COMMENT AND ANALYSIS

THE COMPETITION BUREAU'S NEW FOCUS: INCREASED RISKS FOR INDIVIDUALS UNDER THE COMPETITION ACT

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The enforcement policy of the Bureau of Competition Policy (the Bureau) respecting the criminal provisions of the *Competition Act*[1] (the *Act*) has been evolving. This paper comments on the growing trends towards increased fines against corporations and increased prosecutions of individuals who violate the criminal provisions of the *Act*. This discussion necessarily entails commenting on the compliance-oriented approach of the Bureau and the recent development of an immunity program under the *Act*.

Overview of the Bureau's Evolving Enforcement Policy

Howard Wetston, Director of Investigation and Research of the Bureau (the Director), the person primarily responsible for administering and enforcing the *Act*, has repeatedly warned members of the business community that he intends to take a tough line on enforcing the conspiracy and bid-rigging sections of the *Act*. In a number of speeches and interviews, Mr. Wetston has advised lawyers and business persons that he intends to recommend to the Attorney General of Canada (the Attorney General), in appropriate cases, that higher fines be sought against corporations and that more charges be laid against individuals for their participation in such crimes.[2] In a recent address to corporate counsel in Calgary, he stated that the Bureau will continue to recommend that charges be laid against individuals where the evidence warrants doing so. He also stated his view that more charges against individuals will be necessary to strengthen the disincentives to engage in collusive conduct.[3]

In that same address, however, Mr. Wetston went on to outline an immunity program which the Bureau is developing in conjunction with the Attorney General. Under the program, a recommendation for immunity from prosecution may be given, but only if the party granted immunity is "first in" to the Bureau and if certain other criteria are met, as discussed below. This policy does not differ to any significant degree from the immunity policy which has been in existence in the United States, implemented by the U.S. Department of Justice's Antitrust Division, since the late 1970s.

In the recent compressed gas companies proceedings, three record fines of $1.7 million each were handed down in relation to price-fixing charges in September 1991.[4] To date, five companies have been convicted and the fines have totalled $5.8 million. In addition, two senior executives of one of the companies have been convicted and fined. Prohibition orders have also been issued. The orders generally apply not only to the companies but also to their individual officers, directors and managers, and any breach of the orders can lead to criminal contempt proceedings. Once again, this reflects the current stand that the Bureau, the Attorney General and the courts have been taking in relation to the criminal provisions of the *Act*. In essence, they are following the U.S. practice of seeking not only higher financial penalties against corporations, but also more charges and convictions against individuals who were involved or who acquiesced in the conduct.

It has therefore become more important for companies to establish and operate effective compliance programs, not only to try to ensure that they do not breach the *Act*, but also to provide some measure of protection for senior management if and when offences are committed by lower-level employees.[5] As

discussed below, the benefits of a compliance program can range from a greater opportunity to take advantage of the new immunity program, to increasing the possibilities of alternatives to full prosecution and mitigating sentences.

The Bureau's Enforcement Policy
Criminal Offences and the Enforcement Process under the *Act*

An overview of the types of offences contained in the *Act* is provided in the Bureau's annual reports.[6] Those offences found in sections 45 to 51 and section 61, which may be loosely characterized as offences in relation to competition, include conspiracy to lessen competition, bid-rigging, price discrimination and predatory pricing. These offences are treated separately in the annual reports from the misleading advertising and deceptive marketing practices provisions found in sections 52 through 60 of the *Act*.

Historically, enforcement of the *Act* focused on investigating violations with a view to prosecution and the imposition of criminal penalties. However, it has become clear that in many instances the *Act*'s goals of maintaining and encouraging competition can be pursued with greater effectiveness and certainty, and with less time and expense, through an approach to enforcement which stresses the promotion of continuing voluntary compliance with the *Act* and relies on a broader range of responses to non-compliant behaviour. These responses include use of information visits, undertakings and prohibition orders.

Before a matter is referred by the Director to the Attorney General for criminal prosecution, the Director has the authority to decide whether the case should be resolved without proceeding any further: for example, the Director may accept an undertaking to discontinue the conduct in question. Mr. Wetston, however, has indicated that there is significantly less flexibility available for alternative resolution mechanisms, such as undertakings or even prohibition orders, in instances of bid-rigging and price-fixing allegations.[7] This is consistent with the Director's view that the Bureau continues "to view conspiracy and bid-rigging as the most serious of competition law offences, and the ones most deserving of full enforcement measures."[8] Mr. Wetston has stated that most cases which were resolved on the basis of a prohibition order without a criminal conviction involved special extenuating circumstances, an unusual or far-reaching order or a purely local offence.[9]

However, when appropriate, broadly worded prohibition orders are likely to be sought against corporations, their officers, directors and even employees (such as sales or marketing managers) in order to prohibit all anti-competitive conduct uncovered during the course of the Director's inquiry.[10]

The Bureau's Vigorous Enforcement Policy

In a discussion of the Bureau's enforcement priorities in respect of the criminal provisions of the *Act*, Mr. Wetston has indicated that the focus will be on horizontal restraints such as conspiracy and bid-rigging.[11] He commented that Canadian competition regulators are not alone in this emphasis, as the United States focuses its attention on horizontal restraints as well:

> The United States Assistant Attorney General in charge of antitrust, Jim Rill, has stated that the investigation and prosecution of price-fixing, bid-rigging and other types of cartel behaviour are among his highest priorities. He has also stated his intention to seek significant jail terms for individuals and substantial fines for corporations.[12]

In discussing a similar trend under the Canadian legislation, Mr. Wetston noted:

> As you are probably aware, in Canada we have begun to see an increase in the level of fines imposed in bid-rigging cases, as well as in instances of price-maintenance. It will continue to be our policy to seek substantial fines in criminal prosecutions under the Act, particularly in conspiracy and bid-rigging cases. In addition, we will continue to recommend to the Attorney General that charges be laid against individuals, where the evidence warrants doing so. Our review of cases over the past several years has led me to conclude that more

> charges against individuals will be necessary to strengthen the deterrent incentive. Among the factors that we take into account in making such a recommendation are the individual's position in the organization, his or her role in initiating, implementing or enforcing the conduct in question, and his or her role in the illegality of the conduct.[13]

Historically, Canadian courts have treated individual conspirators in competition law cases with greater leniency than U.S. courts. Prior to the *Cormie* case and the compressed gas proceedings, discussed below, fines for individuals generally had been nominal. Mr. Wetston has on a number of occasions commented that such penalties amount to nothing more than a licensing fee for corporations and individuals to engage in criminal anti-competitive conduct. In a speech in November 1990, he commented, "These penalties stand in sharp contrast with the heavy fines and prison sentences which are frequently awarded individuals found guilty in conspiracy and bid-rigging cases in the United States."[14] In the same speech, he referred to the need for stiffer penalties to act as a deterrent force:

> Greater compliance with antitrust laws will come about only when penalties are sufficient not only to appropriately punish collusive behaviour once detected, but also to deter other persons from engaging in such activities. Successful deterrence of such crimes requires that penalties be greater than the expected profits from successful collusion.
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> ...
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> Accordingly, an increase in the incidence of individuals charged under the conspiracy or bid-rigging provisions is a necessary by-product of achieving deterrence. The Bureau is now conducting its investigations with a view to identifying cases where individual charges would be appropriate, and gathering evidence which would support such action.[15]

He also indicated that the trend toward increased fines and individual prosecutions is not isolated to the Canadian competition context. The Bureau's vigorous enforcement policy parallels a larger global trend:

> Collusion is justifiably regarded as a serious crime in most industrialized nations. The reasons for this are well-documented and overwhelmingly persuasive. While conspiracy law enforcement is scarcely a new development, and most firms are undoubtedly aware of the basic parameters of the law, the continued occurrence of these crimes remains a major concern. Throughout the industrialized world, we are now witnessing a renewed commitment to the vigorous enforcement of conspiracy offences.[16]

Increased Fines Against Corporations

Historically, fines awarded by Canadian courts in conspiracy cases have not come near the maximum levels provided for by the *Act*. While deterrence has been emphasized as a fundamental sentencing issue in competition law cases, the level of fines did not achieve this purpose, at least in the view of the Bureau.[17] However, today the sanctions which may be imposed for collusion in Canada are among the highest in the world. Under the general conspiracy provision (section 45 of the *Act*), both corporations and individuals may receive fines of up to $10 million per offence, while individuals face jail terms of up to five years. Fines for bid-rigging agreements are not constrained by a monetary upper limit and may be set at the discretion of the court, although the maximum prison sentence for individuals remains five years.

Increasingly, Canadian courts are accepting submissions by the Crown that fines in relation to criminal offences under the *Act* ought to be large enough that the offender cannot simply treat them as "licensing fees" for continuing the illegal conduct. For example, in *R.* v. *Shell Canada Products Ltd.*,[18] the accused's application for leave to appeal its conviction for resale price maintenance contrary to paragraph 61(1)(a) of the *Act* was dismissed, but a cross-appeal by the Attorney General on the quantum of the fine was allowed, with the fine being increased from $100,000 to $200,000. The Manitoba Court of Appeal held that the earnings of a corporate accused are relevant in assessing the fine to be imposed in order to ensure that the penalty is not a mere "slap on the wrist."

Conduct such as bid-rigging and price-fixing has been consistently characterized as unambiguously harmful and of no redeeming social benefit.[19] That characterization is now being reflected in the higher fines and prohibition orders imposed on companies found guilty of such conduct. For example, in

1988, two business forms companies pleaded guilty to bid-rigging on Nova Scotia provincial government tenders and were fined $200,000 each, an amount which was agreed to by the Crown and the accused.[20] A comprehensive prohibition order was also imposed, requiring the companies not to continue or repeat the offence, not to do anything directed towards the commission of any further bid-rigging offence and requiring an internal compliance education program. Shortly thereafter in Saskatchewan, two of the same business forms companies, together with two other companies, pleaded guilty in the Court of Queen's Bench to one global charge of bid-rigging on a tender submitted to the Saskatchewan Government in 1980-81.[21] The firms were each fined $400,000 for a total fine of $1.6 million, which is one of the largest total fines ever imposed under the *Act*. (One of the companies had also pleaded guilty to one count of resale price maintenance occurring in 1981, and its total fine included a $40,000 penalty which was levied in respect of that charge.) A similar prohibition order to that which was imposed by the Nova Scotia Supreme Court was imposed by the Saskatchewan Court.

