CANADIAN COMPETITION LAW AND POLICY DEVELOPMENTS

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DIGITAL EQUIPMENT'S UNDERTAKING TO STOP TIED SELLING HAS IMPLICATIONS FOR DURABLE EQUIPMENT MANUFACTURERS IN CANADA

On October 29, 1992, Digital Equipment of Canada Limited ("Digital") entered into undertakings with the Bureau of Competition Policy to put an end to its practice of linking computer hardware and software servicing in a manner which the Bureau alleged had been freezing out independent hardware service providers. Digital admitted to no wrongdoing under the tied selling provision contained in section 77 of the *Competition Act*. However, the undertaking was given as a result of the Bureau's investigation into complaints that Digital's integrated service policy had been "lessening competition substantially" in the hardware service after-market.

Following as it does in the wake of the June 8, 1992 United States Supreme Court decision in *Eastman Kodak Company* v. *Image Technical Services, Inc.*,[1] ("*Kodak*"), the Digital investigation and undertaking signal a new focus for the North American law relating to tied selling.[2] Both Digital and Kodak are manufacturers of durable business equipment in highly competitive markets. Nonetheless, the U.S. Supreme Court and now the Bureau of Competition Policy in Canada appear willing to accept that a lack of market power in the equipment sales market does not necessarily preclude market power in the after-sales servicing and parts markets for that particular brand. In the face of patent, copyright or other restrictions on competition of one component of the after-market (a natural comparative advantage in the manufacture and marketing of brand-specific parts in the case of Kodak, and proprietary software updates and servicing in the case of Digital), marketing practices which link and extend this power to other elements of the after-market in that particular brand will contravene the tied selling provision if they squeeze out independent after-market suppliers, despite the competitive forces which admittedly remain unhindered in the foremarket for equipment sales. In the face of consumer demand for comprehensive sales and servicing, all durable goods manufacturers should re-examine their marketing policies to ensure that they do not run afoul of this new trend in antitrust enforcement.

The *Kodak* Case in the U.S.

Prior to 1985, Kodak had freely provided replacement parts to anyone who would use them to repair Kodak machines. Pursuant to a policy change in that year, Kodak refused to sell parts to independent service organizations ("ISO's"), had its outside equipment manufacturers agree to do the same, and refused to sell parts to customers unless the customers refused to use the ISO's. The ISO's alleged that these policies, particularly the latter, constituted an illegal tying of service to parts and an attempt to monopolize the after-sale service market for Kodak copying and micrographic equipment.

Kodak attempted to have the case thrown out of court before the discovery stage on the grounds that Kodak could not possibly have market power in the parts and services market when even the ISO's admitted that it lacked such power in the primary equipment market. If it attempted to price parts and/or equipment supracompetitively, reasoned Kodak, it would lose equipment sales. Accordingly, the market discipline of the equipment market would ensure pro-competitive pricing in the parts and servicing markets.

The ISO's, and eventually the U.S. Supreme Court, disagreed. They contended, first, that there was evidence to show that Kodak's service was more expensive and less reliable than that of the ISO's, yet customers had been effectively compelled to use Kodak service if they hoped to obtain the necessary parts — and Kodak, due to competitive advantage, completely controlled the manufacture and marketing of Kodak parts. Such evidence is not consistent with effective discipline by the equipment market on the after-market for parts and service. On a theoretical level, the Supreme Court agreed with the ISO's that, even though there was competition in the equipment market, such competition could prove to be imperfect due to a lack of consumer access to information on total system costs, and the costs of switching once a consumer had purchased Kodak equipment. There being an arguable basis for the ISO's case, supported by such pre-discovery evidence as was available, the Supreme Court returned the case for full discovery and a trial on the issues.

The Kodak decision is significant in many respects. First of all, it clearly states that the after-markets for sales and servicing of a particular brand of equipment can constitute a separate market for antitrust purposes, even if the equipment market itself would not constitute such an independent market. Second, the Supreme Court was willing to entertain the possibility that market imperfections prevented the competition in the equipment market from disciplining the after-markets for that brand. Third, the Supreme Court rejected the notion that the ISO's were "free-riding" on Kodak in that they demanded the right to use Kodak parts to service Kodak machines but declined to manufacture their own parts. Rather, the Court reiterated that the purposes of antitrust law would not be served by erecting barriers to entry into a market by requiring entry into more than one market simultaneously. In other words, assuming the ISO's could prove their case, Kodak could not use its natural competitive advantage in the market for its parts to sew up the service market in which it enjoyed no such competitive advantage.

