

## CANADIAN COMPETITION RECORD

**COMMENT & ANALYSIS****RAISING RIVALS' COSTS AND ALCOA:  
A REJOINDER**

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I have only a few remaining comments on John Lopatka's reply to my paper on Raising Rivals' Costs ("RRC").<sup>1</sup> First, the differences between our positions are minor: we both agree that RRC is a blanket terminology describing a set of special cases that need careful individual case analysis. Second, we agree that even where a predatory intent can be identified in some RRC practice, it requires further careful analysis to establish that overall efficiency is damaged. An example that I gave in the original paper involved an efficient downstream firm writing an exclusive contract with an upstream supplier to foreclose his downstream rivals. The rivals will be forced to purchase from a higher cost supplier, their market share will fall in equilibrium, and final goods price and the profits of the predator firm will both increase. But there is no presumption that economic welfare has fallen: as in the modern analysis of mergers, it is quite possible for the efficiency gains from shifting production towards the low cost producer to swamp the losses in consumer surplus from the increase in final goods price.

An issue over which I feel that Lopatka states his case too strongly is in arguing that Alcoa, through the signing of exclusionary contracts with suppliers of electric power, could not have affected the price of electric power.<sup>2</sup> In fact, his case is contradictory. He admits that the relevant geographic market for hydroelectric power was a local one, in which case all of his estimated national market shares for Alcoa are quite irrelevant. The question is simply whether supply was perfectly elastic in the relevant market or not, and Lopatka seems to have accepted that it was not. It then follows that RRC analysis is important in determining the incentives of Alcoa to sign exclusionary contracts with power companies.

Lopatka is skeptical that Alcoa, even with ownership of a substantial share of the domestic aluminum grade bauxite deposits, could use that position to competitively disadvantage rivals and potential entrants.<sup>3</sup> This is consistent with his assertion, made in the original *Alcoa* article and repeated in his reply, that only "RRC advocates consider the theoretical support solid"<sup>4</sup> for a monopolist to engage in a strategy of overbuying in order to disadvantage or deter the entry of rival firms. The basic notion of a monopolist engaging in a strategic overinvestment in capacity (which could be a stockpile of bauxite reserves instead of fixed production capacity or could in fact be a sunk investment in any resource required for production) has

## CANADIAN COMPETITION RECORD

been established with great care in dozens of articles over the past two decades, the single best known being that of A. K. Dixit in 1980.<sup>5</sup> The effect of this strategic overinvestment (or overbuying) is to expand output and lower price, compared to the choices the monopolist would have made in the absence of entry threats by rivals. Of course, price may not be lower than if entry had actually occurred. My point here is not really an expository one: rather it is to argue that this result is really the most orthodox of ideas in modern industrial organization and certainly not one of "economic perversity" as claimed by Lopatka. A broader name for this class of results is "pre-emption models": provided that a monopolist would earn more profits from having the market to itself than if profits were shared with a rival - which almost always holds - then it always pays a monopolist to strategically overbuy inputs, or overinvest in capacity.

### Notes

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<sup>1</sup> Professor Ware's original article, "Understanding Raising Rival's Costs: A Canadian Perspective", appeared in (1994) 15:1 Can. Comp. Rec. 9. Professor Lopatka's reply, "Raising Rivals' Costs and *Alcoa*: A Reply to Ware", appeared in (1994) 15:2 Can. Comp. Rec. 45.

<sup>2</sup> John E. Lopatka and Paul E. Godek, "Another Look at *Alcoa*: Raising Rivals' Costs Does Not Improve the View" (1992) 35 J. Law & Econ. 311.

<sup>3</sup> *Ibid.* at 322-23 and Lopatka, *supra*, note 1 at 48-49.

<sup>4</sup> Lopatka, *ibid.* at 47.

<sup>5</sup> "The Role of Investment in Entry Deterrence" (1980) 90 Economic Journal 95.

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## STRATEGIC ALLIANCES UNDER THE *COMPETITION ACT*: A COMMENTARY ON THE DIRECTOR'S DRAFT INFORMATION BULLETIN

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On August 26, 1994, the Director of Investigation and Research (the "Director") under the *Competition Act* (the "Act") released for public commentary his much-anticipated draft Information Bulletin (the "Bulletin") addressing "Strategic Alliances under the *Competition Act*."

### I. OVERVIEW

In light of recent market trends, the release of the Bulletin by the Director will be welcomed by both the business and legal communities. Although definitive statistics regarding strategic alliances are unavailable, it is apparent that an increasing number of firms are participating in, or at least contemplating, some form of inter-firm cooperative arrangement. In the *Preface* to the Bulletin, the Director specifically cites a number of factors contributing to this trend: increasing competitive pressures, the globalization of markets,

## CANADIAN COMPETITION RECORD

and generally decreasing trade barriers. A number of additional factors could have also been listed by the Director, particularly in the context of technological advancements and research and development based ventures (e.g., risk-pooling between firms).

As noted in the Bulletin, operating against the backdrop of these recent market trends is the Act, which contains no single provision that deals exclusively with strategic alliances. The absence of such a provision is, however, justified by the myriad of corporate forms a strategic alliance may take. An attempt to structure a statutory provision specific to strategic alliances would run squarely into an insoluble definitional problem. As a result, the general enforcement principle contained in the Bulletin is that the focus of the Director will be on the "competitive effects of the strategic alliances and not the form they may take." Based on this standard of assessment, the Director explains that it has been the experience of the Bureau of Competition Policy (the "Bureau") that "*most forms of strategic alliances do not raise issues under the Competition Act.*"

The Director is also concerned that there may currently exist a "chilling effect" upon efficiency enhancing strategic alliances, due to uncertainty surrounding the application of the Act. As such, the Bulletin is predominantly intended to provide general guidance on how the Act will apply to the relatively few strategic alliances which may have anti-competitive effects.

In conducting its analysis, the Bureau will focus on whether the proposed alliance will be likely to "create or enhance market power." As noted in the Bulletin, market power has been interpreted as the ability of parties to behave "relatively independently of the market." The Director confirms in the Bulletin that the experience of the Bureau has been that horizontal alliances involving competitors will more often raise issues of market power as opposed to either vertical or conglomerate alliances.

The substantive portion of the Bulletin commences with a brief description of the general characteristics of inter-firm cooperative arrangements which have been characterized as strategic alliances. The balance of the Bulletin addresses the application of the Act to such arrangements and the key elements of the Bureau's compliance program.

### II. COMMON CHARACTERISTICS OF STRATEGIC ALLIANCES

Prior to addressing specific applications of the Act, the Bulletin provides an overview of certain linking characteristics found in the myriad of inter-firm cooperative arrangements. Specifically, the Director cites the following as the key features of many strategic alliances:

1. *The relevant independence of the parties:* i.e., although there is a clear understanding between alliance partners to work in a cooperative manner, the independence of each is generally retained.
2. *A set (albeit longer-term) time frame:* i.e., there is generally a finite duration contemplated for the alliance in terms of either time or objective.

## CANADIAN COMPETITION RECORD

3. *Limited scope of the arrangement and greater flexibility of the parties compared to takeovers or acquisitions:* i.e., the degree of integration between alliance partners is far less pronounced than that present in the context of takeovers or acquisitions.
4. *Reciprocity in terms of the sharing of information and key assets:* i.e., this is likely the key factor motivating the formation of an alliance.

The Director, however, is unequivocal in stating that, despite the particular form of an alliance, the focus of the Bureau will be on whether market power is likely to be created or enhanced, as a result of its formation, at either the selling or buying level.

### III. APPLICATION OF THE *COMPETITION ACT*

In terms of meeting the objective of clarifying the enforcement policy of the Director in connection with strategic alliances, this section of the Bulletin is unquestionably the most important. Such guidance is particularly vital as a result of the fact that, unlike most other arrangements undertaken by firms, strategic alliances are subject to the application of both certain criminal offences under the Act as well as other provisions which are merely civil reviewable practices. Clearly, there are significant implications to falling under the auspices of one type of provision as opposed to the other.

Prior to delving into particular provisions of the Act, we cite with approval an observation made by the Director in the Bulletin. Specifically, the Director concedes that the combination of relatively small and geographically sparse markets in Canada and increasingly liberalized world trade barriers in recent years, has resulted in firms that, while large from a domestic perspective, remain quite small by world standards. As such, these firms are continuously under pressure to improve the efficiency of their operations. Unfortunately, this astute observation by the Director does not appear to have been incorporated in the Bulletin's discussion regarding the proposed application of the Act. In our view, this observation should have taken the form of either stated thresholds, presumptions or exemptions which clearly acknowledged the economic landscape upon which strategic alliances are currently being formed.<sup>1</sup>

For example, the Director states that the analysis of strategic alliances by the Bureau will follow the analytical framework dictated by the applicable section of the Act. On its own, this approach will likely result in making the selection of the applicable provision(s) the determining factor in each analysis. Moreover, in our view, it is certainly arguable as to whether, as suggested by the Director, an alliance resulting in market power will, in most cases, fall squarely within a single section of the Act. Rather, it is our contention that in many, if not most instances, several sections of the Act could feasibly apply. Most notably among these would be the possible application of both the conspiracy and merger provisions to a single strategic alliance. We therefore submit that the Director should provide further clarity in order to address specifically which provision will prevail in such instances.

## CANADIAN COMPETITION RECORD

The Bulletin provides a fuller description of the provisions of the Act relevant to strategic alliances, to which we now turn.

### 1. Conspiracy Provisions

The Bulletin states that, in order for a strategic alliance to result in a conviction under the conspiracy provisions of the Act, each of the following elements must be established "beyond a reasonable doubt" by the Crown: the existence of an agreement between the parties with or without direct evidence (i.e., an agreement may be inferred based on circumstantial evidence); the presence of *mens rea*; and, the undue prevention or lessening of competition as a result of the arrangement.

In regard to this third point, the Director adopts the approach set out by the Supreme Court of Canada in its decision in *R. v. Nova Scotia Pharmaceutical Society*.<sup>2</sup> The Director also adopts the finding of the Court that an undue lessening of competition results from the combination of market power and the behaviour of the parties.

The Director is also unequivocal in stating that, where the conspiracy provisions are triggered, the Bureau's analysis will be restricted to the competitive impact and will not take into consideration any efficiency enhancing results. Curiously, the Director also adds that, although alliances may be facilitated through the active support or involvement of government officials, this does not reduce their exposure to criminal penalties under the Act. Presumably, this means that one cannot rely on the support of a government or quasi-government body to "bless" a transaction *vis-a-vis* the *Competition Act*. However, we submit that further elaboration on this point is necessary. The Bulletin also refers to the various defences and exceptions to the conspiracy provisions and effectively states that one cannot rely on a defence/exception to do indirectly, what one cannot do directly under the legislation.

One of the most sensitive issues surrounding strategic alliances is the sharing of information by parties. In accordance with the conspiracy provisions of the Act, the Director has set out the governing principle that the "sharing of information between firms involved in an alliance should be designed to preserve the ability of the individual parties to determine "independently" what strategy, outside of the specific confines of the alliance, they will follow in the market." The Director further notes that the Bureau will look to the nature of the information exchanged, the structure of the affected market, and the specific conduct of the parties to determine whether "information exchanges involve, or are likely to lead to, an agreement... ."

In our view, however, this final point goes beyond the scope of the conspiracy provisions as they currently stand. That is, we submit that the scope of the Bulletin should be confined to information exchanges *resulting* from an agreement, rather than including exchanges which may *lead* to an agreement. In our view, this is a particularly pressing concern when one considers the significant emphasis placed on information exchanges in the *Highlights* section of the Bulletin compared to the brief reference to this issue in the balance of the Bulletin.

