COMMENT AND ANALYSIS

COMMENTARY ON THE FINAL "PRICE DISCRIMINATION ENFORCEMENT GUIDELINES" UNDER THE *COMPETITION ACT*

By: Susan M. Hutton and Lawson A. W. Hunter, Q. C.
Fraser & Beatty, Ottawa

Canada's competition watchdog, the Director of Investigation and Research of the Bureau of Competition Policy, released the Price Discrimination Enforcement Guidelines (the "Guidelines") on September 14, 1992. Price discrimination is, essentially, "the practice of granting price concessions to one purchaser which are not available to competing purchasers in respect of a sale of articles of like quality and quantity".[1] The Guidelines will provide an essential service to Canadian businesses and their corporate counsel by clarifying the analytical approach taken by the Director to the enforcement of section 50(1)(a) of the *Competition Act* (the "Act").[2]

The need for such guidance cannot be understated. The section is the subject of more requests for advice from the Director than any other section of the Act, and yet there have been no contested price discrimination prosecutions since its introduction in 1935. In the absence of jurisprudence from the courts, these Guidelines will have a significant impact on Canadian business pricing practices.

The Guidelines do much more than clarify the existing approach of the Director to price discrimination. They reflect a more liberal approach to the section than has been applied historically; an approach which incorporates economic analysis to assist in the exercise of interpreting the many components of the offence. This more liberal approach is deliberately designed to assist Canadian businesses to price competitively in the world marketplace, while at the same time ensuring that competitors do not have their ability to compete with one another diminished by unequal price treatment at the hands of their suppliers.

Section I of this commentary follows the structure of the Guidelines in providing a summary of the text, along with a comparison of the final version with the Draft released in January, 1992, and commentary on the implications for business as appropriate. Highlights of the Guidelines and advice to the business community are summarized in Section II. A brief conclusion follows.

SECTION I: Overview of the guidelines

Part I of the Guidelines sets out the text of section 50(1)(a) and its companion sections 50(2) and 50(3),[3] and provides a brief explanation of the theory and history of the price discrimination offence. The Guidelines state that the theory behind the price discrimination provision is:

> ...that, at least in terms of the prices which competing sellers pay for their goods, those purchasing like quality and quantity can be assured that they should have an opportunity to be on an equal cost footing with their competitors with the market outcome determined by their own entrepreneurship and abilities, and not by the actions of third parties operating elsewhere in the distribution system.[4]

The description of the case law involving this section is necessarily brief. There have been only four convictions — three of which resulted from guilty pleas — and none of which was reported.[5] Still, the dearth of jurisprudence belies the regularity with which the business community has questions concerning the limits of legal price discrimination. As international competition intensifies it becomes all the more important for Canadian managers to be able to price and market aggressively, with a clear

understanding of the line between good business and illegal activity.
It is the Director's view of this line that is set out in Part II of the Guidelines with respect to each element of the offence. These are: (a) the parties to the offence, (b) the transactions covered, (c) the products covered, (d) "discount, rebate, allowance, price concession or other advantage," (e) "available," (f) "purchaser," (g) competitors of a purchaser, (h) "at the time the articles are sold," (i) "directly or indirectly," (j) "like quality and quantity," (k) "knowledge," (l) "a practice of discriminating," and (m) the cooperative exception. Appendix I gives a brief synopsis of other sections of the Act that may be relevant to facts giving rise to price discrimination questions.

The Guidelines make it clear that, being a criminal offence, each and every element of price discrimination under section 50 must be proved beyond a reasonable doubt in order for a conviction to ensue.

(a) Parties to the Offence

With respect to the parties to the offence, criminal liability under section 50 attaches only to the seller, and not to the buyer in an impugned transaction. This can be contrasted with the situation in the United States, where buyers are specifically included in the offence. In Canada, however, any purchaser who pressures a seller into engaging in such behaviour may still be liable to criminal prosecution under the "aiding and abetting" or "counselling" provisions of the *Criminal Code.*

(b) Transactions Covered

Price discrimination is only illegal in respect of sales of articles. Unlike other sections of the *Competition Act* which refer to the "supply" of goods or services, the price discrimination provision refers only to "sales". Leasing, licensing and consignment sales are not covered, as title to the goods does not transfer during the transaction. Note, however, that consignment sales entered into for the purpose of discriminating can be prohibited pursuant to section 76 of the Act.

There is no exception in section 50 for <u>sales between affiliates</u>, yet the Guidelines state that the Director would consider transfers which reflect the interests of the affiliates acting as part of a single economic entity to be something other than "sales". This position was originally taken by the Director in the Discussion Paper on price discrimination,[6] but was then reversed in the Draft Guidelines released in January, 1992,[7] which stated that price concessions granted to affiliates would be judged by the same standards as concessions granted to arm's length parties.

The Director's final position is that transfers to affiliates may or may not be exempt from the section according to whether or not they act as a single economic unit in respect of the transaction. This view, unfortunately, appears to be in contravention of normal principles of statutory interpretation. Given the clear exemption for affiliates elsewhere in the Act, the lack of one in section 50 must be taken to have been deliberate. Even if the Director declined to prosecute, therefore, price discrimination in favour of an affiliate could expose a business to a private prosecution under section 36 of the Act. It is our view that the courts would be hard pressed to agree with the Director's position. Furthermore, since the circumstances under which even the Director will consider a transaction to be exempt are not clearly spelled out, this putative exemption must be treated by affiliated businesses with extreme caution.

The Director has extended the "affiliate" exemption in the final Guidelines to cover concessions granted to an unrelated purchaser who assisted the seller in entering into the business of supplying an article. Favourable treatment afforded a customer who finances a new plant, for example, will not be considered by the Director to violate the section. The discount will be seen as a return on investment, rather than a price concession. In light of the lack of statutory authority for the Director's approach to affiliates in general, however, businesses involved in these types of transactions would perhaps be

wise to make any such financial transactions between suppliers and purchasers the subject of agreements separate from the actual sale of the articles in question.

(c) Products Covered

Price discrimination is only illegal with respect to the sale of articles, as distinguished in section 2 of the Act from services. Price discrimination in respect of services, or in respect of the sale of articles which are merely incidental to the provision of services (such as stamps which are merely a receipt for the purchase of postal services), are not prohibited. Note, however, that energy is considered to be an article, as is a ticket for admission to an event or a passenger transportation service.

(d) "Discount, Rebate, Allowance,Price Concession or Other Advantage"

The terms discount, rebate, allowance and price concession are familiar to the business community and are interpreted by the Director to include "monetary arrangements advanced by a seller which reduce the effective price paid by a purchaser to a level below that of the face or nominal transaction price".[8]

The interpretation by the Director of "other advantage" has undergone some change between the Draft and the Guidelines. In both the Discussion Paper and the Draft,[9] "other advantage" was said to be broad enough to refer to non-monetary advantages such as free equipment, in-store demonstrations and displays, and just about any advantage that a seller could bestow upon a purchaser. This interpretation appeared, however, to violate the principle of statutory interpretation (known as *ejusdem generis*), whereby words of general description which follow an enumeration of persons or things are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned. Since the other advantages referred to in section 50(1)(a) are monetary in nature, the words "other advantage" should be interpreted as referring only to other monetary advantages. The Guidelines recognize that such advantages as the provision of technical assistance, the use of free equipment, in-store demonstrations and displays, and gifts of tickets to theatrical or sporting events will not normally fall within the kinds of advantages which give rise to liability for price discrimination.

Credit arrangements, on the other hand, will fall within the scope of "other monetary advantages", and the granting of different credit terms to different customers without any credit-related cause (such as an unproven new account, or a poor credit rating), may give rise to liability under the section. Similarly, discounts for prompt payment must be available to competing purchasers in order not to constitute price discrimination.

(e) Available

The more liberal approach of the Director to price discrimination enforcement centres largely around the interpretation of the word "available" in the section. Whereas previously any monetary advantage which did not result from a difference in the quality and/or quantity of the articles sold would be considered by the Director to be in violation of the section, such differences will now be considered to be perfectly legal, provided that the conditions of eligibility are the same for all competing purchasers and the program is "available" to all such purchasers.

According to the Guidelines, it is now quite acceptable for competing purchasers to pay different prices for articles of like quality and quantity when the difference arises because some purchasers qualified for price concessions and others simply failed to meet the conditions. The so-called "conditional discounts" which will henceforth be treated as permissible include not only absolute volume discounts, but growth bonuses and loyalty rebates which are granted to customers whose purchases increase by a certain threshold amount from one time period to the next. So long as the time

period is finite and the required increase in purchases known in advance, failure on the part of one purchaser to qualify for the discount will not affect its availability to all.

Although not mentioned in the Guidelines, this represents a significant departure from past practice. As recently as 1984, a year-end performance rebate granted to customers whose annual purchases had increased by the requisite amount resulted in a conviction for price discrimination and a $15,000 fine for each count.

Similarly, so-called "functional discounts", which are granted in return for the provision by the customer of a service which is otherwise provided by the seller (such as warehousing or transportation services), will not be impugned so long as they are "available" to competing purchasers. It is not necessary that competing purchasers actually possess the facilities to provide the services, so long as they can be purchased on the open market. The Guidelines also point out that sellers are free to enter into separate contracts with their customers for the provision of such services, in which case there is absolutely no question of section 50(1)(a) coming into play at all.

Exclusive dealing discounts are also quite permissible, provided they are available to competing purchasers (although they may still be reviewable practices under section 77 if they lessen competition substantially).

A customer who fails to take advantage of conditional, functional, exclusive dealing or other price concession programs does not have grounds for complaint so long as the program was made "available" to it. The meaning of the word "available" is, therefore, key to understanding the Director's new approach to discount and incentive programs.

One point to note is that price concession programs which are neutral on the surface but appear to have been designed for the purpose of benefiting one customer over another will not be considered to be "available", no matter how widely advertised they may be.

Outside such bad faith situations, however, is a seller obligated to inform all purchasers of every potential price concession, regardless of whether or not such information was requested? This is an interesting question. The use of the word "available" in section 50 contrasts with the use of the word "offer" in section 51 (dealing with promotional allowances), and indicates, one would think, that a less active role on the part of the seller would qualify for compliance. According to the Guidelines, however, the duty on the seller to disclose the existence of a discount program is a qualified duty which depends upon the circumstances surrounding the sale. It is sometimes difficult to discern how the use of the word "available" in the Guidelines differs from that of the word "offer".