The case is currently working its way through a trial of the issues as to whether or not the equipment market does in fact exert discipline on the after-market pricing of the manufacturer, and whether or not such one-brand after-markets constitute separate markets for antitrust purposes.

The Digital Undertaking in Canada

The provision by Digital of an undertaking to the Bureau has precluded a trial, and hence made-in-Canada jurisprudence on the issues raised in such cases. However, the similarities between Digital's and Kodak's situations make it clear that the Bureau is applying the reasoning in Kodak to its enforcement of Canadian competition law.

Like Kodak, Digital is a leading manufacturer of sophisticated, durable business equipment; in Digital's case, computer systems. Still, there is considerable competition in the market for computer equipment, and it is unlikely that either the Bureau or the Competition Tribunal would find that Digital possessed "market power" in the equipment sales market sufficient for a finding of illegal tied selling if servicing were tied to computer sales.

Beginning in 1988, however, Digital introduced an integrated service policy which linked the provision of hardware servicing for its systems to software service for its proprietary operating and applications programs. Under the integrated service policy, Digital customers were denied access to software hotlines and bulletin boards unless they contracted for both software and hardware servicing from Digital. The hotlines and the bulletin boards were, however, free of charge to integrated service customers. This served as an inducement to customers who — in light of Digital's proprietary rights in the software — were more or less obliged to use Digital's software services if they wanted to receive software upgrades and debugging services. The integrated service pricing policy was the carrot, and a prohibitively high price for stand-alone software upgrades was the stick. The result was that most customers purchased the integrated service from Digital, despite the lower prices and allegedly faster service provided by the ISO's.

Like Kodak, Digital would probably argue that competition in the equipment sales market ensures that it prices its after-sales services competitively. In a world of perfect competition, this might be true. Again like Kodak, however, the fact that Digital has most of the business despite being more expensive belies the effectiveness of such competitive discipline from the market for equipment sales.

In the face of the *Kodak* decision in the United States and a threatened Bureau prosecution in Canada, Digital — without admitting any liability or wrongdoing whatsoever — agreed to "unbundle" its hardware and software services as of January 1, 1993. Essentially, all components of the integrated service will be available separately, at stand-alone prices which do not add up to more than the price of the integrated service. As the independent hardware servicers were involved in the negotiations for the undertakings, it is clear that they are satisfied that they will now be able to effectively compete in the market for after-sales servicing of Digital computer systems.

Implications for Durable Goods Manufacturers

Durable goods manufacturers can no longer be content that they will be allowed to enjoy a "natural" monopoly in the provision of after-sale parts and services for their machines. The Bureau appears willing to view after-markets as distinct from equipment markets, and to view one particular brand-name as a distinct market even if the brand-name is not a "dominant" one in the equipment market itself.

On a technical level, in order for tied selling to be reviewable, the seller must possess sufficient market power in the tying product to be able to "force" consumers to purchase something they would not normally acquire. In the case of Kodak, a natural efficiency in producing or contracting for the production of parts for its machines provided it with market power in the parts market which it exploited to charge higher prices for its repair services. In Canada, the market power requirement is more easily met than in the United States, for the wording in the legislation requires only that tied selling be "engaged in by a major supplier in the market or be widespread in the market." For Digital, proprietary rights in its software meant that it was the only supplier of software upgrades, and provided it with sufficient market power in the servicing of its software to extract higher-than-competitive prices for its hardware repair services.

Any manufacturer that provides after-sales parts and/or servicing should review its policies to see if one or more of these after-sales components is tied to the provision of another component in which it has some inherent market power. If so, and if this policy is preventing the independent provision of such tied after-sales components by more efficient providers, then the policy may well be prohibited under section 77 of the *Competition Act*.

A possible loophole raised by the dissent in *Kodak* may be more difficult to apply in Canada. It arises out of the requirement under U.S. case law that a seller have market power in the market for the tying product before tied selling can be found. If the equipment market is competitive, then tying after-sales parts and/or service to such equipment sales will not be illegal, even though tying such parts and/or service to each other may be illegal. In Canada, if the equipment manufacturer is a "major supplier" of the product, or even if the tied selling is a widespread practice in the market, then tying after-sales parts and/or services to the equipment sales could still be reviewable under section 77. So long as the manufacturer has sufficient market power in the after-market to lessen competition substantially, a lack of market power in the tying market will not be relevant under Canadian law.