## CANADIAN COMPETITION RECORD

### **2. Export Consortia Provisions**

As noted in the Bulletin, subsection 45(5) of the Act contains the so-called "export defence" to the general conspiracy provisions. The Bulletin sets out certain circumstances whereby the defence may be lost in the context of a strategic alliance: (1) where there is in fact a competitive impact in the Canadian market; (2) if the alliance in respect of exports is likely to reduce or limit the real value of the exported product; (3) where the export alliance restricts other firms from entering or expanding their business of exporting products from Canada; or (4) where the alliance prevents or lessens competition unduly in the supply of services which facilitate the export of the product.

### **3. Specialization Agreement Provisions**

The Director also refers to the exception to the conspiracy provision under section 85 of the Act, i.e., specialization agreements.<sup>3</sup> It is clear from the intention of the Act that specialization agreements are temporary measures which are meant to assist firms facing pressures from international competition to adjust their production facilities in ways which will enable economies of scale to be realized. As required by the Act, a specialization agreement must be registered with the Competition Tribunal in order to enjoy the exemption.

### **4. Merger Provisions**

As noted in the Bulletin, based on the frequency of equity investments existing in the context of alliance arrangements and the broad definition accorded to mergers under the Act, the merger provisions will often apply. Specifically, under section 91 of the Act, a merger is defined to be an acquisition of control over, or significant interest in, a business or part thereof. Control, in turn, is defined to mean *de jure* control. However, the Bulletin states that a "significant interest" will arise where one or more persons directly or indirectly acquires or establishes the ability to materially influence the economic behaviour of the business, or part thereof.

Furthermore, the Director states that, based on the wide range of ownership structures present in various alliance arrangements, the determination of a "significant interest" may only be made on a case-by-case basis considering issues such as equity ownership; board participation; shareholder agreements; management contracts and other contractual arrangements; financier, supplier or competitor roles; access to commercially sensitive information; the extent of collaboration, etc. The guiding principle in this regard is whether the effect of the strategic alliance will allow one party the ability to materially influence the economic decisions of another. The Director appears to be referring to the absence of independent actions between firms, while not explicitly stating that this is the case.

## CANADIAN COMPETITION RECORD

Finally, assuming the merger provisions are triggered, it is clear from the Bulletin that the general analysis of the Bureau will follow the customary merger analysis (i.e., the analytical framework set out in the *Merger Enforcement Guidelines*).

### **5. Joint Venture Provisions**

The Bulletin also refers to the exemption to the merger provisions which exists for joint ventures under section 95 of the Act. However, it is clearly the view of the Director that since the scope of this exemption is limited to a specific project or program of research and development, the provision will likely have quite a limited application in the context of strategic alliances. The Director supports this contention with the troubling statement in the Bulletin that the competition test which applies to joint ventures is a more onerous one than that which applies to mergers generally. Presumably, this statement was meant as a reference to the notion that, in connection with joint ventures, the anti-competitive impact must not exceed that which is reasonably required to undertake and complete the specific project or program. As worded, this statement represents a misinterpretation of the Act as, in our view, a substantial lessening of competition must also be demonstrated under section 95.

### **6. Abuse of Dominant Position**

The Bulletin has also opened the door for the application of the abuse of dominant position provisions in connection with strategic alliances where "one or more persons" controls a class or species of business. As noted under the abuse provisions, in addition to a finding of dominance, the relevant firms must be engaged in a practice of anti-competitive acts which lead to a substantial lessening of competition.

We cite with approval the Director's apparent broadening of considerations to address the competitive impact of strategic alliances in the context of the abuse of dominance provisions. Specifically, the Director states that "[w]here various acts have efficiency enhancing aspects, as may be the case for strategic alliances, the likelihood that a substantial lessening of competition may result will be assessed by reference to the competitiveness of the market with the alleged anti-competitive acts and its likely competitiveness in their absence." It is explicitly noted in the Bulletin that this assessment is undertaken in addition to the explicit requirement of subsection 79(5) (i.e., a consideration of the "superior competitive performance") when determining whether a violation of the provision has occurred.

## **IV. PUBLIC EDUCATION PROGRAM/COMPLIANCE**

Due to the inherent uncertainty which surrounds the specific application of the Act to the formation of a strategic alliance, the Bulletin understandably contains a strong endorsement for parties contemplating such arrangements to take full advantage of the public education program/advisory opinion mechanism available from the Bureau.

## CANADIAN COMPETITION RECORD

On the public education front, the Bulletin refers to the various seminars and speaking engagements conducted by Bureau staff on various topics. A clear advantage to monitoring such events is that they are prompt in responding to the demands for structural adjustments in the economy. Moreover, such sessions will often lead to a more specific level of consultation/communication with the Bureau.

It is also abundantly clear from the Bulletin that the Director views the Advisory Opinion program as an ideal vehicle for addressing the inherent uncertainty involved with strategic alliances. Under this program, company officials, lawyers, and others are invited to request an opinion from the Director as to whether a proposed business plan or practice would comply with the Act. Essentially, the rationale behind this program is to provide the party with a far higher degree of comfort in undertaking its proposal, as it will address the specific matter being contemplated. Despite this apparently greater degree of comfort that is available, the Director sets out the necessary disclaimers in the Bulletin. That is, the Advisory Opinion will neither regulate conduct nor pronounce the legality of a proposal, nor will it bind the future actions of the current or a future Director.

In our view, there is little doubt that the Advisory Opinion program coincides directly with the overall objective of the Director, i.e., compliance with the Act, as does its emphasis on enhanced communications and its open-door, fix-it-first approach in dealing with the business community. However, in formally seeking such comfort through an Advisory Opinion, it will generally be necessary to provide the Bureau with extensive information which will often make the process quite time-consuming and expensive for the parties involved.

While we would agree that there is certainly a significant role to be played by the Advisory Opinion program, this process itself may deter firms from undertaking efficiency enhancing strategic alliances. As such, even with greater guidance provided in regard to the general application of the Act to strategic alliances, Advisory Opinions should be reserved for the genuinely difficult cases. That is, parties should need to resort to Advisory Opinions only in the exceptional case.

### **V. THE ILLUSTRATIVE SCENARIOS**

As a further attempt to provide guidance to those contemplating a strategic alliance, the Director has provided, in an appendix to the Bulletin, a few illustrative scenarios relating to the various provisions of the Act which may apply. These scenarios should be considered in conjunction with our comments above.

### **VI. CONCLUSION**

In releasing his Information Bulletin regarding strategic alliances, the Director should be commended for addressing a controversial issue which is becoming increasingly prevalent in our domestic economy, as well as the economies of our key trading partners. Such praise is particularly apt in light of the fact that it

## CANADIAN COMPETITION RECORD

is largely an intractable issue, due to the myriad of corporate forms a strategic alliance may take. As such, the Director has undertaken the unenviable but necessary task of attempting to provide guidance in this context, while retaining the maximum flexibility in exercising his discretion.

In addition to its thorough discussion regarding the potentially applicable provisions of the Act, the most telling aspect of the Bulletin is its general tone in regard to strategic alliances. Specifically, the fact that the Director is concerned that efficiency enhancing alliances are being abandoned due to uncertainty surrounding the application of the Act, as well as the general view that most forms of alliances do not raise competition law concerns, is certainly a welcome message to both the legal and business communities.

However, despite these generalizations, it is clear from the Bulletin that strategic alliances are potentially subject to a number of provisions of the Act with a range of possible implications. In this regard, there are numerous situations where either a criminal offence or reviewable practice could feasibly apply to a particular alliance being contemplated. In response to continued uncertainty, the Director is clear in stating that, where an adequate degree of comfort is not provided by the Bulletin, the parties should approach the Bureau for an Advisory Opinion.

We are, however, particularly concerned with the treatment of information exchanges in the Bulletin. Specifically, while the *Highlights* portion of the Bulletin places significant emphasis on the issue of information exchanges, there is very little discussion on this issue in the substantive portion of the Bulletin. Moreover, the discussion which does exist is quite ambiguous and may be interpreted as attempting to extend the discretion of the Director in a manner that was not intended by the Act. As such, it is imperative that the treatment of information exchanges be clarified, in accordance with the Act, in a subsequent version of the Bulletin.

As a final, general comment, it is our view that the Bulletin should include a reference to not only the common characteristics of strategic alliances but also to the types of markets in which they are arising. Presumably, strategic alliances are most common, and their potential benefits most pronounced, in technologically driven industries such as telecommunications. As such, the Bulletin provides an ideal medium for the Director to provide some general statements in regard to the interface between competition law and intellectual property rights. This would be particularly appropriate in light of the recent release of revised draft guidelines concerning this interface by the Antitrust Division of the United States Department of Justice.

### Notes

<sup>1</sup> One possible exception would be the broadened interpretation of efficiency savings in the context of the abuse of dominance provision, which is discussed in greater detail in this article.

<sup>2</sup> [1992] 2 S.C.R. 606. As noted in the *PANS* decision, there are three steps involved in determining "undueness". First, the relevant product and geographic markets must be defined. Second, a determination must be made as to whether the parties possess market power. Third, the behaviour of the parties will be scrutinized for anti-competitive effects.

## CANADIAN COMPETITION RECORD

<sup>3</sup> Section 85 of the Act defines a special agreement as follows:  
“an agreement under which each party thereto agrees to discontinue producing an article or service that he is engaged in producing at the time the agreement is entered into on the condition that each other party to the agreement agrees to discontinue producing an article or service that he is engaged in producing at the time the agreement is entered into, and includes any such agreement under which the parties also agree to buy exclusively from each other the articles or services that are the subject of the agreement.”

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### **CONFIDENTIALITY OF INFORMATION UNDER THE *COMPETITION ACT*: A COMMENTARY ON THE DIRECTOR'S DRAFT INFORMATION BULLETIN**

By: Susan M. Hutton and Lawson A. W. Hunter, Q.C.  
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On July 22, 1994, the Director of Investigation and Research (the “Director”) under the *Competition Act* (the “Act”) issued his long-awaited draft Information Bulletin concerning “Confidentiality of Information under the *Competition Act*”, and requested comments thereon.

The information gathered by the Director in the course of an investigation, touching as it does on every aspect of the competitive dynamic in an industry under review, is almost by definition the most sensitive commercial information imaginable. The circumstances under which such information might be disclosed by the Director are clearly of vital interest to anybody who has ever submitted information to the Director and even more so to those who may have reason to do so in the future. The draft Bulletin sets out the Director's preliminary statement of his interpretation of the rules governing disclosure and, particularly in the absence of jurisprudence on the topic, makes for important reading. In addition, the increasing emphasis being placed by the current Director, George Addy, on international cooperation in competition law enforcement and his desire to exchange information with foreign competition law enforcement agencies, only heightens the significance of the draft Bulletin.

In the *Preface* to the draft Bulletin, the Director states that in formulating his approach to confidentiality he has attempted to balance the “need to respect the confidentiality accorded to parties who provide information to the Bureau” with the “need to share information effectively” (p. 1). The draft Bulletin outlines how the Director balances these competing objectives with respect to the following topics:<sup>1</sup>

- the impact of the requirement in subsection 10(3) of the Act that inquiries take place “in private” (part 1.3);
- the exceptions to the rule of non-disclosure of information protected by subsection 29(1) of the Act (part 1.4);

## CANADIAN COMPETITION RECORD

- the treatment of information not protected by subsection 29(1) (part 1.5);
- the Director's response to requests for confidentiality undertakings by those supplying information (part 1.6);
- the treatment of information supplied in support of a request for an advisory opinion (part 1.7);
- the extent to which information will be shared with foreign competition law authorities (part 2); and
- the Director's policy toward requests from the public for disclosure under the Act, the *Access to Information Act* (the "ATIA") or in connection with private actions under section 36 of the Act (part 3).

