

# CANADIAN COMPETITION LAW AND POLICY DEVELOPMENTS

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## **GEORGE N. ADDY LEAVES THE PUBLIC SERVICE TO RETURN TO THE PRIVATE SECTOR**

*The following is a News Release issued by the Competition Bureau on June 5, 1996, and is reproduced with permission.*

OTTAWA, June 5, 1996 — The Honourable John Manley, Minister of Industry announced today that George N. Addy, Director of Investigation and Research under the *Competition Act*, has decided to leave the public service and will be returning to the private sector effective June 30, 1996.

Mr. Addy left private legal practice to become Senior Deputy Director of Investigation and Research in 1989 and was appointed Director in 1993.

In his letter of resignation, Mr. Addy thanked the Government for having provided him with the opportunity to serve as Director. He expressed his confidence in the *Competition Act* and in the Competition Bureau to continue the tradition of balanced compliance and enforcement which has become the hallmark of Canada's approach to this area of law.

"I am proud of what I was able to achieve as Director and am glad to have had this opportunity to serve my country. It is now time for me to seek out new challenges in the private sector," Mr. Addy said.

Mr. Manley expressed his appreciation for the significant advancements Mr. Addy has made in competition law and policy, particularly in the area of international cooperation in law enforcement with the USA and other OECD member countries.

"In addition to the cases which he brought before the courts and the Competition Tribunal, his determination to increase public awareness of the Act and the transparency of its interpretation and enforcement has been recognized by the business, consumer and legal communities," the Minister said.

"As indicated in the Speech from the Throne, the Government is committed to strengthening economic framework legislation. The steps taken by Mr. Addy in preparing the way for amendments to the *Competition Act* will ensure that Canada stays at the leading edge of competition law and policy. Sound legislation and balanced enforcement are of vital importance to Canadian markets and to the competitiveness of Canadian business. The

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Government has also benefited from Mr. Addy's advice on the challenges facing all of us in bringing the Information Highway to the door of all Canadians," Mr. Manley added.

Pending the appointment of Mr. Addy's successor, Francine Matte, Q.C. Senior Director of Investigation and Research, will immediately be exercising all the powers and duties of the Director as provided for under section 8(2) of the *Competition Act*.

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### **CORPORATE COMPLIANCE PROGRAMS: A COMMENTARY ON THE DIRECTOR'S CONSULTATION DRAFT BULLETIN**

The Director of Investigation and Research (the "Director") under the *Competition Act* (the "Act") recently released, for consultative purposes, a draft Information Bulletin (the "Bulletin") regarding corporate compliance programs. This commentary provides a summary and critique of the Bulletin.

#### **Overview**

As part of the ongoing initiative to encourage and facilitate compliance with the Act, the Director has issued the Bulletin with the recognition that, while most firms do comply with the law, there remains a need for firms to develop their own compliance programs to help them avoid contravening the law. The Bulletin also states that an ancillary benefit of implementing such a program is that it will promote a higher level of competitiveness within the parameters of the law.

In the *Preface*, the Director states that the Bulletin's purpose is to provide guidance on the steps that businesses can take to minimize the risk of violations

of the Act. In this regard, the Bulletin provides practical advice on the essential elements of an effective internal corporate compliance program. As well, the Bulletin provides some insight into how implementation of such a program will affect the Director's viewpoint in considerations of alternative case resolution, immunity discussions, due diligence defences in certain strict liability offences as well as sentencing and remedial orders.

#### **The Five Essential Elements of an Effective Compliance Program**

The Bulletin sets out five elements that are crucial to any effective program. These elements are only intended to provide a general basis for the creation of a compliance program suited to the specific needs of a firm, given the nature of its business, management structure and available resources.

##### *Involvement and Support of Senior Management*

The Bulletin states that the clear and unequivocal support of senior management is the foundation for an effective compliance program. Support from the top down must be demonstrated. Senior management must actively, and in a highly visible manner, promote compliance as part of company policy. As well, it is suggested that a senior person should be designated as a "compliance officer" and given the responsibility of overseeing the program. The Bulletin further suggests that compliance must not be viewed as a matter for legal staff only. Rather, it is the responsibility of all employees.

##### *Development of Relevant Policies and Procedures*

The substantive policies and procedures of a compliance program should be developed and disseminated throughout the company in some form of company publication. While recognizing that the

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required detail and form will be company specific, the Bulletin suggests that the publication should include:

- a statement from the CEO stressing the importance of compliance;
- illustrative examples of prohibited practices;
- a practical code of conduct;
- a statement setting out the internal disciplinary actions that may be taken when employees initiate or participate in anti-competitive conduct; and
- a signed employee acknowledgment indicating they have read and understood the compliance policy.

The Director further suggests that the relevance of these policies and procedures should be maintained by regularly adjusting them to account for changes in the law, new Bureau enforcement policies, new business developments and firm-specific changes.

#### *Ongoing Education of Management and Employees*

The Bulletin states that an effective compliance program will contain a multi-faceted and on-going training component for staff at all levels. The firm's compliance policies and procedures can be supplemented with other materials such as the Bureau's own publications to form the substantive content for annual training seminars and periodic seminars dealing with more specific issues. Training should be provided to all employees who may be in a position to engage in, or be exposed to, anti-competitive conduct. The Bulletin further suggests that a periodic review of the training program should

be undertaken to ensure that the program's objectives remain relevant and are being met.