On December 7, 1990, four flour mill companies pleaded guilty in the Ontario Court (General Division) to one charge of bid-rigging on government wheat flour tenders for food aid programs operated by the Canadian International Development Agency between 1975 and 1987.[22] Record fines totalling $3,225,000 were imposed by the Court. In addition to a prohibition order pertaining to conduct for future government flour tenders, the three largest mills agreed to pay fines of $1 million each, while the fourth mill was fined $225,000. Soo Line Mills Ltd. and B. P. Kent Flour Mills Limited pleaded guilty to the same charge in January 1991 and were fined $50,000 and $30,000, respectively. Regarding these substantial penalties, the Director remarked: "This case set a new benchmark for the highest fine per count under s. 47 and the highest total fines for any charge under Canadian competition law."[23]

The trend in Canada towards larger fines for conspiracy and bid-rigging offences is most recently reflected by the record fines of $1.7 million each imposed against three companies in September 1991 for a conspiracy to fix prices in the compressed gas market in Canada.[24] Another firm received a fine of $700,000 while a fifth firm received a relatively low fine of $200,000. The latter fine reflected the fact that the company in question had cooperated with the Bureau and Attorney General by turning over key evidence of the conspiracy. The fines, totalling approximately $6 million, represent the highest cumulative amount in any one proceeding commenced under any section of the *Act*.[25]

According to the agreed statement of facts filed in the compressed gas proceedings, the agreement which constituted the conspiracy was implemented for a five-month period beginning in January 1990. It may be that a Canadian court would be prepared to impose higher fines in respect of conspiracies which are implemented for a longer period of time or in a larger market.

Prosecution of Individuals

Historically, corporations alleged to have engaged in anti-competitive conspiracies have tended to be charged, rather than the individuals acting on behalf of the corporations.[26] However, the Director has stated publicly that in the future more individuals are likely to face charges under the conspiracy or bid-rigging provisions of the *Act*.[27] In making recommendations to the Attorney General on whether charges should be laid against an individual, the Director will consider the position of the individual in the organization, his or her role in initiating, implementing or enforcing the agreement, and his or her degree of knowledge of the illegality or moral turpitude involved in the conspiracy.[28] This approach is consistent with that of the antitrust authorities in the United States.

According to information provided by Bureau officials, in a recent one-year period, a majority of the cases prosecuted under the marketing practices offences of the *Act* (such as misleading advertising and "bait and switch") involved prosecutions against both corporations and individuals as opposed to prosecutions against corporations alone. This is clearly indicative of the Bureau's increasing trend toward individual prosecutions under the *Act*.

In *R. v. Cormie*,[29] Donald Cormie, former President of Principal Group Ltd., pleaded guilty to misleading investors in his "Chairman's Message" in the company's 1985 annual report. In the message, Cormie claimed the company had divested itself of its real estate investments before the 1982 real estate collapse. In fact, almost half of Principal's portfolio was made up of real estate holdings and mortgages, which were a major factor in the company's collapse. The Attorney General and Cormie's defence lawyer jointly recommended a $500,000 fine, the largest fine ever imposed on an individual under the *Act*. This is also the first prosecution and conviction under the *Act* for a misleading statement made in a corporate annual report.

In March 1992, three corporations and two individuals were charged by the Attorney General with bid-rigging in the road-paving industry.[30] Also, in recent years, there have been more charges brought against individuals in misleading advertising cases. In October 1990, the President of Remington Products (Canada) Inc., Victor Kiam, was charged along with the company under the misleading advertising provisions of the *Act* for a representation made in television advertisements.[31] However, the charges against Mr. Kiam were apparently dropped upon the company pleading guilty and being fined $75,000. These recent cases indicate that the Bureau is forging ahead with its policy towards increased prosecutions against individuals.

According to a 1990 newspaper article examining the degree of competition that has existed in certain industries in Canada, William Stanbury, a professor of regulation and competition policy at the University of British Columbia, commented adversely on the deterrent effect of the Act.[32] In response, Mr. Wetston stated:

> You will see more individuals charged in price-fixing cases while I'm in office and I hope it will serve as an important signal and deterrence to the business community. ... [C]riminal price-fixing conspiracy is white-collar crime as bad as securities fraud, insider trading or a fraud case under the Criminal Code (and) it has major ... consequences for Canadian business.[33]

All signs from the Bureau indicate that it will continue to prosecute vigorously individuals who commit criminal offences under the *Act*. Mr. Wetston summarized the Bureau's position succinctly with respect to individual prosecutions:

> While this ultimately is in the discretion of the Attorney General, I believe that where the evidence is sufficient—particularly for planned and premeditated conduct—appropriate criminal proceedings should be instituted against individual offenders. There is an obvious, very important, deterrent effect from such proceedings.[34]

The Canadian position parallels the position taken by the antitrust authorities in the United States. James Rill recently encapsulated both the American and Canadian positions: "It is very important that corporate employees understand that antitrust liability does not stop at the doorstep of a white-collar office suite."[35]

The Immunity Program

In August 1991, the Director outlined for the first time the circumstances in which he would consider recommending immunity from prosecution for corporations and individuals who report violations of the *Act*. He focussed his remarks on conspiracy and bid-rigging and acknowledged that the "covert nature" of these activities often makes them difficult to discover without the co-operation of persons who are themselves implicated in the commission of the offence.[36] However, the criteria outlined by the Director presumably will also apply to other criminal offences under the *Act*.

To the extent consistent with the fair and impartial administration of the *Act*, the Director indicated that he believes that it is desirable to encourage reporting of violations of the *Act* and that, in appropriate circumstances, such encouragement could take the form of a recommendation by the Director to the Attorney General that the reporting firm or individual not be prosecuted for involvement in the offence. It should be recognized that only the Attorney General may grant immunity from prosecution under the *Act*. However, Mr. Wetston indicated that historically the Director's recommendations have received careful and serious consideration by the Attorney General.

An important consideration in the Director's decision to recommend immunity from prosecution is whether the firm or individual is "first in" to the Bureau with evidence of the offence in question. The Director is not likely to recommend immunity from prosecution if there is an existing complaint or investigation or if an advisory opinion has already been issued by the Bureau regarding the conduct in question.[37] In addition, it should be noted that the immunity program is still in the developmental stage and no information bulletin has yet been released by the Bureau on this subject.

The Director's immunity policy is similar to the amnesty policy of the Antitrust Division of the U.S. Department of Justice, which has been in effect since 1978. In essence, the U.S. amnesty policy provides immunity to the first person or organization that brings an antitrust violation to the attention of the Department of Justice and assists the Department in the prosecution of the antitrust case.[38]

An example of the developing immunity program is illustrated in the compressed gas proceedings. It would appear that the Attorney General and Air Products Canada Ltd. negotiated a lower fine and immunity from prosecution for senior company officials in exchange for assistance in gaining convictions against four other firms in a price-fixing conspiracy. Apparently the firm and its executives provided information that was crucial in proving the conspiracy, but the information was volunteered only after the Bureau had already undertaken an investigation. Thus, although it would appear that Air Products was not granted full immunity because it did not provide the Bureau with the information on a "first in" basis, it may be inferred that the company would have been fully immune from prosecution (subject to the application of the other criteria) had it approached the Bureau before the investigation commenced. In delivering sentence against Air Products, Mr. Justice Hugh Poulin criticized it for its role in the conspiracy but commended the firm's decision to cooperate with the Bureau in resolving the case.[39]

The Bureau's evolving enforcement policy with respect to the criminal provisions of the *Act* is essentially a "carrot and stick" approach. Immunity from prosecution goes along with the Bureau's policy of seeking greater fines and laying charges against individuals where appropriate. In this regard, Mr.Wetston has stated:

> In effect, while the benefits of being the first to report a violation of the Act in a conspiracy or bid-rigging situation may be considerable relative to the potential sanctions, the failure to do so will generally raise the stakes in any subsequent settlement negotiations.[40]

Therefore, in assessing whether a client should be the first one to provide information voluntarily to the Bureau and to seek immunity when it has participated in the commission of a criminal offence under the Act, it is necessary for counsel to keep in mind the Bureau's policy toward increased fines and prosecutions against individuals, and weigh the risks accordingly.

The Compliance Program

The Bureau's *Information Bulletin No. 3*, entitled "Program of Compliance," was released in June 1989. It outlines a number of mechanisms by which the Bureau seeks to achieve greater compliance with the *Act*. Those mechanisms include the Bureau's communication and education programs, the program of advisory opinions, information contacts, monitoring and the use of various means short of contested proceedings to resolve cases. They confirm the Bureau's intentions to enhance the compliance-oriented approach to the administration of the *Act*. Under the compliance program, alternatives to prosecution (such as undertakings or prohibition orders) will be seriously considered where a party satisfies the criteria set out in the *Bulletin*.[41]

In order to avoid or limit criminal liability under the *Act*, corporations should consider taking a proactive approach to compliance by establishing in-house compliance programs for their executives and employees. Such initiatives will be viewed favourably by the Bureau. In addition, in-house compliance programs may help protect senior executives from prosecution and should assist in mitigating sentencing against a convicted corporation or individual. Moreover, since immunity is available only to the first firm to report the events to the Bureau, it may also be advisable for

corporations to encourage employees to report a possible breach of the *Act* to senior management in order to preserve the option of utilizing the Director's immunity program. Merely ceasing the questionable conduct may not give sufficient protection to either the corporate entity or senior management, especially if the latter is not personally involved in the conduct in question.