### GENERAL COMMENTS

Before dissecting the substance of the draft Bulletin, a few general observations are in order.

1. First, as drafted, the Bulletin reads somewhat more like a defence of disclosure by the Director and his staff than like an attempt to reassure the business community that information will as a rule be kept confidential and only be disclosed when such is clearly necessary. The balance is struck too far in favour of preserving maximum discretion for the Director and his staff and away from reassuring the business community that they will have any control over the disclosure of information supplied to the Director, even that which is supplied voluntarily. The policy underlying the draft Bulletin runs a grave risk of backfiring and resulting in materially less cooperation from the business community and therefore in materially less efficient and effective enforcement of the Act.
2. In this regard, the draft Bulletin discourages the provision of information by the business community except under compulsion. Rather than assure readers that information provided voluntarily will be treated no less confidentially than section 29 information, as it purports at the outset to do, the Bulletin actually contains important exceptions wherein voluntary information will be open to more disclosure, and this without even the courtesy of notice to the donor. The Act should be amended to protect all information supplied to the Director in the course of his duties. In the meantime, the Director's own policy of treating all non-public information as if it is protected by the Act should admit of no exceptions.
3. The Director's interpretation of the exception regarding disclosure for the purposes of the administration or enforcement of the Act is overbroad and risks completely swallowing both the rule of non-disclosure and the exception for disclosure to Canadian law enforcement agencies. This exception should be narrowly construed and confined to instances where disclosure is truly necessary, i.e., for use as evidence

## CANADIAN COMPETITION RECORD

in legal proceedings under the Act or to outside experts who are hired to assist in specific investigations and who are themselves subject to the prohibition against disclosure under section 29.

4. The topic of disclosure to law enforcement agencies having been specifically covered by the exception of Canadian law enforcement agencies, the more general exception for the administration or enforcement of the Act does not, we would argue, permit disclosure to foreign antitrust authorities, even for the purposes of enforcing Canada's competition laws. It most certainly does not permit sharing information with foreign authorities to help enforce laws of that other state. If the Director seeks the ability to share section 29 information with foreign governments, even for his own enforcement purposes, he should seek legislative amendments so that all aspects of Canadian public policy can be considered, and the democratic process enlisted to legitimize this change and ensure that appropriate safeguards are statutorily required. Furthermore, both section 29 and non-section 29 information deserve to be treated with this same respect.
5. The Bulletin as drafted is replete with rather vague and often conflicting statements that are open to interpretation in any given situation. The Bulletin, of course, must state general principles and also leave the Director room to deal with unforeseen situations in an appropriate manner. Nonetheless, virtually every topic in the Bulletin would benefit from specific scenarios, similar to the Case Studies found in the *Predatory Pricing Enforcement Guidelines*, which illustrate when the Director would and would not disclose information to competitors in a merger context and in the context of an inquiry, when the Director will notify the donor of the disclosure, what rare circumstances might warrant the provision of undertakings regarding disclosure, and when and how information will be shared with a foreign government. Such Case Studies will go a long way to assuring the business community that the Director is committed to safeguarding the information, even if he must retain the latitude to disclose it if necessary to do his job.

The goals of the Director in seeking to illustrate his policies regarding disclosure are entirely laudable. Unfortunately, the delivery in this draft runs the risk of making his policy on disclosure less rather than more clear, and of leading to a very much lower degree of cooperation by the business community with information requests, and of exposing the Director to potential liability for contravening the Act.

### **PART 1.3: INQUIRIES SHALL BE CONDUCTED "IN PRIVATE"**

Part 1.3 of the draft Bulletin outlines the Director's interpretation of section 10 of the Act in fairly short order. He interprets his duty to inform anyone who has filed a six-resident complaint of the progress of the complaint narrowly, and will inform them only as to whether the inquiry is ongoing, and provide them with generic information about how he conducts inquiries.

The Director does not view the requirement in subsection 10(3) that all inquiries be conducted in private as prohibiting in any way the release of information where to do so would, in his view, advance his

## CANADIAN COMPETITION RECORD

investigations under the Act. Rather, the requirement that he conduct inquiries in private is contrasted with the public hearings used by the former Restrictive Trade Practices Commission in conducting its inquiries under the predecessor legislation to the Act. Once the existence of an inquiry is public knowledge, the Director will confirm that fact, and provide generic information on the manner in which inquiries are conducted, but will not provide the media with information regarding the subject matter of the inquiry or his views thereon.

What the draft Bulletin only alludes to is that, while the Director is rather tight-lipped with the media, subject to the provisions of the Act and his policies on disclosure as outlined in the remainder of the draft Bulletin, the Director feels that he is permitted to disclose confidential information to third parties in the course of conducting his investigations and inquiries. With certain exceptions, such as experts hired to assist in the investigation, these third parties are not constrained from themselves revealing that information publicly, including to the media. Word of an investigation and even comments on the substantive issues by other interested parties, therefore, can leak out. A topic the draft Bulletin does not consider is whether subsection 10(3) requires the Director to take steps including legislation amendments to prevent information disclosed by him to third parties from being publicized.

The Director has recognized that the targets of investigations which have not yet reached the commencement of a formal inquiry nonetheless also merit the protection from publicity and the frivolous claims that publicity may encourage. The Director therefore maintains the same privacy for pre-inquiry "investigations" and formal section 10 "inquiries" alike.<sup>2</sup>

### **PART 1.4: INFORMATION PROTECTED BY S. 29**

Disclosure of information to anyone other than the media is, according to the draft Bulletin, constrained only by the provisions of section 29 of the Act, and by the Director's own policy of protecting the confidentiality of all information provided to him.

Briefly, information protected by section 29 (or "section 29 information"), comprises:

- (a) the identity of the person from whom any information was obtained;
- (b) any information obtained by the Director through the use of compulsory measures (e.g. his powers of subpoena search and seizure under sections 11, 15 and 16 of the Act) and information required to be provided in support of a pre-notifiable transaction under section 114 of the Act;
- (c) the fact that a pre-merger notification has been filed or information provided in respect of same;  
and

## CANADIAN COMPETITION RECORD

- (d) any information submitted pursuant to a request for an Advance Ruling Certificate ("ARC") under section 102 of the Act.

It is important to note that the identity of a person providing information is protected by subsection 29(1)(a) regardless of whether the information was provided voluntarily as part of the Program of Compliance or a complaint, semi-voluntarily pursuant to an information "request" issued as part of an investigation or inquiry by the Director or involuntarily pursuant to the exercise of the Director's formal powers of search and subpoena under the Act or a mandatory pre-merger notification filing. The contents of the information provided are treated differently by the Director, however, according to whether it is specifically protected by the other paragraphs of section 29, i.e., according to whether the provider of the information was compelled to do so by an order under sections 11, 15 or 16, filed a pre-merger notification under section 114 or requested an Advance Ruling Certificate under section 102. Other information, called "non-section 29" information in the draft Bulletin, is not statutorily protected under the Act but will be treated by the Director as if it were so protected, with the exception of disclosure to foreign competition law agencies, and disclosure when subpoenaed in the course of private damages litigation.

With respect to information provided in support of a pre-notifiable transaction, section 29 only specifically protects information which is required to be provided by section 114 of the Act. The draft Bulletin says that the Director will extend the same protection to information required to be filed under the Notifiable Transactions Regulations. Accordingly, supplementary information not required under the Act or the Regulations, but requested by the Director during the course of a merger review is apparently open to disclosure by the Director to foreign agencies or private court proceedings unless, of course, an ARC has been requested in respect of that transaction. Since supplementary information is usually supplied by the notifying parties in order to facilitate the Director's review (and obtain the necessary assurances prior to closing), it is therefore wise to request an ARC in respect of every notifiable transaction, regardless of the chances that a Certificate will actually be issued.

The protection offered by subsection 29(1) is a complete prohibition on the disclosure of section 29 information to any other person "except to a Canadian law enforcement agency or for the purposes of the administration or enforcement of this Act."<sup>3</sup> Since the Director purports generally to treat all information as if it were protected by section 29, the Director's interpretation of these exceptions to the section 29 rule of non-disclosure is of critical importance. These two exceptions are discussed in parts 1.4.1 and 1.4.2 of the draft Bulletin, respectively.

### **PART 1.4.1: DISCLOSURE TO A CANADIAN LAW ENFORCEMENT AGENCY**

The Act does not define a "Canadian law enforcement agency". The Director has interpreted this to include all federal and provincial government agencies who are "mandated to enforce a statute providing for penal consequences, including fines and/or imprisonment" as well as those agencies which are responsible for the

## CANADIAN COMPETITION RECORD

collection of evidence for the purpose of prosecuting violations of statutes with penal consequences, such as the *Canadian Environmental Protection Act*. Given the growing plethora of penal laws which are being administered by specialized enforcement agencies rather than by the police, this interpretation would appear to be reasonable.

Somewhat surprisingly, there has apparently been only rather limited interchange of information between the Director and other Canadian law enforcement agencies to date, consisting mainly of passing on complaints which are more appropriately dealt with by another agency, or requesting the assistance of the police in the execution of search warrants. The Director indicates in the draft Bulletin that he is likely to cooperate more in the future with the various police forces by referring to them evidence he uncovers of fraud or counselling an offence.

It is not clear from the draft Bulletin whether the Director will also share evidence of offences unrelated to anti-competitive acts, such as tax violations. The draft Bulletin states that "should communication of information to a Canadian law enforcement agency be justified, such disclosure would only be made to the extent necessary to provide the Canadian law enforcement agency with information which is relevant to its law enforcement mandate"(p. 13).

It is not clear whether the Director will view disclosure as being justified only if such disclosure will assist in his own investigation, or whether disclosure could be justified on the grounds that the information may reveal the violation of another Canadian statute. It is clear, however, that disclosure will be made, in instances such as when RCMP assistance is required in connection with the execution of a search warrant obtained under section 15 of the Act, when such is required in order to advance the Director's investigation. The final version of the Bulletin will hopefully clarify this issue.

It is the Director's policy to request that information provided to other law enforcement agencies be provided with the same protection from disclosure as is information in his possession. Readers should be cautioned, however, that such "requests" would likely not be legally enforceable by a private party, and in any event would not prevent the use of the information or evidence in prosecutions by that other law enforcement agency.

**PART 1.4.2: "FOR THE PURPOSES OF THE ADMINISTRATION  
OR ENFORCEMENT OF THIS ACT"**

Disclosure of section 29 information is also permissible if it is made "for the purposes of the administration or enforcement of this Act". Taken in isolation, these words could be interpreted to permit the Director to disclose information to anyone, any time that such disclosure might possibly aid an investigation or inquiry in the slightest way. Such an interpretation of this exception, however, would negate the rule of non-disclosure. It is in the application of this exemption to particular cases that the Director's attempt to

## CANADIAN COMPETITION RECORD

balance enforcement concerns with privacy concerns is most vital and most in need of clarification. Unfortunately, the draft Bulletin obscures the Director's policy with inconsistent terminology and, to the extent this policy can be discerned, appears to come down in favour of disclosure when "convenient", rather than disclosure when necessary.

