CANADIAN COMPETITION LAW AND POLICY DEVELOPMENTS

The articles in this section were written by Debbie A. Campbell, Karen B. Groulx, Paul K. Lepsoe, David P. Little, and Michel Wylie, all of Fraser & Beatty.

ONWARDS AND UPWARDS - TRIBUNAL RECONSIDERS AIRLINES CASE

On November 24, 1993 (reasons released on December 1, 1993), the Competition Tribunal ordered that the consent order of July 7, 1989 be varied to require dissolution of the merger of the computer reservation system businesses of Air Canada and PWA and Canadian. The release of Canadian from its obligations under the Gemini hosting contract[1] will permit Canadian to pursue its proposed merger with American Airlines. This order was the result of the reconsideration on remedy heard by the Competition Tribunal composed of Mr. Justice Strayer, Dr. Roseman, and Mr. Smith, from November 15 to 20, 1993.

Background

(a) Competition Tribunal Decision

The Competition Tribunal originally found in its order dated April 22, 1993, that it did not have jurisdiction pursuant to subsection 106(1) of the *Competition Act* to vary the consent order of July 7, 1989. However, the Competition Tribunal held that if it was wrong on the issue of jurisdiction, it would have granted the Director's remedial request that the hosting contract be amended to permit Canadian to terminate its contractual obligations.

(b) Federal Court of Appeal

The decision of the Competition Tribunal was overturned by the Federal Court of Appeal by order of Justices Heald, Hugessen and MacGuigan dated July 30, 1993. Leave to appeal to the Supreme Court of Canada from the decision of the Federal Court of Appeal was denied, without reasons, on October 14, 1993.

The Federal Court of Appeal found that the Competition Tribunal had erred in its interpretation of paragraph 106(1)(a) on the facts before it.[2] In this respect, the Federal Court of Appeal concluded that there had been a change in the circumstances that led to the making of the consent order. The majority of the Federal Court of Appeal (Heald and Hugessen, JJ.A.) found that the Tribunal's powers on an application to vary a consent order are limited to the powers it had under section 92 on the original application. In the view of the majority, pursuant to section 106, the Tribunal can only order divestiture or dissolution of the merger if the parties do not agree to the variation of the consent order. MacGuigan, J.A. held that the remedy proposed by the Tribunal in its April 22, 1993 order was appropriate.

Accordingly, the Federal Court of Appeal sent the matter back to the Tribunal for reconsideration of the remedy on the basis that the condition

precedent to the exercise of the Tribunal's power to rescind or vary had been met, but that the power to vary may only be exercised in accordance with the provisions of section 92.

(c) Pre-Hearing Conference Order

A pre-hearing conference was held on September 28, 1993 to schedule the timing of the hearings, to identify the issues and to establish the scope of evidence that could be tendered at the reconsideration hearing. Mr. Justice Strayer released a decision on September 29, 1993 (reasons on October 12, 1993) which set out the issues for determination at the hearing:

> (a) whether the merger of June 1987 as modified by the Consent Order of July 7, 1989 now prevents or lessens, or is likely to prevent or lessen, competition substantially in the airlines industry in Canada; and
>
> (b) whether the remedy should be the dissolution of the Gemini merger by dissolution of the Gemini Group Limited Partnership (the Gemini Partnership) or the disposal of PWA's interest in the Gemini Partnership, and on what terms.

With respect to the scope of evidence to be heard by the Tribunal, Mr. Justice Strayer ordered that only new evidence as to the relative merits of the remedies or new evidence as to the terms of the remedies would be allowed.

(d) Appeal of Pre-Hearing Conference Order to Federal Court of Appeal

Air Canada appealled the September 29, 1993 Order of Strayer, J. on the basis that he erred in failing to order that new pleadings and examinations for discovery be allowed, and in declining to permit new evidence regarding Air Canada's offer to purchase Canadian's international routes to be heard. The Federal Court of Appeal heard and denied the appeal on November 9, 1993, holding that Mr. Justice Strayer had correctly construed the reach of the reconsideration hearing, and had committed no reversible error in excluding any new evidence on matters which had already been fully canvassed in the original hearing.

Reconsideration Hearing by the Competition Tribunal

The reconsideration hearing commenced on November 5, 1993 on the two issues established at the September 28 pre-hearing conference. The Competition Tribunal found that the hosting contract was an integral part of the merger of the computer reservation systems, and was therefore relevant to the issue of whether the merger is now likely to lessen competition in the airline industry. The Tribunal then concluded that the hosting contract is likely to lessen competition substantially in the airline industry since Canadian's failure due to the terms of the hosting contract would substantially increase Air Canada's market power.

In considering the four possible remedies proposed by the Director, the Tribunal stated that its primary concern was the protection of the public interest in competition, not private contractual arrangements, nor harm to the parties to the merger. All of the remedies proposed by the Director had the objective of transferring Canadian's data base used in hosting from Gemini to Sabre, and removing or extinguishing Canadian's obligations to the Gemini Partnership.