The U.S. *Sentencing Commission Guidelines* (the U.S. Guidelines) released in November 1991 contain a more detailed set of criteria for an effective compliance program than anything yet specified by the Bureau.[42] The U.S. Guidelines establish a range of sentences and fines that courts are required to impose upon individuals and corporations who plead guilty to or are convicted of violations of federal law.[43] Further, they state that the fine imposed on a corporation should be based on the seriousness of the offence and the culpability of the corporation. The court determines a "culpability score" based upon seven factors set forth in the amendments to the U.S. Guidelines. One of these factors is whether the corporation has an effective compliance program. The U.S. Guidelines state that where an effective compliance program exists, the court must subtract three points from the corporation's culpability score. Thus, the existence of an effective compliance program can significantly reduce the amount of the fine that a court may impose. However, James Rill distinguishes true compliance programs from mere "paper" programs:

> All too often, compliance programs exist merely as a page in the corporate manual declaring that company personnel should not violate the antitrust laws. A true compliance program, however, must include an active effort to monitor corporate behavior and interdict problems at the earliest possible times.[44]

It is possible that the Bureau may follow the U.S. Guidelines with its own outline of similar criteria to be established before it will give full effect to a corporate compliance program. In the interim, there is greater latitude in this regard in Canada. In connection with corporations taking a proactive approach to compliance in Canada, Mr. Wetston has commented:

> I think the development of corporate codes of conduct or corporate ethical standards can be of significant value. In the normal course of doing business, they will enhance the individual manager's consciousness of the law and its underlying spirit. ... I believe that corporate codes are important as they set the tone from the 'top' of an organization.[45]

One of the ways in which corporations are implementing proactive compliance programs is through the preparation of seminars, the distribution of concise readable summaries of the key provisions of the *Act*, and the use of videotapes in educating employees about competition law. Some major U.S. companies have also instituted managerial "sign-offs," where each manager must certify annually that he or she has not been engaged in and has no knowledge of any activity that may violate U.S. antitrust laws. In addition, corporate compliance programs in the United States sometimes include the showing of films such as "The Price," which portrays a price-fixing conspiracy that suddenly becomes the subject of a criminal investigation because one of its members decides to seek immunity.

It therefore makes good corporate sense to ensure that a compliance program is operating within a company so as to educate managers and employees about the provisions of the *Act* and to provide them with enough of a basis to seek clarification as to whether particular conduct may run afoul of the legislation. Of additional importance is the recognition by senior management that in the event any contravention of a criminal provision of the *Act*, and particularly the conspiracy or bid-rigging provisions, is brought to their attention, they may be able to ensure that the interests of the company and its executives are protected by examining the possibility of taking advantage of the new immunity program being developed by the Bureau. However, the fundamental purpose of an effective compliance program is to prevent illegal criminal conduct under the *Act* from occurring at all.[46]

In summary, an effective compliance program within a corporation may assist in achieving the following four possible benefits.

- If employees or managers have an increased awareness of the *Act*'s provisions, and of the possible consequences of contraventions, and have available a procedure for answering their questions in this regard, the commission of an offence may be avoided.

- In the event that there has been the commission of an offence by an employee, if the matter is brought to the attention of senior executives and, on the advice of counsel, the company elects to try to take advantage of the new immunity program, both the company and its executives may be able to avoid prosecution for the questionable conduct.
- In the event that the company has not taken advantage of the immunity program, the fact that efforts were made at achieving compliance within the corporation may be viewed favourably by the Bureau and should increase in the Bureau's willingness to consider alternatives to full prosecution such as an undertaking or prohibition order, or in the event of a prosecution, to confine the prosecution to the corporation alone.
- In the event that there is a prosecution and a conviction, the efforts at compliance should assist in mitigating sentence.

Conclusion

This paper has attempted to highlight the evolving enforcement policy of the Bureau with respect to the criminal provisions of the *Act*. An overview of the recent speeches and cases in this area makes it clear that the Bureau will be vigorously enforcing the criminal provisions of the *Act* against both corporations and individuals who participate in illegal conduct. The risk to individuals of prosecution under various sections of the *Act* has increased, as reflected by the specific warnings of the Director. Although the Bureau is developing an immunity program, and although it is prepared, in appropriate circumstances, to consider alternatives to recommendations of full prosecution, clients should appreciate that compliance with competition law from the start is the best approach to avoiding criminal liability.

Notes

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[1] R.S.C. 1985, c. C-34.

[2] See, for example, H. I. Wetston, "Canadian Competition Law: Current Issues in Conspiracy Law and Enforcement" in *Meredith Memorial Lectures* (Montreal: McGill University, 30 November 1990).

[3] See H. I. Wetston, "Notes for an Address to the Canadian Corporate Counsel Association" (Ottawa: Consumer and Corporate Affairs Canada, 19 August 1991).

[4] See newspaper articles by Drew Fagen, *The Globe & Mail* (7 September 1991) B2 and *The Toronto Star* (7 September 1991) C1.

[5] Many companies in the United States and some in Canada have established compliance programs designed to educate managers and employees about antitrust law provisions. In addition, the Bureau has set out its program of compliance in Director of Investigation and Research, *Information Bulletin No. 3* (Ottawa: Consumer and Corporate Affairs Canada, June 1989). Counsel should consult the *Bulletin* at the earliest stage after they become aware of an investigation (even pre-charge). The *Bulletin* outlines alternatives to full prosecution.

[6] See, for example, Director of Investigation and Research, *Annual Report* (Ottawa: Consumer and Corporate Affairs Canada, 31 March 1991) at 14.

[7] For a detailed analysis of Canadian law pertaining to conspiracy and bid-rigging, see M. R. Dambrot, Q.C. & J. S. Tyhurst, "Conspiracy and Bid-Rigging: A Conceptual Framework" (Toronto: Insight Educational Services Conference, 4 December 1989).

[8] *Supra*, note 3 at 18.

[9] H. I. Wetston, "Compliance into the 1990's: Notes for an Address to the Insight Educational Services Conference" (Ottawa: Consumer and Corporate Affairs Canada, 4 December 1989) at 5.

[10] See I. Nielson-Jones, Deputy Director of Investigation and Research, "Canadian Antitrust Enforcement" (Address to the Criminal Practice and Procedure Committee of the American Bar Association Section of Antitrust Law, 8 August 1988).

[11] *Supra*, note 3.

[12] *Ibid.* at 3. For a sense of the tough enforcement stance taken by U.S. antitrust authorities, *see* James F. Rill, "The Importance of Deterring Antitrust Crime: Corporate Compliance Programs and Federal Antitrust Enforcement" (Washington: Symposium on Antitrust and Association Law sponsored by the Bar Association of the District of Columbia, 20 February 1992), where Mr. Rill stated: "I am here to tell you that, despite some recent suggestions to the contrary, the Department of Justice is deeply committed to strong enforcement against criminal antitrust violations. No mistake should be made about that. Resolve to prosecute cartel behaviour is firm" (*ibid.* at 7).

[13] *Supra*, note 3 at 3.

[14] *Supra*, note 2 at 15. In commenting on the U.S. antitrust authorities' position with respect to the increase of statutory fines for antitrust crimes, James Rill states that "[f]ines will reflect accurately the economic impact of the crime, and corporations will find it impossible to regard antitrust penalties as a mere tax on their cartel profits" (*supra*, note 12 at 8).

[15] *Supra*, note 2 at 16-17.

[16] *Ibid.* at 21-22.

[17] See *ibid.*

[18] (1990), 29 C.P.R. (3d) 32 (Man. C.A.).

[19] *Supra*, note 2 at 1.

[20] *R.* v. *R. L. Crain Inc.* (1988), 22 C.P.R. (3d) 462 (N.S.S.C.T.D.).

[21] *R.* v. *R. L. Crain*, *R.* v. *Moore Corporation Limited*, *R.* v. *Lawson Business Forms (Manitoba) Ltd.*, *R.* v. *Southam Printing Limited* (9 June 1988) [unreported].

[22] *R.* v. *Maple Mills Ltd.*, *R.* v. *Ogilvie Mills Ltd.*, *R.* v. *Robin Hood Multifoods Inc.*, *R.* v. *Parrish & Heimbecker Limited* (7 December 1990) [unreported].

[23] Director of Investigation and Research, *Annual Report* (Ottawa: Consumer and Corporate Affairs Canada, 31 March 1991) at 14.

[24] See *supra*, note 4.

[25] In addition to the fines levied against the corporations in the compressed gas proceedings, two senior executives of one of the corporate defendants pleaded guilty to charges under the *Act* and received fines of $75,000 each. Counsel for the Attorney General has indicated that other senior executives of the firms involved may be prosecuted in the near future. See *The Toronto Star* (26 October 1991) C1. The fines were accompanied by comprehensive prohibition orders against each of the defendant corporations, prohibiting each of them and their officers, directors, managers, employees and salespersons from entering into further unlawful conspiracies. Each prohibition order also required the defendant corporation to provide employees with information concerning the offences and a statement that non-compliance with the prohibition order may result in termination of employment.

[26] However, in a number of cases in recent years, individuals have also been charged along with their companies. In addition to the compressed gas proceedings (*supra*, note 4), five executives were originally charged in the business forms proceedings (*supra*, note 20, and accompanying text), but the charges were subsequently withdrawn. (On the right to charge executives along with the company, see *R.* v. *Fell* (1981), 34 O.R. (2d) 665 (C.A.).) In addition to the common law cases dealing with officers'

and directors' liability, subsections 65(2) and (4) of the *Act*, which were implemented as part of the amendments to the *Act* in 1986, make it clear that individuals may be prosecuted where a corporation commits an offence under the *Act*.

[27] *Supra*, note 2 at 16.

[28] *Ibid.* at 16-17. It should also be noted that, under subsection 67(4) of the *Act*, a corporation can only be tried by a judge alone, whereas an individual can elect to be tried by a judge and jury. The net effect of this is that in the event that individuals are charged with an indictable offence along with the corporation, the individuals can always elect to be tried by a judge and jury, which generally means that their trial will take place at some point after the trial of the corporation by a judge alone. This gives the individuals the benefit of a "dry run," but at the same time they may be compellable in the prosecution against the corporation as witnesses for the Crown, which raises a host of additional evidentiary issues beyond the scope of this paper. Any such election makes the Crown's work far more difficult, but notwithstanding this, the evolving policy of the Bureau will see more individuals charged in the future.