#### *Audit, Monitoring and Reporting Mechanisms*

##### (a) Audit Mechanisms

The Bulletin defines an audit as a systematic preventive measure designed to ensure that violations of the Act are not in progress and that any violations that are discovered are dealt with appropriately. It is suggested that audits on a periodic or *ad hoc* basis, as well as event-triggered audits, or any combination of these audit types may be appropriate depending on the risk of non-compliance. For example, the Bulletin suggests that periodic audits are most appropriate where a company is reasonably confident of its compliance and would like to regularly confirm that this is in fact the case. Conversely, if there is a significant risk of non-compliance, *ad hoc* audits throughout the entire company or in the specific area of risk might be prudent. The Director further suggests that all companies, as a minimum, should establish the capacity to undertake, quickly and effectively, an event-triggered audit. Appropriate triggering events would be major pricing initiatives, certain client complaints, or the termination of clients under certain conditions.

Whatever the type of audit chosen, the Bulletin maintains that the auditor must have independence and the support of senior management, as well as the authority to examine documents and interview employees. Furthermore, the existence of an effective audit mechanism will help convey senior management's commitment to compliance and encourage all staff to be diligent in meeting the requirements of the Act.

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### (b) Monitoring Mechanisms

The Bulletin distinguishes a monitoring mechanism from an audit in that it is an ongoing procedure that checks for potential violations of the Act. It is suggested that such mechanisms would be of particular benefit in areas such as advertising. As well, monitoring mechanisms may serve as a vehicle for feedback in that they should also be used to ensure the compliance program's continuing relevance, measure employee awareness of competition issues and evaluate the effectiveness of the training programs.

### (c) Reporting Mechanisms

The Bulletin sets out that employees should be provided with a means of voicing their concerns when they encounter practices that are not consistent with the company's compliance policies. It is essential that an environment promoting free and frank disclosure be created such that any employee using the "whistle blowing" procedure can do so without fear of retribution or reprisal. Moreover, there should be positive recognition for employees who report information about possible illegal practices.

The Bulletin suggests several specific elements for an effective reporting mechanism:

- reports should be made to an employee's superior, or if appropriate, one level higher;
- a right of confidential access to a managing director or chairperson, and a neutral person within the firm, to whom employees can make a final appeal; and
- a process to determine whether to report offences or possible offences to the Bureau.

Finally, the Bulletin suggests that, because of the important function served by a reporting mechanism, companies should consider implementing one in combination with an audit or monitoring system, or both.

### *Disciplinary Procedures*

Consistent and even-handed disciplinary procedures will demonstrate the importance of compliance and make employees aware of the consequences of their actions. The Bulletin suggests that such measures be implemented after a grace period, giving sufficient time for all staff to become aware of the compliance program and its objectives. In addition, it is suggested that allowances should be made and lesser penalties levied where employees self-report any wrong-doing.

### **Impact of an Effective Compliance Program in Dealings with the Bureau**

A compliance program that is properly implemented and maintained will not completely protect a firm and individuals from enforcement action by the Bureau or prosecution by the Attorney General. However, the Bulletin suggests that a proper compliance program will be a consideration in cases where alternative case resolution ("ACR") might be appropriate or when remedial action of any kind is being considered.

One exception to note is that, if senior personnel, as the "directing minds" of the corporation, are found to have condoned or participated in conduct contravening the Act, the existence of a compliance program will not likely be a mitigating factor in the Director's considerations. Such behaviour would suggest that the firm's compliance program was not effective because the commitment and support of senior management was not serious or meaningful.

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*Alternative Case Resolution*

The Bulletin sets out that, in cases where the Director is considering ACR, the existence of an effective corporate compliance program may influence the Director's determination of what may be an appropriate resolution of the matter. In such cases, the effectiveness of the program would be demonstrated by:

- (i) the illegal conduct being terminated as soon as it came to light and before Bureau involvement;
- (ii) the company attempting to remedy the adverse effects of the conduct; and
- (iii) inconsistency of the conduct with corporate policy.

If these results are demonstrated, the Director will be more willing to advise the Attorney General to accept ACR, rather than prosecution, as a remedy. As well, in cases where a form of ACR is appropriate and no compliance program exists, the Director may include the implementation of a program as part of the resolution of the matter.

*Program of Immunity*

One of the conditions for the granting of immunity is that the person seeking immunity must be the first to approach the Bureau with evidence of the offence. The Bulletin points out that companies without a compliance program may not become aware of possible violations of the Act early enough to request immunity. Moreover, firms without compliance programs may suffer the consequences of others being the first to seek immunity in a matter.

*Strict Liability Offences*

Certain strict liability offences under the Act provide for a due diligence defence. The Bulletin suggests that effectiveness of a company's compliance program in avoiding errors will be some indication of whether the company exercised due diligence to prevent the offence.

*Sentencing and Remedial Orders*

An effective compliance program may give the Director cause to recommend a lesser sentence to the Attorney General in criminal matters where a guilty plea has been entered. To be considered effective, the Bulletin suggests that the compliance program should demonstrate that the criminal conduct:

- (i) was stopped once it became known;
- (ii) was not consistent with the firm's compliance policy; and
- (iii) was contrary to the actions and statements of management.