The Director proposed the following alternatives:

(1) PWA transfers its interest in the Gemini Partnership to Air Canada and Covia, Canadian's hosting obligations are extinguished, and the Gemini Partnership continues to exist without the participation of PWA and Canadian;

(2) the Gemini Partnership is dissolved at the end of 1995, and Canadian's obligations under the hosting contract are extinguished in November 1994 after the transfer of Canadian's database out of Gemini. Air Canada and Covia wind-up the partnership without PWA;

(3) the Gemini Partnership is dissolved and Canadian's database is transferred by the end of 1994, Air Canada and Covia wind-up the partnership without PWA; or

(4) PWA disposes of its shares and interest in the Gemini Partnership, the Gemini Partnership is required to dispose of the assets associated with Canadian's hosting as directed by Canadian, and the Gemini Partnership continues to exist.

The Director recommended that the Tribunal adopt remedy number (4), so that the Gemini Partnership would remain in existence. PWA and Canadian also favoured the preservation of the Gemini Partnership. Air Canada and Covia opposed the granting of any remedy, but submitted that they preferred the dissolution and wind-up of the Gemini Partnership.

Although dissolution is the most instrusive remedy, the Tribunal was influenced by the parties' submissions that none of the partners to the Gemini Partnership had an interest in its continued existence. In the end result, the Tribunal chose a variation of remedy (2), and ordered that the Gemini Partnership be dissolved as of November 5, 1994 or such other date between November 1, 1994 and November 15, 1994. On the dissolution date:

(a) the Gemini Partnership shall be dissolved and wound up in accordance with the terms of the Partnership Agreement;

(b) the Canadian data base and other assets necessary to transfer hosting of Canadian to Sabre shall be transferred to Canadian; and

(c) Canadian and the Gemini Partnership shall be divested of all rights which would otherwise arise under the hosting contract with respect to the hosting of Canadian.

It is a further term of the Order that the other partners, Covia and Air Canada, co-operate to ensure the orderly transfer of assets to Canadian.

The Tribunal rejected the submission by Air Canada that PWA and Canadian be required to fully compensate the remaining partners for the costs of de-hosting Canadian. The Tribunal ordered that PWA and Canadian be responsible for paying all direct costs in connection with the transfer of assets to Canadian incurred by the Gemini Group Automated Distribution Systems, Inc., Air Canada and Covia. Further, the costs of winding up the Gemini Partnership are to be borne by the partners equally, in accordance with the terms of the Partnership Agreement.

The Tribunal also recognized Covia's submission that it provides a viable alternative to the Gemini Partnership to compete with Sabre in the computer reservation systems market. Accordingly, the

Tribunal ordered that Air Canada, Covia or the Gemini Group Automated Systems, Inc. be permitted to commence or continue to carry on the business of the Gemini Partnership through a new business either before or after the dissolution date. The effect of this aspect of the order is that Covia is entitled to immediately begin operating as a competitor to Sabre, outside the parameters of the Gemini Partnership.

The December 1, 1993 reasons of the Tribunal provided that the effective date of the order was December 14, 1993. The Tribunal provided the parties with an opportunity to reach a negotiated alternate form of order by December 8, 1993. Those deadlines were then extended by order dated December 8, 1993 such that the effective date of the order is December 24, 1993 and the parties have until December 20, 1993 to file any alternate order. Intervenors would then have the opportunity to respond by December 22, 1993 with any alternate order released on December 23, 1993.

As of mid-December 1993, Air Canada had announced its intention to appeal the November 24, 1993 order of the Tribunal to the Federal Court of Appeal.

Civil Proceedings

The various civil actions in which Air Canada and Gemini Group Automated Systems, Inc. sought damages exceeding $1.5 million for breach of fiduciary duty and breach of contract against PWA, Canadian and American have been settled for an undisclosed amount. The trials in these action were to begin on Monday, December 13, 1993, but were settled on December 7, 1993.

D.A.C.

Notes

[1] The Gemini Partnership entered into a hosting contract dated June 30, 1989 whereby Gemini agreed to host Air Canada and Canadian and their respective affiliates. The Gemini hosting contract was terminable upon the written consent of each limited partner, upon the termination of the partnership, or otherwise on December 31, 2067. For a further description of "hosting", see Debbie A. Campbell and Randy T. Hughes, "Canadian Airline Mêlee reaches Competition Tribunal" (1993) 14:1 Can. Comp. Rec. 1.

[2] The Federal Court of Appeal found that the Tribunal had erred in finding that only a change in circumstance that directly and demonstrably caused the order to be issued was relevant under s. 106(1)(a). It held that all that is required is the establishment of a simple causal relationship between the changed circumstances and the order. Accordingly, the Federal Court of Appeal found that the existence of a strong duopoly in the airline business was an important feature of the landscape in which the previous order had been made, and that the drastic change in the financial position of Canadian and its imminent failure were changes in the circumstances that led to the making of the consent order. Given the circumstances that existed at the time the Director brought the application, the Federal Court of Appeal concluded that the consent order would not have been made. See Crystal L. Witterick and Paul S. Crampton, "Gemini II: The Saga Continues" (1993) 14:3 Can. Comp. Rec. 77 at 78-79.