For instance, the Guidelines state that a seller who unilaterally offers a price concession, or grants a request for a price concession to one customer gratuitously, must inform competing purchasers of the program in sufficient detail to enable them to make a sound business decision as to whether or not to take the steps to qualify for the concession.

On the other hand, if the concession results from negotiations initiated by a particular purchaser who offers to supply some service, there is no obligation on the seller to take steps to inform other purchasers of the concession. In this case, it will be enough to respond to the specific inquiries of competing purchasers regarding similar concessions. In contrast to the Draft, the Guidelines state that a seller need not disclose a particular concession even in response to a request for the seller's "best deal". This approach appears sensible, as it will encourage customers to bargain for concessions, safe in the knowledge that they will benefit thereby with respect to any competitor who fails to ask for the same concession.

Apart from providing sound guidance as to the permissible response to a request for the vendor's "best deal", however, the Guidelines fall short in providing guidance as to how much disclosure is required in other situations. They assume that it is always possible to distinguish in business situations between negotiations initiated by a purchaser and those initiated by a vendor. Relying upon such a fine distinction, the Guidelines call upon vendors to "offer" concessions to all competing customers when the vendors initiate the negotiations, and merely to make them "available" when the

customer initiates the discussions and offers to perform some service.

Three comments emerge from a close look at this distinction. First, Parliament must be taken to have deliberately distinguished between "offer" and "available", and the Guidelines appear to read in the word "offer" in situations involving vendor-initiated concessions.

Second, the Guidelines assume that one can always distinguish between vendor-initiated and customer-initiated negotiations. In many cases, however, individual negotiations between customers and their suppliers are merely the way in which business is habitually conducted. It is impossible to say that one side or the other has "initiated" the negotiations.

Third, the concessions which result from such negotiations will not always relate exclusively to services provided by the customer. They may, for instance, relate to the customer agreeing to use a single supplier for a given period of time. The reference to services as the only justification for granting price concessions which need not be effectively "offered" to all competing customers appears to bring the Guidelines close to requiring that all concessions be cost justified. In contrast with the United States, Canada does not require cost justification for price concessions, and this reference obscures that very important point.

Overall, it appears that the Guidelines have, in this area, attempted to be overly precise. In so doing, they have sacrificed real-world applicability for illusory clarity. Perhaps unwittingly, the Guidelines have defined the only situation in which they consider "availability" to suffice so narrowly that it will very seldom apply. For the rest, it is difficult to see the difference between the Director's approach to "available" and "offer" as these words are commonly defined.

(f) Purchaser

The identity of the true purchaser of the goods becomes relevant in situations in which a customer is granted a price concession on the basis of its membership within a larger group. If the larger group — with its high volume of purchases — is considered to be the true purchaser, then the price advantage which benefits the group's members will not be discriminatory *vis à vis* the competitors of those members. If, however, the true purchaser is the member itself, and the member would not qualify on its own for the price concession, then such contracts may be discriminatory and run afoul of the section.

This issue is discussed in the Guidelines with respect to three common scenarios: buying groups, franchise systems and international volume price concessions ("IVPC's").

Buying Groups

The Guidelines indicate that three factors will be relevant to determining if the group is the true purchaser for the purposes of section 50: (1) the group should be a legal entity capable of acquiring property in the articles purchased; (2) the group should in fact acquire title in the articles, although it need not take possession; and (3) the group should be liable and assume responsibility for payment for the goods purchased, even if the members pay for the goods as agents for the buying group.

These same criteria have been articulated by the Director in the past. What is new, however, is the Director's position that in order to satisfy the second criterion, the buying group need not document a second transaction between itself and its members. Such a transaction will be deemed to have taken place in the absence of evidence to the contrary.

For buying groups, it appears that the crux of the matter will be whether the group is liable for payment and in a position to satisfy its suppliers that it has sufficient resources to do so. A variety of mechanisms, such as retaining revenues from membership fees or rebates, or an agreement to collect surcharges from the members in the event of shortfall, are suggested. The bottom line is that the seller must reasonably believe that it can look to the group to satisfy payment for goods shipped to the

members, even if the members take delivery and pay for the goods in the first instance.

It should also be noted that, consistent with the broader scope of allowable price concessions discussed under "availability", buying groups are not confined to merely accepting after-the-fact price rebates to distribute to their members. The definition of buying groups has been expanded from that used in the Discussion Paper, which referred only to rebates, to include "any association of independent firms which combines the volumes of the members' purchases for the purpose of qualifying for or earning price concessions based on volume."

It is also important to note that the Guidelines imply that there is a positive duty on the part of the seller to inquire into the status of a buying group with which it proposes to deal. The Guidelines refer to the three factors stated above as "important indicators relevant to the seller's determination of whether the group is the true purchaser." (emphasis added)[10] The assertion of this duty to inquire can be contrasted with the Draft, which clearly stated that "(w)hen confronted with a buying group, the seller is not obliged to make any more inquiry than it would normally make in the context of dealing with a purchaser in the course of business".[11]

Franchise Systems

With respect to franchise systems, the final Guidelines mention for the first time that the Director will be willing to allow price concessions granted on the basis of system-wide purchases in certain circumstances, despite the fact that the franchisees may order articles on their own behalf and be the only legal entity liable for payment for the articles purchased. The Guidelines state that, where the franchisor contracts with the seller to enter into contracts with its franchisees committing them to purchasing from that seller, the seller is justified in treating all of the franchisees as a single economic unit for marketing purposes, and granting price concessions based on the total franchise system purchases.

This approach may be correct in terms of cost justification by the vendor in light of the clear distribution and marketing savings involved in selling to franchise systems. However, it appears strained both in terms of the interpretation of the word "purchaser" and in terms of viewing a franchise system as a united economic whole. According to the Director's own definition of a purchaser, if a franchisee orders, takes delivery of and is solely liable to pay for the goods, then the franchisee is the true purchaser of the goods. The Director may "deem" it not to be the purchaser in order to give effect to the seller's real cost savings, but this would appear to conflict with the wording of the Act. In the absence of a cost justification defence in the Act, sellers should be careful to ensure that concessions granted to franchisees are justified in terms of the volume of purchases by those franchisees.

Moreover, the assumption which underlies the Director's approach to franchise systems — that they function as integrated economic units where purchasing is concerned — is questionable. Whether this assumption will be appropriate depends upon whether the concession is used to benefit the franchisees or is retained by the franchisor. As is exhibited in the frequent contractual disputes between franchisors and franchisees, franchisees and franchisors often share only limited economic interests. It is quite conceivable, for instance, that a franchisor would negotiate a volume rebate in exchange for requiring its franchisees to source from a particular supplier, and keep the entire rebate to itself. Rather than attempt to redefine the word "purchaser", or to justify the preferential treatment of franchisees in terms of the buyer's interests, the better basis upon which to exempt concessions granted to franchise systems is the real cost savings afforded to the vendor. Unfortunately, in the absence of a cost justification defence in Canadian competition law, vendors must still be careful to ensure that the actual purchaser of the articles in question does not receive an unwarranted price concession.

To this end, there are several alternative arrangements suggested by the Guidelines which clearly do not run afoul of the Act: the franchisor may order articles from the suppliers and direct their delivery

to the franchisees; the franchisees could purchase articles on behalf of the franchisor; or the franchisor could itself purchase and take delivery of articles and then distribute them to the franchisees. However, all of these solutions involve liability on the part of the franchisor; an onerous burden that many are unwilling to undertake. A practical solution to the dilemma is actually suggested by the fact that franchisor and franchisee interests often diverge: if the franchisor keeps the signing consideration for committing its franchisees to itself, then the franchisees can purchase the articles for full price. The purchasers themselves receive no concessions, and the possibility of price discrimination disappears.

IVPC's

A similar problem arises with respect to international volume price concessions ("IVPC's"). IVPC's are price concessions granted to Canadian subsidiaries or affiliates of multinational firms on the basis of the multinational's worldwide purchases from either the seller itself or from the seller's own multinational group. The Draft indicated that, where competing purchasers are present in the Canadian marketplace, IVPC's may result in a violation of the price discrimination provision where the true purchaser of the articles is the Canadian subsidiary or affiliate rather than the multinational.[12] The final Guidelines, however, indicate that the same economic approach as is applied to franchise systems will be applied to IVPC's. Thus, where the "substance of this transaction from the seller's point of view is the sale to a single economic unit, not a sale to each of its diverse parts",[13] the Director takes the view that IVPC's may be granted with impunity despite the fact that the Canadian operation orders, takes delivery of, and pays for the goods in question.

Again, while sound in terms of economic principle, this interpretation of the word "purchaser" appears to be stretched rather thin and should be relied upon with extreme caution.

(g) Competitors of a Purchaser

Section 50(1)(a) only prohibits price discrimination between businesses which the seller knows to be competitors of one another in their downstream markets. Since consumers, charities, and non-market government institutions do not have any downstream markets, price discrimination against these groups is not constrained by the Act. With respect to the relevant business customers or market-oriented government agencies, it is competition in the customers' selling markets, not competition for inputs, which is relevant. Clearly, therefore, the definition of the relevant downstream market, both in terms of product and geography, is of key importance.

The Guidelines refer the reader to the Merger Enforcement Guidelines for an explanation of the analysis which will be followed by the Director in determining whether two or more customers compete in the same product and geographic markets. Unfortunately, the "rule of thumb" followed by the Director (whether a 5% price increase sustained by a firm for one year will cause customers to switch to the other firm), has been omitted from the final version of the Guidelines. While the "rule of thumb" is by no means the last word on the topic, it at least provides businesses with a starting point and an indication of the kind of analysis which will be important to the Director.

This may be a blessing in disguise, however, as the Merger Enforcement Guidelines' approach to market definition is technical and difficult to apply accurately by businesses involved in speedy transactions. The Guidelines do indicate several more readily discernable ways in which a business can determine if its customers compete in their downstream markets. If customers are known to pay close attention to each other's advertised prices or to engage in comparative advertising, or if one asks for a price concession specifically in order to gain an advantage over another customer, a seller may be presumed to know that the customers compete.

