COMMENT & ANALYSIS

MOST-FAVOURED-NATION CLAUSES AND COMPETITION POLICY

By: Edward Iacobucci

Introduction

A Most-Favoured-Nation clause (hereinafter an "MFN clause") is a type of provision found in many contracts that leaves the price of goods exchanged under the contract contingent on prices charged in other transactions between different parties. The common form of this clause which this paper will consider stipulates a maximum price and provides that during the currency of the contract a supplier of a good to a buyer will charge that buyer a price no higher than the lowest price charged to any customer. Thus if a seller cuts its price to a different buyer, it must also adjust its price to the customer with an MFN clause. These clauses have been the subject of considerable controversy in antitrust law. While they undoubtedly have socially desirable features, there is concern that they also have various anti-competitive effects. This paper will briefly survey the literature on these clauses, both with respect to efficiency and anti-competitiveness, with reference to two Canadian cases: *Director of Investigation and Research* v. *NutraSweet Co.*[1] and *Director of Investigation and Research* v. *D & B Companies of Canada Ltd.*[2] The paper will then outline the policy implications of the discussion.

The Literature

Efficiency Effects

One of the desirable effects attributed to MFN clauses is their capacity to assign risk in long-term contracts.[3] If one party is better situated to bear the risk of changed prices, MFN clauses may efficiently allocate risk between the parties. Under an MFN clause such as that described above (the price is the lesser of a set maximum price and the lowest price charged to any other customer), there is no chance of a future price increase, yet there is a possibility of a lower price in the future. The risk of the contract price becoming too low relative to the market price is thus entirely absorbed by the seller. If the seller is more risk tolerant than the buyer, then agreeing to an MFN clause may be efficient.

Moreover, MFN clauses shift the risk in long term contracts without altering incentives to minimize cost, as a cost-plus formula for future prices would do.[4] If the price formula is based on cost, the incentive to keep costs low is reduced. If, however, risk is shifted by MFN clauses, cost does not directly influence the final price, and efficient cost-reduction incentives are maintained.

Anti-competitive Effects

The most common objection to MFN clauses is that they may facilitate cartelization of the selling market.[5] Since price in a successful cartel is above marginal cost, cartels are inherently unstable. Each firm in the cartel has an incentive to undercut the cartel price slightly in order to increase its sales while maintaining a supracompetitive margin, thus increasing profit. For a cartel to be effective, therefore, there must be a mechanism to reduce the attractiveness of undercutting the cartel price. MFN clauses offer one possibility. If a firm undercuts the cartel price to gain a particular customer, the firm must also offer lower prices to all of its other customers. The firm therefore commits contractually through an MFN clause to pay a penalty for undercutting the cartel price with respect to a particular customer. Since the cost of cheating is increased, the firm is less likely to cheat, and the MFN clause stabilizes the cartel.

Furthermore, the adoption of MFN clauses by a firm signals to its rivals that it is committed not to undertake price cuts, which may encourage the establishment of tacit or explicit collusion.[6] Cooper formalizes this theory and finds that MFN clauses in a duopoly model raise prices and profits to both firms even if only one firm adopts MFN clauses.[7] Empirically, Grether and Plott conducted experiments using students and businessmen to simulate buyers and sellers in an oligopolistic market.[8] They find that contractual terms such as MFN clauses tend to increase prices relative to the situation where these terms were absent.

Cooper and Fries develop a theory of MFN clauses based on their implications for bargaining between suppliers and buyers.[9] If a seller and a buyer have an MFN clause in their contract together, the seller, in later negotiating with other buyers, is in a stronger position to resist price cuts since a price cut to a second buyer will compel the seller, because of the MFN clause, also to lower price to the first buyer. Consequently, a seller may wish to adopt an MFN clause in order to assist it in resisting price cuts in later bargaining contexts and thereby raise its profits.

An extension of the Cooper and Fries model might consider the notion of "raising rivals' costs" as affecting the bargaining actions of a seller and buyer.[10] If the buyer of an input competes with another buyer of that input in the final product market, requesting an MFN clause in the sale of the input may have a desirable consequence in raising its rival buyer's costs, since that rival buyer will be in a weaker bargaining position. Hence, competition in a downstream market may increase the likelihood of MFN clauses associated with the provision of the input.

The bargaining model of MFN clauses may have been relevant to *NutraSweet.* In that case, NutraSweet held a dominant position in the aspartame (a low-calorie artificial sweetener) market in Canada in the late 1980s. NutraSweet's market share was approximately 95%. The largest buyers of aspartame from NutraSweet were Coca-Cola and Pepsi, who accounted for about 85% of the aspartame purchases in Canada. NutraSweet was alleged to have abused its dominant position in a variety of ways, including providing MFN clauses to Coke and Pepsi as inducements to accept exclusive supply contracts. The Tribunal found that these clauses did indeed amount to an abuse of NutraSweet's dominant position since they were inducements to exclusivity.

While the Tribunal did not consider the bargaining impact of MFN clauses, the competitive situation could have given rise to this motivation for the clauses. Clearly, because of their size and importance in the sweetener market, Coke and Pepsi would have had countervailing market power such that the price for aspartame would likely have been the result of bargaining with NutraSweet. An MFN clause between Coke and NutraSweet may have affected the bargain between Pepsi and NutraSweet in a way which advantaged NutraSweet in resisting price cuts to Pepsi and advantaged Coke by raising its rival Pepsi's costs. An MFN clause between Pepsi and NutraSweet may have had analogous effects. Of course, the efforts of Coke and Pepsi to disadvantage the other would have cancelled each other out, thus resulting simply in higher prices for aspartame through NutraSweet's ability to resist price cuts.

Another view of MFN clauses and raising rivals' costs concerns situations in which a monopsonistic buyer purchases an input for a product market in which that buyer has significant market power as a seller. Commentators suggest that the buyer may insist on MFN clauses in order to discourage selective price cuts by the sellers of the input to an entrant into the downstream market.[11] The theory is that an incumbent with market power can contract for high prices for inputs and use MFN clauses to ensure that a potential entrant or smaller rival in the final output market cannot make headway in that market by bargaining for low prices. Input providers will not lower price to the smaller rivals, given that if they do the MFN clause will compel lower prices to the incumbent, which represents a much larger share of the input providers' business. The incumbent can thus ensure higher input prices to potential entrants or smaller rivals by contracting for higher input prices along with MFN clauses. The clauses may deter entry by discouraging selective price cuts to entrants who otherwise have higher costs and require lower prices to enter successfully.

To illustrate, consider the context in which this argument has arisen in several American cases.[12] A health insurer with significant market power contracts for an MFN clause with doctors in a particular market: if the doctor offers her services to a rival health insurer (for example, a new entrant) at a lower price, she must also lower her price to the insurer with market power. The Department of Justice has challenged these arrangements as discouraging price cuts by doctors to rival insurers and therefore raising barriers to entry. In *Nielsen,* the competitive situation was similar. In that case, Nielsen purchased sales data pertaining to consumer packaged goods from retailers which it used as an input in market tracking services which it in turn sold to manufacturers. Nielsen was the only seller of such particular services in the

Canadian market, but another company, Information Resources Inc. ("IRI"), had unsuccessfully attempted entry. While it was peripheral to the main issues in the case, which largely centred on exclusivity, the Tribunal held that Nielsen must stop using MFN clauses until competition had been established in the market since Nielsen could use the MFN clauses effectively to set a minimum price for the data higher than what IRI could afford to pay as an entrant.

Why are MFN Clauses Accepted?

One of the puzzling aspects of MFN clauses is their acceptance by the party they potentially harm. If the MFN clauses raise price and are known to raise price, why would a buyer accept an MFN clause? One obvious explanation is that MFN clauses' efficiency effects dominate any anti-competitive effect. Crocker and Lyon, for example, studied empirically the effect of MFN clauses in the natural gas industry in the U.S.[13] They find that the "theoretical literature's emphasis on MFNs as practices facilitating tacit collusion is misplaced,"[14] at least with respect to this industry. MFN clauses in this industry are better explained, they find, by efficiency considerations such as price flexibility in long-term contracts.

While efficiency benefits may explain buyers' acceptance of MFN clauses, even if the clauses are inefficient (price-increasing) on balance, it is important to recognize that buyers may continue to request and accept them. If, for example, the clauses facilitate collusion, but confer particular advantages on the buyer that adopts them, such as insurance, externalities may lead to their acceptance by buyers even if the overall effect of the clauses on the buyers is negative.[15] If a particular buyer accepts an MFN clause, it reaps the benefit of the insurance privately, while the cost of such an action through higher prices is shared. In such a case, a firm may find it privately beneficial to request or accept an MFN clause, even though its social effects are harmful. All buyers face similar incentives, and the general adoption of MFN clauses may occur despite their harm overall to the buyers who requested/accepted them in the first place.