COMCELL CLAIM AGAINST ROGERS: UPDATE

Four independent cellular radio telephone dealers have joined a suit commenced by a Toronto dealer, Comcell Enterprises Inc. (Comcell), against Rogers Cantel Inc. (Cantel) claiming the national cellular carrier is engaged in anti-competitive practices, saying it unfairly prices cellular phones below wholesale cost trying to drive the small dealers out of business.[1] The four other plaintiffs are: Advanced Cellular Systems and MSR Communications Inc., both of Toronto; 164506 Canada Inc. of Hull, Quebec; and Raycell Communications Ltd. of Ottawa.

Comcell and the four independent dealers have alleged that Cantel's own stores have undercut their prices for cellular telephones and excluded them from special promotions. All five independent dealers have claimed that Cantel has breached its agreements with the small affiliates by not offering them the same terms. They are all Cantel super-agents, which means they earn higher commissions by signing up at least 25 new Cantel subscribers a month.[2]

Comcell, in its statement of claim, states that Cantel did not own any retail outlets when Comcell signed up to distribute Cantel's services and alleges that it must now compete with Cantel in the retail sale of cellular equipment. Comcell's claim further alleges that Cantel now controls the availability and cost of the equipment which Comcell must sell to carry on its business. In its statement of defence filed in response to Comcell's claim, Cantel admitted that it is selling phones through its retail outlets at less than cost. However, it denied the charge that its pricing strategy is aimed at putting the independent dealers out of business and alleges that Cantel's prices and service fees are mandated by the fierce competition received from the telephone companies and from other suppliers of cellular telephone equipment. "It makes no sense for Cantel to seek to drive its agents out of business", said Cantel in its statement of defence.

A case management judge of the Ontario Court, General Division recently combined all five actions so they can be tried together. Examinations for discovery are continuing and the trial is not expected to take place until sometime next year. Comcell has filed a jury notice and Cantel has responded with a motion to strike the jury notice on the grounds that Comcell is seeking equitable relief in its claim against Cantel. The motion is to be heard sometime this month. A confidentiality order was made in May sealing the court file thereby making it more difficult to ascertain the progress of the case.

It is interesting to note that a similar case was tried by a jury in the United States. The unreported decision in *Cellular Phone Stores* v. *Bell Atlantic Mobile* involved a cellular telephone dealer who had negotiated a contract with Bell Atlantic Mobile. The contract provided Cellular Phone Stores with a "most favoured nation clause" which provided them with the best commission package for activation and equipment comparable to other direct and independent agents. Unknown to Cellular Phone Stores, Sears had negotiated a deal with Bell Atlantic Mobile which provided them with a better commission package. Bell Atlantic Mobile, in breach of its contract with Cellular Phone Stores, refused to provide Cellular Phone Stores with the same deal. The independent dealer was successful and was awarded damages for breach of contract in the amount of US$11 million. This decision, however, dealt with breach of contract as opposed to competition law issues which, according to Mr. Sheldon Jacobs, counsel for Cellular Phone Stores, would only have clouded the issues.

K.B.G.

Notes

[1] For further details regarding the issuance of the statement of claim by Comcell, see S.J. Simpson, "Comcell Commences Competition Act claim against Rogers" (1993) 14:2 Can. Comp. Rec. 7.

[2] "5 Independent Dealers Sue Cantel; Rogers Network Undercuts Cellular Telephone Process They Say" *The Toronto Star* (1 September 1993) .

COMPETITION ACT SECTIONS HELD CONSTITUTIONAL

In its recent decision in *R.* v. *Royal Lepage Real Estate Services Ltd.*,[1] the Alberta Court of Queen's Bench considered the constitutionality of sections 61(1)(a) and 61(1)(b) of the *Competition Act* (the Act).

The facts of the case involved several real estate brokers who were charged with attempting to influence upward, or discourage the reduction of prices for real estate services, in contravention of section 61(1)(a), and with unlawfully discriminating against other real estate brokers or refusing to supply services to them because of their low pricing policy, in contravention of section 61(1)(b).

In response to the charges, the applicants, by motion, sought declarations that both sections of the Act infringed their rights of freedom of expression contrary to section 2(b) of the *Charter* and, further, infringed upon their rights of liberty and security of the person due to vagueness, in breach of the principles of fundamental justice protected by section 7 of the *Charter*. In addition, the applicants contended that the infringement of their rights under sections 2(b) and 7 of the *Charter* could not be saved under section 1 on the grounds that they did not constitute reasonable limits prescribed by law demonstrably justified in a free and democratic society.

Sections 61(1)(a) and 61(1)(b) of the *Competition Act* provide as follows:

> 61(1) No person who is engaged in the business of producing or supplying a product, or who extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards, or who has the exclusive rights and privileges conferred by a patent, trade mark, copyright or registered industrial design shall, directly or indirectly,
>
> (a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada; or
>
> (b) refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

Section 61(9) of the Act provides that the penalty for contravening section 61 is a fine in the discretion of the court or imprisonment not exceeding five years, or both.

In passing judgment on the applicants' argument regarding the vagueness of section 61(1)(a), Mason J. stated that the conduct proscribed in the provision was comprised of private actions influencing upwards or discouraging the reduction of prices by agreement, threat or promise, or any like means. In keeping with the object of section 61, which is to establish competitive control of prices as opposed to private price control and price maintenance, flexibility is required when interpreting the section. In other words, the area of risk covered by the section is not overly generalized by the use of the words "any like means" since this phrase introduces flexibility rather than vagueness and can be interpreted in the context of the specific types of actions proscribed by the section.