Where the seller could not reasonably be expected to know that two or more customers compete, it will be absolved of liability for price discrimination between them. The Guidelines suggest that there

is a duty on the part of the seller to inquire as to whether or not customers compete where there are circumstances, such as those mentioned above, which warn the seller that such may be the case.

(h) "At the time the articles are sold"

Since the price discrimination provision is not meant to restrict sellers from changing their prices over time, it is important that the Director examine only those price concessions which were available to a competitor at the time the articles were sold. In most simple transactions, goods are paid for and received at the same time, and there is no issue as to when the articles have been sold. Long term or complex transactions can give rise to questions as to the correct period of time for comparison purposes under section 50(1)(a).

The Guidelines point out this problem and indicate that, since the price terms are the important aspects of the transaction for price discrimination questions, it is the time at which these terms are agreed upon which will be relevant.

(i) "Directly or Indirectly"

Section 50(1)(a) prohibits granting discriminatory price concessions either "directly or indirectly". The Guidelines point out that this wording covers attempts by a seller to avoid the Act by incorporating a shell company to market the goods on a preferential basis to a preferred customer.

(j) "Like Quality and Quantity"

Prior to the Guidelines, the Director's approach to price discrimination enforcement was that price differences could only be justified on the basis of different quantities or qualities of the articles in question. Under the new Guidelines, price differences are fine so long as they are made "available" to competing purchasers of goods of like quality and quantity. Although disputing "like quality and quantity" is no longer a seller's only defence once a price differential is proved, it is certainly still open to a seller to assert that the articles sold are not of like quality and/or quantity.

The word "like" is used in the sense of "similar". Goods need not be identical to be of "like" quality. Generally, two articles will be considered to be of like quality, despite some differentiation in terms of physical attributes (e.g. colour), functions (e.g. precise features of a consumer electronic good), labelling or trade-marks if end-use consumers are not willing to pay more for one of the articles.

> In general, a trade-mark or label or other attribute which causes consumers to perceive a difference significant enough to be reflected in the price they are willing to pay for the article suggests to the Director that the article so differentiated should not be considered to be of "like quality" when compared with physically identical articles lacking the trade-mark or other differentiating feature.[14]

Similarly, "like" quantity does not mean that precisely the same number of articles need be ordered. The Director will consider industry practices in pricing the articles to determine if the quantities involved would ordinarily be afforded the same price treatment. This common sense approach should not be difficult for industry to apply. The issue of "like" quantity is thus not likely to be highly contested for single product sellers.

For multi-product sellers, however, both the Discussion Paper and the Draft[15] indicated that price concessions could only be granted on the basis of the total purchases if the articles sold were within the same general category of goods, such as consumer electronics. The rationale behind this restriction was never clear, since multi-product sellers benefit from high volume purchases regardless of any similarity in the end-use of the products sold. The Guidelines have done an about-face on this issue and now clearly state that volume rebates can safely be granted on the basis of aggregate purchaser volumes across product lines, regardless of the nature of the products, so long as any tied selling which

may be involved does not lessen competition to the point where a review under section 77 of the Act is called for:

> The purchaser who may pick and choose among the articles, when all are available for purchase from the supplier, should not, in the Director's view, be able to complain successfully about the larger rebates earned by competitors who take full advantage of the supplier's broad offering. If the same rebate scheme was available to all buyers, failure to take advantage of what was on the table should not afford sufficient grounds for complaint.[16]

(k) Knowledge

Price discrimination under section 50(1)(a) of the *Competition Act* is a criminal offence. A necessary element of the offence is, therefore, some measure of intent on the part of the perpetrator. The *mens rea* of price discrimination is supplied by the requirement that the seller have "knowledge" of each substantive element of the offence.

According to the Guidelines, "willful blindness" will also satisfy this element in the sense that a person who deliberately fails to inquire, while knowing that there is a reason for inquiry, will be deemed to have the knowledge which the inquiry would have supplied. Sellers cannot defend themselves against price discrimination charges by failing to ask whether, for example, customers who have never done so in the past actually met some volume or growth quotas upon which price discounts have been based. Similarly, willful blindness as to whether or not two customers are competitors will be deemed to be knowledge of such competition. Again, the Guidelines would suggest the existence of a duty on the part of sellers, when in doubt, to make reasonable inquiries in order to assure themselves as to whether or not their price concession programs will result in discrimination.

(l) A "Practice" of Discriminating

Section 50(2) states that no single sale constitutes price discrimination unless the impugned price concession was part of a "practice" of discriminating. There must be some systematic pattern of discriminating. For example, temporary concessions granted in order to meet a competitor's terms, to win a new account or to enter a new market will not normally constitute a "practice". Similarly, one-time price concessions such as clearance or anniversary sales will not be part of a practice of discriminating. In any situation, however, the Director will look at the frequency, duration, consistency and purpose behind the pricing behaviour.

The Director's explicit recognition of the existence of a "meeting the competition" defence will be welcomed by the business community. This defence is explicitly included in the *Robinson-Patman Act* in the United States, and its recognition by the Director is both sound in law and a welcome step toward compatibility of our competition law regimes. Uncertainty remains over the time limits which the Director will consider reasonable for the application of this defence, but the statement nonetheless gives the green light to a more competitive pricing strategy by Canadian businesses.

Perhaps significantly, there is no separate mention of tender offers as there was in the Draft, and it must be assumed that tender offers can be the basis for price discrimination if a "practice" of discriminating can be found.

(m) Cooperative exception:

Section 50(3) provides a very specific exception to the price discrimination offence defined in section 50(1)(a). Cooperative associations, credit unions, caisse populaires and cooperative credit societies are allowed to distribute their operating surpluses to their members, suppliers or customers in proportion to their respective purchases or supplies as the case may be.

The Guidelines point out that this exception is quite narrowly worded, and applies only to precise conduct engaged in by a narrow class of associations. Corporations, for instance, are not covered by the section.

(n) Appendix I: Related Provisions of the Act

Sections 50(1)(b) and 50(1)(c) prohibit regional price predation and predatory pricing respectively. They apply to the sale of both articles and services, and to consumer sales as well as sales to businesses. Moreover, the effect, tendency or design of the pricing practice must be to lessen competition substantially. The Predatory Pricing Enforcement Guidelines[17] provide information on how predatory pricing complaints will be analyzed by the Director.

Section 51 prohibits the granting of disproportionate promotional allowances that are not applied directly to the sale price of the goods. It was enacted to counteract the power of large grocery store chains to extract promotional allowances which were out of proportion to the amount of goods being purchased. As discussed in Section II(c) below, the provision is more narrowly worded than the price discrimination provision and there is no indication in the Guidelines of a liberalized approach. Care must be taken to avoid falling under this section.

Section 61(1)(b) prohibits discrimination in the context of price maintenance, where higher prices are used to discipline a discounting distributor.

Price discrimination can also be used in ways which run afoul of section 61(1)(b): resale price maintenance, section 76: discriminatory consignment selling, section 75: refusal to deal, section 77: exclusive dealing, tied selling and market restriction.

Price discrimination by a dominant seller which has the effect of substantially lessening competition in a market can be the subject of review by the Director under section 79 of the Act. Dominant buyers who are able to extract discriminatory concessions from sellers could also be controlled through this provision.

Finally, section 36 of the Act provides for private actions for damages by victims of the criminal provisions of the Act. There is a two year limitation period which begins to run on the latter of the last day the criminal conduct was engaged in, or the day on which criminal proceedings in relation to the conduct were finally disposed of by the courts.

SECTION II:IMPLICATIONS FOR BUSINESS

(a) Pricing Flexibility

The key impact of the Guidelines for the conduct of business in Canada will likely be the greater flexibility they provide for Canadian businesses in designing pricing policies and servicing individual accounts.

Purchase volumes are no longer the only acceptable basis for price concessions. Multi-product firms can aggregate purchases across their entire product lines for the purpose of granting price concessions. Non-monetary advantages, such as in-store displays, free baseball tickets, or the use of free equipment are not covered by the provision at all. Buying groups may qualify for concessions, even

if the members take possession and pay for the goods as their agents, so long as the groups take legal title to the goods (a mirror transaction between the group and its members is no longer required) and are liable for and reasonably able to satisfy payment for the goods. Trade marks and other superficial differences between otherwise identical goods can be the source of acceptable price discrimination if the ultimate consumers of the goods are willing to pay different prices as a result of those differences.

The key to this greater flexibility under the Act is the interpretation of the word "available". No longer are volume discounts the only form of justifiable price concession under the Act. Neither must concessions be justifiable in terms of cost savings involved in supplying a particular customer, as is the case in the United States. Rather, so long as concessions are "available" to competing purchasers on the same terms as are granted to a customer, the seller will not run afoul of the Act.

So long as a concession program is not designed specifically in order to benefit or exclude a particular customer or group of customers, any price differentials which may result from the fact that some customers take advantage of the program while others do not will no longer lead to price discrimination enforcement by the Director. Performance bonuses, incentive programs, functional discounts based on customer-provided services, and exclusive dealing discounts are all legal so long as they are "available" to competing purchasers (and do not run afoul of other provisions of the Act).

Not all customers need be actively informed of a price concession in order for it to be "available". A price concession will be considered to be "available" if, in the case of unilateral or gratuitous concessions granted by the seller, they are communicated to those competitors whom the seller may reasonably expect to be able to qualify for the program. In the case of concessions for which a particular customer negotiates with the seller in return for the provision of services by the customer, however, they will be considered to be "available" to all so long as the seller informs customers who actively inquire about that specific type of concession. Even a request for the seller's "best deal" need not elicit information concerning a special deal with another customer in these circumstances.

(b) Words of caution

The Guidelines embody a clear, comprehensible account of the Director's approach to each element necessary to prove price discrimination as a criminal offence. The more lenient approach adopted by the Director is, generally, both legally and economically sound. There are a few areas, however, in which the Director's desire to permit businesses to engage in competition-enhancing price discrimination seems to run up against the wording of the Act.

For instance, the Guidelines extend the analysis of buying groups as "purchasers" to franchise systems and multinationals. While this may be economically sound in light of the cost benefits to a seller in terms of distribution and marketing costs, it runs up against the clear wording of the Act. Unless the franchisor can be consideredthe true "purchaser" of the goods, then a seller ought not to grant franchisees volume discounts based upon the accumulated purchases of the franchise system. Based upon the Director's own criteria enunciated with respect to buying groups, this would only be the case where the franchisor takes legal title to the goods and accepts legal liability for payment. An alternative solution, to have the franchisees purchase the goods, but to have the franchisor keep the benefit of the concession to itself, may be the most practical form in some cases. Similarly, international volume price concessions (IVPC's) ought not to be granted in respect of purchases by a Canadian subsidiary unless it can be said either that the true "purchaser" is the multinational parent itself, or that the benefit of the price concession does not flow to the Canadian subsidiary.