A similar explanation may be relevant to the bargaining explanation for MFN clauses. Given the tendency of MFN clauses to raise prices by allowing the seller to resist future price cuts, why would a buyer accept or request them? The answer rests on the fact that the buyer adopting the MFN clause is not affected by higher prices to other buyers; the effect is entirely external. Consequently, a seller may offer a small inducement, such as a cash payment, to the buyer in exchange for the imposition of an MFN clause, which will not affect the buyer itself but will benefit the seller. Moreover, if the good in question is an input, competition in the output market may spur the buyer to request such a clause. If A and B compete in the output market, raising the cost of an input to B through the adoption of an MFN clause provides a competitive advantage to A. Furthermore, the seller will gladly grant an MFN clause to A, since this will allow it to resist price cuts in its negotiations with B. Thus it is rational for A to request an MFN clause, and for the seller to grant this request.

The bargaining theory may give rise to a prisoner's dilemma for buyers. In the bargaining model with competition in the downstream market, each buyer's preferred scenario is for it to have an MFN clause while no other buyer does since the clause may give the buyer a cost advantage in the downstream market. Of course, the worst case for the buyer is for others to have MFN clauses while it does not because of a cost disadvantage in the downstream market. Consequently, whether or not other buyers do so, each buyer has an incentive to request MFN clauses. If all buyers request MFN clauses, competitive advantages between firms are cancelled out, while prices are generally higher. A better result for buyers would be no MFN clauses, but a prisoner's dilemma may preclude this possibility.

The acceptance of MFN clauses by sellers and buyers where there is a monopsonistic buyer is straightforward to understand. Under this raising rivals' costs theory, the monopsonistic buyer seeks to discourage competition in the output market and therefore wishes to keep input prices high; it is in the interest of the sellers to agree to a commitment through MFN clauses to keep prices high.

Policy Implications

MFN clauses have ambiguous welfare effects. On the one hand, they may be welfare-enhancing by providing buyers with the possibility of lower prices during the currency of a contract. On the other hand, they may be welfare-reducing by permitting a seller to resist price cuts either through collusion with other sellers or by altering bargaining. Moreover, they may permit an incumbent with market power in an output market to discourage entry by keeping input prices high.

In light of the variety of possible motivations for the MFN clauses, with often opposing welfare and therefore policy implications, how should antitrust authorities respond? Some commentators have taken the approach that the actions of the parties allegedly harmed indicate the welfare effects of the clauses. In *NutraSweet,* for example, both Coke and Pepsi requested the MFN clauses. Graham concludes that the requests by Coke and Pepsi suffice to infer that the clauses were efficient. He states:

> Whatever reason customers had for requesting exclusivity, it would not have been for the purpose of excluding Nutrasweet's competitors from the market. Although Nutrasweet engaged in the practice, it could not have done so for an exclusionary purpose if its action was dictated by customers. These contract clauses could therefore not have been anti-competitive because they lacked the requisite purpose...[16]

Where the "victims" of the clauses are asserted to be buyers of a product, who are harmed by higher prices through collusion or bargaining effects, it is significant to note, as Graham implicitly does, that buyer and social interests align: both buyers and society are better off as prices fall and move closer to the competitive outcome. An important implication of the above theories, however, is that observing buyer behaviour will not necessarily indicate whether the MFN policies are socially desirable. As discussed, in the collusion and bargaining models set out above, it may be privately optimal for a buyer to request an MFN clause even though their widespread adoption results in higher prices. It may be overly simplistic to treat the alleged victims' request for the clauses as sanitizing them from a competition policy perspective.

There is room for buyer influence on policy, however, if buyers are alleged to be the victims: buyers should simply be asked what their views are. Self-interested behaviour which is ultimately harmful results because of the potential for asymmetries in the provision of the MFN clauses: I am best off if I have a clause and nobody else does; if everybody else has a clause, then I am worse off if I do not have a clause; therefore, it is always rational for me to request a clause. The race to be the only customer with an MFN clause, or to avoid being the only customer without one, may result in their adoption. Antitrust proceedings, however, will likely eliminate the possibility of asymmetric provision of the clauses to buyers by taking an "all-or-nothing" approach: either the practice of granting MFN clauses will be found anti-competitive in a particular case and generally banned, or they will be found innocuous and generally permitted. In making submissions in antitrust proceedings, therefore, parties which may face private incentives to request MFN clauses in practice are constrained to support or condemn the clauses generally; there is no asymmetric option whereby an individual party is permitted to have an MFN clause while a different party is not. Because the "asymmetric option" is eliminated, parties should make submissions to the competition authorities which are consistent with social welfare: if the costs of widespread use of MFN clauses through higher prices outweigh the benefits, buyers should reject them; if the reverse is true, buyers should praise them. The all-or-nothing character of antitrust proceedings induces buyers to reveal the social benefits or costs of the clauses in a way that observing actions cannot.[17]

Different analysis applies if the alleged victims of the clauses are potential entrants. In the raising rivals' costs scenario, both the monopsonistic buyer and the seller may have an interest in widespread adoption of MFN clauses: the buyer because they may retard the growth of (potential) rivals; the seller because they help it commit to higher prices. The clauses are implemented not because of prisoner's dilemma or collective action problems, but because of net benefits to the parties involved. If, therefore, the alleged victims of the clauses are the buyer's rivals, canvassing the parties' opinions will not reveal the clauses' net social effects. Canvassing potential rivals may be informative, but potential rivals may have incentives to impugn the clauses even if they are efficient in order to impose higher costs on the incumbent. Thus, the fact that the potential entrant IRI objected to MFN clauses in *Nielsen* does not necessarily indicate their inefficiency. A broader inquiry is required where MFN clauses are alleged to harm smaller rivals and potential entrants.

Note that if the alleged harm from MFN clauses concerns potential entrants, rather than buyers, antitrust proceedings need not take an "all-or-nothing" approach. The Tribunal in *Nielsen* did not generally condemn the clauses, but rather enjoined Neilson specifically from using them. If potential entrants are allegedly harmed by MFN clauses, potential asymmetry in implementation of the clauses did not motivate them, as it might have had buyers been the alleged victims, thus an idiosyncratic order is unobjectionable. Clearly, small rivals and potential entrants would not be using the clauses to deter entry by the large incumbent; thus, permitting them but not the incumbent to use the clauses may make sense. If, however, buyers are the alleged victims, idiosyncratic orders (for example, only Coke may have an MFN clause, not Pepsi) may permit a buyer to impose costs on others which in aggregate are greater than the private benefits it receives; given these negative externalities, blanket orders banning or permitting MFN clauses should apply if buyers are alleged to be harmed.

Summary and Conclusion

In summary, in assessing MFN clauses, antitrust authorities should first canvass buyer and seller opinions, rather than observe their actions. If buyers generally object to the clauses, this indicates their potential inefficiency. If both parties welcome the clauses, then examination of the raising rivals' cost possibility should follow, recognizing that reliance on the views of the parties and potential entrants may not be reliable because of self-interest that does not align with societal interests. If the only potential victims are the buyers, however, authorities should be deferential to their views. In this instance, words speak louder than actions.

Notes

[1] (1990), 32 C.P.R. (3d) 1 (hereinafter *NutraSweet*).

[2] (1995), 64 C.P.R. (3d) 216 (hereinafter *Nielsen* D & B Companies carried on the relevant business through a division named "Nielsen Marketing Services").

[3] See K. Crocker & T. Lyon, "What do 'Facilitating Practices' Facilitate? An Empirical Investigation of Most-Favored-Nation Clauses in Natural Gas Contracts" (1994) 37 J.L. & Econ. 297; and J. Simons, "Fixing Price With Your Victim: Efficiency and Collusion with Competitor-Based Formula Pricing Clauses" (1989) 17 Hofstra L.Rev. 599.

[4] See Simons, *ibid.*

[5] See S. Salop, "Practices that (Credibly) Facilitate Oligopoly Co-ordination" in J. Stiglitz & F. Mathewson, eds., *New Developments in the Analysis of Market Structure* (1986). For cases involving this theory, see, *e.g.*, *United States* v. *General Electric Co.*, 42 Fed. Reg. 17003 (March 30, 1977) (the Justice Department dropped its threat of antitrust prosecution when General Electric agreed to abandon its practice of using MFN clauses) and *Ethyl Corp. et. al,* 101 FTC 425 (1983) (the FTC charged Ethyl Corp. and three other firms for anti-competitive pricing practices that included MFN clauses; this was overturned by the Second Circuit in *E.I. Dupont De Nemours and Co.* v. *FTC,* 729 F.2d 128 (2d Cir. 1984)).

[6] See G. Hay, "Oligopoly, Shared Monopoly, and Antitrust Law" (1982) 67 Cornell L.Rev. 439.