According to the court, the same analysis was applicable in the case of section 61(1)(b). In particular, its proscription of acts of discrimination against any person having a low pricing policy was

found to provide a risk zone capable of judicial interpretation.

Therefore, despite the fact that both sections 61(1)(a) and 61(1)(b) have flexible boundaries, it was possible to distinguish between permissible and impermissible conduct. Thus, there was sufficient limit on enforcement discretion and neither provision offended either branch of the vagueness test adopted by the Supreme Court of Canada in *R.* v. *Nova Scotia Pharmaceutical Society*[2], being the proper identification of the area of risk and the proper delineation of prosecutorial discretion.

In terms of the argument that the impugned sections of the Act violated section 2(b) of the *Charter*, Mason J. acknowledged that both provisions constituted infringements on freedom of expression since section 61(1)(a) restricts persons from making oral or written agreements and from making promises or threats to influence price maintenance, while a refusal to supply under section 61(1)(b) could be expressive in nature. However, the court also noted that the prohibition of price maintenance is a legitimate objective in today's society and was clearly of sufficient importance to override a constitutionally protected right or freedom. Therefore, since the provisions are also rationally connected to such an objective and are appropriately tailored to achieve the desired prohibition on price maintenance such that the effect is proportionate to the purpose of the legislation, they were saved by section 1 of the *Charter* as reasonable limits prescribed by law that can be demonstrably justified in a free and democratic society.

In other words, since the provisions are directed at preserving a free market economy and providing protection to members of the general public who are vulnerable to the effects of price maintenance schemes devised by persons who wield more economic clout, the limit on freedom of expression in the business community under the impugned provisions justified the end result — public protection from price maintenance.

The conclusion of the court in the *Royal Lepage* case reflects the overall acceptance by Canadian courts of the importance of the *Competition Act* in regulating business in Canada. As Gonthier J. remarked in *R.* v. *Nova Scotia Pharmaceutical Society*, the legislative objectives of the Act are "a central and established feature of Canadian economic policy" and the purpose of the Act is to prohibit actions which have the object of unlawfully lessening competition, considered an injury to the public.[3] The logical conclusion of these principles is that the prevention of injury to the public constitutes a reasonable limit on the fundamental rights and freedoms enshrined in the *Charter* provided that the results are rationally connected and proportionate to the competition objective concerned.

D.P.L.

Notes

1 (1993), 105 D.L.R. (4th) 556.
2 [1992] 2 S.C.R. 606.
3 *Ibid.* at 648-49.

QUEBEC PHARMACIES INQUIRY PROCEEDS

L'Association québécoise des pharmaciens propriétaires as well as certain pharmacy chains and individual wholesalers of prescription drugs in Quebec have been charged with conspiracy to lessen

competition under s. 45 of the *Competition Act*.[1] A preliminary inquiry initially set for September 27, 1993 was adjourned at the request of the accused to December 16, 1993.

The charge pertains to oral contraceptive pills and prescription narcotics. The Crown alleges that between December 1, 1987 and September 30, 1989, the accused together illegally combined, agreed, or arranged to limit competition unduly in the sale and supply of said drugs in the province of Quebec. If convicted, the accused could face imprisonment for a maximum term of five years or a fine not exceeding $10 million or both.

M.W.

Notes

1 See M. Goldbloom, "Quebec Pharmacists Inquiry" (1993) 14:2 Can. Comp. Rec. 8.

BUREAU OF COMPETITION POLICY STAYS AT INDUSTRY IN CHRÉTIEN GOVERNMENT

The incoming Prime Minister, Jean Chrétien, has left former Prime Minister Kim Campbell's government re-organization largely intact. This means that the abolition of the Department of Consumer and Corporate Affairs has been adopted by the new Liberal government, with the department's constituents parts being absorbed into several larger departments.[1]

In particular, the office of Director of Investigation of Research under the *Competition Act* and the Bureau of Competition Policy are now housed in the Department of Industry, or Industry Canada. The new Industry minister is John Manley, an Ottawa-area MP.

Mr. Manley's department has had several names this year alone. Prior to the changes introduced by the Campbell government in June 1993, its name was Industry, Science and Technology. She changed the name to Industry and Science, despite the fact that, with the addition of the telecommunications policy and development functions from the old Department of Communications, the technology role of the department was actually larger. Now, as noted, the name is simply Industry.

Although legislation will be required to effect the name change for certain formal legal purposes, re-organization Orders in Council in force provide that Mr. Manley is the responsible Minister for officials of the Bureau.

So far, Bureau staff remain physically located in the same offices in Hull. Additionally, as of early December, the acting Director, George Addy, had still not been confirmed in his position by the new government. Mr. Addy has been acting Director since Howard Wetston was appointed to the Bench in June.[2]

P.K.L.

Notes

1 See P.K. Lepsoe, "Bureau of Competiton Policy moves to Industry Dept. in Government Re-organization" (1993) 14:3 Can. Comp. Rec. 6.