[29] Transcript of guilty plea (22 January 1992) (Alta. Q.B.) [unreported]. See also Wendy Smith, "Lonely but still loaded" *Financial Times of Canada* (3 February 1992) 18; and Cathryn Motherwell, "Principal's Cormie fined $500,000" *The Globe and Mail* (23 January 1992) A1.

[30] See Jock Ferguson, "Paving companies, executives charges" *The Globe and Mail* (19 March 1992) A11.

[31] See Marina Strauss, "Kiam charged with misleading ad" *The Globe and Mail* (1 November 1990) B1.

[32] Jock Ferguson, "Millions lost through rigged bids" *The Globe & Mail* (13 October 1990) A3.

[33] *Ibid.*

[34] *Supra*, note 9 at 6-7.

[35] *Supra*, note 12 at 13.

[36] *Supra*, note 3 at 4.

[37] *Ibid.* at 4-5. The other criteria necessary for immunity are: (i) the firm must provide full and frank disclosure of the facts at its disposal; (ii) the firm must cooperate fully with the Bureau's investigations and with the ensuing legal proceedings, if any; (iii) the evidence provided by the firm must be important and valuable in terms of any prosecution or other legal proceedings; (iv) the firm must be prepared to make restitution commensurate with the facts and its responsibility; (v) the evidence must confirm that the firm took immediate steps to terminate the illegal activity and report it to the Director as soon as it was discovered by senior executives; (vi) a prior record of anti-trust violations will be a significant negative factor; (vii) the firm should usually be prepared to consent to the issuance of a prohibition order of fixed duration; and (viii) the role of the firm in the conduct in question will be considered (*i.e.*, it will be viewed negatively if the firm seeking immunity was the instigator of the criminal conduct).

[38] James Rill, *supra*, note 12 at 18-19. For a succinct summary of the U.S. amnesty policy, see "Prosecutorial Amnesty—'Whistleblowing Conspirators'" 43 *Trade Regulation Reporter* ¶13, 112.

[39] "Gas firm is praised in price-fix conspiracy" *The Toronto Star* (26 October 1991) C1,

[40] *Supra*, note 3 at 5.

[41] *Supra*, note 5 at 12-13. These criteria consist of some general factors which the Director may take into account in his deliberations as to the most appropriate course of action to resolve an investigation.

[42] See James Rill, *supra*, note 12 at 4-5. The U.S. Guidelines set out seven steps believed to be essential to any effective compliance program for mitigation of sentence:

- the organization must have established standards and procedures to be followed by its agents and employees that are reasonably capable of reducing the prospect of criminal conduct;
- a specific high-level person within the organization must have been designated and assigned ultimate responsibility to ensure compliance with those standards and procedures;

- the organization must have used due care not to delegate significant discretionary authority to persons whom the organization knew, or should have known, had a propensity to engage in illegal activities;
- the organization must have effectively communicated its standards and procedures to its agents and employees;
- the organization must have taken reasonable steps to achieve compliance with its standards;
- the standards must have been consistently enforced by appropriate disciplinary mechanisms; and
- after an offence was detected, the organization must have taken all reasonable steps to respond appropriately to the offence and to prevent further similar offences.

[43] For example, the U.S. Congress increased the maximum fine for antitrust crimes by corporations to $10 million per violation—up from $1 million: see James Rill, *supra*, note 12 at 8. In addition, Mr. Rill stated that the U.S. Sentencing Commission raised the individual offence levels such that jail time will almost invariably result.

[44] *Supra*, note 12 at 6.

[45] *Supra*, note 9 at 9.

[46] "Just as in the medical profession where it is a lot more efficient and effective to practice preventative medicine than to always embark on surgery—similarly preventative compliance may obviate the need for costly and time-consuming litigation ..." C. S. Goldman, "The Impact of the Competition Act of 1986" in R. S. Khemani & W. T. Stanbury, *Canadian Competition Law and Policy at the Centenary* (Halifax: The Institute for Research on Public Policy, 1991) at 541.

THE CANADIAN MERGER ENFORCEMENT GUIDELINES: LESSONS FROM RECENT LITIGATION

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The *Merger Enforcement Guidelines* (*MEGs*) issued in April 1991 by the Director of Investigation and Research of the Bureau of Competition Policy are an important element of Canadian merger enforcement. Because many merging firms negotiate directly with the Director rather than litigating before the Competition Tribunal, the Director's enforcement policies (now formalized in the *MEGs*) play an especially important role in the development of merger policy.[1]

Since the Bureau of Competition Policy was reorganized in mid-1986, it has reviewed approximately 5,500 mergers. About 900 of these were subjected to detailed examination. On March 9, 1992, the Competition Tribunal ruled on the first merger case litigated in Canada since the merger provisions of the 1986 *Competition Act* took effect. In that ruling, the Tribunal decided not to require Hillsdown Holdings (Canada) Limited (Hillsdown) to divest itself of Ontario Rendering Company Limited (Orenco), which it had acquired in July 1990.[2] This decision was the first judicial test of the *MEGs*. In this paper, we examine three specific areas in which the Tribunal's decision has important implications for merger review and the *MEGs*: market definition, interdependent market power, and efficiencies.

Market Definition

The *MEGs* provide a detailed market definition paradigm (sections 3.1-3.3.) which is summarized as follows in section 3.1:

> Conceptually, a relevant market for merger analysis under the [Competition] Act is defined in terms of the smallest group of products and smallest geographic area in relation to which sellers, if acting as a single firm (a "hypothetical monopolist") that was the only seller of those products in that area, could profitably impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger.

In the Hillsdown case, the Tribunal did not explicitly adopt the *MEGs* market definition paradigm, but reached a conclusion consistent with it. It defined a relevant market as "that product or service with respect to which after a merger there is likely to be a substantial lessening of competition."[3] It went on to state:

> [I]dentification of the relevant market in which it is alleged a substantial lessening of competition is likely to occur is normally assessed from two perspectives: the product or products with respect to which a merged firm acting alone or in concert with others is likely to be able to exercise market power and the geographic area within which such power is likely to be exercised.[4]

Product Market

Hillsdown, through its Rothsay division, and Orenco both render inedible red meat by-products in Ontario. Rendering is the process by which the inedible raw material such as offal, bones and fat is cooked down into tallow and protein products. Orenco's facility is in Dundas, about sixty miles from the Rothsay operation in Moorefield. Rothsay had operated a rendering facility in Toronto until the property was expropriated by the city and closed in November 1990.

In the industry, rendering is generally classified as either "captive" or "non-captive." Captive renderers are vertically integrated into slaughtering while non-captive renderers receive their renderable materials from independent slaughterers. Both Rothsay and Orenco are vertically integrated renderers that also process non-captive material.

The Tribunal accepted the product market definition, based on the *MEGs*, advanced by the Director.[5] This market includes, on the demand side, those slaughterers requiring rendering services for their red meat by-products. On the supply side of this market are the facilities that render red meat material, deadstock and blood because of their interchangeability. The analysis focused on non-captive product. In any event, since the merging parties have very large shares of the captive rendering business, concentration would be even higher if the market were measured as the rendering of both captive and non-captive material.

Geographic Market

The Tribunal also appears to have applied the *MEGs*' market definition paradigm in its treatment of the geographic market issue. It agreed with the Director's position that the maximum shipping radius for renderable material is about 200-250 miles.[6] The Director had also contended that, while there is no absolute barrier to shipping renderable material from Canada to the United States, the border disrupts shipments sufficiently to form a geographic market boundary. The Director had noted, however, that even if proximate U.S. renderers were included in the market, market concentration was not significantly different. The Tribunal used the broader definition:

> While it is clear that the Canada-United States border will result in some additional costs for renderers who engage in the cross-border collection of the material as a result of required paper work and possible delays at the border, the Tribunal is of the view that renderers located within the United States but close to the border could provide effective competition to the merged firm.[7]

Interdependent Market Power

The *MEGs* specifically consider the possibility of mergers creating interdependent market power as well as unilateral market power.[8] The Tribunal's decision implies, however, that it was focusing only on the latter. It mentions, for example, that:

> excess capacity of firms both within and outside the relevant market will provide a degree of competitive pressure on the merged firm and restrain to a considerable extent its ability to raise prices.[9]

Indeed, the Tribunal explicitly rejected concerns about collusion or "tacit price following" because of what it considered "the non-homogeneous nature of renderable materials (including differences in quality, quantity and distance from the rendering plant)."[10]

The Tribunal did not discuss the homogeneity of the rendering services, which it had identified as the product market. It also made no reference to evidence regarding the possibility of collusion taking the form of a market allocation conspiracy in this business. The decision leaves the Tribunal open to consider the possibility of interdependent pricing in future merger cases. Nonetheless, it suggests that the Tribunal would require the relevant product to be homogeneous, and that its definition of homogeneity would be quite narrow.

Efficiencies

For a merger's cost savings or "gains" to be counted as efficiencies, the *MEGs* require an assessment of whether each of the particular gains that it is anticipated will be realized subsequent to the merger would likely be attained by alternative means if the order to prevent a merger being sought, or that would likely be sought, were made. The assessment generally involves an evaluation of whether any of the gains that are identified as being likely to be realized post-merger would also be likely to be attained through less anticompetitive means such as internal growth, a merger with a third party, a joint venture, a specialization agreement, or a licensing, lease or other contractual arrangement, if the order in question were made.[11]

After the efficiencies have been properly identified, the *MEGs* require that likely efficiencies from a merger be balanced against likely anticompetitive effects:

> Section 96(1) [of the Competition Act] creates a tradeoff framework, in which efficiency gains that are likely to be brought about in Canada are balanced against the anticompetitive effects that are likely to result from the merger.... An order [to prevent a merger] cannot be made in respect of a merger where it can be established that the gains in efficiency that will likely be brought about by the merger will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger.[12]

In the Hillsdown case, the Tribunal did not accept all of the efficiency claims made by the merging parties. Furthermore, although the Tribunal did not find it necessary to evaluate efficiencies relative to any anticompetitive effects (because it had concluded that the merger was not likely to lessen competition substantially) it rejected the *MEGs*' tradeoff analysis.