Initially, recognizing the need to interpret this exception in a responsible manner, the Director states that "the disclosure must be made with the intent of advancing a specific investigation being carried out pursuant to one or more sections of the Act for which disclosure is necessary" (p. 14). This statement is undermined by the later statement that "disclosure...will occur only when the Director is satisfied that it is appropriate to advance the matter in question" (emphasis added), as well as by the rather vague examples of "appropriate" disclosure actually listed. These specific examples include eliciting additional information from other market participants, disclosure to outside experts (economists, statisticians, etc.) hired to assist in the inquiry, disclosure to other law enforcement agencies including foreign agencies, assessing the accuracy or evidentiary value of the information or commencing proceedings before the courts or the Competition Tribunal.

Disclosure to outside experts whose contracts contain confidentiality undertakings and who are in any event bound by section 29, or disclosure to a court or the Competition Tribunal (both of which can issue protective orders in respect of confidential information), is clearly necessary for the administration and enforcement of the Act as well as reasonable given the continued protection of the information disclosed.<sup>4</sup> An examination of the specific examples in the draft Bulletin reveals, however, that some are worded in such a way as to provide the Director with virtually unlimited freedom to disclose section 29 information any time such disclosure would be convenient, or could conceivably advance the inquiry in question. In the context of criminal or civil inquiries, for instance, one can think of cases in which the disclosure of confidential company information would speed up the process of eliciting additional information from the target's competitors, customers or suppliers, or assist more easily in the verification of information, but in which disclosure to such parties could perhaps be avoided by the hiring of industry experts.

The draft Bulletin leaves one wondering, for example, whether the Director, contrary to past practice, would now inform competitors and customers of a proposed merger before the transaction closes and despite objections from the notifying parties, on the basis that market reactions are more appropriately sought prior to a "scrambling of the eggs", even though the three year period during which the Director can challenge a transaction arguably renders such premature disclosure unnecessary. If the Director has serious concerns about a merger he can seek an injunction under section 100 of the Act to temporarily prevent closure, and the Tribunal can issue appropriate sealing orders to protect the privacy of the parties to the merger. The public policy implications for Canadian business of losing the ability to control the timing of merger announcements are grave, particularly for public companies where disclosure has securities law implications, and specific mention of the Director's views on this score would be a useful addition in the final Bulletin.

Furthermore, businesses would find it useful to know what information is likely to be disclosed when the Director's staff approaches competitors and customers for their reactions to a merger? Is only the fact of

## CANADIAN COMPETITION RECORD

the proposed transaction “necessary” to disclose, or will the Director also feel that it is “appropriate” to share the notifying parties’ views of market structure and competitive dynamics in the industry in order to “assess the accuracy” of this sensitive, and often costly, information? In our view, the Director should avoid sharing with competitors information which, in addition to that which relates specifically to the confidential details of the operations of the notifying parties, was nonetheless obtained at some cost to the notifying parties. Detailed commentary and examples describing the Director’s usual practice regarding information sharing in merger reviews would go a long way toward improving the usefulness of the draft Bulletin to the business and legal communities, and toward ensuring that the supplementary information regarding competition continues to be provided voluntarily as part of notification filings.

Similarly, in the context of investigations and inquiries by the Director, the draft Bulletin suffers from a lack of concrete application of the principles enunciated. Regardless of whether the Director sets the standard at “necessary” or “reasonable” disclosure, what does this mean in terms of the types of information disclosed and the parties to whom it will typically be disclosed? Of course, it is impossible to predict all situations in advance, but a few hypothetical examples of situations where information would be, and would not be, disclosed would improve the practical utility of the Bulletin significantly. In this regard, Case Studies of the kind found in the *Predatory Pricing Enforcement Guidelines*<sup>5</sup> would be a significant addition to the Bulletin.

The Director’s discussion of the exception to the rule of confidentiality for the “administration or enforcement of this Act” also includes a detailed justification for the Director’s willingness to disclose even section 29 information in case-specific hearings before other federal or provincial regulatory tribunals before which the Director has intervened. According to the draft Bulletin, disclosure of section 29 information in general regulatory review proceedings would be “highly unlikely” (but not impossible). In case specific proceedings, however, the Director will reveal any relevant information whether protected by section 29 or not. He will first attempt to gather the information using the information gathering powers of the regulatory body in question, but if this is not possible, he will nonetheless reveal section 29 information despite the fact that the regulatory body in question had not been accorded the broad powers to compel information which are available to the Director.

In our view, one must seriously question the Director’s interpretation of his ability to disclose section 29 information “for the purposes of the administration or enforcement of this Act”, when it effectively leads to the provision of section 29 information and the extension of the Director’s strong powers to compel information to regulatory bodies who have not been granted similar investigatory powers by the legislatures, and whose regulatory mandate is not the administration and enforcement of the *Competition Act*. Whether such information gathering powers should be so extended is a matter of public policy for the legislatures to decide, not the Director on his own discretion. In light of the Director’s stated policy in the draft Bulletin, however, any company who is subject to regulatory oversight by a body such as the NTA or the CRTC must be aware of the possibility that any information provided to the Director might be revealed by him in regulatory proceedings before those bodies.

## CANADIAN COMPETITION RECORD

### **PART 1.5: INFORMATION NOT PROTECTED BY SECTION 29**

Information not covered by section 29 is referred to in the draft Bulletin as "non-section 29 information". Such information would include all information (other than the identity of an informant) provided voluntarily to the Director either in the context of an inquiry or prior to the formal commencement of an inquiry, and all information provided to the Director in support of a pre-merger notification (other than the identity of the informant) if such information is not strictly required by the Act or the Regulations.

The draft Bulletin states that all information provided to the Director which is not statutorily protected by section 29 is nonetheless treated by him in the same manner as is section 29 information. That is, it would not be disclosed to third parties other than Canadian law enforcement agencies or for the purposes of the administration or enforcement of the Act. That said, the Director's comments on this section are prefaced by his view that information not protected by section 29 is not protected by any provision of the Act, a statement which, in our view, ignores the protection, albeit limited, afforded by the stricture contained in subsection 10(3) against the public dissemination of information gathered during an inquiry. As stated previously, in order to protect innocent reputations in the event an inquiry or investigation is closed without enforcement action, the Director would be required to take steps to ensure that even non-section 29 information is not publicized by those with whom it is shared.

Even more telling, perhaps, is the fact that the Director says that the disclosure of confidential information of any kind, whether protected by subsection 29(1) or not, "would generally occur only where the Director's objective in a particular matter cannot be achieved as effectively through alternative means" (emphasis added)(p. 15/16). Again, this would appear to contradict the earlier statements to the effect that section 29 information would only be revealed when "necessary", and leads one to question the degree to which, as a practical matter, convenience might influence a decision regarding disclosure in a particular case. Moreover, the Director's speech at the annual conference of the CBA National Competition Law Section on September 30, 1994 pointed to a greater delegation of decision making powers to his staff. With a multiplicity of decision makers, there is a real risk that the standard will not be consistently applied without more concrete guidance from the Director.

Furthermore, after stating that non-section 29 information is treated in the same manner as is section 29 information, the draft Bulletin carves out a rather large exception: non-section 29 information will be revealed to foreign competition law enforcement agencies more readily than will section 29 information. As does the Director, we will return to this topic in the discussion of Part 2 below. The additional exception regarding different standards of disclosure for non-section 29 information involves the Director's response to subpoenas in private actions for damages, discussed in Part 3 below.

## CANADIAN COMPETITION RECORD

### **PART 1.6: THE DIRECTOR'S POLICY TOWARD PROVIDING UNDERTAKINGS TO MAINTAIN THE CONFIDENTIALITY OF INFORMATION**

The draft Bulletin makes it clear that the Director generally will not be willing to provide undertakings which constrain his use of information beyond the requirements of section 29, e.g., not to disclose it to third parties, or not to disclose it to other law enforcement agencies. As a general rule, according to the draft Bulletin, confidentiality undertakings will not be granted.

The mysterious caveat to this general rule is that "in rare circumstances where...the Director finds it appropriate to provide additional assurances, they would only be provided in accordance with and in the context of this policy described in this Bulletin...". Illustrative circumstances which might warrant the provision of such additional assurances or factors taken into consideration are not mentioned.

If this caveat means that the Director will be willing to provide assurances that non-section 29 information will be treated in the same manner as section 29 information an assurance which appears to us to be reasonable if the Director expects Canadian businesses to continue to provide information voluntarily - then the words used convey a rather unfortunate reluctance to back up the claim that all information is treated alike. Indeed, unless the Director is willing to undertake in specific cases to treat section 29 information and non-section 29 information alike, then the draft Bulletin will likely not succeed in its presumed goal of fostering the continued trust and the voluntary cooperation of the business community with the Director's pre-inquiry investigations, or indeed with the inquiries themselves. Such assurances are appropriate in light of the role which non-disclosure of the information except to outside experts or in the course of enforcement proceedings plays as the *quid pro quo* for voluntary provision of the information.

In this context, the next Bulletin should clearly recognize the possibility that information provided "voluntarily" in the course of settlement discussions in relation to that inquiry is covered by the litigation privilege and cannot be disclosed without the consent of the donor.<sup>6</sup> Moreover, undertakings in this regard will only facilitate enforcement of the Act and should specifically be mentioned as possibilities in this section of the Bulletin.

One situation in which the Director will be willing to provide undertakings which might even curtail his ability to use information in order to administer or enforce the Act would be in connection with a request for immunity under the Director's Favourable Treatment Policy.<sup>7</sup> Since the purpose of granting favourable treatment or immunity in exchange for information is to be able to use that information in the "administration or enforcement of this Act", it seems counter-intuitive that this is the one situation in which the draft Bulletin claims that the Director might be willing to curtail his ability to use the information for that purpose.

The draft Bulletin does not elaborate as to the "appropriate circumstances" which might prompt the Director to provide a confidentiality undertaking in response to a request for favourable treatment. However, the

## CANADIAN COMPETITION RECORD

criteria outlining the policy indicate that favourable treatment falling short of immunity might be afforded to informants whose information is found to fall short of that which would warrant full immunity. Perhaps the Director would be willing in such circumstances not to use the information to prosecute the informant for offences revealed by the informant, but would not be so constrained in the use of the information to prosecute other offenses which were not disclosed. Alternatively, since the Director apparently will not decide whether to recommend immunity until after the witness has made full disclosure under oath, perhaps the Director would be willing to provide an undertaking in advance not to disclose the information to other law enforcement agencies. All this is pure speculation, however, as the draft Bulletin tells us only that confidentiality undertakings are not ruled out in "appropriate circumstances in response to a request under the Director's Favourable Treatment Policy".

### **PART 1.7: INFORMATION PROVIDED PURSUANT TO A REQUEST FOR AN ADVISORY OPINION**

Since requests for Advisory Opinions relate to proposed actions, the draft Bulletin points out that disclosure of this information to other law enforcement agencies (including foreign antitrust authorities), or for the administration or enforcement of the Act, would "generally" not be appropriate. Given the hugely chilling effect that potential disclosure of such information would have on the Director's Program of Compliance, this point ought to be underlined, and the final version of the Draft should state unequivocally that such information will not be revealed. In the alternative, detailed examples of situations where it will be revealed should be provided, and the factors which might lead to disclosure explained.

The draft Bulletin also states that, should the actions or circumstances which eventually unfold differ from the information upon which the Advisory Opinion was based, then an investigation and inquiry may follow. In this case, the Director would treat information provided to him in connection with the request for an Advisory Opinion "in accordance with the policy identified in this bulletin" (i.e., presumably, the same as other non-section 29 information).

Careful consideration therefore should be given before requesting an Advisory Opinion, particularly regarding plans which have not yet been fully developed, as information provided pursuant to such a request is not covered by section 29, and so would presumably be transmitted by the Director to foreign competition law enforcers if he thought a competitive issue might be raised in that foreign country. The Director's policy on disclosure to foreign governments is the next topic of discussion.