In reviewable matters, the remedial jurisdiction of the Competition Tribunal is considerably more limited than that of courts in regard to criminal offences under the Act. Only the provisions dealing with abuse of dominant position, exclusive dealing and tied selling allow for remedies that go beyond prohibiting the anti-competitive conduct. Accordingly, the Bulletin states that the Director, in seeking a remedial order under these provisions, will consider including a requirement that a compliance program be implemented to prevent future anti-competitive behaviour.

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### A Critique

The release of the Bulletin and the increased attention to promoting compliance with the Act is a laudable objective and the Director should be commended for maintaining a prominent role in this regard. In only a few short years, the Bureau has established a comprehensive communication and education program comprised of bulletins, guidelines, pamphlets, periodicals and other publications and programs which the business and legal communities consult on a regular basis.

The latest effort in this regard, i.e. the Bulletin, has certain characteristics that distinguish it from other Bureau publications. Most other Bureau publications focus on the interpretation and enforcement policy related to specific provisions under the Act (e.g., misleading advertising, price discrimination, predatory pricing, etc.) and therefore provide invaluable guidance about how business should be conducted in specific contexts to ensure compliance with the Act. These publications are buttressed by the Advisory Opinions Program. The common thread linking these efforts of the Bureau is that these publications or programs are consulted or used by firms when they choose to undertake certain business practices; they do not otherwise impose any positive obligation on such firms.

By contrast, in establishing minimum standards for an effective compliance program, the Director is implicitly, if not explicitly, imposing an obligation on companies to establish such internal compliance programs. While the general premise of promoting compliance with the Act should be encouraged, the thrust of the comments below regarding the Bulletin can be summarized as follows: (i) the standards established by the Bulletin are too onerous and

burdensome for the overwhelming majority of businesses and, in this regard, too intrusive; (ii) the Bulletin does not sufficiently recognize the distinctiveness between the market presence of, and resources available to, different firms and thus their relative exposure under the Act; and (iii) in light of (i) and (ii), a cost-benefit analysis would likely lead most entities to conclude that the costs of implementing a compliance program in accordance with the Bulletin would outweigh the related benefits.

### *Motivation for the Bulletin*

Before delving into the specific aspects of the Bulletin, there is a threshold question that needs to be addressed: what factors motivated the issuance of the Bulletin by the Director at this time? Other than the obvious objective of promoting compliance with the Act, the answer to this question is not apparent from the document.

In contrast, it is evident from preceding Bureau publications that they were motivated largely by the uncertainty surrounding the statutory interpretation and enforcement policy related to certain provisions of the Act. The *Merger Enforcement Guidelines* and *Price Discrimination Guidelines* are two good examples. However, clients rarely inquire about establishing a corporate compliance program. Assuming, therefore, the Bulletin was not in demand from the business and legal communities, the impetus for its issuance was presumably based on certain observations and/or developments apparent to the Bureau. These should be communicated in the next iteration of the Bulletin. As discussed below, the Bulletin, in its present form, imposes a significant burden on companies who decide to implement a compliance program. In this regard, any such burden

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would be more palatable if the motivation for the Bulletin was explicit in the document.

*Components of an Effective Compliance Program*

In reviewing the five essential components of an effective compliance program discussed in the Bulletin, it is apparent that these were significantly influenced by the guidelines for the sentencing of organizations found in Chapter Eight of the United States Sentencing Guidelines (the "US Guidelines"), particularly in regard to the definition "an effective program to prevent and detect violations of the law", which is contained in the latter. Each of the seven key components of an effective compliance program, as defined under the US Guidelines, are included in the Bulletin, although the latter is considerably more detailed. In this regard, the administrative burden imposed by the Bulletin is as far-reaching, and arguably more so, than that imposed by the US Guidelines. However, it is submitted that there are a number of compelling reasons why the US Guidelines represent an overly intrusive model for Canadian corporate compliance guidelines.

First, the US Guidelines are specifically directed at criminal conduct whereas the Bulletin addresses compliance with both criminal offences and reviewable practices under the Act. Moreover, there is a reasonable likelihood that a few criminal offences under the Act will become reviewable practices in light of the proposed amendments to the legislation. Such offences include price discrimination, promotional allowances and misleading advertising. If this were to occur, very few criminal offences would remain. Yet, unless the Bulletin is substantially modified, it would reflect a compliance program model based largely on the prevention and detection of criminal conduct.

Second, in regard to the most prominent criminal offence under the Act — the conspiracy provision — its treatment in Canada is significantly different from the United States. Specifically, the inclusion of an "unduly" test under section 45 makes a conviction for such conduct far less likely in Canada than in the United States, where such conduct is a *per se* offence. This is clear from the recent decision in *R. v. Clarke Transport Canada Inc.*<sup>1</sup> where the corporate accused avoided a conviction under section 45 despite the fact that there was irrefutable evidence of an agreement amongst competitors to fix prices which prevailed for a number of years. In the end, Justice Moldaver held that the Crown had not met the test for demonstrating an "undue" lessening of competition. By contrast, in the United States, such conduct would have resulted in significant fines and likely incarceration.

Third, even assuming a conviction were to arise in connection with a criminal offence under the Act, it is generally accepted that the level of fines in Canada are substantially below those in the United States. This said, the US Guidelines provide for a quantifiable reduction in fines where an effective compliance program is in place. Conversely, while the Bulletin suggests that an adequate compliance program may be viewed as a mitigating factor, it is difficult to estimate the magnitude of its impact and therefore the potential benefit arising from its implementation.