[7] T. Cooper, "Most-Favored-Customer Pricing and Tacit Collusion" (1986) 17 Rand J.Econ. 377 (1986).

[8] D. Grether & C. Plott, "The Effects of Market Practices in Oligopolistic Markets: An Experimental Examination of the *Ethyl* Case" (1984) 22 Econ. Inquiry 479.

[9] See T. Cooper and T. Fries, "The Most-Favored-Nation Pricing Policy and Negotiated Prices" (1991) 9 Int'l J. of Ind. Org. 209.

[10] For discussions of the general theory of "raising rivals' costs", see S. Salop & D. Scheffman, "Raising Rivals' Costs" (1983) 73 Am. Econ. Rev. 267, T. Krattenmaker & S. Salop, "Anticompetitive Exclusion: Raising Rivals Costs to Achieve Power over Price" (1986) 96 Yale L.J. 209, and R. Ware, "Understanding Raising Rivals' Costs: A Canadian Perspective" (1994) 15 Can. Comp. Rec. 9.

[11] J. Baker, "Vertical Restraints with Horizontal Consequences: Competitive Effects of 'Most Favored-Customer' Clauses" (1996) 64 Antit. L.J. 517; A. Celnicker, "A Competitive Analysis of Most Favored Nations Clauses in Contracts Between Health Care Providers and Insurers" (1991) 69 N.C.L. Rev. 863; S. Stenger, "Most-favored-nation Clauses and Monopsonistic Power: an Unhealthy Mix?" (1989) 15 Am. J.L. & Med. 111.

[12] See, for example, *United States* v. *Delta Dental Plan of Ariz., Inc.,* 1995-1 Trade Cas. (CCH) para. 71,048 (D. Ariz. 1995); *United States* v. *Vision Serv. Plan,* 7 Trade Reg. Rep. (CCH) para. 50,775 (D.D.C. 1994)(proposed final judgment).

[13] Crocker & Lyon, *supra,* note 3.

[14] *Ibid.*, at 317-328.

[15] See Simons, *supra,* note 3.

[16] B. Graham, "Abuse of Dominance - Recent Case Law: *NutraSweet* and *Laidlaw*" (1993) 38 McGill L.J. 800 at 819.

[17] In *NutraSweet,* the case about which Graham comments, Coke and Pepsi did not intervene so their views of the clauses are not known. It is perhaps noteworthy that both Coke and Pepsi both initially requested intervener status, but declined once their witnesses were promised the presence of counsel during any examination. If the clauses were a matter of concern for the firms because they resulted from prisoner's dilemma problems, not efficiency, Coke and Pepsi would presumably have been more likely to pursue intervener status. The Tribunal was correct, however, not to place undue weight on the fact that the parties themselves had requested the clauses in dispute.

MARKET FORECLOSURE UNDER "ABUSE OF DOMINANCE": A COMMENTARY ON *NIELSEN*[*]

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I. Introduction

On August 30, 1995 the Competition Tribunal (the "Tribunal") released its third decision involving a contested application under the abuse of dominance provisions of the *Competition Act*: *Canada (Director of Investigation and Research)* v. *D & B Companies of Canada Ltd.* ("*Nielsen*").[1] The decision in *Nielsen* further developed the law and economics of this rapidly evolving area which, to date, has been one of the most actively litigated provisions of the Act.[2] The objective of this paper is to analyze the decision in *Nielsen* from two perspectives. The first is a legal analysis to assess the precedential value of *Nielsen* for future abuse of dominance cases and for assisting counsel in advising clients who, due to their market position, are potential targets of abuse of dominance allegations. Second, this commentary will assess how the Tribunal in *Nielsen* utilized economic theory in its decision-making process.

This commentary is structured as follows. Part II summarizes the facts surrounding *Nielsen*. Parts III and IV summarize the principal arguments advanced by the Director and Nielsen, respectively. Part V discusses the findings and Order of the Tribunal. Part VI provides an analysis of *Nielsen* from a legal and economic perspective. Finally, Part VII offers some concluding remarks.

II. The Facts in *Nielsen*

Overview

The facts in *Nielsen* are relatively straightforward. The application filed with the Tribunal by the Director of Investigation and Research was concerned with the field of marketing research relating to consumer packaged goods.[3] The case addressed three channels of distribution of such goods: grocery stores, drug stores and mass merchandisers, with the focus being on grocery stores. Marketing research related to such products is commonly used by retailers and, more notably, manufacturers to assist them in decision-making and planning toward an enhanced approach to the marketing and distribution of their products.

The range of marketing research services available in Canada is broad and the specific form and scope of such services is dictated by the particular requirements of consumers of these services. At the time the application was brought, Nielsen offered the widest range of such services in Canada. The specific types of market research services relevant to the application by the Director were: (i) market tracking services; (ii) household (or consumer) panels; and (iii) key accounts. Each of these forms of marketing research services is described briefly below.

Market Tracking Services

The Tribunal defined market tracking as follows:

> Market tracking involves collecting data, over time, on product movement to produce an estimate of total market size and direction of growth for each product category being tracked and to indicate the relative performance or market share of a particular brand or item within the product category.[4]

An important characteristic of the reports prepared by providers of market tracking services is that they may be tailored for specific types of manufacturers by focusing on, for example, different channels of distribution or "causal" factors, such as price, promotions, and feature advertising. Therefore, the fundamental elements of market tracking are the collection of data and the manipulation thereof. Three principal methods can and have been used to undertake these tasks: audits, warehouse withdrawals and scanner-based data. Each of these methods is discussed immediately below.

(i) Audits

The original method of data collection was the store audit. This relatively crude process involves the collection of data from a sampling of retail outlets by field auditors who visit the selected outlets, usually on a bi-monthly (60 day) basis. Typically, an opening inventory is taken at the beginning of the period and a closing inventory is taken 60 days later. By using information obtained related to a store's purchases during that period and by combining that information with inventory observations, conclusions are drawn related to the sales for that store during the period in question. In addition, causal data are collected by the auditors during the store visits. At the time the Director brought his application, Nielsen was the only company in Canada offering retail audit-based tracking services.

(ii) Warehouse Withdrawals

A second, more recent, method of data collection is based on warehouse shipments, and known in the industry as "warehouse withdrawals". This form of market tracking service involves the collection of data relating to shipments from the warehouses of a co-operating organization to individual stores. To incorporate price data under this method, Nielsen would use a suggested retail price from the manufacturer of the product as a proxy. Initially, no other causal data were included, however, as various service offerings were enhanced, additional causal data became available. At the time the Director brought his application, Nielsen was the only provider of warehouse shipment-based services in Canada.

(iii) Scanner Data

The third source for market tracking services - and one which has revolutionized the industry over the past decade - is scanner data. Scanner data are generated at the point of purchase. Consumer packaged goods generally have a bar-coded label, the Universal Product Code ("UPC"), affixed on them by the manufacturer.

The UPC contains critical product-identifying information which is scanned electronically. Significant additional data such as store identification, and the price and time of purchases, are also recorded when the product is scanned. Generally speaking, retailers install scanners and collect scanner data for internal management purposes (*eg.*, inventory control). Therefore, the use of scanner-data for market tracking purposes is essentially a by-product of its internal use by retailers.

In comparison to audits and warehouse withdrawals, the advantages of using scanner data for market tracking are numerous. First and foremost, scanner data are highly accurate. Second, such data are available on a weekly basis which typically corresponds with the timing of the promotional initiatives of retailers, particularly in the grocery sector. Third, scanner data include a broad range of causal data. These and other advantages have led to scanner data being the principal basis for market tracking services. At the time the Director brought his application, Nielsen was the only provider of scanner-based market tracking services in Canada.

Consumer/Household Panels

A household panel, also called a consumer panel, involves a sampling of households across a defined area that, on a systematic basis, retain and record information about their purchases. As is the case with any form of survey analysis, the objective in creating a household panel is to select a sampling that is representative of the various regions in question or the country as a whole in order to ensure that the sample data accurately reflect the trends among larger groups of consumers. Both Nielsen and ICL International Surveys Ltd. ("ISL") have offered services based on the household panel concept for some time in Canada, however, their sampling approach differs somewhat. In the case of Nielsen, its product has been a monthly report available for distribution approximately 21 days after the close of the four week review period.

Key Accounts

Key account data are retailer specific tracking data related to product movement. As such, it can involve data sourced from scanners, consumer panels, warehouse shipments, or audits depending on the available collection method used in the related tracking service. Until 1990, ISL's consumer panel data represented the only source of retailer-specific data in Canada. However, since 1991, retailers have permitted the release of their data to Nielsen who, in turn, provides a key account service based on the scanner data acquired directly from retailers. ISL, however, continues to provide retailer-specific information based on only its panel data. An important consideration in regard to key accounts is the fact that retailers vary in their willingness to release their key account data to intermediaries, such as Nielsen, for their manipulation and ultimate resale to manufacturers. Specifically, retailers are concerned about the confidentiality of information, loss of bargaining power over manufacturers and, in the context of private label data, the release of such information to competitors.