The franchisor or the multinational may be able to ensure that the system as a whole qualifies for a concession, but unless either they can also be said to be the actual "purchasers" of the articles or the true purchasers do not benefit from the concession, then the seller may be open to liability for price discrimination. Appropriate caution should be exercised when granting concessions to franchise systems or IVPC's.

The Guidelines also state that the Director may consider some transfers between affiliates not to be "sales" if they are based upon the value of the goods to the economic unit as a whole. Again, there is no basis in the Act for excluding non-arm's length transactions from the definition of sales. The extension of this reasoning to exclude sale to customers who assist the supplier in entering into a particular line of business is similarly questionable.

Even though prices afforded to affiliates, franchise systems and multinationals may be perfectly justifiable economically, sellers who rely on these interpretations of the Act could wind up being the target of private actions for damages under section 36 of the Act.

(c) Implications for Promotional Allowances: section 51

Finally, the Guidelines mention in the Appendix that section 51, which deals with discriminatory promotional allowances, may be relevant to fact situations which give rise to price discrimination issues. Unfortunately, there is no discussion of the Director's approach to enforcement of this provision, and it is not safe to assume that it is the same as that which applies to price discrimination. The wording of section 51 leaves little room for maneuvering by a seller when granting allowances or other concessions to customers for use in advertising or displays.

To begin with, advertising allowances which are collateral to a sale but not directly applied to the purchase price must be offered by the seller on the same proportionate terms to all customers. The use of the word "offer" implies a duty on the part of the seller to take active steps to inform all customers of the availability of the allowance. A seller need only grant an offending allowance on one occasion; there is no requirement that it be part of a practice of discriminating, as there is for price discrimination. Furthermore, the prohibition covers allowances granted collateral to the sale of any "product", which includes both articles and services. Finally, the allowances can only be granted in proportion to the total volume of sales to each purchaser. Other criteria for qualification, such as sales growth or minimum sales volume would be quite acceptable in relation to price discrimination, but would constitute grounds for criminal liability when applied to non-price promotional allowances under section 51 of the Act.

Businesses who wish to steer clear of the strict dictates of section 51 should apply promotional allowances directly to the purchase price of the articles or services in question, by granting, for instance, a promotional discount calculated as a certain percentage of the sales price of the goods sold. The problem for the business community, however, is that businesses do not distinguish between price and non-price concessions. The bottom-line cost to the seller of granting any concession is all that is relevant to that seller, regardless of the formal manner in which the concession is eventually awarded. Clarification from the Director to bring section 51 into line with this economic reality would be helpful. If the wording of the section proves to be too restrictive to permit such clarification, then amendment of section 51 may well be warranted.

CONCLUSION

The Guidelines represent a clear and complete statement of the analysis the Director will follow when faced with a price discrimination complaint or inquiry. Not only will Canadian industry benefit from the increased understanding which these Guidelines will afford of the nature of the offence, but Canadian competitiveness will benefit from the increased pricing flexibility thus afforded. The Guidelines should be mandatory reading for any pricing manager.

Caution should be exercised, however, as outlined above, in respect of a few areas in which the Director's interpretation may not be supported by the courts. Even if the Director will not prosecute, the guidelines do not bind the Attorney General, and a private action for damages can still be brought under section 36.

Users of the Guidelines should also keep in mind that price discrimination can form part or all of the basis of a civil prosecution by the Director under the "abuse of dominant position" provision in sections 78 and 79 of the Act. In this case, however, the focus would be less on the seller's actions, and more on the competitive effects of these actions. Pricing programs which fall short of criminal price discrimination may still constitute an abuse of market power if their effect is to lessen competition substantially. In such cases, the Director could prosecute before the Competition Tribunal rather than the courts, and a civil rather than a criminal standard of proof would apply. Moreover, the section provides the Director with the ability to combine different forms of behaviour to show abuse, without the requirement that each form of behaviour on its own form a practice of discrimination. Given these evidentiary advantages, and the fact that the overall purpose of the *Competition Act* is to constrain action with anti-competitive effects, one would expect to see price discrimination arise in the context of section 79 cases perhaps even sooner than in section 50 prosecutions.

In fact, the Discussion Paper indicated that price discrimination which did not have anti-competitive effects would not be likely to be the subject of a criminal prosecution by the Director. The Director stated in that document that most price discrimination matters would be resolved by information or investigation visits, undertakings or consent orders, rather than by criminal prosecution. No such statement has been made in the Guidelines. Despite this omission, the Director's policy is still to attempt to achieve compliance rather than to prosecute infractions in all but the most egregious of cases.

Notes

1 *Price Discrimination Enforcement Guidelines*, Director of Investigation and Research, *Competition Act*, Consumer and Corporate Affairs Canada (Minister of Supply and Services Canada, 1992), p. 2.

2 R.S.C. 1985, c. C-34, as amended.

3 Section 50 of the *Competition Act* states as follows:

(1) Everyone engaged in a business who...

(a) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage that, at the time the articles are sold to the purchaser, is available to the competitors in respect of a sale of articles of like quality and quantity,

...is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

(2) It is not an offence under paragraph (1)(a) to be a party or privy to, or assist in, any sale mentioned therein unless the discount, rebate, allowance, price concession or other advantage was granted as part of a practice of discriminating as described in that paragraph.

(3) Paragraph (1)(a) shall not be construed to prohibit a cooperative association, credit union, caisse populaire or cooperative credit society from returning to its members, suppliers or customers the whole or any part of the net surplus made in its operations in proportion to the acquisition or supply of articles from or to its members, suppliers or customers.

4 *Op. cit.*, note 1, p. 2.

5 *R.* v. *Mary Maxim Knitting Wool*, Exchequer Court of Canada, May 16, 1968 (unreported); *R.* v. *Neptune Meters Ltd.*, Ontario Dist. Ct., June 2, 1986, Borins D.C.J. (unreported); *R.* v. *Simmonds Limited*, Ontario Prov. Ct. (Crim. Div.), October 15, 1984, Richards P.C.J. (unreported); *R.* v. *Commodore Business Machines*, Ontario Dist. Ct., January 31, 1989, Wren D.C.J. (O.J. No. 2588, unreported).

6 *Price Discrimination, Section 50(1)(a) of the Competition Act: Discussion Paper* (the "Discussion Paper"), Director of Investigation and Research, Bureau of Competition Policy, July, 1990, p. 9.

7 *Price Discrimination Enforcement Guidelines: Draft* (the "Draft"), Director of Investigation and

Research, *Competition Act*, Consumer and Corporate Affairs Canada (Minister of Supply and Services Canada, 1991), p.6.

8 *Op. cit.*, note 2, section 61(2): price maintenance, for example.

9 *Op. cit.*, note 1, p. 8.

10 *Op. cit.*, note 6, p. 10.

11 *Op. cit.*, note 7, p. 7.

12 *R.* v. *Simmonds Limited, op.cit.*, note 5.

13 Section 51 prohibits a specific form of non-price discrimination, that of granting to a customer an advertising or display discount or other concession which is collateral to the sale of a product and which is not offered on proportional terms to that customer's competitors. The section does not apply to advertising concessions granted which are applied directly to the selling price of the product (see discussion in Section II, *infra*).

14 *Op. cit.*, note 1, p. 14.

15 *Ibid.*, p. 15.

16 *Op. cit.*, note 7, p.14.

17 *ibid.*, p. 15.

18 *Op. cit.*, note 1, p. 18.

19 Director of Investigation and Research, *Competition Act*, Consumer and Corporate Affairs Canada (Minister of Supply and Services Canada, 1991).

20 *Op. cit.*, note 1, p. 22.

21 *Op. cit.*, note 6, p. 20.

22 *Op. cit.*, note 7. pp. 21-22.

23 *Op. cit.*, note 1, p. 23.

24 *Op. cit.*, note 7. p. 24.

25 Director of Investigation and Research, *Competition Act*, Consumer and Corporate Affairs Canada (Minister of Supply and Services Canada, 1992).

26 *Robinson Patman Act*, section 3; *FTC* v. *Morton Salt* (1948), 334 U.S. 37 at 43.

27 *Canada (Director of Investigation and Research)* v. *Nutrasweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.), at 35.

28 *Op. cit.*, note 6, p. 6.

THE FIRST TWO YEARS OF EC MERGER CONTROL: REVIEW AND ASSESSMENT

By: Professor Christian Marfels, Department of Economics, Dalhousie University

INTRODUCTION

The *EC Merger Regulation* (MR) went into effect on September 21, 1990[1]. This date marks the beginning of a new era in merger control as large, Community-wide mergers will now be subject to notification requirements, as well as screening and adjudication by the EC Commission (Commission). Although decisions of the Commission in this regard are final and binding, a decision can still be appealed to the European Court of Justice.

As of September 23, 1992, a total of 121 merger notifications were received by the Commission, of which 12 were received in 1990 (since September 21), 62 in 1991, and 47 in 1992 (as of September 23). Among the 115 decisions concerning merger notifications under Art. 6 of the MR, 15 referred to notifications which did not qualify [Art. 6(1)a], 91 cleared a merger application within the statutory period of one month [Art. 6(1)b], and in 9 decisions a formal investigation (proceedings) with a statutory period of four months was conducted [Art. 6(1)c]. The latter group included the following merger applications: Varta/Bosch, Alcatel/Telettra, Magneti Marelli/CEAc, Aérospatiale-Alenia/de Havilland, Tetra Pak/Alfa/Laval, Accor/CIWLT, Nestlé/Perrier, DuPont/ICI, and Mannesmann/Hoesch.[2] According to Art. 8, final decisions in longer investigations can involve: (i) no conditions for restructuring [Art. 8(2)1], (ii) conditions for restructuring [Art. 8(2)2], or (iii) disallowance of the merger [Art. 8(3)]. Only one of the aforementioned mergers was disallowed, (Aérospatiale-Alenia/de Havilland)[3]; another one was cleared without restructuring (Tetra Pak/Alfa Laval), whereas the other mergers were allowed subject to specified restructuring conditions with the exception of DuPont/ICI and Mannesmann/Hoesch which are still pending.