2 See J.F. Blakney, "Wetston leaves Bureau: Addy becomes acting Director" (1993) 14:3 Can. Comp. Rec. 1.

CBA COMPETITION LAW SECTION NEWS

A successful conference on competition law developments was held by the Competition Law Section of the Canadian Bar Association at Vancouver on October 1, 1993.

A number of excellent papers were presented to the conference. (Revised versions of two of them are contained in the Feature Articles section of this issue of the *Record*.) All of the papers are listed below. A bound collection of them is available for $140 + GST ($9.80) (includes shipping and handling) at the following CBA office:

The Canadian Bar Association, Suite 902, 50 O'Connor Street, Ottawa, Ontario K1P 6L2
Phone: (613) 237-2925 Fax: (613) 237-0185

Papers Presented

John Barker, "The Merger Review Process Under the *Competition Act*"
Peter Franklyn, "Ensuring Compliance Under the *Competition Act*"
Calvin S. Goldman and Paul S. Crampton, "Current Priorities of the Bureau, its Case Selection Criteria, its Immunity Program, Merger Resolution and Individual Liability"
Warren Grover, "Merger Review Process"
Randal T. Hughes and Shona L. Bradley, "Conflict of Interest Issues in Criminal Investigations under the *Competition Act*"
Lawson A.W. Hunter, "Right to Choice of Counsel When Dealing with the Bureau of Competition Policy"
Arthur B. James, "Refusal to Deal and Tied Selling: Emerging Issues in Canadian Competition Law in the After-markets for Durable Products"
Donna Soble Kaufman, "Designing & Implementing An Effective Competition Law Compliance Program"
Glenn Leslie and Stephen Bodley, "The Record of Private Actions Under Section 36 of the *Competition Act*"
Robert J. Patton, "Implementing A Compliance Program"
François Rioux, "The Issue of Corporate & Witness Immunity Before & After the Bureau Comes Knocking at Your Door"
John F. Rook, "Who Do Grants of Immunity Best Serve and Are These People Meant to Benefit Under the *Competition Act*?"
Margaret Sanderson, "It is Better to Know Some of the Questions Than all of the Answers"
Jo'Anne Strekaf, "Various Issues Relating to Private Enforcement"
Kent E. Thomson,"The Constitutional Validity of the Investigative Provisions of the *Competition Act*: The Implications of *Thomson Newspapers*"
Judy Whalley and Scott Scheele, "Developments in U.S. Anti-Trust Law & Enforcement"
Stanley Wong, "Some Thoughts on Doing Business with Buying Groups and Warehouse Clubs"
Barry Zalmanowitz, "Strategy and Issues Relating to a Section 36 Action & Common Law Actions Where a Breach of the *Competition Act* is Relied Upon for the Unlawful Element"

STATEMENTS ISSUED BY THE BUREAU OF COMPETITION POLICY

SUMITOMO FINED $1.25 MILLION FOR FOREIGN-DIRECTED CONSPIRACY

Following the recent $1.25 million fine levied against Sumitomo Canada Limited, the Bureau of Competition Policy issued the following news release. It is reprinted with permission.

OTTAWA, November 19, 1993 — George N. Addy, Acting Director of Investigation and Research for the Bureau of Competition Policy announced that Sumitomo Canada Limited was fined $1.25 million in Federal Court today.

Sumitomo had pleaded guilty to implementing a foreign-directed conspiracy in violation of Canada's *Competition Act*. The conspiracy involved a clandestine agreement to divide market share for chemical insecticide in Canada.

On June 11, 1993, the other company involved, Chemagro Limited, pleaded guilty to the same offence and was fined $1.25 million.[1]

The arrangement was between Sumitomo Chemical Co. Ltd. of Osaka, Japan, and Bayer AG of Leverkusen, Germany, Chemagro's parent company, to share the chemical insecticide market in Canada from 1987 to 1988. The insecticide was used by provincial forest agencies and private companies in Newfoundland and New Brunswick to control the spread of forest insects including the spruce budworm and gypsy moth.

"In this era of international markets, corporations operating from outside the country engaging in anti-competitive behaviour that affects the Canadian market should not feel that they are beyond the reach of Canadian competition law," commented Addy. "The imposition of significant fines delivers a strong message to such companies that they can expect severe penalties for engaging in such illegal activities."

The Bureau's investigation into the insecticide industry was prompted by Abbott Laboratories' voluntary disclosure of its involvement in a conspiracy with Chemagro to divide the market for biological insecticide in 1990. Abbott was granted immunity from prosecution and consented to a prohibition order issued by

the Federal Court of Canada on November 3, 1992.[2] Chemagro was fined $750,000 for its role in this conspiracy. The information provided by Abbott also led to the detection of the Bayer AG and Sumitomo Chemical Co. Ltd. conspiracy. A total of $3.25 million in fines were handed down by the courts in the two cases. In addition, Abbott paid $2.122 million in restitution to the Ontario and Quebec governments.

Notes

1 See D. Gilkes, "Chemagro Fined under s. 46 of *Competition Act*" (1993) 14:3 Can. Comp. Rec. 3.
2 See K. Clease, "Abbot Laboratories Gets Immunity" (1992) 13:4 Can. Comp. Rec. 5.