Efficiencies Claimed

The respondents had claimed three basic categories of efficiencies:

- *Administrative costs*: Duplicate employees were terminated and their salaries saved.
- *Transportation costs*: Collection routes were consolidated, reducing collection costs.
- *Tallow costs*: The Orenco plant needed a certain high-quality tallow to produce a particular product. Before the merger it paid a premium to buy this tallow from a U.S. source. The Rothsay plant was obtaining this high-quality tallow from an Ontario source before the merger. After the merger, the respondents counted as an efficiency the premium that Orenco avoided by buying the tallow from an Ontario source rather than from the United States.

The Tribunal did not accept all of the claimed efficiencies for two reasons. First:

> Many of the claimed efficiency gains [were not] proven to have arisen out of the merger as opposed to having arisen as a result of the restructuring caused by the expropriation [and closing of the Rothsay Toronto plant].[13]

Second, the merging parties did not meet their burden of proof on an efficiencies claim:

> Counsel for the respondents seemed to argue that once they had established the claimed efficiency gains on a *prima facie* basis, that was sufficient to transfer the onus of disproving them to the Director. He argued that if on the balance of probabilities there was uncertainty, the doubt should be resolved in the respondents' favour. The Tribunal does not accept that argument. The respondents have the onus of proving the existence of the efficiencies claimed, or the likelihood of their existence when the merger has not been consummated, on the balance of probabilities in the normal way.[14]

Tradeoff Analysis

One of the more interesting parts of the Tribunal's decision refers to a fundamental aspect of the analysis involving the tradeoff between anticompetitive effects and efficiency gains. The Tribunal noted that:

> Both the Director and the respondents argue that subsection 96(1) [of the *Competition Act*] directs the Tribunal to balance "the gains in efficiency" which will arise from the merger against [only] allocative inefficiency or deadweight loss.... The Tribunal has difficulty accepting this interpretation.[15]

It concluded that wealth transfers, as well as deadweight losses, must be considered in the tradeoff analysis:

> If only allocative inefficiency or the deadweight loss to the Canadian economy was intended by Parliament to be weighed in the balance then one would have thought that the section would have been drafted to specifically so provide. The interpretation which both the Director and the respondents put on section 96 requires a reading down of the phrase "effects of substantial lessening of" so that it does not include the transfers from consumers to producers which will generally be the largest effect of the substantial lessening.[16]

In short, it specifically rejected the section of the *MEGs* that suggests that only the deadweight losses caused by a merger should be weighed against the efficiency gains.

There has been a debate in the economics literature on the likely magnitude of deadweight losses. Traditionally, economists have defined deadweight loss as the consumer surplus on units that would have been produced under competition that is foregone because of an output restriction. This is often called the "welfare triangle" after its graphical representation. Posner and others have suggested, however, that the deadweight loss due to monopoly power may be greater than the welfare triangle. Resources may be wasted in attempts to acquire the rents created by market power. Under certain circumstances, the Posnerian approach may reveal that the deadweight loss attributable to a merger could be as large as the wealth transfers considered by the Tribunal. Nonetheless, this does not appear to be what the Tribunal had in mind. Its decision makes no reference to this line of argument and refers to the rents as wealth transfers, not as misallocated resources.

The Tribunal offered another possible interpretation of the efficiencies tradeoff, which is:

> to weigh any alleged efficiency gains against the degree of likelihood that detrimental effects (both wealth transfers and allocative efficiency) will arise from the substantial lessening of competition. That is, in those cases where such effects are likely but not positively certain to follow, one could give more weight to efficiency gains than where the reverse is true.[17]

It remains to be seen how the Tribunal may apply this interpretation in future cases. If the Director continues to apply the tradeoff analysis currently described in the *MEGs*, his standard will be more lenient than that proposed by the Tribunal. In that event, merging parties would have a better chance of having their efficiency arguments, as they relate to the tradeoff analysis, accepted by the Director than by the Tribunal.

Conclusion

The Hillsdown ruling is the first judicial test of the *MEGs*. It suggests that the Competition Tribunal's market definition analysis is consistent with that of the *MEGs*. It also appears to reveal that the Tribunal's concern is primarily with mergers that concentrate market power in the hands of a dominant firm, rather than with those that might encourage interdependent pricing. Finally, it indicates that the Tribunal will be less receptive to efficiencies defences than the *MEGs* permit.

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Notes

* Mr. Hughes litigated the Hillsdown case, which is the subject of this article, for Canada's Bureau of Competition Policy; Mr. Smith testified as an expert witness on behalf of the Bureau.

1 See J. Kazanjian & W. Rowley, "The New Canadian Merger Enforcement Guildelines" (May 1991) *International Merger Law* 2.

2 For a summary of this decision, see J. F. Blakney, "Ontario Meat Rendering Merger: Competition Tribunal Turns Down DIR Divestiture Application" (1992) 13:1 *C.C.P.R.* 6.

3 Tribunal *Reasons and Order* at 16.

4 *Ibid.* at 18 (footnote omitted).

5 *Ibid.* at 22.

6 *Ibid.* at 40.

7 *Ibid.*

8 Sections 2.2-2.3.

9 *Supra*, note 3 at 58.

10 *Ibid* at 73.

11 Section 5.2.

12 Section 5.1.

13 *Supra*, note 3 at 86.

14 *Ibid.* at 86.

15 *Ibid.* at 88-89 (footnotes omitted).

16 *Ibid.* at 89 (footnotes omitted).

17 *Ibid.* at 98-99.

THE PERFECT IS NOT THE ENEMY OF THE GOOD: A RESPONSE TO ROY DAVIDSON'S ARTICLE "WHEN MERGER GUIDELINES FAIL TO GUIDE"

By: Andrew Kleit and Margaret Sanderson[1]

Introduction

The purpose of the *Merger Enforcement Guidelines* (the *Guidelines*) is to give guidance. Merger analysis is, by its nature, an uncertain art form. Predicting the future, while required under the law, is never an easy task. Further, when civil merger law is new (as in Canada today) or dramatically altered (as in the United States in the decade after the *General Dynamics* decision[2]), merging parties face a great deal of uncertainty in determining how competition authorities will react to a proposed transaction. The *Guidelines* therefore serve to reduce this uncertainty and to create a common framework for merger analysis.

In his recent article in this journal,[3] Roy M. Davidson makes the following statements: There are some areas where the Guidelines do not eliminate uncertainty. There are other areas where the Guidelines do not meet Davidson's standards or Davidson does not agree with them. Therefore, the Guidelines are a complete failure.

What Davidson fails to recognize is that no set of guidelines can eliminate uncertainty, and that no set of guidelines will meet the approval of every observer in every paragraph.

Predicting the Future

It is generally recognized within economic theory, the practising bar, and the *Guidelines* themselves that economic forecasting is an imprecise science—by its very nature, competitive analysis entails simplification. In keeping with this dilemma, the Director does not claim to have a precise means of forecasting the likelihood of a substantial lessening of competition. Despite this, it would be imprudent of Canadian competition authorities not to build upon the proven track record of other enforcement authorities. For example, while the hypothetical monopolist approach used in market definition is not precise, it does provide a useable framework. And that is why it has been a tremendous success in the United States.

Davidson, on the other hand, argues that employment of the famous five percent test used in market definition will be problematic when buyers are relied upon for information. The chief problem Davidson sees is that Canadian buyers are "not sophisticated," that is, not aggressive in seeking out the lowest prices. In our experience, buyers are often (though not always) a good source of information. Company documents, which the Director also uses, are frequently a better source of information. As to Canadian buyers being less than aggressive, if indeed this is the case, one can only assume that the reason they are less rigorous in their search for the lowest cost inputs is that they operate in a sheltered, relatively uncompetitive market. Presumably, as their own markets of operation become more competitive they will go to greater lengths to obtain the lowest cost inputs.

On the issue of "readily available transaction prices," enforcement authorities are often in the predicament described by Davidson of trying to determine at what prices transactions take place. However, asking buyers for information on the magnitude and frequency of discounts and reading internal documents should properly adjust for this problem. The Director is not required to argue that "this merger will lead to an increase in the price of widgets from five to ten dollars." Instead, the Director seeks to ascertain if will be increased or protected as a result of the relevant transaction. In any event, a merger law calls upon the Director to forecast the future exercise of market power. He has no other option.

Davidson also asserts that prices are not a good proxy for market power, because in Canada market power usually leads to higher costs ("X-inefficiency"). While we would agree that costs are often "too high" in anticompetitive environments, this will naturally imply that prices are also "too high," otherwise revenues would fail to cover the higher costs and the firm with market power would no longer be in business. Once the vigour of competition is felt, costs *and* prices will be lowered. On a practical front, measuring whether or not costs are too high or if they would rise in the case of a merger would be even more difficult than the present forecasting of prices.

Davidson does raise an interesting point when he asks what constitutes a "substantial" lessening of competition in an already anticompetitive market. To a considerable extent the Canadian *Guidelines*, like their U.S. counterparts, implicitly assume that the pre-merger market is competitive. Thus, firms who implicitly collude and raise their prices up to the price of the nearest (in the case presented by Davidson, foreign) substitute may be able to merge at will, even though such a merger would reduce or eliminate the chance of competition breaking out between them. Thus a partial reading of the *Guidelines* may lead one to fall into the famous *Cellophane* trap.[4]

It is precisely to deal with this problem that section 2.3 of the *Guidelines* discusses how the Director may bring a case under a "prevent" theory. Under this approach, the Director will review a transaction to determine if, despite the merger, competition is likely to break out in the market, resulting in lower prices for consumers. The common thread throughout the *Guidelines* is not whether prices are expected to be higher after a transaction than before it, but rather if prices will be higher in the future than they would have been had the transaction not occurred.

The Efficiencies Defence and Retrospective Merger Enforcement

Part 2 of Davidson's article criticizes the approach of the *Guidelines* towards efficiencies. Davidson claims that efficiencies and the effects of lessening competition cannot be measured on the same scale. Actually, Oliver Williamson already accomplished this in a famous article twenty-four years ago.[5] In practical terms, the question is difficult, but the law calls on Canadian competition authorities[6] to compute a "trade-off" nonetheless. Further, the Director cannot be ahead of the academic literature on this question, and the literature does not give much guidance.