An interesting question which has not been directly addressed by the facts in either Kodak or Digital will nonetheless pose itself to manufacturers supplying both equipment and after-sale parts and service to its customers. Whereas Kodak seems to suggest that, in certain circumstances, a manufacturer might be obliged to supply parts to independent service organizations, does this mean that a manufacturer can also be obliged to provide service to customers who use independently-manufactured or "jobber" parts? Laying aside any question of patent or trademark infringement by the parts manufacturers, the answer would appear to depend upon whether or not there are also independent service organizations who are willing and able to provide such service in place of the brand-name manufacturer. If such ISO's exist, then the refusal of the manufacturer to service customers who use non-brand parts will simply mean more business for the ISO's. If, however, due perhaps to the existence of proprietary information, it is not feasible for ISO's to service the machines, then the tying of servicing to a refusal to allow non-brand parts may squeeze out the independent parts manufacturers — and result in an investigation by the Bureau of Competition Policy under the "tied selling" provision of the Act.

S.M.H. & L.A.W.H.

NOTES

1 R.S.C. 1985, c. C-34, as amended.
2 112 S. Ct. 2072 (1992).
3 Section 1 of the *Sherman Act* (15 U.S.C. section 1), states, in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

Section 77 of the *Competition Act* (*supra*, note 1) reads, in part, as follows:

(1) For the purposes of this section

...

"tied selling" means
(a) any practice whereby a supplier of a product, as a condition of supplying the product (the "tying" product) to a customer, requires that customer to
(i) acquire any other product from the supplier or the supplier's nominee, or
(ii) refrain from using or distributing, in conjunction with the tying product, another product that is not of a brand or manufacture designated by the supplier or the nominee, and
(b) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (a)(i) or (ii) by offering to supply the tying product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs.
(2) Where, on application by the Director, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to
(a) impede entry into or expansion of a firm in the market,
(b) impede introduction of a product into or expansion of sales of a product in the market, or
(c) have any other exclusionary effect in the market,
with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market. (emphasis added)

CONSPIRACY CASES PROCEED AFTER N.S. PHARMACEUTICALS

The prosecution of several cases involving charges of conspiracy to lessen competition unduly, which had been delayed pending the decision of the Supreme Court of Canada in R. v. *Nova Scotia Pharmaceutical Society*[1] (the "PANS" case), resumed after that judgment was handed down on July 9, 1992.

The leading example is the case against the Nova Scotia Pharmaceutical Society itself, which had not been heard. The appeal to the Supreme Court was based on a pre-trial motion attacking various aspects of section 45 of the *Competition Act* as contrary to section 7 of the Charter. When the case resumed in the Trial Division of the Supreme Court of Nova Scotia in October, defence counsel attempted to have the charges stayed on the grounds of inadequate disclosure by the Crown. The motion was denied. Further pre-trial proceedings ensued. The result was that the trial was severed such that there are to be separate trials for the individual companies and pharmacists who were also charged with the Society and the Pharmacy Association of Nova Scotia.

As of December, the trial of the Society and the Association had proceeded to final argument, while the trial against the individuals had not yet begun.

In northern New Brunswick in December, two ready-mix companies were found guilty of conspiracy to lessen competition and were made subject to a prohibition order.[2] Each company was fined $50,000 by the New Brunswick Court of Queen's Bench. The companies had previously agreed to the filing of an agreed statement of facts and to guilty pleas, subject to the outcome of the PANS case. Conspiracy charges had originally been laid in December 1990.

At the other end of the country, the suspended negotiation of a plea bargain by a number of companies in the pulp baling wire business in British Columbia proceeded to convictions and an order of prohibition. The case, known as *Western wire*, was disposed of in the Supreme Court of British Columbia before Associate Chief Justice Campbell on November 5, 1992.[3] The companies were sentenced on the basis of guilty pleas and an agreed statement of facts concerning their price-fixing arrangement Fines ranged from $200,000 to $725,000 and totalled $1.6 million for the four companies involved. Five current or former officers of the companies also agreed to be parties to the prohibition order which had been consented to by the companies.

It should be pointed out that the enforcement of the conspiracy provisions by the Bureau of Competition Policy had by no means completely ceased pending the PANS decision. For instance, convictions were obtained prior to PANS in the compressed gas matter, for which record fines were levied.[4]

P.K.L.