Fourth, although the US Guidelines are directed primarily at the sentencing stage, there are far more significant related benefits in the United States arising from the prevention of a violation than exist in Canada. That is, in addition to the enforcement of antitrust laws in the United States at the federal

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level, there is also vigorous enforcement at the state level and significant litigation within the private sector. As such, the risk of a company facing significant fines and/or damage claims, the latter being treble rather than single, is far greater in the United States than Canada.

### *Market Presence and Resources*

In a number of instances throughout the Bulletin, it is evident that consideration was given to the tailoring of a compliance program to the characteristics of the business in question. Nevertheless, the Bulletin appears to contemplate that all firms will be subject to its application, in a relatively similar manner, with a degree of "fine-tuning" reserved for each specific firm. In this regard, the Bulletin establishes a high minimum standard. It is submitted that this is a somewhat curious outcome in light of the structure of the Act.

Rather than the approach contemplated by the Bulletin, the necessity to implement a compliance program and, if so, its specific components, should turn entirely on the significance of a firm in the market in which it operates. The basis for this position is that the majority of the Act is subject to a rule of reason analysis and that the risk of liability under the Act is very much a function of the size of an entity in its relevant market. For example, firms with a relatively small market share, e.g., less than 20 percent, would typically face a significantly lower risk of offending any provisions of the Act which entail a "lessening of competition" analysis. As such, the Bulletin should reflect this by establishing significantly different standards for effective compliance programs.

In a related point, the Bulletin also appears to recognize some flexibility in the formation of a

compliance program depending on the resources available to the firm. However, the Bulletin provides little guidance in determining the appropriate level of resources that should be allocated toward the establishment of a compliance program.

### *Impact of an Effective Compliance Program*

In considering whether to implement a compliance program in accordance with the Bulletin, it would be rational for a firm to undertake its own cost-benefit analysis. While the costs will be easily ascertainable, the Bulletin provides little assistance to a firm in assessing the benefits arising from a compliance program, particularly in a quantifiable manner. For example, at page 16, the Bulletin states that "(w)hen a guilty plea is entered, an effective compliance program *may* lend support to a reduction of the sentence that the Bureau would otherwise recommend to the Attorney General" (emphasis added). Other references to potential benefits, e.g., recommending a Prohibition Order, are equally vague.

In regard to reviewable matters, the Bulletin acknowledges that with the exception of provisions dealing with abuse of dominance, tied selling and exclusive dealing, the Director lacks the statutory authority to pursue orders requiring the institution of a compliance program. Therefore, with respect to reviewable practices, the apparent benefits to a firm of instituting the compliance program will likely appear limited.

### **Conclusion**

Despite the obvious virtues of promoting compliance with the Act, in considering whether or not to implement a compliance program, the typical firm will likely consider one simple question: do the

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benefits outweigh the costs? In its current form, the Bulletin imposes a significant burden and therefore, cost, on a firm. While, in certain limited circumstances, this cost may be justifiable due to the high risk of a violation under the Act associated with certain firms, this cost will be excessive in an overwhelming majority of the cases. That is, most companies are not significant players in their relevant markets and therefore run little, if any, risk under any of the provisions of the Act which involve a rule of reason analysis. Therefore, subsequent versions of the Bulletin should acknowledge this reality of the marketplace and considerably scale down the requirements of a compliance program in situations where the risk of violation is comparatively low.

P.C. and M.T.

#### Notes

<sup>1</sup> (1995), 64 C.P.R. (3d) 289 (Ont. Gen. Div.).

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### REVIEW BY COMPETITION TRIBUNAL OF INTERAC CONSENT ORDER

On April 15, 1996, the Competition Tribunal resumed its review of an agreement between members of the Interac Association ("Interac") and the Competition Bureau (the "Consent Order"). The Application for a Consent Order filed with the Competition Tribunal on December 14, 1995 (the "Application") is the result of a lengthy investigation by the Director of Investigation and Research (the "Director") and extensive discussions between the Director and Interac.<sup>1</sup>

The Consent Order involves the nine charter members of Interac, namely: Bank of Montreal, The Bank of Nova Scotia, Canada Trust, Canadian Imperial Bank of Commerce, La Confédération des Caisses Populaires et D'Economie Desjardins Du Québec, Credit Union Central of Canada, National Bank of Canada, Royal Bank of Canada and the Toronto-Dominion Bank (collectively the "Charter Members") and Interac Inc.

This matter was pursued by the Director as a case of "joint dominance" under the abuse of dominance provisions (sections 78 and 79) of the *Competition Act*.

The agreement worked out between Interac and the Competition Bureau would allow retailers and other non-financial institutions to buy and control their own debit-card equipment, instead of paying fees to a financial institution to do that for them. In addition, non-financial institutions would be permitted to set up their own networks of cash machines. Previously, only deposit-taking companies could own and operate these machines. Interac must accept these new players on its nationwide system if they meet technical and security standards set by Interac. As well, Interac would no longer be able to charge entrance fees claimed by the Director in the Application to be "prohibitive" to financial institutions that want to join. Interac members would also be allowed to charge different fees for services, creating competition among the members of Interac. Previously, the by-laws that governed Interac required any member that issued a card used in the shared cash dispensing transaction (the "Issuer") to pay a collectively set fee to the Interac member that deployed the automated bank machine used in the transaction (the "Acquirer"). The by-laws prohibited the Acquirer from charging any surcharge to the

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cardholder of another Interac member in respect of any Interac transaction. Another key reform would allow bilateral or multilateral deals among members, so consumers will be able to deposit money, pay bills and do other transactions at machines owned by financial institutions other than the one that holds their deposits. Currently, only cash withdrawals and cash advances against Interac member-issued credit cards can be made at the machines of other institutions.