The following discussion of EC merger control begins with an account of the procedures involved in of merger screening and adjudication. Emphasis is placed on the Commission's perception of relevant markets and on its appraisal of concentrations in the realm of Art. 3 MR.[4] The review of leading cases will focus on Varta/Bosch and Magneti Marelli/CEAc as prime examples of the difficulties seen when dealing with Community-wide mergers.

THE PROCEDURE OF EC MERGER CONTROL

The title of the MR is: *On the control of concentrations between undertakings*. This control is directed at concentrations with a Community dimension. According to Art. 1, a Community dimension means that the following three criteria must be met: (i) the aggregate worldwide sales of the merger partners exceed ECU 5 billion, (ii) the Community-wide sales of at least two of the merger partners exceed ECU 250 million, and (iii) the sales of each of the merger partners do not exceed two-thirds of their respective Community-wide sales in one and the same Member State.[5] The main task of the Commission is to determine whether or not a notified merger creates or strengthens a dominant position and, thus, endangers free competition in the Community or a significant part thereof. When a merger application is received the Commission will perform a stepped screening procedure as follows:[6]

Classification of the operation: is it a true concentration in the sense of Art. 3 or merely a form of cooperation which might be in the realm of Arts. 85 or 86 of the EC Treaty?

Determination of the Community dimension of a concentration: have the thresholds of Art. 1 been reached?

Appraisal of concentrations

Delineation of the markets: what is the relevant product market and what is the relevant geographic market?

Compatibility with the Common Market: is the proposed concentration likely to create or strengthen a dominant position?

With this procedure a number of merger applications are returned immediately because they do not qualify as a "concentration" or they do not qualify as a "concentration with a Community dimension". Furthermore, since the vast majority of the qualifying concentrations pass the test of dominance in the statutory period of one month, only a handful of applications require an in-depth analysis because of potential anti-competitive effects. In this case, the Commission initiates proceedings according to Art. 6(1)(c), and will notify the merger partners of it. In due course, the merger partners are invited to a hearing in order to present their views on the matter. Afterwards, the Commission prepares a draft report which contains its recommendation: (i) to allow the merger with or without restructuring or (ii) to disallow the merger. This report is then transmitted to the Advisory Committee on Concentrations (Committee) consisting of up to two competition-policy experts from each Member State for an opinion. Following the receipt of this opinion, the Commission decides by majority vote on the fate of the merger. The Commission's report on the merger along with the Committee's opinion are published in the Official Journal of the EC.

ANALYSIS OF MERGERS BY THE EC COMMISSION

The appraisal of a concentration begins with the establishment of the markets affected by it. It would appear that the Commission encountered far fewer problems with the delineation of relevant product markets than with relevant geographic markets. As was laid down in Aérospatiale-Alenia/de Havilland, the Commission employs the following classical definition as a guideline: "A relevant product market comprises in particular all those products which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics and their intended use."[7] This means a combination of the — wider — reasonable interchangeability test — or the narrower — particular characteristics and uses test — as the need arises.

By contrast, the determination of the relevant geographic market means the exploration of new territories for the Commission inasmuch as the Community dimension has to be taken into account. Specifically, the decisions of whether the relevant market is still national in character or Community-wide is not an easy one since it has to balance future structural developments such as the continuation or disappearance of trade barriers and the potential change to competition and consumers.[8] Generally speaking, the Commission appears to favour a wider delineation of markets in anticipation of a further opening of national markets in the wake of Europe 1992. This reasoning was applied in Alcatel/Telettra; in spite of achieving very high market shares in Spain (81% for line equipment and 83% for microwave equipment). The merger was allowed on the grounds that Telefonica, the main purchaser of said equipment, would be able to buy from other competitors in the foreseeable future.[9] Similarly, in Alcatel/AEG Kabel, the relevant market for telecommunication cables was declared Community-wide since Deutsche Telekom, the main buyer of these cables, has indicated its intentions to move to an international buying policy in 1993. The Commission viewed this as an element of an opening of the German market and, thus, refused to delegate this case to the German Federal Cartel Bureau which had determined the market as national in character in order to gain jurisdiction, in this case according to Art. 9.[10] Among other important factors in support of a wider geographic market are the absence of barriers to entry, absence of price differences, low transportation costs, presence of the major suppliers in all Member states, substantial cross-border trade/imports, and no strong national buying preferences.[11]

The critical point in the appraisal of mergers is the test of dominance under Art. 2 which is used to determine whether the concentration is compatible with the Common Market. Since the notion of a dominant position which endangers effective competition is not defined in the MR, the Commission has followed the definition of a dominant position adopted by the European Court of Justice with regard

to Art. 86 of the EC Treaty.[12] However, there is an important difference: Art. 86 of the EC Treaty is retrospective since it deals with abuses of an already achieved dominant position. By contrast, Art. 2 is future-oriented and looks at the creation or strengthening of a dominant position and its potential to impede competition.[13] In order to assess the impact of the merger on the competitive environment in a market, the Commission employs the following criteria: the market position of the concentration, the strength of remaining competitors, and potential competition.[14]

In all decisions of the Commission, the addition of market shares is regarded as an important step in the appraisal of a concentration. According to Preamble No. 15 of the MR, a low market share usually leads to a presumption of compatibility with the Common Market even without further examination of other factors; a share of 25% has been viewed as the upper threshold in this regard. However, this does not mean that the reverse is true for very high market shares. In fact, in Tetra Pak/Alfa Laval and Alcatel/Telettra shares of 90% and 80%, respectively, were regarded as strong indicators of dominance. Nonetheless, it was felt that this evidence was offset and even overcompensated by other factors, such as buying power of customers and competition from potential newcomers. What is being done here is clearly the application of a dynamic analysis of trends of market share in the sense of (i) what has affected them in the past; (ii) whether there have been changes in rankings among the top firms; and (iii) what might affect market shares in the foreseeable future. The Commission also differentiates between a high market share existing in a mature industry, as it did in Tetra Pak/Alfa Laval and Mannesmann/VDO, and high market shares established in growth markets, where innovative, potential and progressive attitudes are predominant, as it did in Digital/Kienzle and Digital/Philips.[15]

The issue of the strength of the remaining competitors in a merger case is somewhat reminiscent of the competition-remaining test, which emerged but quickly disappeared in the discussion leading to the *Competition Act* in 1985. There can be no doubt that the assessment of the financial and competitive strength of other competitors is important, but where can a line be drawn below which remaining competition can be regarded as insignificant?

The criteria of buying power and of potential competition have played a significant role in several decisions of the Commission. In fact, buying power was the decisive factor for the allowance of Alcatel/ Telettra and was also a very important element in Alcatel/AEG Kabel. In both cases, Telefonica and Deutsche Telekom, respectively, were viewed as countervailing powers in their capacities as monopolists and, thus, able to buy from existing competitors and/or potential newcomers.[16] The inclusion of buying power is certainly a welcome addition to the elements used in appraising mergers.

The Commission's test of dominance refers only to single-firm dominance in terms of dominance being created or enhanced by the concentration. But what about few-firm dominance when a tight-oligopoly scenario occurs? Thus far, the Commission has not stated whether the MR applies to this structural situation. However, this very situation became, indirectly, an issue in Alcatel/AEG Kabel. It became an issue because the German Federal Cartel Bureau had made a request for referral under Art. 9 MR: the Bureau felt that the post-merger scenario would mean a market with oligopolistic dominance in the German market of power cables since Alcatel/AEG Kabel, Siemens, and Felten & Guillaume would hold more than 50% of the market.[17] Furthermore, the Bureau pointed to supporting evidence such as the remainder of the market being scattered among a number of smaller firms, the maturity of the market and stagnant demand. Still, it must be remembered that German competition law has a presumption of oligopolistic dominance according to s.23a(2) of the *Competition Act and, th*us, Alcatel/AEG Kabel might very well have passed that test. However, the Commission refused the referral on the grounds that such presumption does not exist in the MR even if it were to apply to oligopolistic dominance. The Commission did not deny that the market for power cables — unlike the market for communication cables — was still national in character, but it also pointed to the buying and bargaining power of public enterprises in their demand for power cables which can be viewed as a countervailing force.[18] Thus, the merger was allowed according to Art. 6(1)b in the statutory one-month period.

This was precisely the point that was criticized by the influential German Monopolies Commission (GMC) in its assessment of the case.[19] The GMC felt, regretfully, that the Commission had not clarified the situation with a position of "Yes" or "No". If the Commission had stated that the creation or strengthening of dominant oligopolies was not subject to Art. 2(3) it was right to proceed with Art. 6(1)b. However, had the Commission assumed the perhaps more-realistic position that the MR does, in fact, pertain to the said scenario, then it ought to have started an in-depth investigation under Art. 6(1)c. The GMC feels, and rightly so, that the statutory one-month period is much too short to deal adequately with the potentially anti-competitive effects associated with tight oligopolies.[20]

AN ASSESSMENT OF THE VARTA/BOSCH AND MAGNETI MARELLI/CEAc MERGERS

The proposed merger between Varta and Bosch referred to the establishment of a joint venture with respect to Starterbatterie GmbH. This new company would combine the automotive battery divisions of Varta and Bosch, with Varta holding 65% of Starterbatterie and Bosch 35%.

After receipt of the notification on February 25, 1991, the Commission found that the proposed merger was, in fact, a Community-wide concentration: Varta is the leading German manufacturer of automotive batteries and, for that matter, a member of the Top 3 in the EC, and Bosch needs no further introduction as the world's leading manufacturer of electrical automotive equipment, including batteries. The paramount importance of the two merger partners raised serious concerns with the Commission as to the potential anti-competitive effects of the merger. Thus, a formal in-depth investigation according to Art. 6(1)c was announced on April 12, 1991. The concerns of the Commission related mainly to the market of replacement batteries in Germany and Spain.