III. The Case for the Director

In his application to the Tribunal, the Director made the following allegations: (i) Nielsen substantially or completely controlled the supply of scanner-based market tracking services in Canada, which the Director defined as being the relevant market; (ii) the supply of scanner-based market tracking services constituted a distinct class or species of business which is synonymous with the relevant product market; (iii) Nielsen had engaged in and was engaging in a practice of anti-competitive acts within the meaning of section 78 of the Act; and (iv) such anti-competitive acts had the effect of preventing or lessening competition substantially in the supply of scanner-based market tracking services in Canada.

With respect to item (iii) above, the Director identified the following acts as being anti-competitive: (i) the signing of exclusive contracts with retailers, many of which contained staggered terms, for the acquisition of raw scanner data; (ii) the offering of significant financial inducements for such exclusive contracts; and (iii) the entering into of long-term contracts with manufacturers of consumer packaged goods for the sale of its scanner-based market tracking services.

IV. The Case for Nielsen

Neilsen disputed each of the foregoing grounds of the Director's application. In particular, one of Nielsen's principal allegations was that the key intervener, Information Resources, Inc. ("IRI"), was the first company who attempted to introduce, albeit unsuccessfully, exclusive contracts with retailers for scanner-based data in Canada. The argument made by Nielsen, in essence, was that it was simply "meeting the competition". Interestingly, unlike Nielsen, who had negotiated independent and sequential exclusive contracts with retailers, IRI had pursued an "all-or-nothing" exclusive contract initiative.[5] In addition, the respondent disputed the Director's definition of the relevant market, arguing that it should be defined as either decision support services or market tracking services in general.

V. The Findings and Order of the Tribunal

The Tribunal's Findings

The principal findings of the Tribunal are set out below.

1. Following the decisions in *NutraSweet*[6] and *Laidlaw,*[7] the Tribunal interpreted the word "control" in paragraph 79(1)(a) of the Act as being synonymous with market power - *i.e.*, the ability to set prices above a competitive level for a considerable period of time.

2. Again, following the decisions in *NutraSweet* and *Laidlaw*, the Tribunal concluded that the words "class or species of business" in paragraph 79(1)(a) meant a product market, but not a geographic market.

3. The Tribunal defined the relevant product market to be scanner-based market tracking services and the relevant geographic market to be Canada.

4. The Tribunal accepted the position of the Director that Nielsen controlled the relevant market by virtue of the fact that,

   (i) it was the sole source of such services in Canada; and

   (ii) it foreclosed other potential suppliers from entering into this market principally through its use of staggered exclusive contracts with retailers and long-term exclusive contracts with manufacturers.

5. The Tribunal concluded that the acts engaged in by Nielsen constituted a "practice" and, specifically, that the (i) exclusive and staggered term retailer contracts; (ii) the inducements to exclusivity; and (iii) the nature of the manufacturer contracts were anti-competitive under paragraph 79(1)(b) of the Act.

6. The Tribunal held that the anti-competitive acts engaged in by Nielsen had the effect of preserving and/or enhancing its market power and therefore resulted in preventing or lessening competition, substantially, in a market in accordance with paragraph 79(1)(c) of the Act.

The Order

The Order[8] issued by the Tribunal focused on the retailer contracts, manufacturer contracts and historical scanner data, and may be summarized as follows:

1. With respect to the negotiation of future retailer contracts, Nielsen was ordered not to:

   (i) enter into contracts which precluded or restricted a supplier of retailer scanner data from providing a supplier or potential supplier of a scanner-based market tracking service with access to scanner data necessary for the provision of that service;

   (ii) offer an inducement to a supplier of retailer scanner data to restrict access to its data necessary for the provision of a scanner-based market tracking service; and

   (iii) enter into contracts with suppliers of retailer scanner data containing "most favoured nation" clauses.

2. With respect to existing retailer contracts, Nielsen was ordered to not enforce the following provisions in such contracts:

(i) "exclusivity" provisions;

(ii) "preferred supplier status" provisions; and

(iii) "most-favoured-nation" clauses.

3. In regard to existing manufacturer contracts, the respondent was ordered not to enforce any provisions which,

(i) prevented the customer from giving notice of termination during any "minimum commitment period";

(ii) required the customer to give more than eight months notice; and

(iii) required the customer to pay a penalty or lose a discount for early termination of its contract with the respondent.

4. In connection with the negotiation of future manufacturer contracts, for a period of eighteen months from the date of the Order, the respondent was ordered not to enter into any contracts for the supply of scanner-based market tracking services which included provisions that correspond to items 3(i) - (iii) immediately above.

5. With respect to historical scanner data, the Tribunal ordered that, for a period of nine months from the date of its Order, Nielsen shall provide to the supplier or potential supplier of a scanner-based market tracking service that historical data which it has dating back fifteen months. This order was made subject to certain conditions related to cost recovery.

VI. An Analysis of *Nielsen*

Legal Implications

(i) "Class or Species of Business"

From a strict legal perspective, arguably, the most significant contribution of *Nielsen* may be the fact that it appears to have finally settled the question of how the words "class or species of business" in paragraph 79(1)(a) of the Act should be interpreted. However, while being in full support of its ultimate finding, it is submitted that the Tribunal's attempt at explaining the difference in language between paragraphs 79(1)(a) and (c) of the Act led to a tortured legal analysis involving, among other things, troubling statements regarding the extraterritorial application of the Act. In this regard, the Tribunal's analysis only serves to unnecessarily raise issues where they previously did not exist.

Turning to the Tribunal's analysis, although its focus was on paragraph 79(1)(a), it is necessary to consider all of subsection 79(1) which reads as follows:

> 79(1) Where, on application by the Director, the Tribunal finds that
>
> (a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,
>
> (b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and
>
> (c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,
>
> the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

Relying on the decision of the Tribunal in *NutraSweet*, the Director argued that "class or species of business" was synonymous with the definition of the relevant product market.[9] Specifically, the Director argued that the Tribunal must determine whether close substitutes exist for scanner-based market tracking services. In essence, therefore, the Director argued in favour of applying the "hypothetical monopolist" approach to market definition set out in section 3.1 of the *Merger Enforcement Guidelines*[10] - the standard approach used to define the relevant product market throughout the Act.

In contrast, Nielsen argued that the words "class or species of business" cannot be synonymous with the "product market" since the word "market" was not used in paragraph 79(1)(a) and was used in paragraph 79(1)(c). Rather, Nielsen proposed defining "class or species of business" as the "collection or grouping of all the elements that are *necessary* for the conduct or performance of the business of the respondent" (emphasis added).[11] Having said that, Nielsen did not go so far as to argue that, within a diversified company, all facets of the operation should be included. In essence, it restricted the class or species of business to that of a particular operating division. However, Nielsen did argue that the Director had the onus of proving the respondent controlled *each and every* element of that class or species of business in order to satisfy paragraph 79(1)(a). In essence, Nielsen was arguing in favour of a *commercial* definition of "class or species of business".

In considering the issue of defining the phrase "class or species of business", the Tribunal undertook an extensive analysis commencing with a review of the purpose of the abuse of dominance provision. The Tribunal then turned to the various dictionary definitions of the words "class" and "species" advanced by Nielsen. Based on this analysis, the Tribunal concluded that,

> These definitions would lead one to surmise that the elements considered to be within a single class or species of business should have common characteristics. They do not, however, indicate any basis upon which the common characteristics should be assessed, nor did Nielsen advance one.[12]

The Tribunal, therefore, concluded that the traditional approach to market definition provided the objective basis upon which the common characteristics of a "class or species of business" should be assessed.

To further support the Tribunal's finding, it is submitted that the basic flaw with Nielsen's definition of a "class or species of business" is that it was premised on commercial rather than economic grounds.[13] The following example illustrates the inherent difficulty with such an approach. Assume that two diversified companies have significant operations in the food industry with their key activities being in the manufacturing of baked and canned goods. The first company undertakes these activities within its "food division" whereas the second company subdivides these operations into a "bakery division" and "canned goods" division. If one were to apply the approach suggested by Nielsen, the result would be that the definition of "class or species of business" would necessarily differ between these two companies. Yet, it is difficult to fathom how this could be possible in the context of a competition law analysis. As aptly stated by the Tribunal, "... the respondent cannot be the person who determines the class or species of business in a particular case."[14] If this were the proper interpretation of paragraph 79(1)(a), market definition in the context of abuse of dominance cases would be reduced to a subjective rather than objective analysis.