Insurers and independent brokers (the "Intervenors") will be allowed to make their case before the Competition Tribunal for better access to the Interac electronic banking system than that being proposed in the Consent Order. In this regard, the Intervenors will be allowed to present evidence and cross-examine witnesses at the hearing into the proposed settlement set out in the Consent Order. However, the Intervenors' participation has been limited and restricted to issues raised by the terms of the proposed Consent Order. The group challenging the Consent Order includes Midland Walwyn Capital Inc., Richardson Greenshields of Canada Ltd., McKenzie Financial Corp., Trimark Investment Management Inc., The Canadian Life and Health Insurance Association, The Retail Council of Canada and TelPay, a division of CTI-Comtel Inc. This group is presently prevented from issuing bank-style cards by federal legislation that limits eligibility in the payments system to financial institutions that accept demand deposits and have deposit-insurance coverage. The major concern of the group of insurers, investment dealers and retailers is that the proposed Consent Order defines "Financial Institution" in a way that precludes them from issuing cards used by consumers to access the Interac services. Their position is that this restriction has left them at

a competitive disadvantage to the banks and other deposit-taking institutions that control Interac.

The Federal Government is expected to release a White Paper on financial reform which may address some of the issues raised by the Intervenors in the Interac case including the law governing the Canadian Payments Association, the agency that runs the system for clearing cheques and other transactions among banks and other deposit-taking institutions. According to Julie Dickson, a former financial policy adviser for the federal government, now a consultant at the firm GPC Government Policy Consultants, the White Paper could ultimately overshadow the Competition Tribunal's ruling on Interac.<sup>2</sup>

K.B.G.

### Notes

<sup>1</sup> See (1995-1996) 16:4 Can. Comp. Rec. at 12 and 14.

<sup>2</sup> The Financial Post, February 8, 1986, "Battle begins in earnest over Interac System."

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### DIRECTOR ANNOUNCES RESULTS OF COMPETITION ACT REVIEW OF STENTOR

*The following is a News Release issued by the Competition Bureau on February 22, 1996, and is reproduced with permission.*

OTTAWA, February 22, 1996 — George N. Addy, Director of Investigation and Research under the *Competition Act* announced today that he has concluded that there are insufficient grounds to proceed at this time with an application to the

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Competition Tribunal with respect to Stentor, the alliance of major Canadian telephone companies.

The Director's announcement follows an extensive examination of the structure and conduct of Stentor which was carried out pursuant to the merger provisions under sections 91 and 92 and the abuse of dominance provisions under sections 78 and 79 of the *Competition Act*.

In making his announcement, Mr. Addy cautioned that there are continuing concerns about the Stentor arrangements and their effect on competition in telecommunications markets. While the Stentor Alliance facilitates a fully interconnected national telecommunications network among its nine member companies and enables them to offer customer services on a national and regional basis, these arrangements also constrain the telephone companies from entering into competition with one another. Mr. Addy said that his concerns about the effects of the Stentor Alliance were tempered by evidence of competitive entry into long distance markets and significantly declining rates for long distance services since the Canadian Radio-television and Telecommunications Commission ("CRTC") opened the door for facilities-based competition in 1992.

"The information obtained in the course of the examination did not establish that the arrangements among the Stentor companies had the effect of preventing or lessening competition substantially, which is the test which must be met under the *Competition Act* for the Director to make an application to the Tribunal," Mr. Addy said. "What's important to recognize is that the Canadian telecommunications industry is in a period of dramatic transition — from monopoly and regulation to competition and deregulation. It is important that

the benefits of competition which have already been achieved as well as tomorrow's benefits not be jeopardized."

During the transition from monopoly and regulation to a market driven environment, the Competition Bureau will continue to closely follow the future activities of Stentor in respect to long distance services and the emerging market for competitive local telecommunications and broadband services and the Director will not hesitate to take action under the *Competition Act* to safeguard the competitive process.

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## REVIEW OF STENTOR

*The following is an Information Backgrounder prepared by the Competition Bureau and is reproduced with permission.*

On February 22, 1996, the Director of Investigation and Research under the *Competition Act*, George N. Addy, announced that he will not be proceeding with an application to the Competition Tribunal with respect to Stentor, the alliance of the nine major Canadian telephone companies (the "Alliance"). The member companies of the Stentor Alliance are BC Tel, AGT Limited, Sask Tel, Manitoba Tel, Bell Canada, Maritime Tel & Tel, New Brunswick Tel, Island Tel and Newfoundland Tel.

The Director's announcement followed an extensive examination of the structure and conduct of the Alliance which was carried out pursuant to the merger provisions under sections 91 and 92 and the abuse of dominance provisions under sections 78 and 79 of the *Competition Act*.