Notes

1 (1992), 93 D.L.R. (4th) 36. See comment by Lawson A.W. Hunter, Q.C., "Supreme Court upholds conspiracy section" (1992) 13:3 C.C.P.R. 1.

2 R. v. *Kenny Ready Mix Ltd., Blanchard Ready Mix Ltee* (10 December 1992), Bathurst B/M/74/90 (N.B.Q.B.).

3 R. v. *Davis Wire Industries Ltd., Gerrard-Ovalstrapping (EII Limited), Titan Steel and Wire Co. Ltd., Tree Island Industries Ltd.* (5 November 1992), Vancouver CC921294 (B.C.S.C.).

4 See (1991) 12:4 C.C.P.R. 11.

AIRLINE MANIA

Various machinations unfolded throughout the autumn of 1992 with respect to the potential merger of Air Canada and Canadian Airlines International. Many competition issues have been raised, including the possible rescission of a previous order of the Competition Tribunal with respect to the airline reservation system, Gemini.

The situation was still in a state of flux as this edition of the C.C.P.R. went to press. We will endeavour to report on developments in the next issue.

P.K.L.

ABBOTT LABORATORIES GETS IMMUNITY

In June, 1992 Abbott Laboratories approached the Director of Investigation and Research (the Director) and described its own anti-competitive behaviour in connection with the supply of Bacillus Thuringiensis (Bt). Bt is a biological insecticide which Abbott sold under the trade-mark DiPel and is used in forest pest control programs for the Spruce Budworm, Gypsy Moth and Hemlock Looper. The Bureau had no knowledge of the anti-competitive actions of Abbott before the firm approached the Director.

On November 3, 1992 the Director announced that a settlement with Abbott had been reached which would see the company pay restitution of $2.122 million to the province of Ontario and *La Société de protection des forêts contre les insectes et maladies* (SOPFIM), an entity of the government of Quebec. As part of the settlement, Abbott was granted immunity from charges under the conspiracy and bid rigging provisions of the *Competition Act*, and agreed to a prohibition order issued by the Federal Court under section 34(2) of the Act.

Another company which supplies the same product under the brand name Futura XLV was charged in the Quebec courts on the same day the Abbott settlement was announced. Chemagro Limited was charged under the bid-rigging and conspiracy provisions of the Act.

According to the Bureau release, "the resolution of the Abbott case reflects the joint approach of the Bureau of Competition Policy and the Attorney General's office to improving the detection of serious, covert corporate crime and to encouraging the voluntary reporting of activities contrary to the Act".

K.C.

TRIBUNAL DENIES "SHOW CAUSE" ORDER AGAINST CHRYSLER

In a decision released September 22, 1992,[1] the Competition Tribunal denied the Director of Investigation and Research (the Director) the show cause order for contempt which was sought nearly three years earlier. The Director asked for an order to force Chrysler Canada, Chrysler U.S.A. and Bernard Lerner to show why they should not be held in contempt of the Tribunal's order[2] of October 13, 1989 which required that "Chrysler Canada Ltd. accept Richard Brunet as a customer for the supply of Chrysler parts on trade terms usual and customary to its relationship with Brunet as the said terms existed prior to August, 1986."

The delay was due to the appeal to the Supreme Court of Canada on the question of the Tribunal's jurisdiction regarding contempt orders. On June 25, 1992 the Supreme Court held that the Tribunal did have the jurisdiction to entertain contempt proceedings, in part because the Tribunal has the expertise in the matters in issue.[3]

On the question of including Chrysler U.S.A. and Bernard Lerner in the show cause order, the Tribunal avoided the jurisdictional issue of serving parties outside the original order, which only applied to Chrysler Canada and the Canadian market for parts. The Tribunal did this by finding that there was not enough evidence to enable the Tribunal to conclude that a *prima facie* case of contempt has been made with respect to Chrysler U.S.A. and Lerner.

With regard to the issue of Chrysler Canada's alleged contempt, Tribunal members Dr. Frank Roseman and Mr. Justice Leonard Martin for the majority found that there was also insufficient evidence to establish a prima facie case of contempt against Chrysler Canada. The presiding judicial member Madame Justice Barbara Reed dissented.

The Tribunal's decision offers some guidance to the Director for future cases. Because contempt is serious, and the failure to comply with a Tribunal order offers new civil remedies to the applicant, the Tribunal will require evidence of "a fairly specific nature to support the allegation being made." In addition, defences based on the strict wording of the order without regard to its intent and spirit will not meet with much acceptance.