While it is submitted that the Tribunal correctly defined a "class or species of business", its analysis is troubling in certain respects. In particular, unlike the decisions in *NutraSweet* and *Laidlaw*, the Tribunal in *Nielsen* apparently felt compelled to provide a rationale for the differences in wording between paragraphs 79(1)(a) and (c). Toward this end, the Tribunal relied on a 1991 article by Professor R.J. Roberts - which criticized the jurisdictional reach of section 79 - as providing the basis for the differences in language.[15] Specifically, the Tribunal described the article as expressing concern for the fact that section 79 may only reach firms which are dominant, or have market power in Canada, and therefore could not be used to reach a firm which, while dominant in the world market for a product, has a small market share in Canada. As stated by the Tribunal in describing the crux of Professor Roberts' argument,

> He expresses concern that, for example, the Canadian statute cannot be used to stop an American firm that is dominant in the world market, but has a small Canadian market share, from taking anti-competitive action against a Canadian company in Europe. He believes this situation causes harmful effects in Canada because the Canadian company will be crippled and may even go bankrupt.[16]

The Tribunal claimed to adopt Professor Roberts' argument only to the extent that it could have provided a possible explanation for the differences in wording between paragraphs 79(1)(a) and (c). However, while it may have been inadvertent, it is arguable that the Tribunal took the argument considerably further.

That is, while the Tribunal claimed to be focusing its attention on the wording of the legislation and not the substance of Professor Roberts' argument, the basis of this argument appears to have been, nevertheless, endorsed by the Tribunal. This is evidenced by the following statement:

> Based on the words of s. 79 as drafted, Parliament was concerned about firms dominant in Canada and the effects of abuse of that dominance on Canadian consumers. If Parliament had simply referred in para. (a)

> to control of a market, "market" having both product and geographic dimensions, the section could apply to situations where there were no direct connection to Canadian consumers. It could have been used for aggressive, extraterritorial application to protect Canadian *firms* operating in other markets in which Canadian *consumers* do not buy the product[17] (emphasis in original).

The danger of such statements is that they could lead one to argue that the Tribunal has drawn certain conclusions regarding the jurisdictional scope of the Director when filing applications under section 79(1) and, more importantly, under other provisions of the Act which *do* include the term "market". For example, under section 77, for a finding that either exclusive dealing or tied selling is lessening competition substantially, the practice must be engaged in by a "major supplier of a product in a *market* or because it is widespread in a *market*". Does this mean the jurisdictional scope of the Director for filing an application is considerably broader under section 77 as opposed to section 79? There is no theoretical basis for such a result. Nevertheless, Professor Roberts and, arguably the Tribunal, appear to be endorsing an approach toward competition law enforcement which is tantamount to the protection of competitors and not necessarily competition. Presumably, this was not the intention of the Tribunal.

With the benefit of hindsight, however, it appears that Professor William Stanbury was correct when he voiced concerns over the differences in wording between paragraphs 79(1)(a) and (c). Specifically in 1986, Professor Stanbury testified before the House Committee considering Bill C-91, the bill which eventually became the new *Competition Act*, in which paragraphs 79(1)(a) and (c) appeared in exactly the same form as they do today. Professor Stanbury stated as follows:

> Now we come to the matter of defining the market. Paragraph 51.(1)(a) speaks of 'a class or species of business'. On the other hand, paragraph 51.(1)(c) speaks of a 'market'. The problem is, are these the same terms, or just different terms for the same thing? I would think we need to clarify them both; and I would argue that the phrase that should be substituted in both cases is 'the relevant market.'
>
> I do not want to see a snare, trap, or delusion inserted in the bill merely by the failure to recognize the slight difference in the use of terminology in two different places in the same proposed section. I think that it is a technical amendment everyone could support, and I think it would reduce a lot of bickering.[18]

It is submitted that the Tribunal fell into the "trap" described by Professor Stanbury and that the tortured reasoning which resulted confirms the soundness of Professor Stanbury's position before the House committee.[19]

(ii) Internal Documentation

Under the abuse of dominance provision, once it has been determined that the respondent holds a dominant position in the relevant market, the next consideration, found at paragraph 79(1)(b) of the Act, is whether this dominant firm has engaged in or is engaging in a practice of anti-competitive acts. In addressing this issue, the Tribunal in *Nielsen* adopted the test established by *NutraSweet* and followed in *Laidlaw* - namely, that the nature and purpose of the acts which are alleged to be anti-competitive, and their effect on the relevant market, must be determined.[20] The Tribunal also followed *Laidlaw* in confirming that the Director

was not required to prove a subjective intent to restrict competition. Rather, the respondent would be deemed to intend the effects of its actions.[21]

Based on the foregoing legal test, it is submitted that this provision has the potential to afford a respondent its best opportunity at refuting the allegations of the Director. Having said that, the analysis undertaken by the Director also has the potential to uncover highly incriminating evidence against a respondent as it entails an examination of the respondent's internal strategy and tactics. In *Nielsen*, largely as a result of the respondent's internal documents, the latter occurred. In fact, it would not be an overstatement to describe these documents as representing the most damaging evidence faced by Nielsen. A number of examples are set out below.

In the context of its exclusive retailers contracts, the Tribunal cited a comment from G.F. Finlay, then President of Nielsen Canada, following the signing of Canada Safeway to an exclusive contract:

> This signing is a major hurdle and it means that it would not be possible for a competitor to come in and sign contracts sufficient to produce a national product. It will also improve our negotiating position immensely in the next few years.[22]

A further document, related to the motivation for Nielsen staggering its retailer contracts, was particularly incriminating in addressing the issue of market entry:

> After we did our retailer deals five years ago, we recognized that we were vulnerable because virtually all of these agreements expired around the same time. We set ourselves a goal then to pursue a practice that would result in our retailer and distributor contracts expiring at different times. *This would make it much more difficult for any competitor to set up a service unless he was prepared to invest in significant payments before he had a revenue stream*[23] (emphasis added).

Clearly, imposing a serious impediment to market entry was at the forefront of Nielsen's intentions.

Self-incriminating documents also provided compelling evidence in the context of the alleged inducements to exclusivity. For example, the Tribunal cited an internal Nielsen document which revealed that payments to retailers increased over 500% once exclusive contracts began being negotiated. Turning to manufacturer contracts, again the Tribunal cited a number of Nielsen's documents as referring to strategies of "locking-up" as much business as possible in the face of potential entry by IRI. In fact, the Tribunal's discussion of manufacturer contracts is quite telling:

> Proof of the existence of a business motive for long-term contracts that was unrelated to an anti-competitive purpose would undoubtedly be relevant to an evaluation of an allegation of anti-competitive acts. The mere proof of *some* legitimate business purpose would be, however, hardly sufficient to support a finding that there is no anti-competitive act. All known factors must be taken into account in assessing the nature and purpose of the acts alleged to be anti-competitive (emphasis in original).[24]

The foregoing examples demonstrate how important it is for firms who hold a large market share to develop a concerted approach toward document creation and retention. In this regard, outside counsel can play a critical role in prescribing a strong dose of "preventive medicine" for his or her client.[25] However, ideally, a document management program would be developed as part of a broader competition law compliance program which includes an educational component for employees.[26] The benefit of this approach is that, in addition to addressing the creation of incriminating documents, the objective of such a program would be to ensure that the client appreciates the concerns of the Director. Having said that, structuring such a program can be a particularly challenging task in the context of a multi-national corporation like Nielsen.[27] Nevertheless, it is submitted that implementing and maintaining a document management program, coupled with an educational component related to competition law, would significantly reduce the likelihood of generating self-incriminating documents.

(iii) The Scope of Remedies under Section 79

a. The IRI Undertaking

Where the Tribunal finds, as it did in *Nielsen*, that the requirements under paragraphs 79(1)(a)-(c) are satisfied, it is authorized to make an order prohibiting all or any of those persons alleged to be abusing their dominant position from engaging in the impugned practices. Moreover, the Tribunal is granted additional power under subsection 79(2) where an order under subsection (1) would not be likely to restore competition in the market. In such circumstances, the Tribunal may,

> ...in addition to or in lieu of making an order under subsection (1), make an order directing any or all the persons against whom an order is sought to take such actions, including the divestiture of assets or shares, as are reasonable and as are necessary to overcome the effects of the practice in that market.

However, subsection 79(3) requires that, when making an order under subsection 79(2), the Tribunal should "...interfere with the rights of any person to whom the order is directed or any other person affected by it only to the extent necessary to achieve the purpose of the order." In this regard, the scope for making an order under section 79 is more restrictive than in the context of, for example, the merger provisions, which authorize the Tribunal to make an order against "any other person".