CANADA POST PURCHASES PUROLATOR

Recently, we reported on the status of Canada Post Corporation's purchase of 75% of Purolator Courier Ltd.[1] In September 1993, the Bureau of Competition Policy was reviewing the proposed transaction and the decision of the National Transportation Agency (NTA) following its related hearings in early September had not yet been released.

On September 28, 1993, the NTA issued its decision stating that the proposed acquisition was not against the public interest. In this respect, the NTA concluded that the proposed acquisition was not inconsistent with the national transportation policy and that, if the proposed acquisition were implemented: (i) competition in the small parcel express business would not be jeopardized, (ii) the range of courier service options would not be restricted and (iii) services to the regions across Canada would not be materially affected.

Federal Express Canada Ltd., United Parcel Service Canada Ltd. and D.H.L. International Express Inc. subsequently sought leave to appeal from, and judicial review of, the NTA's decision. On November 24, 1993, the Federal Court of Appeal dismissed the leave application and allowed the motion by Canada Post, PCL Courier Holdings Inc., Purolator Courier Ltd. and Onex Corporation (the holder of 75% of the common shares of PCL Courier Holdings Inc.) to quash the judicial review application.

On November 26, 1993, the Bureau of Competition Policy announced that it would not oppose the transaction, which was subsequently completed on that date. The Bureau has issued an informative Backgrounder explaining its reasoning, which is reproduced below with permission.

Staff

Notes

1 See J.S. Trent, "Canada Post Purchases Purolator" (1993) 14:3 Can. Comp. Rec. 4.

BACKGROUNDER
CANADA POST CORPORATION/PUROLATOR COURIER INC.

Introduction

On November 26, 1993, the Acting Director of Investigation and Research of the Bureau of Competition Policy ("Director"), George N. Addy, announced that he would not oppose the proposed acquisition of control of Purolator Courier Inc. ("Purolator") by Canada Post Corporation ("Canada Post").

The transaction was the subject of a detailed, six-month examination by the Bureau to determine its likely impact on competition. During the examination, the Director contacted, interviewed and received information from a variety of sources, including the parties, customers, competitors, and other industry participants. The Director also considered a substantial number of documents and submissions received from the parties and others. In addition, the Director also received a considerable amount of correspondence from competitors, customers and suppliers objecting to the proposed acquisition.

Two major concerns were identified in the representations received by the Director: first, the appropriateness of allowing a Crown corporation which is already operating in the private sector to acquire a competing company in order to strengthen its position in that market in competition with the private sector; and second, the potential for Canada Post to cross-subsidize its courier operations with funds from its exclusive privilege in letter mail. Only the latter was considered potentially relevant to a *Competition Act* ("Act") analysis of whether the merger is likely to substantially lessen or prevent competition. Whether Crown corporations should compete with firms in the private sector is not within the purview of the Act, the purpose of which is to maintain and encourage competition in Canada.

The issue of cross-subsidization was examined in detail and included an analysis within the framework of the predatory pricing provisions of the Act.

As a result of his examination, the Director has concluded that the acquisition is not likely to substantially lessen or prevent competition within the relevant courier market. In addition, the Director was satisfied that Canada Post has not engaged in the practice of cross-subsidization and that grounds do not exist to believe that such behavior is likely to occur in the future.

The Transaction

On June 4, 1993, Canada Post announced that it intended to acquire 75% of the shares of PCL Courier Holdings Inc. either directly or through a newly incorporated wholly-owned subsidiary. The minority

shareholders of Purolator following Canada Post's acquisition will be Onex Corporation ("Onex"), the Ontario Municipal Employees Retirement Fund and Purolator management. The Shareholders Agreement provides that the minority shareholders may require Canada Post to purchase their shares after December 31, 1996.

After the completion of the transaction, the Shareholders Agreement provides that Purolator and Canada Post will continue to carry on business as separate corporations, each with its own board of directors.

Canada Post was created in 1981 through the *Canada Post Corporation Act*. Under section 14 of this Act, Canada Post possesses the exclusive privilege with respect to letter mail in Canada. In addition to the delivery of letters, Canada Post operates a courier business under the name Priority Courier, and also delivers parcels. Purolator is the largest courier company in Canada and is a subsidiary of PCL Courier Holdings Inc., which in turn is effectively controlled by Onex.

In their press release of June 4, 1993, the parties indicated that one motivation for the merger was to allow both companies to take advantage of each other's innovative and technical expertise as well as to provide a basis for further technology-based advancements. As well, Canada Post cited the decline in letter mail activity as another reason for expanding its presence in the courier industry.

The Examination Process

In assessing the competitive impact of mergers, the Director follows the analytical framework set out in the April 1991, Merger Enforcement Guidelines. Competition is likely to be substantially prevented or lessened whenever a merger creates market power. Generally, the exercise of this market power takes the form of a significant, non-transitory price increase in a substantial part of a relevant market. There are also non-price examples of this exercise of market power including reductions in service, quality and variety.