Davidson correctly points out that "there can be diseconomies of scale (and scope) as well as economies." The concept here is that the efficiency investigation process generates what is known as "sample selection bias." In almost any merger investigation, the firms shout the merger efficiencies to the high heavens, but any inefficiencies may be carefully hidden. The Competition Tribunal recognized many of the problems associated with demonstrating efficiency gains in the *Hillsdown* decision.[7] It is now clear that the onus is on the parties to prove the magnitude and likelihood of efficiency gains.

More fundamentally, Davidson argues that since the existing trade-off is "arbitrary," then an alternative arbitrary guideline should be employed—namely, that only where efficiencies will result in a minimum increase in the real value of exports, or a minimum increase in import substitution in harmony with section 96(2) of the *Competition Act*, should the transaction be allowed to proceed. In our view, adopting an efficiency defence for an anticompetitive merger based on "beggaring thy neighbour" in trade is wholly unacceptable, particularly given the international moves to liberalize trade. Further, such a rule would exclude from an efficiency defence firms that do not export or compete in markets with imports, and whose actions therefore do not directly affect international trade flows. There appears to be no reason for such a policy. Moreover, to choose a fixed number for an increase in real exports under which firms would not be allowed to merge introduces an unnecessary degree of arbitrariness into the process.

Even if Davidson's approach were modified to eliminate the reference to trade (so that it would then read that if the postulated efficiencies do not appear, the Director should sue even after the acquisition has been consummated), there would continue to be at least four potential problems. First, gaining

effective relief after consummation has been shown to be often quite difficult.[8] Second, it might have to be shown in a proceeding that anticompetitive effects had already taken place, a problem that plagued the U.S. Justice Department in *Syufy*[9] and *ADM*.[10] Third, the Director could have difficulty finding out if these efficiencies have taken place. Finally, even if the Director could show there have been no net efficiencies, the parties would of course try to put up some credible story about how, while things have not improved, they would have been worse without the merger.

Imperial and Wolverine

In Part 3 of his article, Davidson criticized the Director for not bringing a case based on a tacit collusion theory in the Imperial Oil/Texaco matter. Contrary to Davidson's suggestion, the Director's application to the Tribunal for a consent order in Imperial Oil/Texaco did argue that the transaction would lessen competition substantially through increased ability to exercise market power interdependently.[11] The Tribunal was asked to approve a consent order because the parties offered a resolution which removed the Director's grounds to challenge the transaction.

In the case of Wolverine,[12] the relevant issue was whether or not the 1988 merger resulted in a substantial lessening of competition. If it had, the market presumably would have witnessed an exercise of market power over the last three years. Instead, Wolverine lost market share to imports while prices declined in the industry. Indeed, Wolverine was losing money to such a degree that it decided to close its only western plant and serve the western market from central Canada despite the higher transportation costs this would entail. In other words, even with higher transportation costs, it could serve the western market at lower overall cost from Ontario than from its higher-cost B.C. plant—hardly the sign of a firm with market power.

Turning to the matter of intent, it is interesting that Davidson should refer to this question. Proving intent has been the bane of Canadian competition law enforcement for over a hundred years.[13] The fact that "intent" to monopolize is not a legal requirement of the merger provisions is certainly a plus from the enforcement authorities' perspective. Despite this, internal corporate documents indicating that a firm's intent is to lessen competition substantially through a merger are clearly a relevant factor of consideration, and are given weight accordingly.

Consents and Private Action

In his concluding section, Davidson claims that business leaders cannot get guidance when they have to read 59 pages of *Guidelines* plus 35 pages of appendices. This, however, is not the relevant question. The better question is whether merging parties can hire a lawyer or economist to give them guidance. Business leaders do not generally make merger decisions overnight. Prior to coming to the Director, negotiations between businesspersons and their legal and accounting experts on a particular transaction have often gone on for a period of months, sometimes years.

Davidson then argues that the "spurious precision of the Guidelines masks a high degree of discretion in the Office of the Director." The discretion of the Director is given by the *Competition Act*. The *Guidelines* note in a necessarily imprecise manner how he intends to exercise his enforcement responsibilities. Indeed, the *Guidelines* are clear that each decision will rest on situation-specific factors. Moreover, they are only guidelines. Put another way, in what world would people either believe or desire that the Director be an automaton? Certainly this would create an even greater degree of "spurious precision."

Davidson spends a good deal of effort arguing that consents are a poor way of making law. This is true in some circumstances. But the Director cannot sue a firm merely because Canada needs more competition case law. It "takes two to tango": firms often want negotiated settlements more than the Director, hence their reluctance to proceed on a challenge basis to the Tribunal. This is not surprising,

given the legal and time costs of litigation, as well as the business uncertainty it generates. It would be inappropriate of the Director to deny firms' proposals on the basis that "No, we want jurisprudence from a contested case."

In his final point, Davidson suggests that if the Director fails to bring more cases, Canada should have private enforcement of merger laws. While this may appear to be a good idea for increasing accessibility to the law, in the case of mergers the only private parties possessing the financial ability to sue are likely to be competitors, whose incentives might not be consistent with the goals of competition policy. There is a difference between protecting competition and protecting competitors. Before Canada adopts the private enforcement of merger laws, it should review what has occurred in the United States. We suspect that such a review would find that the public interest has not been served by this aspect of American law.[14]

In sum, Davidson's main argument is that the *Guidelines* do not eliminate the uncertainty in merger law. But there is no reason for the perfect to be the enemy of the good. Merger law is inherently uncertain. In our experience we have seen how the *Guidelines* have reduced that uncertainty. To the extent that the *Guidelines* present a comprehensive statement of the Director's position on virtually all of the key issues in the merger review process, they represent a significant step in the direction of increased certainty and accountability. More case law would certainly help, but suing parties merely to generate the necessary cases is not responsible law enforcement. In any event, we believe that the Director's *Merger Enforcement Guidelines* will continue to give useful guidance to merging parties, as well as the general public, for many years to come.

Notes

1 Dr. Kleit is Senior Economic Advisor to the Director of Investigation and Research, on secondment from the U.S. Federal Trade Commission. Ms. Sanderson is Executive Assistant, Mergers Branch, Bureau of Competition Policy. The views expressed herein are solely those of the authors and not necessary those of the Director of Investigation and Research or the Federal Trade Commission.

2 *U.S.* v. *General Dynamics Corp.*, 415 U.S. 486 (1974).

3 Roy M. Davidson, "When Merger Guidelines Fail to Guide" (1991) 12:4 *C.C.P.R.* 44.

4 See *U.S.* v. *E. I. du Pont & Co.*, 351 U.S. 377 (1956); R. Posner, *Antitrust Law: An Economic Perspective* (1976)128; R. Pitofsky, "New Definitions of the Relevant Market and the Assault on Antitrust" (1990) 90 *Columbia Law Review* 1805 at 1814.

5 See Oliver Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs" (1968) 58:1 *American Economic Review* 18.

6 See Madame Justice Reed's *obiter* comments in *D.I.R.* v. *Hillsdown Holdings Ltd.* (Competition Tribunal, 9 March 1992) at 89-100.

7 *Ibid.* at 86.

8 See K. Elzinga, "The Antimerger Law: Pyrrhic Victories?" (1969) 12 *Journal of Law and Economics* 43 and R. A. Rogowsky, "The Economic Effectiveness of Section 7 Relief" (1968) 12 *Antitrust Bulletin* 187.

9 *U.S.* v. *Syufy Enterprises*, 712 F. Supp. (N.D. Cal. 1989), *aff'd* 903 F.2d 659 (9th Cir. 1990).

10 *U.S.* v. *Archer-Daniels-Midland*, 1991-2 Trade Cas. (CCH) 69,647 (S.D. Iowa 1991).

11 We note the Tribunal's discussion in the *Hillsdown* case, *supra*, note 6 at 72-73, reviewing the difficulties of collusion in particular markets.

12 The Wolverine case was discussed in (1991) 12:4 *C.C.P.R.* 10. We understand that Mr. Davidson was a consultant to the labour unions who petitioned the Director to take action in this matter.

13 See, for example, *Atlantic Sugar* v. *A.G. Canada*, [1980] 2 S.C.R. 644.

14 See, for example, *Consolidated Gold Fields PLC* v. *Minorco, S.A.*, 1989-1 Trade Cas. (CCH) 68,500 (2nd Cir. 1989), where incumbent management successfully defended itself against a corporate takeover by arguing that previously mined gold did not compete with newly mined gold, despite the fact that the two products are chemically identical.

CRTC AUTHORIZES INCREASED LONG DISTANCE COMPETITION

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Introduction

On June 12, 1992 the CRTC released its much-awaited decision on the provision of competitive long distance services by way of competitor interconnection with local and toll-switching facilities of federally regulated telephone companies.[1]

The decision greatly increases the scope of long distance competition in Canada. However, it is not the first CRTC decision authorizing long distance competition, i.e., competition in the supply of switched voice-grade telephony between telephone exchange areas. Since March 1990, Bell and BCTel have been obliged to supply private line services to third party "resellers" and to terminate these private lines on local telephone company switches to provide for telephone company distribution of traffic assembled by the reseller. This form of interconnected private line service has permitted resellers to provide a geographically limited grade of no-frills long distance service within Ontario, Quebec and British Columbia. As well, resellers may connect private lines in a similar way to U.S. carrier and Teleglobe Canada switches to provide U.S. and overseas long distance service to Canadian customers.

The distinguishing feature of the CRTC's June 12 decision is that it deals with a much higher level of access to telephone company switches, at both the originating and terminating ends of a long distance telephone call, to competitors which control long distance transmission facilities. This will permit the supply of competing long distance services throughout the area served by all federally regulated telephone companies, not to mention access to all the telephone numbers any established telephone company can access for a customer, and the collateral services (such as operator service and credit-card calling) provided by the telephone companies with their basic long distance products.