The scope of an order of the Tribunal may make under section 79 is particularly important in the context of *Nielsen*. As the Director argued, through his expert witness Dr. Ralph Winter, exclusive arrangements between the suppliers of scanner data (*eg.*, grocery chains) and market intermediaries (*eg.*, Nielsen) are inherently anti-competitive as they lead to monopoly. However, under section 79, the reach of the Tribunal's order only extends as far as the parties to the application. This is particularly troubling assuming Dr. Winter is correct in his assertion. This point is further discussed in considerable detail below.

Interestingly, and unique to *Nielsen* was the outcome that, in effect, IRI was made subject to the Order, at least with respect to the use of exclusive retailer contracts. Specifically, while recognizing that it had no authority to extend its order to IRI, the Tribunal accepted the undertaking given by a senior officer of IRI during his testimony. The undertaking was simply that IRI would agree not to enter into exclusive arrangements with retailers assuming Nielsen was prohibited by the Tribunal from doing so. In fact, the Tribunal went so far as to state that "...we took it into account in fashioning the remedies."[28] The formal result was that IRI's undertaking was included as part of the preamble to the Order. Query whether in future abuse of dominance cases, respondents will attempt to secure such undertakings from complainants who are usually existing or prospective competitors, in order to prevent the respondent from gaining a competitive disadvantage following implementation of the order.

b. Altering Contractual Rights/Obligations in Mid-Term

In each of *Nielsen*, *Laidlaw* and *NutraSweet*, the remedies sought from and granted by the Tribunal dealt with the contractual arrangements of the respondent. That is, in each case, the contracts were effectively amended to address a negative competitive impact which such contracts created. In considering the implications of it striking the exclusivity clauses from the retailer contracts without altering the payment obligations of Nielsen, the Tribunal identified two problems. First, with respect to existing retailer contracts, the Tribunal observed that retailers would have the ability to increase their revenues, at least in the short run, by continuing to receive payments from Nielsen - which had been negotiated based on an exclusive relationship while having the new found right to sell their data to IRI. The Tribunal, however, also recognized that retailers could choose to forgo this short-run windfall if they believed that their long-run earnings would be diminished by dealing with IRI. Second, the Tribunal acknowledged that an order striking the exclusivity clauses could provide IRI with an unintended competitive advantage, since Nielsen would continue to be required to make exclusivity-based payments for data while IRI or any other competitor could purchase the data at a lower, non-exclusive cost.

Interestingly, while the Director did not ask for the payment clauses to be struck, Nielsen did request that the Tribunal *not* deal with these clauses. However, Nielsen's position *vis-a-vis* the payment clauses is curious in light of the evidence. That is, internal documents of Nielsen confirmed that significant premiums had been paid to retailers to secure exclusivity. Nevertheless, Nielsen voiced no objection to it being required to continue to pay for an exclusive relationship which the Tribunal was prohibiting. Presumably, Nielsen took this stance based on its view that *de facto* exclusivity and, therefore, its market presence could be maintained even in light of the Tribunal's Order.

Unfortunately, the Tribunal appears to have left open the question of whether such issues represent valid concerns for it to address. It is submitted that, for the following reasons, the Tribunal should not engage in an *ex post facto* exercise of amending impugned contracts. First, as referred to above, the scope of an order should be restricted to overcoming the negative competitive effects of the anti-competitive practice(s).

In other words, it is not the mandate of the Tribunal to ensure that its order is equitable from a contractual standpoint. Second, it is reasonable to assume that at the time Nielsen was negotiating its retailer contracts, it was fully aware of the risk it was running under the Act and could have allocated this risk during its negotiations through, for example, the language in a *force majeure* clause. And third, the Tribunal a specialized administrative adjudicator is not the proper forum to undertake a common law analysis of contract law. This should be reserved strictly for the courts.

Economic Implications

(i) Overview

Abuse of dominance cases present a fundamental challenge to adjudicators: how does one distinguish between "hard competition" and conduct which seeks to prevent competition?[29] There are two key problems that adjudicators face in attempting to resolve this issue. First, hard competition and anti-competitive practices often both lead to the same outcome - the elimination of competitors. That is, it is generally not the practices *per se* that are anti-competitive but rather the fact that they are being undertaken in a particular market context by a dominant firm.[30] Second, in a related point, the acts which are alleged to be anti-competitive are typically vertical in nature and the public policy in this regard has been more controversial than in any other area of anti-trust law.[31] In fact, the analysis of contractual arrangements between economic agents which are purportedly entered into for mutual gain has been "the most actively researched area in modern micro-economics."[32]

In light of the foregoing, it is submitted that the best opportunity adjudicators have for unravelling this conundrum is through a thoughtful application of economic theory to the facts. It is further submitted that the legal infrastructure the Act and the Tribunal is conducive to such an undertaking.[33] Yet, despite having this infrastructure in place and receiving submissions from the parties' economic experts, it is submitted that the Tribunal's decision in *Nielsen* provides little guidance for resolving critical economic issues in future cases. This is not a criticism of the result in *Nielsen*, *per se*, but rather of the decision-making process, at least to the extent that it was made apparent in the Tribunal's reasons. This process is critical for providing guidance to all stakeholders as the precedential value of the Tribunal's economic analysis is as important, and arguably more important, than in respect of its legal analysis.

In an effort to provide support for the foregoing assertions, the balance of this commentary will review selected aspects of the Tribunal's analysis which would have been enhanced significantly with a more rigorous application of economic theory to the facts. In some instances, the Tribunal should have scrutinized more intensely the economic arguments put before it. In other instances, the parties should have provided the Tribunal with more evidence, particularly in the case of Nielsen.

(1) The Anti-competitiveness of Exclusivity

It is submitted that one of the ironies of *Nielsen* is that the Director's principal economic argument was premised on the fact that the relevant market was characterized by an inherent "market failure". That is, assuming the Director was correct, *no* order against Nielsen, alone, could correct this market failure. Specifically, through its economic expert, Dr. Ralph Winter, the Director argued that, in a market with the characteristics of Canadian scanner-based market tracking services, a monopoly was the inevitable outcome of the bidding for the exclusive right to purchase scanner data, where exclusivity is permitted. The rationale underlying this conclusion is as follows:

> The maximum that either firm would bid for the *nonexclusive* use of the essential input in a (hypothetical) duopoly would be the revenue that the firm earns in the duopoly... This is because the firm would not bid more for the input than the return it earns from the input. But the other firm, to gain *exclusive* use of the data would be willing to increase its payment by...the difference between the return it would earn as a monopolist and the return that it earns as a duopolist ... A duopoly will not emerge in the market because one of the firms will willingly bid higher for exclusive use of suppliers' data than the maximum possible sum of payments by both firms for nonexclusive use of the data.[34]

Dr. Winter further concluded that even if the entire "monopoly" rents of Nielsen were transferred to the upstream suppliers of raw data, "the distribution of monopoly profits (have) no economic or legal relevance in applying section 79..."[35] In this regard, the Director argued that competition *for* the market was insufficient to prevent a substantial lessening or prevention of competition. The Tribunal accepted this argument without reservation. Unfortunately, in doing so, the Tribunal left certain questions unanswered.

For example, the Director argued that the structure of the market led to a "market failure" in that when all market players acted rationally, an anti-competitive result ensued. If the Director was correct, one would not expect to observe a different result under similar market conditions elsewhere. Yet, the "inevitable" result did not occur in the United States. As stated by the Tribunal,

> Considerable evidence was introduced regarding the situation in the United States, where IRI and Nielsen acquire data from retailers on a non-exclusive basis and compete vigorously in the provision of scanner-based market tracking services.[36]

Unfortunately, no explanation was provided as to why the market in the United States was not characterized by exclusive arrangements and a convergence toward monopoly. It is submitted that there are two possible explanations: either the U.S. market is distinguishable from Canada in some respect or Dr. Winter's theory is flawed. In either case, it is submitted that a thorough consideration of the evolution of the U.S. market would have tested the veracity of the Director's submissions and provided further insight into the Tribunal's market analysis.

Interestingly, in his affidavit, Professor Winter addressed the contingency that a monopoly would not arise, even where exclusivity was permitted:

> Even if the conclusion...on the inevitability of monopoly under exclusivity, is incorrect the exclusivity restrictions are nonetheless anti-competitive. If used by two competing firms in a market like the relevant one in this application, the restrictions serve to differentiate the two firms' products, in an artificial and costly way. This lessens competition, leading to higher prices, and leaves each product less valuable.[37]

Simply stated, Professor Winter argued that competition *for* the market would, in the market for scanner-based services, *always* lead to an anti-competitive result even if each competitor secured some contracts. In other words, the operation of the market failed.

