the price discrimination section, and the word "offer" used in the temporary allowances or co-op advertising section. In the past the Director has always taken the view that there is a distinction. However, the language in the current draft guidelines makes it hard to understand exactly what it is.

The draft guidelines continue to liberalize somewhat the requirements of a properly constituted buying group. They would insist that the buying group or franchisor take legal title to the goods and assume liability for the goods purchased. However, there would be no insistence that a documented second sale from the buying group to a member of the group would be necessary.

With respect to determining who are "competing purchasers", the guidelines would rely on the five percent price increase test used in the merger enforcement guidelines. Whether that test has any real operational meaning when prices are adjusted from time to time during the year remains to be seen.

The Director has changed focus in certain areas. For example, in the first draft he proposed to allow international volume price concessions in situations where the Canadian subsidiary was purchasing as part of its parent's worldwide purchases from the same supplier. The Director has now reversed his position on this issue, arguing that if the actual purchaser in Canada is

the Canadian subsidiary, then competing Canadian purchasers in similar quantity will have to receive the same price concessions. The draft indicates that if the Canadian subsidiary orders the goods, takes delivery and pays for them, this would indicate that the subsidiary and not the foreign affiliate or parent is the purchaser.

The Director has also changed his position on the approach toward affiliate transactions. In the first draft, he proposed to imply an affiliate exception to the price discrimination law even though none exists in the statutory language. It will be recalled that in many other sections of the *Competition Act*, such as the conspiracy section, there is an explicit affiliate exception. In the second draft of the price discrimination guidelines, the Director has dropped any reference to such a defence. This appears to have been in response to criticism that he could not import such a defence since Parliament had not included it. It may also have been a response to criticisms that such a defence would have been unnecessarily broad in scope.

The Director has also provided guidance with respect to the requirement that an offence occurs only when a "practice" of discrimination takes place. In giving examples of situations which would not constitute a practice, the draft guidelines cite occasional discounts for store openings, clearances, anniversary sales, temporary allowances granted to win new accounts, pricing on entering a new market or matching a competitor's price in a price war. All of these examples are quite common and provide real practical guidance to business. Indeed, using "meeting competition" as an example raises the possibility that a full-fledged "meeting competition" defence may soon become part of Canadian law as it is in the United States. This would be a commendable result.

Overall, the new guidelines are a significant improvement over the previous draft. They are clearer and more concise in most respects and legally well founded.

L.A.W.H.

CANADIAN COMPETITION POLICY RECORD

**MERGER EXAMINATIONS UNDER THE COMPETITION ACT
STATISTICAL SUMMARY**

	1986-87 ¹	1987-88	1988-89	1989-90	1990-91 ²	1991-92
MERGER EXAMINATIONS COMMENCED ³	40	146	191	219	194	176
EXAMINATIONS CONCLUDED						
Concluded as posing no issue under the Act ⁴	17	120	166	204	193	146
Concluded with monitoring only ⁵	5	7	10	13	9	1
Concluded with pre-closing restructuring ⁶	-	2	1	-	-	-
Concluded with post-closing restructuring ⁷	1	2	3	1	-	-
Concluded with Consent Order	-	-	-	3	-	1
Parties abandoned proposed merger in whole or in part as a result of Director's position	3	2	2	2	2	-
TOTAL EXAMINATIONS CONCLUDED	26	133	182	223	204	166
EXAMINATIONS ONGOING AT END OF PERIOD						
INTENT TO FILE APPLICATION ANNOUNCED	14	25	32	31	39	-
APPLICATIONS BEFORE TRIBUNAL						
Concluded ⁸	-	-	2	-	-	-
Ongoing	1	-	2	3	-	-
	-	2	2	1	3	3

Notes

- 1 Statistics commenced on June 19, 1986.
- 2 Statistics to March 31, 1992.
- 3 Two or more days of review. Includes 363 prenotifications since July 15, 1987 of which:
- in short form (s. 121); 1987/88-44; 1988/89-50; 1989/90-89; 1990/91-49; 1991/92-52.
- in long form (s. 122); 1987/88-21; 1988/89-42; 1989/90-20; 1990/91-25; 1991/92-15.
- 4 Includes:
372 Advance Ruling Certificates:
1986/87 2; 1987/88 26; 1988/89-59; 1989/9-72; 1990/91-74; 1991/92-80.
28 Advisory Opinions
1986/87-3; 1987/88-10; 1988/89-6; 1989/90-3; 1990/91-2; 1991/92-4.
- 5 All Advisory Opinions.
- 6 All Advisory Opinions.
- 7 One Advance Ruling Certificate and six Advisory Opinions.
- 8 These matters are counted under examinations concluded.