The decision also dealt with the general question of whether telephone companies should be permitted to restrict third-party resale of bulk discount or bulk purchase long distance products such as Wide Area Telephone Service (WATS, 800) and the Advantage family of volume discounts.

The decision examines the proposed interconnection terms and evidence of two specific applicants: Unitel Communications Inc. (Unitel) and a consortium of B.C. Rail Telecommunications and Lightel Inc. (BCRL). In effect, the decision goes beyond a determination of the specific applications that were before the CRTC and approves an open entry régime for long distance telecommunications competition involving both telephone company switch and local loop interconnection, service resale and the establishment of general conditions of entry for all potential competitors (including Unitel and BCRL). The evidence of Unitel and BCRL was primarily used by the CRTC as a starting point for establishing general entry conditions, including the key financial terms of the "contribution" charge to be paid by competitors to subsidize low local rates of incumbent telephone companies, and the rates and design of interconnection services to provide the higher order of inter-supplier transparency (termed "equivalent access" by the CRTC) requested by the applicants.

The decision applies to all federally regulated telephone companies with the exception of AGT Limited, which at the time of the applications was still a Crown Corporation and therefore exempt from CRTC jurisdiction.

Elimination of Economic Viability Test

In August 1985 the CRTC turned down an application for telephone company interconnection for the provision of long distance service by CNCP Telecommunications, Unitel's predecessor.[2] That application's terms were very similar to those proposed by Unitel in its latest application before the

Commission. With respect to the more recent application, the CRTC was persuaded that Unitel would likely be economically viable using its market share and geographic roll-out projections, while still making substantial payments to the telephone companies to compensate them for long distance revenue surpluses lost because of competition-induced market share losses. These surpluses are used to keep basic local service rates at a low level (the local service "contribution"). In its 1985 decision, the CRTC found that CNCP Telecommunications would not be viable over a ten-year time horizon if it was required to make the contribution charge calculated by the Commission to provide an adequate offset representing the telephone companies' foregone contribution. The CRTC concluded that this finding provided a sufficient reason to deny CNCP's application and also to decline to set general entry terms. In the June 1992 decision, the CRTC used the same ten-year time horizon for viability evaluation, but adopted somewhat more generous assumptions concerning demand and productivity growth, and calculated a contribution charge formula that differed somewhat from both Unitel's own evidence and the evidence presented by CNCP Telecommunications in 1984-85. This enabled the Commission to conclude that Unitel would be viable.

However, the decision also makes it clear that Unitel's economic viability was not the Commission's sole decision-making criterion. In fact, testing for Unitel's economic viability appears to have been only one means for assessing the overall reasonableness of the contribution and interconnection service charges developed for all new suppliers requiring equivalent access interconnection. Moreover, Unitel's projected viability appears to have had little to do with the CRTC's conclusion that equivalent access long distance competition was now in the public interest.

Once the CRTC found that Unitel would be viable under its business plan evidence, it then expressly announced that henceforth, with respect to BCRL (whose business plan the CRTC found not to be viable using the contribution payment structure set out in the June 1992 Decision) and *all other potential entrants* into long distance business through interconnection with telephone company switches (interconnection carriers or IXCs), an economic viability test would no longer be applied.

This change of practice is of great significance. In fact, a major reason why the CRTC's 1991 hearings into the two applications were so lengthy and generated such a great volume of written materials was that Unitel and BCRL felt compelled to prove, and the telephone companies felt compelled to rebut, the proposition that, on the terms proposed, they would be profitable enterprises.

The Commission has now decided that *any* entrant that is prepared to compensate the telephone companies for lost contribution and to pay for interconnection and related services, in accordance with the charges established in its latest decision, will be allowed to enter through equivalent access arrangements, and that the entire risk of failure will be borne by the new entrants' owners. There will no longer be any heavy evidentiary burden or lengthy hearings to test the merits of a new IXC's business plan.

Choosing Competition Not Competitors

The second major difference between the Commission's 1985 and 1992 decisions is the CRTC's forceful conclusion that long distance competition, regardless of the specific form it takes, is now not only in the public interest but is also essential for general economic development and for the continued efficient development of the telecommunications sector in terms of industry productivity, product choice, and customer responsiveness.

The Commission did not accept the telephone companies' argument that the long distance sector was in fact a natural monopoly characterized by costly decreasing unit costs at the margin. Rather, the CRTC noted that the evidence presented on economies of scale in the long distance business was inconclusive. The Commission did accept evidence that the presence of long distance competition will cause the industry supply curve to shift down (reducing unit costs for all suppliers), and the demand curve for long distance services to shift out (through non-price market stimulation arising from

increased customer responsiveness and more vigorous product innovation and differentiation). The Commission accepted that the use of telephone company networks to provide for interconnection and increased telephone company marketing efforts would cause pressure on telephone company unit costs to increase somewhat over the short term. But it also found that it was not possible to conclude that these start-up cost increases would have the effect of offsetting competition-induced productivity gains achieved permanently.

The Commission accepted that industry performance, as measured by customer responsiveness and product and price innovation, would be superior in a competitive environment when compared to a single supplier environment, and that customer needs (particularly business customer needs) were not being adequately met through a single-supplier environment. Finally, although not a driving force in its public interest finding, the Commission concluded that long distance competition would open new markets for equipment suppliers while stimulating research and development in the industry, and would therefore create spin-off benefits for the telecommunication equipment manufacturing sector.

No Service Quality Requirements for IXCs

In addition to rejecting further application of an economic viability test for new entrants and in order to keep regulatory entry to barriers low, the Commission has also rejected any suggestion that new IXCs should be obliged to achieve any particular geographic market coverage for the origination or termination of traffic, achieve minimum customer quality of service standards, or obtain a minimum level of switch connection or entrant-owned transmission facilities in order to be allowed into the market. The CRTC has decided to permit all new IXCs, including Unitel, to choose any long service resale and facilities-based infrastructure combination, as well as the geographic and customer roll-out strategy that they consider to be most profitable. The only outward regulatory restraints on new IXCs would be that they must suborn to the CRTC's jurisdiction and file tariffs for approval and, except in the case of pure service resale, they must for the time being accept general route-averaged pricing principles which reduce the extent to which a supplier can offer lower prices to customers in higher density routes.

The basic elements of the CRTC's new open entry policy may come as a blow to Unitel, whose case appeared to have been built upon the assumption that entrants interconnecting their own facilities to telephone company switches to provide long distance service would be required to establish that they were viable before entering the market and, as had Unitel, would be expected to provide market and service rollout commitments that indicated the supplier would be in a position soon after start-up to provide "universal access and termination" within the geographic areas served by the federally-regulated telephone companies.

However, the absence of service quality requirements is of great benefit to resellers wishing to upgrade their networks to provide equivalent access and broader geographic coverage, and to include a rudimentary regional fibre-optic/microwave transmission facility spine (as did BCRL's business plan). The requirement to file tariffs should not pose an additional burden to most resellers upgrading to IXC status. In this respect, interprovincial resellers which manage a network would already be accustomed to CRTC tariff approval procedures. Currently, the CRTC treats cellular service tariffs as confidential until they are approved and takes about a week to approve them. There may also be more opportunities for IXCs to use special assembly tariffs for negotiated deals with major customers in the future.

All Long Distance Resale Restrictions Lifted

Of perhaps greater short term significance is the fact that the CRTC has also lifted all remaining restrictions against third-party resale of long distance telephone service products including WATS, 800

service, and the Advantage family of domestic, transborder and overseas bulk discount products. The reseller industry has been pressing hard for some time to generalize resale rights and now the CRTC has finally agreed. This part of the June 1992 Decision should give an immediate shot in the arm to the reseller sector and provide a very quick and easy means for new IXCs to provide broad geographic service coverage until their own company trunk facility investments are up and running and equivalent switch access is achieved.

Arbitrage through long distance service resale should be expected to be a transitory business providing profits only as long as prices in basic long distance services exceed unit costs. A major effect of this decision is to increase the incentives (and as discussed below, the opportunities) for the telephone companies to decrease long distance rates as quickly as possible. Over the next five years, these rate decreases should significantly reduce arbitrage margins and the overall attractiveness of conducting business as a pure reseller, although there will probably always be some opportunities for pure resale. In fact, many resellers in the United States continue to occupy market niches, notwithstanding vigorous facilities-based long distance competition. However, decreasing basic long distance service rates and entry by IXCs will put great pressure on resellers to upgrade to IXC status or to develop new proprietary value-added features that appeal to particular market segments.

Contribution and Interconnection Service Charges

The principal elements of the decision which will effect the rate and extent of both facilities-based and resale long distance competition are the *contribution charge* and the *interconnection services charge* as calculated in the Commission's decision.

A contribution charge will have to be paid both by IXCs and by service resellers, while interconnection services charges will have to be paid only by interconnection carriers, since these charges relate to costs incurred by the telephone companies in providing equivalent access at their switches. Resellers will continue to obtain lower quality local switch access to deliver services in remote exchanges. Customers of pure resellers will continue to have to dial extra digits to access the reseller switch and the terminating telephone company switch, and will also be exposed to longer connection times and have fewer available collateral services such as operator and calling-card services.

As noted above, the contribution charge for interconnection carriers will be based on the CRTC's calculations of the phone companies' foregone contribution caused by market share loss to new entrants. This approach was proposed by Unitel. The Commission has decided to utilize the results of the telephone companies' Phase III broad service category costing studies applied to forecasts for the next calendar year, with certain adjustments to establish contribution charges on an annual basis. Some of the Phase III adjustments adopted by the Commission had been proposed by Unitel. The Commission's decision calculated a per-minute contribution charge for 1993 using Phase III costing system results which are then transformed into a flat monthly charge per interconnection trunk.

The Commission concluded that a monthly charge per trunk was preferable to a per-minute charge because it was easier to administer, provided better incentives to avoid contribution avoidance games by market participants and provided an incentive to spread services into less dense markets. However, the Commission has included a traffic-sensitive component in its trunk charge by establishing a charge which varies in accordance with the number of circuits in the circuit group acquired by the new entrant in each interconnection trunk facility. The monthly contribution paid per circuit will decline with the number of circuits included in each interconnection trunk up to a maximum of one hundred circuits in the circuit group, at which point the monthly charge remains constant.