Having said that, Professor Winter did go to some length to demonstrate that competition *for* the market may, in some circumstances, lead to a pro-competitive result. The scenario posited by Professor Winter was motivated by the *Standard Fashions*[38] case. Specifically, his framework involved two wholesale firms supplying a single retail outlet. Rather than each selling to the retailer, the two suppliers competed for the right to supply the retailer on an exclusive basis. From a retailer's perspective, it would commit to one supplier if it were made better off than dealing with both suppliers. In other words, the retailer would need to be induced with a lower wholesale price which, if sufficiently lower, may result in a lower retail price, thereby raising consumer welfare. Professor Winter concluded as follows:

> In short, for "competition for the market" to have a beneficial, disciplining effect on market prices under exclusionary restrictions, two conditions are necessary: that the exclusionary restrictions be on buyers, and that prices be per-unit of a product sold. Neither of the conditions holds in the case at hand.[39]

However, there are a number of viable responses to the assertions of Dr. Winter which, curiously, do not appear to have been advanced forcefully by Nielsen.

First, as argued by one commentator, competition *for* the market could be pro-competitive where it led to the more innovative and efficient firm being willing to pay more for the exclusive right.[40] This competition could lead to lower prices and/or enhanced services in the market. Might this have been the case in *Nielsen*? The evidence from the United States suggests that the scanner-based market tracking services available from Nielsen and IRI are very similar. This might suggest that innovation has been stifled in the United States and that competition *for* the market would lead to greater innovation and product differentiation. In other words, if Canada enjoyed a superior market tracking service, as compared to the United States, it would provide a pro-competitive justification for the "monopoly" status of Nielsen. Unfortunately, it does not appear from the decision that the scanner-based market tracking services in the United States and Canada were compared at length to test this hypothesis.

Second, Professor Winter concluded that,

> Competition for the market shifts the profits or rents derived from the preventing (*sic*) competition within the market to the upstream suppliers of raw data. The suppliers capture a significant share of the rents, while playing no active or purposeful role in lessening competition. Nielsen might not be the primary beneficiary of the prevention of competition. The distribution of monopoly profits has no economic incentive or legal relevance in applying Section 79, however.[41]

It is submitted that this conclusion of the Director's expert was also not sufficiently challenged. For example, taking the transfer of rents to one extreme, vigorous competition *for* the market could lead to all or virtually all of the monopoly rents being transferred to the upstream retailers. Under this scenario, all the "spoils" of the alleged anti-competitive acts would go to the retailers while Nielsen would face an order from the Tribunal. This hypothetical demonstrates the fundamental flaw with the assertion that the distribution of rents has no economic relevance under section 79. Presumably, Dr. Winter had been focusing his analysis strictly on the welfare impact in the market for scanner-based tracking services.

This aspect of Professor Winter's conclusion, however, has been challenged recently in an article by Michal S. Gal[42] who argues persuasively that the Director should have included the suppliers of scanner data as respondents to his application. Specifically, she argues that their incentives for exclusive arrangements were just as compelling as those of Nielsen.[43] Moreover, Gal contends that the Act contains the "legal tools" for the Director to have remedied the market failure identified.[44] Interestingly, the premise of Gal's article is consistent with the fundamental tenet of the Director's case. Specifically, as noted above, the Director argued that exclusivity restrictions were, in the market for scanner-based market tracking services, inherently anti-competitive. Yet, the remedy sought by the Director only extended formally to Nielsen.[45] Short of placing a ban on exclusive contracts in the relevant market, which the Director clearly had no legal authority to impose, the only way to prevent exclusive arrangements by new entrants, would be to pursue the source of raw scanner data - retailers and ensure access to their raw data was made available. That is, in the context of a public good, where market efficiency requires full access, one would expect the target of an order to be the holder of the property rights in the public good and not the consumer of the public goods in question.

Second, one would have expected Nielsen to vigorously challenge the notion that competition for the market in the context of market-tracking services is inherently anti-competitive. However, contrary to the position of Professor Winter and at least two other commentators,[46] it is submitted that ambiguity surrounding the welfare impact of the alleged anti-competitive acts exists even under the facts in *Nielsen*. Moreover, it is submitted that the source of this ambiguity is the exclusivity premium being paid by Nielsen to the various retailers. That is, it is feasible that the retailers, who operate in a highly competitive market themselves, would employ these premiums toward welfare enhancing results in their own competitive market.[47] Therefore, a total welfare analysis would require one to compare the reduction in consumer welfare from the monopoly held by Nielsen with the increase in welfare resulting from the premium payment to fiercely competing retailers. It is not clear why the welfare loss in the market for scanner-based market tracking services would necessarily outweigh the gains in the retailers' market. As such, a careful consideration of this point by the Tribunal would have been beneficial.

Unfortunately, based on the decision in *Nielsen*, this point did not appear to be advanced with the vigour one would have expected. As stated in the reasons,

> The only possible benefit of competition for exclusives was raised by Dr. Mathewson who suggested that there was a possibility that the payment received by the retailers might get passed on to their customers. While raised as a possibility, there was no reason given as to why this might be expected to happen and no evidence was before us relating to the possibility.[48]

In the end, the position of the Director prevailed: competition *for* the market was not sufficient to preserve competition. However, as one commentator has observed, perhaps more important than this result was the fact that

> ...the Tribunal put the onus on the respondent to demonstrate why competition *for* the market would contribute to a competitive marketplace. That is, there was a presumption not of efficiency but of foreclosure, which the respondent was required to rebut.[49]

It is submitted that the burden of proof is a critical issue since, whether one is trying to prove or refute allegations of foreclosure, one is forced to make counterfactual claims. It is further submitted that the danger of any implicit shifting of the burden of proof to the respondent from the Director is that it leads to a stronger likelihood that the Tribunal will err on the side of prohibiting practices by dominant firms which do not, in fact, meet the criteria of section 79.

(2) The Impact of Countervailing Power

To date, arguments related to the impact of countervailing power - advanced most notably by NutraSweet and Nielsen as having a disciplinary effect on the ability of a dominant player to exercise market power have been rejected by the Tribunal with little analysis. Interestingly, in both cases, the applications of the Director had been prompted by complaints from prospective entrants and not customers.[50] For example, in *NutraSweet*, the Tribunal rejected the countervailing power argument advanced by the respondent despite the fact that Coke and Pepsi were overwhelmingly the two largest customers of NutraSweet and had not complained to the Director in respect of the alleged anti-competitive acts. Moreover, evidence had been put forth before the Tribunal that it had been Coke and Pepsi who had requested the impugned contractual provisions, *e.g.*, "most-favoured nation" and "meet-or-release" clauses. Presumably, Coke and Pepsi pursued such a strategy to neutralize the sourcing of aspartame as a competitive factor.

The facts in *Nielsen*, however, are more complicated as a result of Nielsen being a true market intermediary. In this regard, Nielsen is subject to countervailing power from both a supply and demand side. From the supply side, as noted above, the Director acknowledged that Nielsen may not be the principal beneficiary of its monopoly rent as a large portion of it could be transferred to the retailers. Nevertheless, as also previously noted, the position of the Director was that this would not be relevant to the analysis under section 79 of the Act.

From a demand side perspective, the Director, however, through its expert, gave no credence to the countervailing power defence. As noted in his rebuttal affidavit, Professor Winter stated,

> A countervailing-power defense of the prevention of competition among sellers may have some economic basis in a market with a single buyer. In a market with even two or three buyers, it has none. Furthermore, in *NutraSweet* the Tribunal explicitly rejected the countervailing power defense in a market with two very large buyers.[51]

It is submitted that this statement over-simplifies the defence of countervailing power. It is further submitted that the treatment of countervailing power by the Tribunal in abuse of dominance cases differs considerably from its treatment in the context of merger review by the Competition Bureau, despite the fact that there is no theoretical basis for this distinction. After all, the issue in both contexts is the exercise of market power - the only distinction is a temporal one.

That is, in the context of a merger review, it is common for merging parties to make submissions to the Bureau that the countervailing power of customers will attenuate the exercise of market power, post-merger. Moreover, it is not uncommon for the Bureau to focus on mid and small-sized customers which suggests that, in at least some instances, countervailing power represents a compelling defence. In other words, there has been no indication from the Bureau that the countervailing power defence should be restricted to the narrow criteria set out by the Tribunal in *Nielsen* of having either: (i) many suppliers; (ii) a single buyer; or (iii) the prospect for backward integration.

Also, as any counsel who have attempted to convince the Director to challenge a merger could attest to, the Director is extremely reluctant to file an application under section 92 of the Act without having sufficient complaints from the customer base relating to actual market experiences. Yet in the context of abuse of dominance cases, this does not appear to be the prerequisite that it is under merger review. Stepping back, this is somewhat of a counter-intuitive result. That is, merger review inherently involves a consideration of the *prospective* exercise of market power. By contrast, an abuse of dominance case generally involves the *past* or *current* exercise of market power. The former involves customers' expectations post-merger, whereas the latter involves customers' actual experiences in the marketplace. One would expect the importance of complaints from the demand side of the market to be more influential in the latter context.[52]

The Tribunal in *Nielsen* apparently also rejected a derivation of the countervailing-power argument related to the international operations of many of the manufacturers. Essentially, the argument put to the Tribunal was that large manufacturers with operations in Canada and the United States would have the ability to leverage off of the competition in the United States to discipline the exercise of market power by Nielsen in Canada. Interestingly, Professors Mathewson and Winter gave directly conflicting factual descriptions of this issue in their respective affidavits.[53] Unfortunately, the Tribunal paid little attention to this issue and, as such, provided little guidance as to the persuasiveness of this specific form of a countervailing power argument in future abuse of dominance cases.