### **PART 2: THE DIRECTOR'S POLICY ON DISCLOSURE TO A FOREIGN AGENCY**

The draft Bulletin emphasizes the importance which the Director places on developing greater international cooperation in competition law enforcement. In fact, we are told that "the Director considers that the ability to disclose information from [sic] foreign agencies enforcing legislation similar to the Act is as necessary to the effective enforcement of the Act as the ability to obtain information"(p. 17).

## CANADIAN COMPETITION RECORD

The Director will disclose both section 29 and non-section 29 information in his possession upon request by a foreign agency if he is satisfied that it is necessary for the administration and enforcement of the Act, as this phrase is interpreted by him (see discussion of Part 1.4.2 above). However, the draft Bulletin also indicates that disclosure would be made on the Director's initiative "where necessary...during discussions regarding a specific Bureau investigation or project, including multi-agency investigative task forces in which the Bureau is a participant, and would take place where the assistance of the foreign agency, for example in providing information in its possession, would advance the matter under investigation by the Director"( p. 18).

While one can certainly think of instances, such as the review of a merger with the potential for a multi-national market definition, which might require the gathering of information from a foreign jurisdiction (e.g., the verification of information gathered in Canada which concerns the marketplace or business dealings in that foreign jurisdiction), it is not as easy to think of why it would be necessary to reveal specific information about a Canadian business or business activities in order to enforce the Canadian Act. Moreover, the disclosure by the Director of section 29 information to foreign law enforcement agencies is prohibited, as Parliament excluded by implication disclosure to non-Canadian law enforcement agencies (see discussion of Part 1.4.1 above).

Even if disclosure to foreign agencies is permitted for the administration or enforcement of the Act, however, care must be taken that the information is disclosed only in order to directly advance the Director's investigation, and not as part of a horse trade in information which will only indirectly advance the Director's investigation by providing "payment" for information from the foreign jurisdiction. It is highly questionable whether such disclosure would qualify as being for the "purposes of the administration or enforcement of this Act". If, as a practical matter, multi-jurisdictional merger reviews can only be carried out effectively if information sharing is reciprocal, then a statutory amendment permitting such exchanges is required.

While the merits of enhanced international cooperation for competition law enforcement may be tangible, information sharing with foreign enforcement agencies also has serious implications for Canadian foreign policy (particularly in light of the expression of public policy against automatic disclosure as embodied in the *Foreign Extraterritorial Measures Act*, R.S.C. 1985, c. F-29). Moreover, given the number of business practices which may be subject to different substantive tests under Canadian law and that of, for instance, the U.S., it is not clear that even Canadian competition policy, as enunciated by Parliament in the *Competition Act*, is served by sharing information to assist in foreign law enforcement. In our view, section 29 currently prohibits providing protected information to foreign enforcement agencies and such protection should be extended to non-section 29 information. If change is required, then Parliament - not an Information Bulletin is the appropriate forum for effecting the change.

Even if the Director's policy in relation to the disclosure of section 29 information when necessary for the enforcement and administration of the Act remains unchanged, the draft Bulletin provides no examples of

## CANADIAN COMPETITION RECORD

when the provision of information to assist in a foreign investigation would qualify as being for the purpose of enforcing Canadian competition law. Again, illustrative examples are required to provide meat to the bones of the Bulletin.

The draft Bulletin states that, "under the current legislative framework" (p. 14), section 29 information would only be released to a foreign agency if disclosure were for the purposes of the administration or enforcement of the Act. This indicates that the Director is not happy with the *status quo*, and that he will likely be seeking to amend the *Competition Act* to permit him to share information more freely with foreign competition enforcement agencies. It would be helpful if the Bulletin would expand upon this and state clearly the nature of the amendments that he has in mind. For instance, will he only share information in respect of offenses which are criminal in both countries? Will the donor be notified of his intention to share the information and provided an opportunity to challenge the disclosure? Our own view is that these safeguards should be in place before information is shared, and that the issues should be aired publicly.

As mentioned earlier, the Director's stated intention to provide section 29 and non-section 29 information with the same degree of confidentiality is subject to an exception relating to the disclosure of non-section 29 information to foreign competition law authorities. This policy is further elaborated in Part 2 of the draft Bulletin. Information not protected by section 29 will be provided to foreign agencies (either on request or on the Director's own initiative) where such information suggests that the competition laws of that foreign jurisdiction have been violated, even if that same information does not appear to raise an issue under the Act. Furthermore, even if the information does not relate to violations of that country's competition laws, it will be revealed (either upon request by the foreign agency or on the Director's own initiative) if "its communication would assist the Director or the foreign agency in the identification of anti-competitive issues"(p. 18).

The Director would apparently also release non-section 29 information upon receipt of a request from the U.S. under the *Mutual Legal Assistance in Criminal Matters Treaty* (the "MLAT") between the United States and Canada, if such were endorsed by the Minister of Justice as being in Canada's best interests. The draft Bulletin also states that section 29 information could only be revealed pursuant to an MLAT request if the disclosure were for the administration or enforcement of the *Competition Act*. Again, it is difficult to envisage a situation in which the advancement of a foreign investigation can be seen as being necessary to the fulfillment of the Director's mandate under the Act, and our own view is that no section 29 information can be revealed pursuant to an MLAT request. Furthermore, the MLAT creates a mechanism whereby Canadian courts may, if deemed appropriate by the Minister of Justice, and subject still to common law principles of comity, Canadian sovereignty, and the courts' discretion generally, order evidence to be gathered on behalf of foreign criminal law investigators or enforcers, from primary sources of such information.

It would therefore appear that the Director will refrain from revealing information voluntarily provided to him to other Canadian market participants (i.e. competitors, suppliers or customers) unless such is either

## CANADIAN COMPETITION RECORD

necessary or at least desirable for the purpose of advancing a specific investigation under the Act. However, the Director feels he is under no such constraint with respect to disclosing non-section 29 information to foreign governments, and might in fact volunteer such information to those foreign governments even when there is no competitive issue raised in Canada, and even when the company-specific information supplied relates only generally to "anti-competitive issues" and not to a specific foreign inquiry or proceeding.

In our view, the lack of uniformity in substantive competition laws between Canada and even its closest neighbour and largest trading partner raises serious questions about the propriety of this policy. For instance, behaviour which is permissible under the export cartel exception to the conspiracy provision in section 45 of the Act may very well violate the competition laws of the export markets concerned. Agreements in restraint of trade may be *per se* criminal in the U.S., but not unduly restrict competition and so not be subject to sanction if Canadian legal standards are applied. The range of substantive issues which gives rise to civil suits for damages and the remedies which are available to private litigants differ widely among Canada and her trading partners. Moreover, Parliament saw fit in the 1986 Act to decriminalize a whole host of business practices which can be either pro or anti-competitive depending on the circumstances, including monopolization (abuse of dominant position, as it is now called), yet these activities might be subject to criminal sanctions in the U.S. With ever-burgeoning globalization of world trade and the trend toward asserting competition law jurisdiction over every issue which affects the economy of the legal system in question, this wide-open disclosure policy by the Director could easily expose Canadian businesses to liability under foreign laws for actions which Parliament has chosen, as the authoritative expression of Canadian public policy, not to sanction here at home.

Despite these criticisms, we should point out that there is some reassurance in the Director's statement that "any disclosure by the Director will take place only in situations where there is a reciprocal arrangement for assistance with the other agency, and where the Director is satisfied of the assurances provided with respect to the use of the information by the foreign agency and the confidentiality of the disclosed information"(p. 18). Furthermore, such reciprocal arrangements would be expected to contain specific confidentiality safeguards. Finally, the Director is prepared to undertake to foreign governments who provide information to the Director that he will only use the information for *Competition Act* enforcement or administration and not for other purposes.

Nonetheless, the potential for criminal liability under U.S. law in particular will have a chilling effect on the willingness of multinational companies to test the boundaries of pro-competitive, but reviewable, business practices in Canada and certainly on their willingness to seek Advisory Opinions, thereby undermining Parliament's goal in decriminalizing these activities. The public policy merits of assisting in the enforcement of foreign competition laws as well as the Program of Compliance, may well in the final analysis, call for more expansive disclosure policies for all information than is currently permitted for section 29 information under the Act. The debate should take place in public, however, and the matter should be decided by those answerable to Canadians for balancing the conflicting public policy goals in areas such as competition law, trade law, Canadian sovereignty, and international relations: Parliament.

## CANADIAN COMPETITION RECORD

### **PART 3: THE PUBLIC'S ACCESS TO INFORMATION IN THE DIRECTOR'S POSSESSION**

The draft Bulletin states that "materials in the possession of the Director as a result of inquiries are not made available to members of the general public"(p. 21). Responses to public queries are limited to confirmation that an inquiry or investigation which has already been made public is ongoing, and to general statements of the procedures followed. In our view, this policy is appropriate if the subject of the inquiry has gone public, but not if the complainant has done so.

The draft Bulletin indicates that the Director will maintain his policy of not providing information to persons to assist in private actions for damages under section 36 of the Act, or other private causes of action. Civil discovery processes and subpoenas are available to private litigants in order to gain access to records, and information in the Director's possession is also open to subpoena. The Director or his staff might meet with a potential private litigant to discuss the issues generally, but in a manner which does not reveal information known only by virtue of the investigation or inquiry undertaken by the Director. This continuation of a prudent policy is welcomed.

The draft Bulletin indicates that the Director will oppose subpoenas for information gathered by him if 1) compliance with the subpoena would impede the Director's own investigation, or 2) no initial pleading has been served on the defending parties (such that the defendants are not yet in a position to protect their rights themselves). If the Director's investigation is complete so that there is no question of impeding the Director's work, and if the defendants are aware of the issuance of the subpoena, then the Director will not oppose disclosure himself, but will notify informants who have provided section 29 information so that they can request protective orders if they think it is necessary.

By implication, therefore, the Director will simply comply with a subpoena for non-section 29 information, without even informing the source of that information that such has been requested. It is not clear why a party who has provided information voluntarily is less deserving of notice of a subpoena than a party from whom information was subpoenaed, but such is the result in the draft Bulletin. Thus, in one more respect, the draft Bulletin will discourage the provision of information without the "protection" of subpoenas or search warrants (with all the attendant fears shared by the Director and the business community of unnecessarily escalating matters).

With respect to the Director's response to public requests for disclosure under the *Access to Information Act*<sup>8</sup> (the "ATIA"), the draft Bulletin points out that the Director does not have the final say as to whether information in his possession falls within one of the exemptions to the right of public access to government records, as such determinations are made by the Access Coordinator for Industry Canada. That said, his recommendations would be expected to be determinative of the issue in all practical respects, as stated in the draft Bulletin.

## CANADIAN COMPETITION RECORD

Even under the ATIA, there is a distinction between section 29 and non-section 29 information. Whereas section 29 information is exempted from disclosure under the ATIA, and cannot be released even if the informant has no objection, the ATIA provides that non-section 29 information must be disclosed upon receipt of an ATIA request, unless the informant can maintain a valid objection under section 20 of the ATIA.<sup>9</sup> That said, section 16 of the ATIA provides the Director with the discretion to refuse to disclose "investigative information" which came into his possession less than twenty years prior to the request. While the Director must consider each request for access under the ATIA individually in light of its circumstances, "the ATIA provides the Director with the necessary tools to recommend to the Minister (of Industry Canada) that investigative and commercially sensitive information be exempted from disclosure whenever appropriate"(p. 25).

A stronger statement indicating the Director's intention to prevent disclosure of non-section 29 information to third parties under access requests would be desirable if non-section 29 information is to continue to be provided. In addition, legislative amendments to the ATIA should be sought such that all information gathered in the performance of the Director's functions is exempt from disclosure.