The recognition that the intent and spirit of the original order must be complied with, and that "attempts to chip away at the edges of the order" so as to render the order ineffectual could be evidence of contempt, is clear in the Tribunal's decision in this case. However, where the allegations of contempt are of the "chipping away at the edges" variety, the Tribunal indicated that it would prefer that counsel for the Director inform the alleged contemner before commencing an application for show cause.

K.C.

Notes

1 CT-88/4 #242

2 *Canada (Director of Investigation and Research)* v. *Chrysler Canada Ltd.* (1990), 27 C.P.R. (3d) 1. For a discussion of the original case, see Warren Grover, "Refusal to Deal" (1991) 12:2 C.C.P.R. 34 at 35.

3 *Chrysler Canada Ltd.* v. *Canada (Competition Tribunal)*, (1992), 92 D.L.R. (4th) 609 (S.C.C.). See P.K. Lepsoe, "Chrysler Decision Confirms Enforcement Powers of Competition Tribunal" (1992) 13:3 C.C.P.R. 5.

BUREAU INVESTIGATES NHL

A recent report in the sport pages indicated that the Bureau of Competition Policy was looking into the National Hockey League's draft system as potentially anti-competitive and in contravention of section 48 of the *Competition Act.* This section makes it unlawful for anyone to conspire, combine, agree or arrange with any other person to limit unreasonably the opportunity for a third person to participate in the sport or to negotiate with the team or club of his or her choice. In considering the matters before it, the court must have regard to both the special circumstances of internationally organized sport and to the desirability of maintaining a balanced league.

The phrase "limit unreasonably" is the key in determining whether or not the provisions of the Act have been violated. For instance, is offering a first round draft choice $5 million a year to play hockey for a club, and refusing to trade him, an unreasonable limit on his opportunity to participate or negotiate with the team of his choice? In any event, the court will not even get to address this question unless it is first convinced that a conspiracy, combination, agreement or arrangement was made. Does the Director think that the NHL draft by itself is the conspiracy, combination, agreement or arrangement? And if he does, does this mean that all 21 team owners, directors, presidents, general managers and so on are potentially guilty of an indictable offence and subject to up to five years in prison because they participated in the draft? And if the draft is ruled illegal, then how will the NHL maintain a reasonable balance among the teams?

When contacted about the investigation, the Bureau gave the "we can neither confirm nor deny that an investigation is taking place" response. The C.C.P.R. has learned that several player agents have already been interviewed by the Bureau and will endeavour to report on developments in future issues.

K.C.

RUSSIAN DELEGATION VISITS COMPETITION BUREAU

The Bureau of Competition Policy recently hosted a delegation of Russian officials who came to learn about Canadian competition law and policy. The program was the result of an agreement between External Affairs and the University of Ottawa developed through the Bureau's involvement with the OECD. The program was six weeks long and began the first week with a visit from Mr. Yuri Burlinov, Vice-chair of the Russian State Committee on Anti-monopoly and Promotion of New Economic Structures. Mr. Burlinov is also the Head of the Anti-monopoly Office. Other delegation members included Mr. Nikolai V. Moiseenko, Head of the External Relations Department, Moscow City Division; Mr. Andrey V. Petrov, First Deputy Chairman, St. Petersburg City Division; and Mr. Oleg I. Novikov, Chairman of the Moscow Territorial Administration. Mr. Burlinov stayed the first week, meeting with Bureau officials as well as other government departments. The other members of the delegation participated in a training and development internship program which lasted the six weeks.

The majority of the first two weeks were spent at the University of Ottawa where the Russians were introduced to the Canadian institutional environment, micro and macro policy making, the Canadian legal system, micro-economics and competition policy and regulation. The next three weeks were spent in working groups headed by representatives from all Bureau Branches. The delegation studied the merger, abuse of dominance, and conspiracy provisions of the *Competition Act*, as well as delineating the relevant market and identifying business practices and strategies which may lessen competition. They also spent some time studying the Director's compliance guidelines. Time was also spent understanding the linkages between competition policy and other areas of government policy.

According to Anne Thomson of the Bureau,

> "two of the main benefits arising from the visit were: firstly, the application of a Russian competition law in a manner similar to Canadian and international standards will benefit Canada by creating a more "harmonized"

international system. And secondly, with the Bureau receiving international requests from countries like Brazil, Mexico, Jamaica and Malaysia for guidance with competition and other framework laws, this visit taught us some lessons on how to go about explaining to other competition authorities how we do our work."

K.C.