In its analysis of the merger scenario, the Commission delineated two separate relevant product markets for batteries: a market for original equipment and a replacement market. The former market is characterized by an organized demand with buying power of the few (oligopsony), such as car manufacturers. By contrast, the latter market is an unorganized market with many buyers (polyopsony). Next, the relevant geographic market for replacement batteries was determined to be national in character and it was found that the proposed merger would account for 44% of the German market and for 45% of the Spanish market. Moreover, the gap to the next competitor in Germany would be more than 30%; in Spain, there is only one competitor, the Spanish firm Tudor which controls more than 50% of the market. The latter market scenario led the Commission to envisage the danger of conscious parallelism of a newly-created duopolistic structure. Subsequently, the Commission communicated its pessimistic assessment to the merger partners and invited them to a hearing on June 12, 1991.

At the hearing, the merger partners emphasized that both original equipment and replacement batteries belonged to one single market although they admitted that differences in technology and quality existed between them. Furthermore, they pointed to the existence of a European market for automotive batteries rather than to national markets. All this did not impress the Commission. However, what made a difference and, ultimately did influence the Commission's position, were structural changes in the European batteries markets which had occurred in the meantime through the acquisition of CEAc in France and of Sonneschein in Germany by Magneti Marelli, a subsidiary of Fiat. Through these acquisitions, Magneti Marelli's share in Germany increased from 1% to about 12% which would still leave a gap of more than 30% to the would-be market leader, Starterbatterie. The Commission viewed this change as significant inasmuch as expected synergistic effects would most likely increase the competitive potential of Magneti Marelli in Germany. Furthermore, Varta agreed to terminate its cooperative ties with the Deta-Mareg Group, a smaller German manufacturer of batteries. Subsequently, the Commission transmitted a draft report in support of the merger to the Committee on Concentrations for an opinion. However, in its meeting of July 17, 1991, the majority of the Committee did not share the Commission's positive view of the merger. Rather, the alleged structural

relief from the acquisitions of CEAc and Sonneschein was not envisioned: the acquisitions would not substantially affect the Varta/Bosch dominance in the German market and they would have only a negligible effect, if any, on the Spanish market. Therefore, the Committee felt the merger should be disallowed. Nevertheless, the Commission allowed the merger on July 31, 1991, according to Art. 8(2)2, subject to the aforementioned separation of ties with the Deta-Mareg Group.

On December 10, 1990 the Commission received notification of the intended acquisition of 50.1% of CEAc of France by SICIND of Italy, a subsidiary of Fiat; control of CEAc would eventually be held by Magneti Marelli, another subsidiary of Fiat. The parent of CEAc was SAMAG which, in turn, is a subsidiary of Alcatel Alsthom of France. Magneti Marelli is a manufacturer of electrical automotive equipment, including batteries, and CEAc is one of Europe's premier manufacturers of batteries. The acquisition was part of a comprehensive set of agreements between Fiat and Alcatel Alsthom, which included the exchange of small minority stakes between the two companies, a joint R&D company, and the sale of Telettra to Alcatel by Fiat. However, the Commission emphasized that the present case would focus only on this acquisition. The relevant product market was determined to be the one for lead-based batteries with the distinct submarkets of batteries for industrial use and batteries for automotive use; the latter was further subdivided into an original-equipment market and a replacement-equipment market. The Commission found that the merger would have only negligible effects on the Italian market. By contrast, serious concern arose with regard to the post-merger impact on the French market of replacement batteries. Thus, the Commission decided to begin a detailed investigation on January 21, 1991.

The main indicator for the anti-competitive nature of the acquisition of CEAc was seen in the creation of a dominant position with a 60% market share reached by adding up the shares of more than 40% of CEAc and 18.5% of CFEC, which is Magneti Marelli's French subsidiary. This would also mean a gap of about 40% to the nearest competitor. Furthermore, the Commission saw the dominance compounded by the financial power of the parents and by the easier access to the supply of lead for the concentration. Since there was no evidence of appreciable buying power, which might have been viewed as a balance, the Commission communicated its serious concerns to the merger partners. These concerns were reiterated by the Committee in its meeting of April 30, 1991, where a recommendation to disallow the merger was passed by majority vote. In an earlier hearing, the merger partners had already conveyed their disagreement with the Commission's assessment of the situation. Sensing the danger of likely defeat for the merger plans, Fiat nevertheless offered to lower its holding in CFEC from a majority to a 10% stake along with a reduction of its representation on CFEC's board of directors to one member. The Commission recognized this divestiture as a significant change of the previously perceived adverse post-merger effects on the French market. Thus, the acquisition of CEAc by SICIND was allowed according to Art. 8(2)2 MR on May 29, 1991, subject to the indicated partial divestiture of Fiat's holding of CFEC.

The two mergers in the European market for automotive batteries raise some interesting questions and provide insight into the working of EC merger controls. Since both mergers relate to the same relevant product market and happened almost simultaneously their eventual fate was closely intertwined: it is unlikely that the Varta/Bosch merger would have been allowed without the prior clearance of Magneti Marelli/CEAc which, in turn, would most likely not have been allowed without massive political intervention from the French and Italian governments.

Historically speaking the talks between Varta and Bosch of combining their battery activities had been going on since early 1990,[21] i.e. prior to the EC Merger Regulation coming into effect. A preliminary consultation with the German Federal Cartel Bureau brought the bad news that the Bureau would not approve the merger. Consequently, the plans were postponed until after the EC Commission had assumed the jurisdiction for large mergers with a Community-wide dimension. Generally, the new EC merger control had been perceived as being more lenient than national merger controls where such controls existed. Therefore, it must have come as a shock to Varta and Bosch when the Commission

communicated its strong reservation and potential disallowance of the merger on May 24, 1991. What is more, the timing of the communication was odd because it happened at the same time as a positive decision in Magneti Marelli/CEAc was made and was proclaimed only five days thereafter on May 29, 1991. Approving Magneti Marelli/CEAc put a heavy burden on the Commission: it would have been next to impossible not to allow Varta/Bosch. But why was the former merger allowed? After the Committee had recommended disallowance by a clear 7:2 majority a business-government coalition began its lobbying efforts.[22] The Chairman of Fiat, Mr. Agnelli, asked the Italian government to put pressure on the Commission, and the French President, Mr. Mitterand, did the same by stating that he favoured the merger and that it should be granted. Although it is not known whether this lobbying made a difference, it could hardly have been ignored.

Closer scrutiny of the two mergers shows that the plans for restructuring in both cases were not impressive. In fact, it would appear that they were not significant enough to alleviate the anti-competitive effects which were stated earlier in the investigation. At least, this was the view of the Committee on Concentrations in Varta/Bosch, a view which was not accepted by the Commission. Unfortunately, the Committee was not consulted again in Magneti Marelli/CEAc after Fiat's last-minute offer of restructuring re. CFEC was made. Should the Commission, then, have disallowed the two mergers? Perhaps not, when the relevant geographic market had been established as being Community-wide: Mr. Bangemann, Vice-President of the Commission for Industrial Affairs, put the shares of the two concentrations at about 20% each, and he felt that this should create no concern. One would have to agree with this statement, particularly in view of the fact that two nearly equal-sized competitive entities have been established. However, in its investigations of the two mergers the Commission had clearly stated that the relevant geographic market for replacement batteries was national in character and there can be no doubt that the two mergers did, indeed, increase concentration dramatically in national markets. This is most evident in the German market where the undisputed leader, Varta, joined forces with its only significant rival, Bosch. It should also be remembered that in the absence of EC merger control, this merger would most definitely have been blocked by the German Federal Cartel Bureau.

It is also questionable whether the separation of the ties with Deta-Mareg had a material impact to lessen the anti-competitive effect of the merger. The majority of the Committee did not think so, and it is very hard to see why this view should not be supported: the formal ties were cut but the informal ones may persist since both Varta and Deta-Mareg are controlled by the Quandt family, albeit by different branches. Even if the informal ties do not continue — and the Commission cannot and should not be expected to enter the speculative arena — it would not make a dent in the superior competitive position of Varta and Bosch since the two brand names are firmly entrenched in the buyer's mind with regard to quality and reliability.

The same assessment applies to the acquisition of Sonnenschein by Fiat with about 10% of the German market of replacement batteries which was viewed by the Commission as an alleviating factor because of the towering financial power of the new parent. Here, again, the wide gap of more than 30% to the new company does not even adequately express the competitive superiority of the latter. Since the aforementioned restructuring does not affect the Spanish market, the merger has a strong impact inasmuch as the former triopoly has been transformed into a duopoly with the Spanish firm Tudor as the other duopolist and holding about 55% of the market. In an unexpected move, the Spanish government signalled its support for the merger to the partners in case Tudor would be included in the new company.[23] It is not quite evident what prompted the Spanish offer but it could very well be that the concentration was viewed with awe and respect and that it was perceived to be too much of a competitive threat for Tudor. For good reason, this offer was not accepted since it would have terminated the entire merger at one strike in the eyes of the Commission.

Similar questions arise with Magneti Marelli/CEAc. Fiat is operating from a position of competitive strength in its domestic market where it controls about 60% of the automotive batteries market via Magneti Marelli although this in itself cannot be held against Fiat. However, when a superior position of almost equal proportions is created in the French market through the acquisition of CEAc, it clearly becomes a matter of concern for competition policy. The pre-merger situation was a share of 18% of the French market through the subsidiary CFEC. The acquisition of CEAc would create a post-merger scenario of 60% when CEAc's 42% share is added. The relief offered by Fiat to reduce its holding in CFEC to 10% still means that Fiat will increase its share of the French market from 18% to 42% which, by the way, comes close to the share of the combined Varta/Bosch entity in the German market. This way, Fiat will become the number one supplier in both Italy and France. What is more, the reduction to 10%-control in CFEC is only a kind of half measure[24]: it stops short of relinquishing the former ties to the subsidiary. This leaves some legitimate doubt as to whether the 18% share of CFEC should be taken completely out of the hands of Fiat. Just how much control will be exercised on the business of CFEC may be subject to speculation but it definitely will be more substantial than the share itself suggests.

In defence of the Commission it must be stated that it cannot engage in speculation although, in order to offset lingering doubts, the Commission should have insisted on a complete divestiture. This may be viewed as an academic exercise since a case can be made that complete or incomplete divestiture would, again, not significantly alter the post-merger scenario inasmuch as CEAc is no longer CEAc as it was before, but is now part of a much more powerful entity which has extended its control of the batteries market in a substantial part of the EC. This could be viewed as a lever to disallow the merger once more. Basically, it all depends on the delineation of the relevant geographic market. If, in fact, the EC in its entirety was the market, as a minority of the Committee felt it was, then one would have to agree that both mergers were compatible with the Common Market. By contrast, when the market for replacement batteries was declared to be national in character, the mergers were not compatible.