As set out in the Act, a wide range of factors are considered in making this determination, including: market share and industry concentration; foreign competition; the likelihood that one of the firms involved in the merger will fail or exit the market; the availability of acceptable substitutes; the effectiveness of remaining competition; whether the merger removes a vigorous and effective competitor; the extent to which change and innovation in the market will be affected; and any other relevant factor. In addition to the above, the Act also provides for an exception to otherwise unlawful mergers where the merger is likely to bring about gains in efficiency that will be greater than, and will offset the effects of, any prevention or lessening of competition. In the case of Canada Post's proposed acquisition of Purolator, the Director focused his examination on the key issues of market share and concentration, barriers to entry, the effectiveness of remaining competition, and issues surrounding cross-subsidization.

Relevant Markets and Market Share

The Director determined that the relevant product market in which both Canada Post and Purolator operate is the Small Parcel Express (SPX) market. This product market is defined by service characteristics which distinguish it from other package delivery or transportation services. For instance, door-to-door pickup, track and trace capability, time-certain delivery, and signature proof of delivery are important features of the SPX market. In choosing between competing suppliers of the relevant product, customers consider these service characteristics as well as the price of the product when making their purchase decisions. The Director determined that the relevant geographic market in which the parties compete is comprised of a series of origin-destination points within and originating from Canada.

While there are currently well over 2,000 SPX companies operating in Canada, the bulk of these companies are small, local operators which do not offer sufficient service levels to be included in the relevant market. They do not, for example have easy access to an integrated national network. Following the merger Canada Post and Purolator will account for approximately 40% of the revenue generated in the SPX market in Canada, and the four largest firms in the SPX market will account for approximately 70% of all SPX revenues.

Barriers-to-Entry

In his examination of the nature and extent of barriers to entry and expansion, the Director determined that there are a number of levels at which a firm might enter the SPX market. For instance, the investment required to enter the SPX business on a regional basis is modest, and generally recoverable on exit from the market. In contrast, *de-novo* entry as a full-service, national courier requires incurring substantial costs, such as the establishment of a track and trace system, a substantial delivery network, and a brand reputation. While the *de-novo* entry costs may be substantial, recent evidence suggests that they do not constitute a critical impediment to entry. As well, numerous less-than-truckload trucking companies (LTL) offer services that are near to the services offered by the firms in the SPX market. The Director therefore concluded that these companies, where they were not currently offering SPX services, were potential competitors in the event of a significant price increase in the market. In particular, Roadway Package Systems Ltd. and Sameday Right-O-Way, a division of Day & Ross Ltd., are two examples of trucking companies which have recently expanded into the SPX market in Canada. The examination also indicated that the barriers facing an existing regional courier company wishing to expand to serve a larger geographic market or to provide a broader range of services, are moderate.

Furthermore, deregulation of the transportation sector has eased entry requirements. In particular, it is no longer difficult to obtain trucking licenses to operate on an intra and inter provincial basis. The licensing obstacles which companies such as United Parcel Services (Canada) Ltd. ("UPS") faced when they entered the Canadian market have been substantially reduced.

Current State of Competition

Information received from customers indicates that demand is very sensitive to price and service levels. Customers expressed the view that they would not hesitate to switch suppliers in the event of a price increase or a significant decrease in service. As well, most customers use more than one courier company to meet their needs. Thus, to the extent an individual firm is not able to offer the full range of courier services, customers are quite prepared to deal with several companies. This customer sensitivity to price and service also serves to facilitate entry or expansion in the event that prices are increased or service is reduced. Following the transaction, there will be a large number of competitors remaining in the market, including four major national companies (Federal Express Canada Ltd., UPS, Loomis Courier Service, and Canpar Transport Ltd.) and numerous regional competitors.

In general, industry participants noted that the Canadian SPX market is currently characterized by significant excess capacity and is highly competitive with respect to both price and service levels. In this regard, the Director noted that there is a significant amount of restructuring in this market which has already occurred. For example, UPS, in recently announcing the closure of 29 facilities and discontinuance of direct service to these affected areas, commented that "there are probably more players than packages in Canada."

Based upon the above information, the Director concluded that there are not sufficient grounds to believe that Canada Post would, through this acquisition, gain the ability to exercise market power such that it could impose and sustain a significant non-transitory price increase or a substantial reduction in service quality.

Complaints Received

A large number of complaints were received by the Director concerning the appropriateness of allowing a Crown corporation which is already operating in the private sector to acquire a competing company in order to strengthen its position in the market. As mentioned earlier, this issue is not within the purview of the Act.

More relevant to the Director's mandate were the concerns raised by a number of competitors of Canada Post that Canada Post had engaged in cross-subsidization in the past and would use its acquisition of Purolator to further cross-subsidize its activities in the SPX market with funds derived from its exclusive privilege in letter mail. These competitors indicated that they were not concerned about the competitive effects of the transaction so long as Canada Post did not subsidize Purolator's operations. Specifically, there is a concern that Canada Post will allocate its common costs of providing exclusive privilege letter mail and courier services disproportionately towards its exclusive privilege operations by charging Purolator less than market value for the use of Canada Post assets. Should a misallocation of common costs occur in this

fashion, Canada Post would be inflating its true costs of providing letter service and possibly use this as the basis for seeking an increase in allowable postal rates. The costs of providing its courier services would be reduced below true levels, thereby allowing Canada Post to price its and Purolator's SPX products below long-run incremental cost. It was then argued that the price reduction in the SPX market would reduce the revenue base of the remaining competitors in the market to the point where one or more of them could be forced to exit the industry resulting in a substantial lessening of competition.