### CONCLUSION

In issuing this draft Bulletin, it would appear that the Director seeks to reassure the business community that confidential business information will not fall into the hands of competitors, customers and suppliers, and that details of their inner workings, or of their dealings with the Bureau, will not be publicly divulged. The wording of the draft Bulletin is careful at all times, however, to retain complete flexibility for the Director. The Bulletin therefore combines comforting language ("with the intent of advancing specific investigations...for which disclosure is necessary") with language which suggests that the only factor relevant to the decision to disclose is whether this disclosure is beneficial in any way for the investigation.

Of course, the Director's mandate is to administer and enforce the Act, and if the disclosure of information is necessary for achieving this purpose, then that must be what Parliament intended to happen. In the grey zone between necessity and convenience, however, the Bulletin as currently drafted particularly in relation to disclosure before other regulatory tribunals and to foreign competition law agencies - leaves one with the impression that the Director might be tempted to disclose confidential information in situations where disclosure is convenient, but not necessary.

Moreover, despite the statement that all information will be treated as confidential information protected by section 29, the draft Bulletin makes it clear that information voluntarily supplied to the Director outside of section 29 can and will be shared freely with foreign governments, subject to safeguards which the Director considers appropriate, but concerning which the source of the information has neither notice nor input nor recourse. Non-section 29 information is also afforded less protection than section 29 information in the context of the Director's response to subpoenas from private parties involved in section 36 litigation. The prospect of having detailed, confidential business information supplied without notice to foreign

## CANADIAN COMPETITION RECORD

governments may well make more than one business with dealings outside of the country think twice about supplying information to the Director except under compulsion of a section 11 order or a search warrant.

In general, however, the inability of counsel now to provide their clients with legal opinions to the effect that the Director will not disclose information provided voluntarily without first seeking the donor's permission, and seemingly without even notifying the donor, runs the risk that the voluntary flow of information to the Director, particularly in the context of civil inquiries and merger reviews, will be severely curtailed. The potential implications for the cost and efficacy of competition law enforcement in Canada suggests that the Director should not only revise the Bulletin to protect non-section 29 information adequately, but should seek an amendment to the Act protecting such information, and providing for notice to the donor and an opportunity to object to disclosure.

Of course, in the increasingly small world we live in, and in light of the recent U.S. legislation proposing bilateral information sharing agreements,<sup>10</sup> some form of international cooperation in the realm of competition law enforcement is inevitable. The draft Bulletin makes it clear that the Director feels strongly that such cooperation must include information sharing, and that such information sharing will be subject to safeguards contained in bilateral or multilateral agreements. Unless and until such agreements and such safeguards are in place, however, we question the advisability of the Director acting on his own to discern what is in Canada's best interests and to disclose all non-section 29 information of potential interest to foreign governments, lest legitimate Canadian business interests and public policy goals unnecessarily be harmed. Moreover, the Director must, in our view, seek a statutory amendment before he can disclose any section 29 information to foreign governments. Such statutory amendments should protect all information supplied to the Director, whether voluntarily or not, and create the safeguards necessary to ensure Canadian interests are protected. Such an approach would also ensure that information sharing will be in the best interests of Canada, and not only the Director.

Finally, as a general comment, if the bulletin is to achieve its goal of familiarizing the business and legal communities with the Director's treatment of information and thereby increasing transparency and efficiency in competition law enforcement, then specific, concrete illustrative Case Studies of the type found in the *Predatory Pricing Enforcement Guidelines* are required.

These comments should not be taken to detract from the importance of the draft Bulletin on confidentiality. This draft opens up the dialogue concerning these vital issues to public debate. Moreover, the Director's willingness to engage in such public debate amply demonstrates his sensitivity to the business community's legitimate interest in privacy and confidentiality. I suspect that the actual practice of the Director is to disclose much less information than would be possible if he were guided by the draft Bulletin as currently written. Comments on the draft Bulletin were requested by September 23, 1994, which was later extended to October 14, 1994. Once the consultative process is complete, a further and perhaps final Bulletin can be expected, to be followed, we hope, by proposals for legislative amendments to protect all information gathered under the Act.

## CANADIAN COMPETITION RECORD

## Notes

<sup>1</sup> Specifically excluded from the draft Bulletin is any discussion of the treatment of confidential information by the courts or the Competition Tribunal. Once formal proceedings have been commenced, the procedural rules and rulings of the tribunal in question regarding discoveries, privilege and protective orders will apply. The Director or the Attorney General, as the case may be, is bound by these rules and rulings, and must proceed accordingly. The draft Bulletin fails to mention the decisions of the Competition Tribunal in the *Director of Investigation and Research v. Southam* (1991), 38 C.P.R. (3d) 390 and dated April 21, 1991 and June 20, 1991 (affirmed by the Federal Court of Appeal on May 6, 1993)(Appeal Nos. A-634-91 and A-429-91), to the effect that the Director is in the position of a private party in its litigation before the Competition Tribunal and, as such, is subject to an implied undertaking not to use any information obtained on discovery for purposes outside of the litigation, without the approval of the Tribunal.

It is also important to note that the Director does not feel constrained in any way to refrain from the "use" of information which falls short of disclosure in the course of carrying out his duties. Confidential information will be analyzed by the Director and integrated into his understanding of the competitive concerns arising out of a particular matter, thereby facilitating informed discussions and avenues of inquiry. So long as specific information is not disclosed to a third party, the Director does not view the Act as imposing any limitations upon his use of confidential information in this manner. The draft Bulletin therefore only addresses the verbal or documentary communication of specific information to third parties.

<sup>2</sup> An "inquiry" refers to an inquiry formally commenced under section 10 of the Act. An "investigation" includes both inquiries and pre-inquiry investigations.

<sup>3</sup> Note that information which has been made public is excluded from any protection by virtue of subsection 29(2) and may be freely disclosed by the Director, subject only to his duty to conduct inquiries in private under subsection 10(3).

<sup>4</sup> See generally Hutton & Hunter, "Confidentiality of Information Provided to the Director: Protection and Pitfalls under the *Competition Act*" (1994) 15:2 Can. Comp. Rec. 63.

<sup>5</sup> Supply and Services Canada, 1992.

<sup>6</sup> See generally Bériault & Renaud, "Information Provided to the Director of Investigation and Research: To What Extent Should It Be Kept Confidential?" (1994) 15:2 Can. Comp. Rec. 79, for a discussion of privileges which may attach.

<sup>7</sup> The criteria which the Director uses in deciding whether and when to recommend that the Attorney General grant preferential treatment, including immunity from criminal prosecution, in exchange for information were outlined in a speech delivered by H. Chandler, Deputy Director of Investigation and Research (Criminal Matters) at an Insight Conference on March 10, 1994. This speech revealed that the Director has expanded the circumstances under which immunity will be considered to include the provision of information after the commencement of an inquiry, and immunity will also be considered for individuals as well as legal entities.

<sup>8</sup> R.S.C. 1985, c. A-1.

<sup>9</sup> Subsection 20(1) of the ATIA permits the sources of information to block an access request by a third party on four grounds: a) trade secrets; b) confidential financial, commercial or scientific information; c) information whose disclosure would result in material financial loss to the informant or prejudice its competitive position; or d) information whose release could reasonably be expected to interfere with contractual or other negotiations of the informant.

<sup>10</sup> *International Antitrust Enforcement Assistance Act of 1994*, H.R. 4871, S. 2297, referred to the House and Senate Committees on the Judiciary as of September 16, 1994.

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## CANADIAN COMPETITION RECORD

*The following is the text of an address given by John F. Blakney on September 28, 1994 in Monterrey, Mexico at the First International Conference on Information Technology, Communications and Their Impact on Industry and Society organized by Integer. Mr. Blakney was asked by the conference organizers to provide a review of the development of telecommunications competition in Canada, and to discuss what other countries might learn from the Canadian experience.*

### **THE CHANGING CANADIAN COMMUNICATIONS LAW ENVIRONMENT**

By: John F. Blakney  
Fraser & Beatty, Ottawa

#### **I. INTRODUCTION**

My remarks today on the changing legal and economic environment in Canadian communications will be divided into two parts. Although I will be concentrating on the telecommunications industry, I will also address some recent developments in broadcasting regulation and industry structure.

The real action in Canada is presently in telecommunications and the key government player is the Canadian Radio-television and Telecommunications Commission ("CRTC").

Broadcasting remains subject to extremely tight entry and content regulation and foreign ownership restrictions designed to support Canadian cultural development. The opportunities created by digital video compression ("DVC") and DTH satellite in the country with the world's highest cable TV service penetration continue to be regarded with considerable apprehension but with the implications of the technology on consumer sovereignty largely having been left to date to further study.

I will begin by summarizing the principal regulatory, industry, and legislative changes in Canadian telecommunications from the first tentative steps towards greater competition in the late 1970s to today. I will conclude by reviewing the substance and implications of a seminal CRTC decision on the future regulatory framework for the telecommunications industry issued this September 16.

#### **II. THE DISTANT PAST**

In the late 1970s, the Canadian telecommunications service sector was the sole domain of full service vertically integrated telecommunication carriers organized as provincial, and, in some cases local, monopolies. These firms were regulated as traditional public utilities. But federal regulation extended only to the carriers serving British Columbia, Ontario, Quebec, the Northern Territories and rural Newfoundland, the national message carrier CNCP Telecommunications (now Unitel), and Telesat Canada, the domestic satellite

## CANADIAN COMPETITION RECORD

service supplier. Telephone companies serving other provinces and numerous small independent local exchange companies were regulated at the provincial level again as traditional public utilities.

Unlike other countries, with the exception of the United States, Canadian telephone companies have largely been investor-owned. State ownership extended only to the telephone companies serving Manitoba, Saskatchewan and Alberta (privatized in 1991), Telesat Canada (privatized in 1992) and Teleglobe Canada (privatized in 1987).

Since the 1930s, the principal full service telephone companies have cooperated in a loose partnership to provide interprovincial and international services based upon an interregional revenue settlement and profit redistribution scheme. This consortium is now known as Stentor the name of a blind warrior in ancient Greek literature best known for his loud yell.

With a series of decisions commencing in the late 1970s, the CRTC began to break up incrementally the telephone company monopoly over services of a specialized nature, principally for business use, and particularly where no case could be made to support the presence of economies of scale and scope arising from the use of extensive common network infrastructure.

The principal remedy supplied by the CRTC was to require telephone companies to provide interconnection to competitors' systems or equipment on a non-discriminatory basis. As we will see, this remains the CRTC's remedy of choice up to its September 1994 regulatory framework decision. The CRTC at no time has required a telephone company to exit a line of business or has prevented a telephone company from entering a new telecommunications market. The CRTC's goal has been fair competition through fair competitor access to the core or bottleneck network.

The principal CRTC decisions providing for niche and carefully defined competition include:

- |      |   |
|------|---|
| 1977 | Automatic mobile phone inter-connection ( <i>Challenge Communications v. Bell Canada</i> , Telecom Decision CRTC 1977-16).  |
| 1979 | Paging service interconnection ( <i>Colins Inc. et al. v. Bell Canada</i> , Telecom Decision CRTC 1979-12).   |
|      | Interexchange voice/data private line service interconnection ( <i>CNCP Telecommunications v. Bell Canada</i> , Telecom Decision CRTC 1979-11).   |
| 1980 | Customer-owned terminal attachment, including extensions, PBX's, key systems, data terminals ( <i>Bell Canada - Interim Requirements Regarding the Attachment of Subscriber-Provided Terminal Equipment</i> , Telecom Decision CRTC 1980-13). |

## CANADIAN COMPETITION RECORD

- 1984                      Radiocommunications common carrier interconnection, cellular, mobile phone (Telecom Decision CRTC 1984-10).
- 1984                      -                      Enhanced services: resale of underlying PSTN service to third parties to provide competing enhanced services    principally store and forward products (Telecom Decision CRTC 1984-18).