OUTLOOK

In its *Twenty-First Report on Competition Policy* for the year 1991, the Commission strikes a positive note on its experience with the first full year of merger control. Specifically, the Commission points to the fine line "between the free competition which is crucial to the dynamism of European industry and the mergers and acquisitions which are likely to improve the structure of industry and to strengthen international competitiveness."[25] Furthermore, the Commission notes the willingness, if not eagerness, of firms to comply with the notification requirement in order to gain legal certainty. In fact, a practice of holding pre-notification meetings between representatives of would-be merger partners and the Commission's Competition Directorate has proven to be helpful in this respect.[26] However, the Commission also mentions the "lively debate" that followed its decision to disallow Aerospatiale-Alenia/de Havilland.[27] This refers to the criticism of the decision by the French government and to discussions in the European Parliament. As a matter of fact, the merger had to be disallowed in order not to have EC merger control perceived as a paper tiger: the intended acquisition of Boeing's subsidiary de Havilland by the French/Italian consortium Aérospatiale and Alenia e Salenia would have led to additions of market shares reaching 50% worldwide and 65% Community-wide in the market of commuter turboprop airplanes. Since this market is a mature market with high natural entry barriers the Commission had no choice but to deny the merger application in the realm of the MR. The European Parliament in its "Resolution on de Havilland" recognized the Commission's obligation to do just that in the confines of the MR but it felt that a balanced approach should take account of a merger's likely impact of European industrial strength and the need for stronger European players on the world market.[28] Thus, Parliament called on the Commission to submit an amended

regulation on mergers to the Council of Ministers which would include such considerations as well as social, regional, and environmental policy considerations. It can only be hoped that this recommendation is shelved quickly and/or forgotten rather than implemented because it would mean the end of an effective and operations merger control. Virtually all mergers would have to be allowed because competition-policy considerations would no longer be the leading criterion in merger appraisals.

The built-in dynamism of EC merger control is exemplified, inter alia, by the provision of Art. 1(3) which calls for a review of the thresholds before September 21, 1993. In this regard, the Commission has indicated that such a review means a lowering of the thresholds in order to guarantee equal treatment of mergers in the Common Market.[29] It would also mean an enlargement of the Commission's powers, an enlargement which would be substantial when the Commission's ideas of lowering the combined worldwide sales in Art. 1(2)a to ECU 2 billion and the Community-wide sales in Art. 1(2)b to ECU 100 million are kept in mind.[30] In both instances, the thresholds would be reduced by 60% from their current minimal levels and this would necessarily mean a sharp increase of qualifying merger notifications. The case-load of 61 applications in 1991 would likely triple, if not quadruple. Given the limited staff of the Commission's Merger Task Force it would be very hard to maintain the statutory one-month period without a substantial increase in manpower for initial merger screening.

By comparison, the thresholds of the *Hart-Scott-Rodinio Act* in the U.S. are much lower, ($100 million and $10 million, respectively, in sales or assets (size of the merger partners) and $15 million or control (size of the transaction)) but then, the staff of the Bureau of Competition (FTC) and of the Antitrust Division (DOJ) is also much bigger. What is more, just comparing numbers here is perhaps a misnomer. With all due respect, the EC Merger Regulation is international rather than national in scope and it is more complex. One may also wonder whether the inclusion of 'second-tier' mergers, i.e. below the level of mega-mergers, would really be necessary in order to maintain free competition in the sense of Preamble 1 of the MR. After all, there are still the national competition-policy authorities, especially in Germany and in Great Britain, with their well-known enforcement record.

In conclusion, it would appear that the Commission would be ill-advised to propose a reduction of the thresholds, whether that is now 60% or less. Rather, the Commission should strive to maintain its unquestionably ambitious enforcement program, and improve it where necessary. One such improvement would certainly be the application of Art. 2 of the MR to domination oligopolies.

Notes

1 EC, *Council Regulation No. 4064/89 of 21 December 1989 on the control of concentrations between undertakings*, O.J. Legislation (1989) No. L 395/1 of 30 December 1989 (original version) and (1990) No. L257/14 of 21 September 1990 (corrected version).

2 Merger statistics were kindly communicated by the Commission's Merger Task Force. File numbers of mergers mentioned throughout this article and references to their location of publications in the Official Journal are compiled in the Appendix.

3 See P.K. Lepsoe, "European Community Competition Law Affects De Havilland Deal" (1991) 12:2 C.C.P.R. 36.

4 According to Art. 3 MR, a concentration refers to mergers, acquisitions of majority and minority control and qualifying joint ventures. The terms "concentration" and "merger" will be used interchangeably in this article.

5 For further details about the history and the concepts behind the MR, see C. Marfels, "The New EC Merger Controls: An Appraisal" (1990) 11:2 C.C.P.R. 58.

6 EC, Commission, *Twenty-First Report on Competition Policy*, Brussels, 1992 at 117-120 (Mimeo.).

7 O.J. Legislation (1991) No. L 334/44 of 5 December 1991.

8 *Supra*, note 6 at 391.

9 O.J. Legislation (1991) No. L 122/53 of 17 August 1991.
10 Monopolkomission, Wettewerbspolitik oder Industrie*politik*, Neuntes Hauptgutachten 1992, Teil 1, Koein at 587 (Mimeo.).
11 *Supra*, note 6 at 388-389.
12 *Supra*, note 5.
13 *Supra*, note 6 at 392-393.
14 *Ibid.*, at 345-346.
15 *Ibid.*, at 397.
16 *Ibid.*, at 400.
17 *Ibid.*, at 394.
18 *Ibid.*, at 395.
19 *Supra*, note 10 at 571-572.
20 *Ibid.*, at 572.
21 *Der Spiegel*, (No. 24, 1991) at 111-113.
22 *Ibid.*, at 113.
23 *Ibid.*
24 *Supra*, note 10 at 570.
25 *Supra*, note 6 at 3.
26 *Ibid.*, at 12.
27 *Ibid.*, at 13.
28 O.J. Information (1991) No. C 280/140 of 10 October 1991.
29 *Supra*, note 10 at 562.
30 *Ibid.*

APPENDIX

Merger applications (September 21, 1990 - September 23, 1992) mentioned in this Article with their filing number (in parentheses) and location of the publication of the FINAL DECISION of the Commission and of the OPINION of the Committee in the Official Journal (OJ)

Digital/Kenzle (IV/M.057)
OJ, No. C 56/16, March 5, 1991

Alcatel/Telettra (IV/M.042)
OJ, No. L 122/48, May 17, 1991 (Decision)
OJ, No. C 127/2, May 17, 1991 (Opinion)

Magneti Marelli/CEAc (IV/M.043)
OJ, No. L222/38, May 29, 1992 (D)
OJ, No. C 209/11, May 29, 1991 (O)

Digital/Philips (IV/M.129)
OJ, No. C 235/13, September 10, 1991

Tetra Pak/Alfa Laval (IV/M.068)
OJ, No. L 290/35, October 22, 1991 (D)
OJ, No. C 275/6, October 22, 1991 (O)

Varta/Bosch (IV/M.012)

OJ, No. L 320/26, November 22, 1991 (D)
OJ, No C 302/6, November 22, 1991 (O)

Aérospatiale-Alenia/de Havilland (IV/M.053)
OJ, No. L 334/42, December 5, 1991 (D)
OJ, No. C 314/7, December 5, 1991 (O)

Alcatel/AEG Kabel (IV/M.165)
OJ. No. C 6/23, January 10, 1992

Mannesmann/VDO (IV/M.164)
OJ, No. C 88/17, April 9, 1992

Accor/CIWLT (IV/M.126)
OJ, No. L 204/1, July 21, 1992 (D)
OJ, No. C 184/2, July 21, 1992 (O)

Nestlé/Perrier (IV/M.190)

MERGER GUIDELINES - A REJOINDER

By: Roy M. Davidson
Ottawa

Dr. Andrew Kleit and Margaret Sanderson introduce their critical comments of my critique[1] of the *Merger Enforcement Guidelines* (the Guidelines) as follows:

> In his recent article in this journal, 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.[2]

This caricature may amuse the authors but it fails to produce a recognizable likeness of my argument.

My quarrel is not with the uncertainty of economic forecasting in merger cases. Some uncertainty is inescapable. My quarrel is with the Guidelines' narrow focus on price projections, and with the false precision implied in the analysis.

One result is the serious neglect of other evidence in the assessment of a substantial lessening of competition. A further result is an even more dubious calculation of the trade-off between lessened competition and gains in efficiency.

In my article, I argued that in most cases there is no useful record of transaction prices to provide a basis for reliable price projections. I also referred to the important view that the real monopoly problem may be that monopolists seek a quiet life, rather than the maximization of short-run prices and profits.

Price change may therefore be a poor measure of monopoly power. A merger may not produce a rise in prices, but we still do not want to lose significant domestic pressure to innovate, or to economize on costs, or to offer better non-price terms to buyers. Nor do we want to forego the possibility of price competition in the future.

Criticism of the Guidelines cannot be swept aside by the assertion that the hypothetical monopoly approach, with its focus on price projections, "has been a tremendous success in the United States."[3] If valentines are to be handed out for this approach, they will be more impressive if they come from arm's length admirers, rather than from already committed enforcement agencies in the United States and Canada.[4]

So far, enforcement authorities in Australia, Germany, the United Kingdom, and the E.E.C. have apparently been reluctant to embrace any price tests.[5]

In Canada, the Competition Tribunal has explicitly resisted the Bureau's view on several occasions. In its recent decision in the Laidlaw Waste Systems abuse-of-dominance case, the Tribunal said:

> The Tribunal wishes to emphasize that the above discussion of the respondent's expert evidence should not be taken as an acceptance that the 5% price rise criterion is necessarily a good one, even in a merger case. While the test of a non-transitory significant price increase may be conceptually useful, what percentage will be significant and what period of time will satisfy the test of non-transitoriness can only be determined by reference to the facts of a particular case.[6]

And further:

> As was also stated in the *NutraSweet* decision: While this [the ability to set prices above the competitive level] is a valid conceptual approach, it is not one that can readily be applied; one must ordinarily look to indicators of market power such as market share and entry barriers. The specific factors that need to be considered in evaluating control or market power will vary from case to case.[7]

With respect to Part 2 of my article, Kleit and Sanderson write:

> 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.[8]

Williamson did not. Williamson focused on the trade-off between cost reductions and price increases attributable to a merger in the short-run.[9] Only the price dimension of competition played an important part in his model. The model ignored dynamic considerations like the impact of the merger on technological change, or on the development of organizational slack, and the potential of the market to grow enough to permit the exploitation of available economies without a merger. Williamson said only that "the highly conjectural nature" of factors like technological progress and managerial discretion made it unclear what weight should be assigned to them at that time.