Cross-Subsidization Issue

The Director carefully examined whether the proposed transaction would give Canada Post the added incentive to cross-subsidize its courier services with funds derived from its exclusive privilege in letter mail. The proper costing of transactions between Canada Post and Purolator would ensure that no cross-subsidization occurs while allowing for the attainment of economies of scope, which the Act encourages. Cross-subsidization is of concern to the Director when it is used to finance anti-competitive acts which would likely result in a substantial lessening or prevention of competition. If Canada Post were to subsidize Purolator's courier operations through its letter mail operations such that prices would be lowered in the SPX market, competitors may eventually be driven from the market. This possibility would be of competitive concern only if, upon the competitors' exit, the merged entity would be able to raise its courier prices above competitive levels or maintain quality and service below competitive levels, without the threat of entry.

It is important to note that several conditions must exist for cross-subsidization to result in a substantial lessening of competition under the Act.[1] First, Canada Post must be able to increase revenues from its exclusive privilege business to cover any losses in Purolator's courier business that would have occurred if costs were properly allocated. Second, Purolator's prices for its courier services must fall so far below the properly allocated costs of providing these services, as to be uneconomic for competitors to match these prices. Third, a sufficient number of customers must switch their business to Purolator away from existing rivals, so as to force the exit of competing firms. Finally, Purolator must be able to raise prices for its courier services above competitive levels following the exit of its rivals, without fear that new entry or re-entry will force prices back to competitive levels. Alternatively, if prices are not raised, it must be demonstrated that service levels or other non-price forms of competition have declined to a degree that results in a substantial lessening or prevention of competition.

Current Costing Practices of Canada Post

The Director first examined whether Canada Post was, at this time, cross-subsidizing its Priority Courier business. Canada Post provided the Director with a substantial amount of information on its costs, its costing methodology and the procedures and policies that are in place to monitor the allocation of costs among its various product offerings. The accuracy of this information was verified by an independent accounting firm. The Director is satisfied, having considered the costing information provided, that the

Priority Courier business is recovering its attributable costs and is not currently being subsidized by the exclusive letter mail operations of Canada Post.

Assessment of Cross-Subsidization Potential

Since it was also argued that the potential exists for Canada Post to cross-subsidize courier services, notwithstanding a finding that it is not currently engaged in such a practice, the Director assessed whether such activity, if it occurred, would likely result in a substantial lessening of competition under the Act. To do so, it would be necessary to establish that a combined Canada Post/Purolator would be able to price its courier services so low as to drive its competitors from the market. It must also be shown that obstacles that would deter entry or expansion into the SPX market, including the threat of further cross-subsidization, are of sufficient magnitude that such entry or expansion is unlikely to occur following a significant price increase or reduction in service after competitors have exited the market. The vigour of existing competition, the large number of potential entrants, the relatively moderate costs of entering or expanding existing businesses, and the sensitivity of customers to overall price and service levels all satisfy the Director that Canada Post, post-merger, is unlikely to be in a position to force the exit of rival firms, subsequent to which profitable price increases or reduced service levels could be maintained.

Thus, after a thorough examination of this issue, the Director concluded that, at this time, he has no grounds to believe that cross-subsidization would occur post-merger which would likely result in a substantial lessening or prevention of competition in the SPX market in Canada.

Canada Post Commitments to the Director

Canada Post recognizes that in reaching a decision in this matter, the Director has relied upon a number of commitments made by Canada Post. One such commitment is Canada Post's assurance to maintain Purolator as a separate corporation. Purolator will continue to operate as a separate corporation with a separate board of directors until at least December 31, 1996. The Director notes that there is a structural disincentive to subsidizing Purolator given that Onex and the other minority shareholders will continue to own 25% of Purolator, a significant minority interest, which would reduce the benefits to Canada Post of any subsidy to Purolator. Canada Post would effectively retain only seventy five cents of every dollar transferred to Purolator. In addition, Canada Post has agreed that if, after December 31, 1996, it acquires the shares of the minority shareholders, the transaction would constitute an acquisition of significant interest under section 91 of the Act, thus making the transaction subject to further review by the Director. It has also agreed that all transactions between Canada Post and Purolator will be on an arm's length commercial basis. Finally, Canada Post has assured the Director that, should he require information on costing and pricing by Canada Post or Purolator, Canada Post will assist in making the necessary information available.

Conclusions

After a thorough examination of all the issues surrounding this proposed merger the Director concluded that grounds do not exist, at this time, for the seeking of an order from the Competition Tribunal under the merger provisions of the Act. The Act provides for a three-year period, after the substantial completion of a transaction, within which the Director may apply to seek a remedial order should he believe that the transaction has resulted in a substantial lessening of competition. In addition, Director will not hesitate to use other provisions of the Act, should he have reasonable grounds to believe that a violation of any of these provisions of the Act has occurred or is about to occur.

Notes

[1] While cross-subsidization, on its own, may result in a misallocation of economic resources, it will only give rise to concerns under the merger provisions if it is likely to result in a substantial lessening or prevention of competition. It would raise issues under the criminal provisions of the Act if it constituted predatory conduct.