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### Stentor

The Stentor Alliance has evolved from an association of Canada's major provincially or regionally-based telecommunications companies that dates back to 1931 with the creation of the TransCanada Telephone System ("TCTS"). It brought together the networks of the major regional telephone companies to form a Canadian-based transcontinental network and also acted as the vehicle for the sharing of revenues from long distance services provided between the member companies. In 1983, TCTS was renamed as Telecom Canada, also an unincorporated association but which retained the same responsibilities. Since that time there have been increasing demands for common national and regional services to meet the needs of large business customers with operations across the country. The advent of long distance competition in 1992 created further market pressures for the incumbent telephone companies to develop and integrate national services and to reduce costs.

These developments led the members of Telecom Canada to reorganize the association's structure into the Stentor Alliance in 1992. The Alliance consists of three entities: Stentor Resource Center Inc. ("SRCI"), Stentor Canadian Network Management ("SCNM") and Stentor Telecom Policy Inc. ("STPI"). While STPI and SCNM began operations in 1992, SRCI began operations on January 1, 1993. The core responsibility of SRCI is coordination of the development and deployment of national and international services. SRCI develops products and standards and coordinates the delivery of national services. SRCI is also responsible for developing and filing national tariffs for all member telcos. SCNM coordinates the interprovincial long distance networks such that they operate as a single national

network. SCNM is also responsible for operating the revenue settlement program and manages the members' North American interconnections. STPI coordinates government relations policy and regulatory initiatives on national issues.

### The Director's Examination Process

On his own initiative, the Director commenced an examination concerning the formation of the Alliance under the merger provisions of the *Competition Act* at the time of the announcement of its formation. The Director's examination was prompted by his concern that the formation of the Alliance, and SRCI in particular, involved a major extension of the long distance interconnection and revenue settlement arrangements from those that existed previously among the member telephone companies of Telecom Canada. The merger provisions provide the Director with a three year period within which he may bring an application before the Competition Tribunal. While SRCI was announced in 1992, it did not commence operations until January 1, 1993, and consequently, the review period expired on December 31, 1995.

During the course of his review, the Director received a number of complaints and expressions of concern from industry participants regarding the structure and conduct of the Alliance and the activities of its members. There have also been numerous comments in the media and in speeches on the concerns of various parties about the competitive implications of Stentor and the question of whether the Stentor Alliance constitutes a "cartel".

Many of these concerns and complaints were voiced by representatives of the Canadian cable television industry and new long distance competitors. The

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representatives of the Canadian cable television industry were concerned that the formation of the Stentor Alliance effectively precluded strategic alliances between cable companies and individual telcos in local service markets. Long distance carriers and resellers raised concerns that the Stentor companies were abusing their dominant market positions in respect to pricing and access. These concerns included complaints relating to allegations of predatory pricing, certain marketing practices of the telephone companies and difficulties in implementing interconnection and related measures and safeguards mandated by the Canadian Radio-television and Telecommunications Commission ("CRTC") in its Telecom Decision 92-12. As a result of these complaints, the Director expanded his examination to include other sections of the *Competition Act*, primarily the abuse of dominant position provisions set out in sections 78 and 79 of the Act.

During the course of his examination, the Director provided industry participants who had publicly expressed concern over the impact of the Alliance on competition with a full opportunity to provide evidence and information to support their complaints. Additional information and views were sought from other competitors of the telephone companies, equipment suppliers and a cross-section of customers who obtain telecommunications services through the Alliance. In addition, the Director obtained a considerable amount of information from the Alliance and its members. The Director retained industry and economic experts and outside legal counsel to assist in assessing the issues that had been raised.

**Factors Affecting the Director's Decision**

The main focus of the Director's examination was

on local and long distance services and, to a lesser extent, equipment markets. The Director noted that communications markets are in a state of evolution. The technological (but not regulatory) distinction between long distance and local service is disappearing as the cost of switching and transmission declines, leading to a broader definition of the appropriate product market. At the same time, the development of other technologies is broadening the range of possible alternative providers and challenging the incumbents whose cost structures are based on older technologies. Mr. Addy said that communications markets in Canada, like global markets, are in a state of dynamic change owing to rapid advancements in technology. This has profound implications for industry participants, regulators and competition authorities as long-standing assumptions about the existence of natural monopolies and barriers to entry into telecommunications are steadily being undermined. The Director's conclusion not to challenge the formation of SRCI was based on an assessment of the market as it has evolved during the three year period since the formation of SRCI and with a view to the emerging trends in the industry as a result of regulatory reforms and technological change.

*Industry Regulation*

The Canadian telecommunications industry is regulated by the CRTC primarily pursuant to the provisions of the *Telecommunications Act*. The CRTC has made progress in opening telecommunications markets to competition. During the process, the CRTC has established or is in the midst of implementing a number of regulatory safeguards. For example, the CRTC has implemented a price imputation test to safeguard against anti-competitive pricing and is eliminating rate of return regulation

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in favour of price cap regulation as a means of reducing the incentive and opportunity for the telephone companies to cross-subsidize competitive services from monopoly revenues. The CRTC has also initiated several regulatory proceedings to open local telecommunications markets to competition, one of which resulted in Telecom Decision 95-21 on October 31, 1995.

The telecommunications industry is not only in a transition from monopoly to competition, but also from regulation to deregulation. The Director's examination included careful consideration of this changing regulatory environment in which all telecommunications companies, including the Stentor companies, operate. While the CRTC has exercised its powers of regulatory forbearance in respect to wireless services, resellers and non-dominant carriers, the Stentor companies remain subject to considerable regulatory oversight, including the safeguards which the CRTC has established as part of the transition to competitive markets.