The contribution charge structure appears to be fairly close to that proposed by Unitel, although the sliding rate makes it somewhat lower in less dense markets and during the start-up period in urban centres. The Unitel charge was based upon fairly aggressive market share and total market growth assumptions in its own business plan, and what may be conservative assumptions on other entrant

market share taking into account the framework of Decision 92-12.

It therefore remains to be seen whether Unitel, or any other new IXC, will be able to sustain the approved level of contribution payments if, due to greater competition, each IXC's market share and density of interconnection is lower than Unitel projected for itself in its own business plan. It may be that Unitel and other IXCs may reduce their consumption of interconnection trunks and hence the extent of equivalent access offered, and instead consume more direct access lines and resell more bulk long distance product than originally envisaged. Initially, the result may be a cheaper, lower quality long distance product than originally planned by Unitel.

Of particular significance, the Commission has adopted Unitel's proposal that, during the start-up period and until 1997, the contribution charge should be discounted by a declining percentage to reflect the initial market advantages of the incumbent telephone companies and the Commission's expectation that customers of new entrants will face unequal ease of access compared to incumbent suppliers over the start-up period. The contribution discount concept is similar to that which was applied in the United States during the run-up to an equal access regime for MCI and Sprint following the divestiture of ATT in 1982-84. The effect of this contribution discount clearly is to reduce the cost of entry for new competitors.

From the telephone companies' perspective, this contribution adjustment will appear unfair because it means, other things being equal, that their long distance rates will have to be higher over the near term than those of new interconnection carriers, since the telephone company and its customers are expected to generate a proportionally higher contribution to local service costs. This contribution discount principle also implies that telephone companies may not be able to reduce their long distance rates as quickly than would have been the case, had no contribution discount been afforded to new interconnection carriers.

Notwithstanding these theoretical arguments, the extent to which this contribution discount will in fact restrain price innovations of the incumbent telephone companies, and the extent of overall contribution payment reductions by IXCs, are unclear. The actual value of contribution disparity between telephone companies and interconnection carriers arising from this discount will depend on many factors, including the rate of increase in interconnection trunks supplied in the first few years of the transition period when this contribution discount is at its highest. The extent to which new entrants elect to pursue market coverage through service resale, as opposed to interconnection of their own facilities with phone company switches to provide a higher order of long distance service, is also relevant, as is the overall rate of growth in the long distance market (which, the Commission concluded, would be faster in a competitive environment in any event). Finally, the extent of market share lost by the telephone companies to new interconnection carrier entrance will also be a factor during the first few years when the access contribution discount is at its highest.

Further, it should be kept in mind that the Commission has signalled that, over the next few years at least, it would be very reluctant to accept any general rate rebalancing application from the telephone companies which would have the effect of significantly shifting the burden for recovering local access costs from long distance customers to local customers. The Commission concluded that, under the terms of entry which it has established, the telephone companies should not have any reason to request significant local rate increases. Rather, the Commission noted that competition-induced efficiency gains of these companies should be sufficient to provide opportunities to establish competitive long distance rate reductions, without causing local rates to rise.

The Commission has, however, accepted telephone company arguments that the contribution charge applicable to resellers should rise. In 1990, when the Commission approved private lines service resale where the reseller interconnected with a telephone company switch for exchange traffic termination and distribution, it also concluded that resellers should pay a contribution charge of $200 per channel. In Decision 92-12, the Commission has decided that, if this charge were maintained under the new environment where the geographic scope of resale has been expanded to cover all federally

regulated telephone companies (except AGT) and all long distance products of the telephone companies, overall access contribution erosion of the telephone companies at the prevailing level of reseller contribution would be unreasonably high. Accordingly, the Commission has decided that, over time, the contribution generated from pure resale activities should rise to 85 percent of the contribution generated by the consumption of an equivalent circuit by an interexchange carrier. However, beginning in 1993, the contribution charge per circuit applicable to resellers will remain essentially as is.

For business planning purposes, a key question will be what happens to the interexchange carrier and reseller contribution charges after 1993 and in subsequent years, given that the Commission has indicated annual Phase III filings of the carriers will determine how these charges move. This is a very difficult question to answer and involves the consideration of a number of variables. These include the rate at which telephone companies reduce their long distance rates and hence their internal contribution levels; the rate of productivity growth within the telephone companies; the rate of overall long distance market growth; and the rate of market share loss from the telephone companies to new interconnection carriers and resellers. Other things being equal, the per-circuit contribution charges of interconnection carriers and resellers should grow after 1993 because the access contribution discount for interexchange carriers is being wound out, and reseller contribution is being scaled up to 85 percent of interexchange carrier contribution. However, the per-minute access contribution generated internally by the telephone companies' long distance service is likely to decline, due to lower telephone company long distance rates, increased telephone company productivity and increased overall long distance market growth. Therefore, it is possible to envisage a situation where telephone company competitors are faced with contribution payments that increasingly come close to the calculated foregone contribution of the telephone companies, while that foregone contribution figure is itself declining over time. The effect could be a per-circuit contribution charge that is either very close over the years to the numbers established for 1993 or that is, in fact, declining over time.

The Commission's treatment of *interconnection service charges* applicable to interconnection carriers is also significant. Rather than requiring new interconnection carriers to provide significant upfront cash payments to telephone companies to cover switch conversion or start-up costs and to cover ongoing costs associated with telephone company provision of equivalent switch access, the CRTC has adopted a flat per-minute charge to cover up to a ten-year period starting in 1993. This means that interconnection carrier payments to telephone companies for interconnection services will be directly proportional to the amount of traffic they generate using the telephone companies' interconnection services, and will track their own operating revenues. Again, the telephone companies may perceive some unfairness in the fact that they must incur substantial cash outlays in order to gear their systems up for interconnection, while in all likelihood the revenues to offset these costs flowing from their interconnection services tariff will not be significant until the middle or latter part of this decade. It is quite probable that the CRTC took these cash flow considerations into account and concluded that for most new entrants—with the possible exception of Unitel—a requirement to provide significant upfront cash to cover telephone company switch and network conversion costs would seriously strain their capital resources and, in effect, amount to an unreasonable barrier to entry.

New Rate Approval Practices

In addition to discouraging near-term telephone company rate rebalancing applications, the Commission has announced a new regulatory framework for the incumbent telephone companies aimed at increasing their pricing flexibility and generally encouraging long distance telephone rates to come down to U.S. levels over the course of the next decade.

The Commission has announced that it will initiate a proceeding into the structure of local telephone service rates with the objective of determining whether it is now appropriate to unbundle the primary service rate, which currently provides overall network access plus unlimited local calling for

a fixed monthly charge, into a network access and a local network services component. If this unbundling were to occur, the Commission and telephone companies may find it easier to increase more rapidly the extent to which access pays for itself and to ensure that the usage-driven component of local service is profitable.

The Commission has also announced that it will establish an expedited tariff approval régime for incumbent telephone company long distance rate reductions. The CRTC would provide interim approval on an *ex parte* basis for telephone company long distance rate reductions if the applicant provides *prima facie* evidence that the new rates are compensatory relying upon prospective analysis conforming to the Commission's Phase II Cost Inquiry Economic Evaluation Study criteria (which adopt the principal features of discounted cash flow analysis). However, the Commission has indicated that if there is any reduction in the access contribution from long distance services within a year caused by such long distance rate reductions, this contribution adjustment will have to reflected in the contribution charges paid by interconnection carriers.

As a general principle, the Commission has announced that it will no longer be necessary for long distance rates to maximize their contribution to local access costs. Rather, over the long term, such rates will only have to be compensatory.

The overall objective of these measures is to provide long distance carriers with price flexibility comparable to that of new interexchange carriers and resellers involving minimum regulatory lags and administrative costs, while at the same time, establishing a floor to prevent anti-competitive pricing behaviour.

Rules to Prevent Market Foreclosure

Finally, the Commission adopted a number of collateral measures to ensure that the incumbent telephone companies cannot exercise their dominant position in bottleneck facilities and activities which new interconnection carriers must acquire in order to provide a comparable quality of service.

The Commission will require that telephone companies provide both a form of lower grade network access and a higher order transparent access arrangement similar to the AT&T divestiture equal access régime (termed Feature Group B and Feature Group D Switch Access, respectively). The Commission will require telephone companies to establish an operator services tariff available for interconnection carriers. The telephone companies will also be required to bill and collect for casual calls charged to a non-subscriber. As well, telephone companies will be required to provide access to their databases to permit interexchange carriers to verify calling cards. New IXCs will also have the right to participate in numbering and dialling plan decisions within Canada (on much the same terms as MCI and Sprint participate in the United States), in order to assure that telephone number assignment practices do not favour the incumbent telephone companies. For the time being, however, new interexchange carriers will not be permitted to establish their own pay telephone outlets, as has been permitted in Britain and some parts of the United States, although pay telephone users will be able to code in access to IXCs when using the incumbents' pay telephones, in much the same way as they would using their own personal telephones.

Conclusion

The Commission's decision is complex and its impact on competition depends on the interrelation of a large number of variables. On balance, the Commission has probably done the best job that it could within its legal framework and the precedents and policies with which it had to work to establish an open entry environment for new long distance service suppliers with the maximum range of interconnection and resale options coupled with the lowest possible regulatory barriers to further entry. There remains the possibility that the incumbent telephone companies will attempt to gain

strategic advantages through periodic assessments of the contribution charge mechanism and in commercial dealings related to the physical relationship between the new entrants networks and their own. This risk is inevitable in any event. The Commission has probably gone as far as it could in this initial decision in establishing general conduct rules for the incumbent telephone companies over the next decade.

At the time of writing, representatives of Bell Canada and BC Tel had announced that they would appeal some aspects of the decision to the courts and/or the Cabinet, although no formal appeal had been launched.

Notes

[1] Telecom Decision CRTC 92-12, *Competition in the Provision of Public Long Distance Voice Telephone Services and Related Resale and Sharing Issues.*

[2] Telecom Decision CRTC 85-19.

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