Kleit and Sanderson themselves acknowledge somewhat lamely that:

> In practical terms the question is difficult, but the law calls on Canadian competition authorities 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.[10]

Quite so. As I said in my article, any trade-off must be more or less arbitrary. What we need is an interpretation that involves the least damage to the competitive process.

Next, Kleit and Sanderson write:

> 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. 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.[11]

In reality my "suggestion" was that because of the evidence of rapidly increasing concentration in the industry, and because of the network of interlocking supply arrangements, the Director should have sought an order of prohibition against the merger, rather than merely a consent order. What in fact happened was that the Director and the firms negotiated, and on successive applications to the Tribunal, proposed four different consent orders before arriving at one that was acceptable to the Tribunal. The very least that can be said about this is that clearly there were significantly different opinions about "a resolution which removed the Director's grounds to challenge the merger."

This is one of the very few cases in which the Director was obliged to provide a detailed accounting for his decision. One of the most important elements in all versions of the consent order required the divestiture of large numbers of service stations. In the final version, this involved all of Texaco's stations in Atlantic Canada plus 410 service stations in other regions.[12] Recent press reports indicate that far larger numbers of service stations are currently being closed on their own initiative by Imperial Oil, Petro Canada and Shell. Such closures make a mockery of the divestiture provisions at the service station level in the consent order. What appears to be happening is that Imperial Oil is able to exercise market power interdependently with other majors, to produce a step-by-step reduction in over-capacity in retailing, without risking loss of market share.

Consumers undoubtedly have a different view about the ideal number and configurations of service stations, and about more competitive ways to get there. It is not irrelevant to note that the Director's latest *Annual Report* states that:

> The Bureau examined almost 4700 complaints alleging anticompetitive behaviour in the setting of retail gasoline prices, and carried out spot checks in selected markets to determine if cases could be made under any of the provisions of the Act.[13]

The second merger mentioned in my article involved copper tubing and the monopoly achieved by Wolverine in 1988 when it acquired two plants from Noranda, its only Canadian competition. Most of the evidence on which the Director relied, according to his *Annual Report* for 1989, in reaching a

decision not to seek a prohibition order, subsequently turned out to be incorrect.

However, Kleit and Sanderson defend the decision as follows:

> In the case of Wolverine, 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.[14]

This provides a different rationale for the Director's decision than the one he gave in 1989. In his *Annual Report*, the Director recognized that a monopoly would be created by the merger, but he concluded that the alternative to a merger was liquidation, that there was no other buyer, that with the merger the assets would continue in production and that there would be gains in efficiency.[15] This analysis proved to be wrong. The different Kleit and Sanderson thesis does not stand up either.

In Laidlaw, the Competition Tribunal noted that subjective intention "is almost impossible of proof in many cases involving corporate entities unless one stumbles upon what is known as a 'smoking-gun.'"[16] The Tribunal defined this as "a document which makes it clear that the purpose of the conduct in question was to exclude competitors from the market." Kleit and Sanderson manage to ignore just such a smoking gun. In my article, I quoted the following statement made by a Vice-President of Wolverine in 1991:

> If the New Westminster plant were sold, and was then operated by a competitor, this would seriously harm our other Canadian plants. Therefore, we would want an enormous premium on the sale of the New Westminster plant to cover the loss of orders for our other Canadian plants. Realistically, this means that no sale is possible. That is why we have not sought out buyers and have tried in every way we could, short of saying the plant is not for sale, to discourage the Union's efforts to find a buyer.[17]

The union in fact found a buyer and obtained a temporary injunction against the dismantling of the plant, in the expectation that some solution would be available under the *Competition Act*.[18] Wolverine fought off a renewal of the injunction and proceeded to dismantle the plant and to disperse the assets abroad. Apparently the purchase and closure of the New Westminster plant does not qualify, in the words of Kleit and Sanderson, as "an exercise of market power."

There are other problems with their thesis. This case strikingly demonstrates how unreliable price changes may be as a measure of market power. The price of refined copper is closely linked to the general level of industrial activity, and in a severe recession such as we are now experiencing, the price of the metal falls. It is a fact that a high proportion of the price of copper tubing is accounted for by the price of the refined metal, which changes frequently. Therefore, Wolverine sells much of its copper tubing at a fixed spread (the fabrication price) plus the metal price (which is quoted daily on the New York commodity exchange) at the time of shipment. A monopoly by Wolverine can be expected to control only the fabrication price. Kleit and Sanderson do not say, and probably do not know, what part if any of the changes in industry prices over the past three years is attributable to changes in the fabrication price. Also perhaps the Bureau is reluctant to acknowledge that the Wolverine method of establishing prices may itself be a device for promoting pricing coordination in the industry.

Finally, what Kleit and Sanderson have to say about imports also raises difficult questions for them. Import data cannot easily be broken down by destination, so no one has much reliable information about importation into Western Canada. What we do know is that while there is no longer any plant within 3,500 kilometres of Vancouver, the new Wolverine plant in Oklahoma is as close as any other U.S. plant and far closer than most. The Oklahoma plant is also closer to Vancouver than are Wolverine's remaining Canadian plants. Since the New Westminster plant has been dismantled, there is no longer any reason for the closest plants to absorb freight costs in order to reach Vancouver, and the full cost of freight will normally be borne by the buyer. Therefore, before the Bureau hangs very

much on import figures for British Columbia, if they exist, it is incumbent on the Bureau to say what proportion of increased imports into that market, if there have been any, is not attributable to Wolverine (U.S.). The new Wolverine plant in Oklahoma, with surplus capacity and a more compliant labour force than New Westminster, may well serve better the over-all interests of the corporation. This at least is a more plausible explanation of the closure of New Westminster than the Kleit and Sanderson theory of heavy losses, for which they provide no evidence and which is incompatible with the smoking gun.

In my article, I referred only to Imperial Oil/Texaco and Wolverine/Noranda because in both cases the outcome was so suspect, and in both cases sufficient information found its way into the public domain to permit independent judgments to be made. Other merger cases of course exist, where the Director's application was rejected in whole or in part by the Competition Tribunal. See *Palm Dairies/ Fraser Valley*,[19] *Hillsdown Holdings/Canada Packers*,[20] and *Southam Inc.*[21]

About the concluding part of my article, Kleit and Sanderson write:

> 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.[22]

Kleit and Sanderson are of course correct that the discretion is conferred by the *Competition Act*. However, it is unlikely that Parliament ever intended that so much discretion should be exercised behind closed doors.

Even where the Bureau deploys substantial resources, as in the cases referred to above, its analyses in this difficult field are fallible enough. But we know next to nothing about such merger examinations as are referred to in the Director's latest *Annual Report* — ten of which were concluded with monitoring only; two with post-closing undertakings; one with the merger abandoned in whole or in part as a result of the Director's position; 70 with advance ruling certificates issued; and 13 with advisory opinions issued.

In merger cases that do not get before the Tribunal, the facts are not disclosed in detail. The Director is virtually unaccountable to anyone. It is not enough for the Director to say in his speeches that "the effectiveness of our enforcement policy has been enhanced through the openness and transparency achieved by the release of guidelines and our continuing pursuit of alternative case resolutions."[23] Actions speak louder than words. There is a discordance between the Director's speeches and his decision to cut the size of his *Annual Report* in 1991 by half, and the discussion of mergers from 13 pages to six. Given the Bureau's track record where the facts have become known, the case for much greater disclosure is simply unanswerable.

Notes

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

2 Andrew Kleit and Margaret Sanderson, "The Perfect is not the Enemy of the Good: A Response to Roy Davidson's Article "When Merger Guidelines Fail to Guide"" (1992) 13:2 C.C.P.R. 48.

3 *Ibid.* at 48.

4 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 of the Bureau.

5 Paul S. Crampton, "A Comparative Review of Canadian Merger Enforcement Guidelines" (1992) 13:1 C.C.P.R. 55.

6 *Canada (Dir. of Investigation & Research)* v. *Laidlaw Waste Systems*, (1992), 40 C.P.R. (3d) 289 at 320. See (1992) 13:1 C.C.P.R. 1.

7 *Ibid.* at 325.

8 *Supra*, note 2 at 49.

[9] O.E. Williamson, "Economics as an Antitrust Defense", (March 1968) *The American Economic Review*.

[10] *Supra*, note 2 at 49.

[11] *Ibid.* at 50.

[12] *Director of Investigation and Research, Annual Report*, 1990 at 10.

[13] *Director of Investigation and Research, Annual Report*, 1991 at 15.

[14] *Supra, note 2 at 50.*

[15] *Director of Investigation and Research, Annual Report*, 1989 at 14.

[16] *Supra, note* 6 at 342.

[17] *Supra*, note 1 at 49.

[18] See (1991) 12:4 C.C.P.R. 10. Mr. Davidson acted as a consultant to the union in its efforts to involve the Director in the matter.

[19] *Canada (Director of Investigation & Research)* v. *Palm Dairies* (1989), 12 C.P.R. (3d) 540 (Comp. Trib.). See (1989) 10:2 C.C.P.R. 17.

[20] *Canada (Director of Investigation & Research)* v. *Hillsdown Holdings (Canada) Ltd.* (1991), 38 C.P.R. (3d) 187 (Comp. Trib.). See (1992) 13:1 C.C.P.R. 6, (1992) 13:2 C.C.P.R. 43.

[21] *Canada (Director of Investigation & Research)* v. *Southam Inc.* (1992), 43 C.P.R. (3d) 161 (Comp. Trib.). See (1992) 13:2 C.C.P.R. 1.

[22] *Supra*, note 2 at 50.

[23] Howard I. Wetston, Speech to the Canadian Institute, Toronto, June 8, 1992.