#### *Canadian Telecommunication Markets*

From the outset of the formation of TCTS, the subsequent development of Telecom Canada and now Stentor, the telephone companies have had a history of not competing in each others' markets to any significant degree. Through the formation of the Stentor Alliance, the member telephone companies have developed one entity ("SRCI") through which they can compete against other carriers. The relevant question for the Director under either the abuse provisions or the merger provisions of the *Competition Act* was whether the formation of the Alliance has resulted or is likely to result in a "substantial prevention or lessening of competition."

To assess these issues and other concerns expressed by industry participants, the director considered a number of developments in respect to competition in Canadian telecommunications markets in the period since the Alliance was first announced in January 1992. These developments included:

- (1) The opening of the market for long distance service to facilities-based competition in June 1992, including the introduction of equal access in mid-1994;
- (2) Entry into the long distance sector of facilities-based carriers, including the participation of large foreign carriers such as Sprint and AT&T;
- (3) Reductions in rates for long distance services in Canada at a pace faster than that which was seen in the US after the AT&T divestiture;
- (4) The introduction of new and innovative services;
- (5) Loss of more than 20% of the overall long distance market by Stentor member companies. Loss by Bell Canada of almost 30% in certain product markets in Quebec and Ontario;
- (6) Growing potential for further competition from the development of wireless networks and from the cable industry;
- (7) A changing regulatory environment, including the decision by the CRTC to replace the rate base rate of return regulation of the telephone companies with price cap regulation effective January 1, 1998; and
- (8) The decision to open the local/access market to competition.

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**Findings with Respect to Merger Review**

The Director is of a view that the formation of SRCI meets the definition of a merger, as defined under the merger provisions of the *Competition Act*. As in any merger review, the applicable legal test was whether the merger, i.e., the formation of SRCI, would allow the members of the Alliance to *substantially* lessen or prevent competition in any of the relevant markets. The relevant markets that were considered were the market for the provision of long distance telephone services, the market for the provision of local telephone services and the equipment market.

With respect to the equipment market, the Director examined whether the formation of SRCI would affect the purchasing patterns of the members of the Alliance. Concern was expressed by some participants in the equipment sector that supply arrangements between Bell Canada and Nortel might be extended to other members of the Stentor Alliance. However, the Master Supply Agreement between Bell Canada and Nortel was terminated in March 1994, for reasons which did not involve Stentor. Subsequent to this, parties who had previously expressed concern about the purchasing arrangements embodied in the Bell Canada-Nortel Master Supply Agreement did not raise any further concerns. Furthermore, the procurement data obtained by the Director from the telephone companies did not provide him with grounds to pursue his examination of the equipment market further.

With regards to the long distance and local telephone markets, the Director conducted a thorough review of the available evidence to determine whether the formation of SRCI has lessened or prevented, or is

likely to lessen or prevent, competition substantially within these markets. As a result of the geographic monopolies that the member companies of Stentor have historically held and because of the regulatory environment in which these monopolies have evolved, the members have not competed against each other in any of these markets to any significant degree. The Director's assessment did not provide evidence that demonstrated that the formation of SRCI would result in a substantial "lessening" of competition.

The Director also considered whether the formation of SRCI would result in a substantial "prevention" of competition. A substantial prevention would result if the formation of SRCI and its activities substantially impeded the erosion of, or substantially entrenched, the market power of the Stentor companies in their respective geographic markets. The Director's examination suggests that even though the formation of SRCI amounts to an agreement by the Stentor companies not to enter and compete in each other's geographic markets, the Stentor companies do not have substantially more market power now than they would have in the absence of the merger. The factors that the Director considered important in this regard included the trends in the long distance market with respect to changing regulation, the number of alternative suppliers in the market, market share loss by the Stentor companies and declining prices in the market. In particular, there is significant evidence of both competitive entry into the long distance market and declining rates for long distance services since the CRTC allowed facilities-based competition in 1992. As a result, it is clear that the capacity of the Alliance and its members to exercise market power in long distance markets is eroding due to increased competition.

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During his review, the Director considered very carefully the effect of the formation of the Alliance in preventing competition between the member companies. The Director's concern in this respect was, however, tempered by a number of factors. Customers, particularly large business customers who require advanced telecommunications services on a regional or national basis, indicated very clearly that they have realized substantial benefits in terms of service quality, innovation and price as a result of the facilities-based competition in long distance services that was introduced in 1992. In a number of cases, these customers indicated that they had benefited from the coordination of the telcos in providing telecommunications services through the Alliance. These customers also indicated that substantial competition from new entrant carriers has developed over a period of two or three years.

In addition, there are increasing indications that future competition in communications services will develop from alternative technologies such as wireless or broadband cable. The Canadian cable television industry is currently undergoing a period of consolidation and rationalization to improve its competitive position and the government has facilitated the introduction of new wireless technologies and services by awarding licenses for the use of the electro-magnetic spectrum for PCS in December 1995. The formation of the Alliance does limit the opportunity for cable companies to enter into alliances with out-of-province or regional telephone companies. However, the information available suggests that cable entry into local telephony and telephone company entry into broadband services is not contingent upon the formation of strategic alliances between firms in the two industries. In addition, the conditions for entry

into local telephony are the subject of current proceedings before the CRTC.