Significantly, none of these initiatives were in response to any positive federal government action. All flowed from competitor-initiated CRTC proceedings. Many, particularly CNCP's initiative for interexchange voice/data private line interconnection with the local network, were vigorously opposed by the telephone company respondent (typically Bell Canada which serves Ontario and Quebec and hence the majority of Canadian subscribers). Throughout this formative period the federal government was content to be a passive observer. The federal government did, however, license two cellular service suppliers in 1983 using its radio spectrum management powers.

The single federal government initiative in relation to the impact of monopoly supply, a public hearing initiated by the Canadian antitrust authority into allegations of equipment market foreclosure due to the control of Northern Telecom by Bell Canada, resulted in the "null verdict": no clear evidence of a negative impact on competition or industry efficiency coupled with the belief that the CRTC could and should police the carrier sector to prevent efficiency harming equipment sourcing practices.

### III. THE ADVENT OF LONG DISTANCE COMPETITION

Up to 1984 there was no serious challenge to the monopoly supply of switched interexchange voice (or long distance) service by the integrated telephone companies. The principal focus of the CRTC and other telephone company regulators was restraining local rate increases to maintain "universality" of basic service in a period marked by strong inflation pressures (by Canadian standards, with consumer price increases of around 10% in some years). Where revenue increases were needed, regulatory policy caused them to come primarily from interexchange switched and dedicated services. This tendency was reinforced in the early 1980s by a federal government administered prices policy that required long distance rates to increase at just below the projected rate of inflation.

In the early 1980s, there was no substantial government perception of the emerging importance of telecommunications as a factor in increasing overall economic efficiency and, in particular, labour force efficiency. Telecommunications policy was essentially a subset of social policy.

The second principal policy objective was to ensure that the telephone companies could fund a massive changeover to digital switching technology (to be supplied primarily by Northern Telecom, Bell Canada's affiliate).

## CANADIAN COMPETITION RECORD

The net result was that, by the mid-1980s, Canadian interexchange service rates were much higher than comparable U.S. rates and no change in Canadian policy priorities was in view. In contrast, post-divestiture, U.S. long distance rates had begun to drop and viewing telephone as a social policy instrument had started to lose pre-eminence.

Seizing upon the next logical step in the development of telecommunications competition as confirmed by the U.S. market, CNCP Telecommunications applied in 1984 for local network interconnection rights with Bell Canada and BC Tel to provide competing nationwide long distance services using its cross-Canadian network as a spine. The application was strenuously opposed by Bell, BC Tel and all other members of Telecom Canada (as the Stentor consortium was then known). In mid-1985, the CRTC turned CNCP's application down outright (Telecom Decision CRTC 1985-19).

The basis of the Commission's decision was that CNCP had not proven that its long distance business would be "economic" given its price and market share estimates of the size of the local service subsidy or "access contribution" payments it would have to make to the telephone companies to compensate them for lost internal subsidies due to market share losses to CNCP. The implicit conclusion was that CNCP could not be as efficient as the integrated telephone companies in supplying long distance service - a conclusion consistent with the received wisdom of the post-World War II period that the telephony industry was a natural monopoly by virtue of the presence of economies of scale and scope at all levels of output. There was some outrage over this decision in the business community, but, even though there was a pro-business Conservative federal government in power at the time, CNCP elected not to appeal the decision to the federal Cabinet.

In hindsight, although the CRTC's decision set the course of telecommunications competition back somewhat, there is some reason to feel that the long distance market may not have become all that competitive had CNCP won. First, at the time the CRTC's territorial jurisdiction was unclear and there was therefore considerable doubt over whether CNCP could enter provinces other than B.C., Ontario, and Quebec. Second, CNCP's industry model was essentially a duopoly of interprovincial terrestrial transmission facility owners. The prove-you-are-economic test, if it became the norm having been applied to CNCP, could have created a substantial regulatory entry barrier on its own and an open-entry model then emerging in the U.S. might not have been adopted in Canada. Quite likely, arbitrage or resale-based competition would not have been allowed to emerge as forcefully it has done.

As it has turned out, the real impetus behind long distance competition in Canada from the mid-1980s to date has been interexchange private line resale with reseller interconnection to the local switched network. As in the U.S., where MCI found a crack in the regulatory screen against competition caused by an absence of necessary restrictive facility licence conditions, reseller competition in Canada can be traced to an early reseller (Call-Net Communications - now operating as Sprint Canada) contending that it was in fact an enhanced services supplier by virtue of its supply of detailed account recording in conjunction with

## CANADIAN COMPETITION RECORD

interexchange voice services. Through a combination of dogged regulatory litigation, good PR, and stalling tactics, Call-Net managed to provoke a general CRTC rulemaking proceeding which, in early 1990, permitted reseller-based long distance competition but again only in B.C., Ontario, and Quebec (Telecom Decision CRTC 90-3). In this decision, possibly to save some face, the CRTC advised that it expected that resellers would concentrate on enhanced services (and hence there would likely be little threat to local service cross-subsidization). In fact, resellers did exactly what good arbitrageurs should do, they headed straight for the fat margins in conventional long distance service focusing on the small-medium business submarket.

Perhaps sensing the pitter-patter of little feet, CNCP (now renamed Unitel Communications and sporting a capital infusion from the Rogers cable TV/cellular conglomerate) finally made good on its oft-repeated promise and reapplied for authority to provide "facilities-based" long distance competition in the spring of 1990. Not to be outdone, pesky Call-Net joined with BC Rail in its own "facilities-based" application. In this context, "facilities-based" has come to mean ownership or control of at least one interexchange (inter-city) transmission path. Unitel also requested interconnection at telephone company Class 4 switches similar to Feature Group D access in the United States.

Again, the applications were strenuously opposed by the telephone companies and others. The CRTC held a public hearing lasting over 2 1/2 months in 1991.

By the time this case was heard, the Supreme Court of Canada had ruled (in an action started by CNCP in the early 1980s) that all Stentor companies were subject to federal jurisdiction. Thus, the CRTC could, when it wanted, ensure that the playing field would be even to long distance competitors across Canada.

Finally, in June 1992, the CRTC approved Unitel's application finding that Unitel's business plan, with the access contribution payment burden calculated (in great detail) in the decision, would indeed be economic. The Call-Net application was turned down as "uneconomic" taking into account that the contribution payment scheme adopted in the Decision was more onerous than the contribution payment the Call-Net consortium had offered up in its application (Telecom Decision CRTC 92-12).

But this result for Call-Net, and indeed the entire reasoning relating to the economic viability of competition from Unitel, became entirely academic because the CRTC also boldly stated that, henceforth, it would no longer test Feature Group D interconnection applicants to see if they were "economic". Opportunities for resale competition were also expanded geographically and among services. In effect, the CRTC authorized open entry into long distance service with no regulatory preference to be given to "facilities-based" firms over simple resellers and with no geographic service obligations. The only conditions would be paying the relevant access contribution charges. Resellers, because they offer a lower quality service compared to a carrier with Feature Group D-type interconnection, pay a somewhat lower contribution charge.

Unitel won entry rights, but at the same time it lost protection from other new entrants. Resellers won big: they were now legitimate. The telephone companies could not believe that the CRTC had completely

## CANADIAN COMPETITION RECORD

rejected their case based on the proposition that economies of scale and scope still made long distance a natural monopoly. They appealed to the courts on narrow grounds concerning the CRTC's use of the interconnection power to foster competition and the manner in which they would be compensated for certain interconnection costs. The appeal was unsuccessful but did stall the implementation of equal (FGD) access arrangements by about half a year.

It was only this summer that long distance competitors could begin to switch over from line-side to trunk side (or equal access) interconnection. But the process by most reports is going smoothly and quickly.

In the meantime, the CRTC has authorized trunk-side access to the local network by resellers (Telecom Decision CRTC 1993-8), thus removing the last regulatory distinction between resellers and facilities-based carriers.

Since 1992, the structure of the long distance sector has evolved quickly. The number of intercity resellers has grown. AT&T has purchased a minority interest in Unitel, as has Sprint in Call-Net (which then renamed its operating company Sprint Canada). Bell has coventured with MCI in developing a Virtual Private Network product while taking a position in Jones cable in the U.S. and Cable and Wireless in England. Some resellers have constructed or acquired their own intercity facilities in selected high-density markets.

The principal competitive response of Stentor has been a program of targetted long distance discounts for business customers (until availability of equal access interconnection this past summer, competition for residence long distance traffic has not been practical). This targetted discount program has successfully limited competitor long distance market share to about 10-12% of total minutes. The CRTC, somewhat belatedly this August, responded to competitor criticism of its Decision 92-12 long distance price reduction tests and has now effectively established a floor price test for future targetted discounts that imputes the average contribution per minute as a cost of producing minutes sold at a targetted discount (Telecom Decision CRTC 94-13). (Additional constraints on predatory pricing were established in this September's Regulatory Framework Decision, see part 5 below).

I will examine the future of long distance competition further in the context of this September's omnibus CRTC regulatory framework decision.

#### IV. NEW TELECOMMUNICATIONS LEGISLATION

Lest it appear that the federal government had been entirely inactive over the last decade, save for issuing cellular and public cordless licences, in October 1993, a new *Telecommunications Act* was proclaimed in force.

## CANADIAN COMPETITION RECORD

This Act largely reenacts the regulatory scheme of the *Railway Act*, which provided the vehicle for all the CRTC's pro-competition decisions in the last fifteen years, and consolidated a number of Special Acts (for Teleglobe, Telesat and Bell Canada). There was indeed a very long legislative process. The first omnibus revision was tabled in Parliament in 1978. Tabled a *Telecommunications Act* in one form or another became virtually an annual event during the 1980s.

The version enacted in 1993, while large in size, contains little that might be viewed as innovative. Of particular note are the following new features:

- (1) The federal government's policy of restricting foreign investment in telecommunication carriers to 20% of voting shares, first made explicit in July 1987 to ensure grandfathering under the Canada-U.S. Free Trade Agreement, has now been legislated (proposed regulations would permit the limit to be 33 1/3% through a holding company structure), thus the minority positions taken by AT&T and Sprint in Unitel and Call-Net respectively.
- (2) Resellers, i.e. carriers that do not own or control transmission facilities, are not caught by the Act and are not subject to foreign ownership restrictions.
- (3) The CRTC can exempt other classes of carriers from the Act and has recently decided to do so for wireless carriers that do not supply switched voice services.
- (4) The CRTC can also "forbear" from applying some or all of the Act's tariff-approval-based regulatory scheme to specific carriers where it finds that competition is or will be sufficient to ensure just, reasonable, and non-discriminatory rates.
- (5) Basically, all power rests with the CRTC subject to the traditional (and little-used) right of the federal Cabinet to vary and rescind any CRTC decision, and a new Cabinet power to issue binding "policy" directions to the Commission (but only after Parliamentary scrutiny of the proposed direction). This direction power is unlikely to ever be used much.
- (6) There is now a U.S.-style wish list of the legislator's views on what the CRTC should do in exercising its powers, termed the "Canadian Telecommunications Policy". It begins by affirming that "telecommunications performs an essential role in the maintenance of Canada's identity and sovereignty" and then lists seven separate objectives that leave the impression that Parliament views telecommunications carriage as a strategic industry which should generally be subject to extensive government intervention. The presence of this statutory policy does not yet appear to have materially restrained the CRTC in its efforts to continue to free up the telecommunications marketplace, and, indeed, some individual elements of this policy encourage competition and more focused regulation.

## CANADIAN COMPETITION RECORD

At its core, however, the *Telecommunications Act* is a public utility regulation and foreign investment control statute. Some observers question whether it will provide adequate flexibility to withdraw traditional regulatory controls on a timely basis that does not frustrate efficiency-inducing innovations; but at least the CRTC can now withdraw from profit or price regulation based only on prospective competition. Others question the breadth of the foreign investment limit which captures pure intercity services such as Unitel and Sprint Canada. Nevertheless, these restrictions are likely to be maintained as long as the U.S. and Mexico maintain similar foreign investment policies for the telecommunications services sector.

### V. OVERHAULED CRTC REGULATORY FRAMEWORK

Not surprisingly, since Decision 92-12, the CRTC has come under increasing pressure from the Stentor telephone companies to let them compete more freely through a combination of long distance deregulation, local/long distance rate rebalancing (i.e. revenue-neutral local subsidy removal), and the removal of alleged contribution charge preferences favouring new entrants. The telephone companies, at the same time, have pressed both the CRTC and the federal government for removal of several long standing policies that prevented or inhibited telephone company entry into vertical or enhanced broadband services, particularly video-on-demand and broadcast retransmission.

Competitors have sought forbearance or exemption based on the lack of market dominance, protection from alleged predatory pricing (or targeted discounts), lower contribution charges than proposed annually by the telephone companies, and special measures such as customer balloting (currently the subject of a CRTC proceeding) to reduce customer "inertia" in the residential market.

Cable TV firms have tried to have their cake and eat it too. The largest urban systems, such as the Rogers and Videotron holdings, have become suppliers of local private line and intercity broadband services to business users and interexchange carriers. (The CRTC has in fact found that the Rogers' intercity business was subject to the former *Railway Act* just like a telephone company). At the same time, cable firms had fought a rear-guard action to put obstacles in the way of telephone company investments in local optical fibre (and hence broadband) facilities to replace copper wire facilities, and to prevent the erosion of their policy status as the instrument of choice for the retransmission of broadcasting and pay TV services (including video-on-demand), and hence the cornerstone for regulated dissemination of Canadian programming.

Canadian cable TV services have only recently been given some breathing space from DBS competition. In June 1993, the CRTC endorsed accelerated conversion of cable networks to digital video compression by authorizing a temporary basic cable surcharge of up to \$1.50/month to fund the supply of household DVC converters. At the same time, the CRTC has been authorizing new specialty/narrowcast services to fill conventional channel slots as cable system upgradings make them available. The CRTC has also taken the position that the supply in Canada of decoding devices for U.S. satellite-based DBS services would constitute a broadcasting undertaking that would require prior CRTC approval and licensing.

## CANADIAN COMPETITION RECORD

Unfortunately, the net result may be that the price of cable TV service in Canada could be diverging from what its value would be in a market with lower regulated entry barriers to a degree similar to long distance service in the mid-1980s. Effectively, the extent to which the CRTC can manage the relative availability of Canadian and foreign broadcast programming depends almost entirely on the Commission's ability to regulate competition with cable TV services. The CRTC appears to be assuming that it can control telephone company competition and ensure that telephone supplied TV services meet Canadian content minima, while still creating enough consumer choice to foreclose a DBS black market. This appears to be a very heroic assumption indeed. Some estimates already put the revenues of the unregulated Canadian video rental industry well above those of all Canadian TV networks combined.

Consumer representatives have been torn between getting on the information highway bandwagon and hence supporting higher cost higher bandwidth service as basic telephone service, on the one hand, and, on the other hand, limiting basic service to voice telephony while leaving competition to deliver enhanced services only where demand warrants and at an unregulated price. (This spring the federal government established an advisory committee to study and report on every possible implication of the information highway. The government would appear to view broadband communication systems as a legitimate and important industrial policy lever).

To deal with these various issues, the CRTC began a proceeding in late 1992 to determine the appropriate regulatory framework for the dominant integrated telephone companies, i.e., the Stentor consortium. A six week hearing was held in late 1993.

The CRTC's decision was released on September 16 (Telecom Decision CRTC 94-19). It is a very political document, appearing to give something to everyone (with the possible exception of Unitel, whose majority shareholder is reportedly now seeking to sell its shares). The present conventional wisdom is that the Stentor members got more than any other interest largely because the general regulatory model they advanced was for the most part accepted by the CRTC. But the decision is complex and there will now be numerous implementation proceedings over the next several years that will be the real test of where the regulatory advantages flow.

Some of the key aspects of the decision are as follows:

- (1) Rate rebalancing through average local rate increases of \$2.00/month over each of the next three years starting in January 1995 to move rates closer to costs, followed by implementation in 1998 of price caps for "utility" services (a portfolio the CRTC has yet to define which may by 1998 encompass more than monopoly services).

The CRTC has finally decided to focus on the overall telephone bill instead of local service rates as the measures of affordability and to use penetration rates (Canada has the highest in the world) as the measure of universal availability to basic phone service.

## CANADIAN COMPETITION RECORD

- (2) The lower long distance subsidy requirement arising from those local rate increases must be immediately reflected in lower basic long distance rates designed to make rate rebalancing in any given year "revenue neutral". The reduced subsidy requirement cannot be used to reduce discounted long distance products further. In principle, further reductions in such targeted discount products should be financed only to the extent that a telephone company enjoys overall productivity improvements.
- (3) Continued rate base/rate of return regulation (i.e. profitability regulation) of the Stentor members' "utility" business for the next three years with that business component to be established using the CRTC's established service category costing methodology (i.e., the rate base will be split). The CRTC will conduct a proceeding late this year to initialize this split rate base transitional model. The utility component will comprise essentially the network access and local service portion of the telephone company's costs and revenues (including optional or vertical to services).
- (4) Both vertically integrated carriers and interconnecting competitors are to be charged the same per minute Carrier Access Tariff ("CAT") for the local network component of long distance calls (including a per minute access contribution). CAT charges assessed against an integrated carrier's long distance business will become a revenue imputation to the "utility" business for rate of return regulation.
- (5) To guard against anti-competitive cross-subsidization between toll services prior to a more even distribution of competitors among the various toll submarkets, the CRTC has elected not to forbear from exercising any of its regulatory powers in relation to Stentor long distance and private line services, and has imposed an immediate price cap on basic toll services which will also help to ensure an outwardly equitable pass-through of the reduced long distance subsidy burden.
- (6) Accordingly, and perhaps of greatest significance, the CRTC rejected divestiture and structural separation as options for dealing with telephone company dominance, finding that a split-rate-base model followed by price caps, along with other narrower predatory pricing controls, would be sufficient. In fact, the CRTC seems to have endorsed vertical integration as a necessary condition for "competitiveness in global markets" and for quick deployment of integrated services made possible by the "convergence" of the communications, information, computing, and entertainment industries.
- (7) The CRTC will no longer stand in the way of content control by telephone companies but will monitor telephone company broadband plant investment in the near term to ensure there is adequate demand and no cross-subsidization. It is unclear, however, whether the CRTC really intends to regulate carefully telephone company fibre to the curb or ATM investment programs. In a related decision, the Commission has exempted video-on-demand trials from requiring a broadcasting licence, thus opening the door to recently announced telephone company menu-driven video trials using ATM technology.
- (8) The CRTC has resoundingly endorsed local network unbundling and collocation, and has required Stentor to file a proposal modeled upon an Ameritech unbundling model published in early 1993. The

## CANADIAN COMPETITION RECORD

Commission has placed considerable faith in unbundling as a primary means of mitigating the market power of vertically integrated carriers, which market power, in the longer term, the Commission sees as flowing principally from control of local access networks and their components. The Commission wants to jump start local competition prior to deregulating Stentor long distance services and implementing a utility segment price cap system.

- (9) While declining to deregulate Stentor long distance rates, the Commission has left open the possibility of doing so before the implementation of price caps in 1998, but only if traditional competition law tests of the absence of market power can be met. As noted earlier, in August, the CRTC adopted a more stringent floor price standard designed to prevent future anti-competitive or predatory targeted discounts. There is no clear standard set out in the decision for deregulating Stentor long distance services or for determining the absence of potentially anti-competitive market power, but implementation of local services unbundling and satisfactory implementation of the split rate base regime are two of six conditions precedent to regulatory forbearance for Stentor long distance services advanced by the Commission.

### VI. CONCLUSION

As has been the case in other regulated industries such as trucking and airlines, the lowering of Canadian constraints on competitive entry in telecommunications has lagged U.S. action by several years. It has, however, largely kept pace with Japanese and British initiatives to introduce network services competition.

Canadian antitrust law and legislators have not been significant factors in this change as they have been in other countries. Nor really has the executive branch of government. The agenda has been controlled and, more recently, driven by the CRTC, especially with the 1992 open entry policy for long distance services and the 1994 requirement for network services unbundling using the Ameritech model.

Measures to prevent anti-competitive behaviour by Stentor members, particularly predatory targeting discounting, may have been less than satisfactory because of their reliance on inexact and somewhat arbitrary common cost assignment methodologies. But short of divestiture, a policy which Canadian governments would never endorse for a variety of reasons, there may be no better control until strict price caps are in place. On balance, the CRTC to date appears to have placed a higher priority on getting business long distance rates down close to U.S. levels than on addressing the consequences on the development of a competitive long distance sector of the Stentor volume discount schemes designed to achieve U.S. levels in practice. However, with the Commission's recent decisions, this balance may now have shifted more towards developing competition principally through tougher controls on further targeted discounts.

Accordingly, over the next few years, we may be able to detect whether the Canadian choice of building a set of niche competitors around an industry core of vertically integrated and territorially discrete telephone companies yields more workable competition and rapid innovation throughout the industry when compared to the U.S. approach which has been built around legislated and court-enforced lines of business restrictions

## CANADIAN COMPETITION RECORD

and cross-ownership prohibitions. The more structural U.S. approach may have been more effective public policy in the 1980s; but, in my view, it is unclear that the structural approach will be found to be the best one for the 1990s.

Several basic lessons emerge from the development of telecommunications competition in Canada over the past two decades that might inform the regulatory policy frameworks of other countries.

First, it is dangerous to assume that bigger is always better in terms of overall industry efficiency or the capacity to meet policy objectives such as broadly based basic service availability. In particular, evidence or arguments supporting economies of scale and scope needs to be approached with considerable skepticism, especially if it is based upon the single (wireline) technology that has characterized the telecommunications infrastructure of industrialized countries since the advent of public telephony and throughout this century.

It follows that governments run a great risk in trying to select winner firms or winner technologies. Support of multiple technologies and freedom of supplier association through standardization of system interconnection, in other words a non-interventionist approach, offers the best route to an efficient infrastructure.

Second, placing social policy objectives ahead of economic growth objectives should be avoided, as should the main manifestation of social policy primary - the generation of massive price-distorting internal cross-subsidy pools. Such cross-subsidy pools provide too much opportunity to frustrate competition through selective cross-subsidizing of services newly subject to competition, and the identification of incumbents with social goods such as basic telephone service gives incumbents an unwarranted advantage in dealing with governments. From this it follows that explicit subsidies should be employed whenever possible and that there should be a very clear and early government understanding of what the subsidizable product (basic telephone service) should be. This understanding should be adhered to; incumbent suppliers should not have the opportunity to expand on the concept of basic services to include services that can be more efficiently supplied in a competitive environment.

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