Some industry participants and customers expressed concern over the financial position of new entrant competitors, both carriers and resellers. A number of resellers have left the market or have been acquired by alternative carriers who themselves are reported to have lost substantial amounts of money. This situation has resulted in fears expressed publicly that long distance competition may not be "sustainable". The Director noted that while some new entrants are reporting poor financial results, many of these same carriers are reporting significant increases in the number of minutes billed and corresponding increases in revenues. In addition, while the open market approach to competition adopted by the CRTC has been good for subscribers, it has created a more competitive market than was anticipated by some industry participants at the outset which, in turn, has resulted in the substantial losses experienced by some of the new entrants. The Director is increasingly of the view that despite the difficult position of some individual firms in the market, the conditions now exist that support competition in the market for long distance services over the long run.

### **Findings with Respect to Abuse**

The test in the abuse provision is similar to that in the merger provision, in that the Tribunal may issue an order when one or more persons substantially or completely control a class or species of business; have engaged in or are engaging in a practice of anti-competitive acts; and the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market. On

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close examination it was determined that the nature of the concerns that were expressed related to issues and practices that involved specific members of the Alliance, as opposed to the Alliance as a whole. Furthermore, the concerns related to conduct are often subject to review by the CRTC. As such, it was concluded that the formation of the Alliance and its ongoing activities do not at this time raise any issues under the abuse provisions of the Act. However, the Director stressed that complaints relating to specific members of the Alliance will continue to be examined on an individual company basis as was the case concerning access to support structures in New Brunswick. The Director continues to be concerned about the market power of the Alliance, particularly in light of the vertically integrated nature of its members. While the Alliance facilitates a fully interconnected national telecommunications network among its nine member companies and enables them to offer customer services on a national and regional basis, it also constrains the telephone companies from entering into competition with one another in all product or geographic markets. As a result, although the evidence available at this time does not support the conclusion that there is a substantial lessening or prevention of competition, the Director remains concerned about the market power that the Alliance may have in some telecommunications markets.

As part of his deliberations, Mr. Addy considered the regulatory role of the CRTC and its relationship to his mandate under the *Competition Act*. While acknowledging that the CRTC actively regulates aspects of the telecommunications market, his conclusions in this matter were determined primarily on the merits of the facts of the case and not with regard to any regulated conduct defence considerations.

### Conclusion

As a result of his findings in this examination, the Director announced that he will not be proceeding with an application to the Competition Tribunal pursuant to the merger provisions or the abuse of dominance provisions with respect to the formation of the Alliance. However, he intends to continue to closely follow developments in the telecommunications industry and will not hesitate to apply any of the provisions of the *Competition Act* in the telecommunications area should circumstances warrant.

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### DIRECTOR CHALLENGES MERGERS IN BRITISH COLUMBIA MARINE TRANSPORT INDUSTRY

*The following is a News Release issued by the Competition Bureau on March 5, 1996, and is reproduced with permission.*

OTTAWA, March 5, 1996 — George N. Addy, Director of Investigation and Research under the *Competition Act*, announced today that, following an extensive review by the Competition Bureau, he has filed an application with the Competition Tribunal with respect to two mergers. Firstly, the application opposes both the October 13, 1994 merger whereby Mr. Dennis Washington, the owner of C.H. Cates & Sons Ltd. ("Cates"), indirectly acquired a significant interest in Seaspan International Ltd. ("Seaspan"), as well as Mr. Washington's proposal to acquire control of Seaspan, as announced on January 10, 1996. Secondly, the application opposes the June 30, 1995 merger whereby Mr. Washington purchased Norsk Pacific Steamship Company, Limited ("Norsk").

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The Director's application alleges that the mergers prevent or lessen, or are likely to prevent or lessen, competition substantially in the provision of tug boat services used to berth ships in the Port of Vancouver, and in the provision of barging services in and around British Columbia's coastal waters.

"Competition for ship berthing services in Canada's busiest port as well as for vital barging services along British Columbia's coast is important to the health of the West Coast marine transportation industry," Mr. Addy said.

For years, Cates has had a virtual monopoly in the provision of ship berthing services in Burrard Inlet, the main portion of the Port of Vancouver. In September 1993, Seaspan entered the Burrard Inlet market bringing unprecedented competition. "The October 1994 transaction we are challenging eliminated the only real competition this market had seen in years," stated Mr. Addy.

The Director's application further alleges that:

- Seaspan has been the only provider of ship berthing services since the Roberts Bank portion of the Port of Vancouver opened in 1970. However, in June 1994, in response to the new competition in Burrard Inlet, Cates announced its intention to enter the expanding Roberts Bank market in competition with Seaspan. The October 1994 merger has removed this only likely source of competition.
- Entry into the Burrard Inlet and Roberts Bank ship berthing markets is difficult and that there will not likely be entry from other Canadian or foreign companies on a scale sufficient to discipline the anti-competitive effects of the merger.

- Seaspan is also the dominant barging company in B.C. After acquiring a significant interest in Seaspan, Mr. Washington acquired Norsk, the third largest company in this market. This merger removed Norsk as a potentially independent and effective competitive force in an already highly concentrated barging market.
- Without the merger with Seaspan, Mr. Washington would likely have emerged as a vigorous and effective competitor to Seaspan by acquiring one of the other barging companies in the market, thereby providing a substantially higher level of competition in the barging market.

The Director has sought interim relief to prevent the integration of the operations of Washington and Seaspan pending ultimate resolution of this matter.

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