(3) Price/Cost Considerations

Continuing the comparison between the economic analysis undertaken in relation to a proposed merger versus allegations of abuse of dominance, in the context of the former, the fundamental concern of the Bureau is the prospect for non-transitory price increases and/or reduced product/service options. The advantage of undertaking such an analysis in the context of an abuse of dominance case is that the concerns which are only hypothetical in the merger context, should be observable market parameters in the relevant market. Surprisingly, the Tribunal spent little time on this issue despite the fact that, unlike a number of other aspects of the case, the Tribunal was presented with two diverging views of the facts by the parties. In regard to prices and services in Canada, Professor Mathewson submitted on behalf of Nielsen that,

> The evidence from Nielsen is that its real prices in Canada for its scanning-based market tracking product not only have not risen over the period from 1986 to the present but have fallen slightly. Real prices remain constant in spite of the difficulties experienced by Nielsen in bringing on stream its scanning-based market tracking services. These difficulties resulted from the low and variable quality of raw data submitted to Nielsen by the retail grocery chains. ... In sum, the period from 1986 to 1992 was characterized by constant or marginally declining real prices associated with the national market tracking product, a discrete improvement in the quality of the product as scanner-based data became more reliable and useable, and increased costs to Nielsen during the transition phase because of the need to maintain the former data sources and collection until the quality of the scanning based data met minimum quality and regional representation standards.[54]

At first blush, constant price levels do not appear to be consistent with the behaviour of a company exercising its dominant power in an anti-competitive manner.

In his rebuttal affidavit, Professor Winter persuasively challenged the representations of Professor Mathewson. In essence, Dr. Winter argued that looking only to price levels made one vulnerable to a "Cellophane fallacy" type trap. That is, one would not expect to observe price increases if Nielsen were already charging a monopolist price. As stated by Dr. Winter:

> No economic theory allows us to infer from inflation rates in a market the extent of competition in the market. Monopoly is associated with high price *levels*, not high price *changes* over time. On its own, the evidence on inflation rates is irrelevant. The evidence on price changes in the Canadian market for tracking services becomes meaningful, for inference about the competitiveness of the market, when it is combined with evidence on price changes in the U.S. market. This is because while the Canadian market has remained monopolized, the market structure in the U.S. has changed. IRI's market share in the U.S. has grown to roughly one half. This natural experiment, with the U.S. market playing the role of a "control group", allows us to infer the impact of the prevention of competition in Canada through Nielsen's exclusivity restrictions.[55]

However, it is submitted that, while comparing price changes in the manner suggested by Dr. Winter would be far more revealing than looking to price changes in Canada only, it still is not sufficient. That is, if one is interested in determining whether an entity is exercising market power - and market power is defined as the ability to set price above marginal cost - then an even more illustrative factor would be to compare the changes in the price/cost ratio between Canada and the United States. If the Director's theory of the case was correct, one would have expected to find a considerably lower ratio in the United States as compared to Canada. Unfortunately, the Tribunal did not address this issue.

VII. Conclusions

This commentary has provided a legal and economic analysis of the Tribunal decision in *Nielsen* with the following results. From a legal perspective, *Nielsen* has settled the issue of how the phrase "class or species of business" should be interpreted. Having said that, there is a risk that, in doing so, the Tribunal has unnecessarily opened for debate the issue of the extraterritorial application of the Act. Moreover, the decision in *Nielsen* provides a textbook example of what can happen when a document management program has not been implemented by a respondent. As Nielsen learned the hard way, it is difficult to refute evidence found in your own files. This, hopefully, will be a lessen which both internal and external counsel will heed when advising their clients. In addition, as a result of the undertaking of IRI, *Nielsen* raises the prospect for respondents in the future requesting that existing or would-be competitors undertake not to engage in the impugned practices in order to maintain a level playing field. The Tribunal, however, should be extremely cautious in entertaining such requests as (i) it achieves indirectly what the Act prevents from occurring directly; and (ii) such undertakings may affect competition negatively. Finally, the Tribunal in *Nielsen* unnecessarily wrestled with the equity of altering contractual rights/obligations in mid-term. As stated above, this should not be a concern for the Tribunal.

From an economic perspective, the general conclusion of this commentary is that the veracity of the arguments put before the Tribunal must be tested more thoroughly. An order of the Tribunal has the ability to alter drastically the competitive dynamics of a market, and thus, before such an order is granted to the Director, it is incumbent upon the Tribunal to explore and test the arguments of the parties to ensure that there is a consistency in its findings. Having said that, the parties must be thorough in their presentation of the evidence and provide objective support where possible. This commentary has reviewed selected aspects of the decision in *Nielsen* which would have been enhanced significantly with a more exhaustive application of economic theory to the facts. It is difficult, however, to assess what impact any shortcomings in this regard may have had on the ultimate decision of the Tribunal and the competitiveness of the market. Unfortunately, the unfolding of the market does not provide us with much solace as the anticipated entry by IRI has, from every indication, yet to occur.

Notes

* An earlier version of this paper was presented at the University of Toronto - Faculty of Law Competition Law Roundtable on June 6, 1997. I would like to express my appreciation to all those who provided their comments including Donald Houston, Lawson Hunter, Professor Michael Trebilcock, Professor Ralph Winter and Professor Frank Mathewson.

1 64 C.P.R. (3d) 216. The two contested cases preceding *Nielsen* were *Canada (Director of Investigation and Research)* v. *NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 *("NutraSweet")* and *Canada (Director of Investigation and Research)* v. *Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 *("Laidlaw")*. The respondent, The D&B Companies of Canada Ltd. was formed as a result of an amalgamation in 1991 of A.C. Nielsen Company of Canada Limited, Dun & Bradstreet Canada Limited and Media Measurement Services Inc. The respondent will be referred to as "Nielsen" throughout this commentary. For other commentaries related to abuse of dominance cases, please see B.M. Graham, "Abuse of Dominance - Recent Case Law: *NutraSweet* and *Laidlaw*" (1993) 38 McGill L.J. 800; J. Musgrove, "Use and Abuse of Dominance: A Brief Review after *NutraSweet, Laidlaw*, and *Nielsen*" (1995) 16:3 Can. Comp. Rec. at 52; J. Church,

and R. Ware, "Abuse of Dominance Under the 1986 Canadian Competition Act", forthcoming, *The Review of Industrial Organization*; and P.J. Collins, "The Law and Economics" of 'Abuse of Dominant Position': An Analysis of *NutraSweet*", (1991) 49 U. of T. L.R. 276.

[2] The other cases under the abuse of dominance provisions of the Act, to date, are *Director of Investigation and Research* v. *Tele-Direct (Publications) Inc., and Tele-Direct (Services) Inc.*, No. CT-94/3 (Comp. Trib.) and two consent order proceedings, *Director of Investigation and Research and AGT Director Limited et al.*, (1995) No. CT-95/02 (Comp. Trib.) and *Director of Investigation and Research* v. *Bank of Montreal et al.*, No. CT-95/02 (Comp. Trib.).

[3] Consumer packaged goods are both food and non-food products which are packaged by manufacturers for purchase by consumers.

[4] *Nielsen, supra,* note 1 at 232.

[5] This was a strategy that appeared destined for failure due to what is known in economic jargon as the "holdout problem". Specifically, in 1985, IRI attempted to secure the exclusive supply of grocery scanner data from all the key grocery retailers. It signed 10 of 11 retailers but failed to secure a contract with Safeway, rendering the 10 signed agreements effectively null and void.

[6] *NutraSweet, supra*, note 1 at 28.

[7] *Laidlaw, supra*, note 1 at 325.

[8] *Consolidated Order*, CT-94/1 (Comp. Trib.).

[9] Interestingly, in *NutraSweet*, the Director unsuccessfully argued in favour of a "commercial" definition of the phrase "class or species of business." The distinction between an economic and commercial definition is considered in further detail below.

[10] *Consumer and Corporate Affairs Canada*, November, 1991.

[11] *Nielsen, supra,* note 1 at 222.

[12] *Ibid.* at 223.

[13] Had there been any uncertainty preceding its decision, the Tribunal in *Nielsen* confirmed that the leading case in favour of a commercial approach toward market definition - *Eddy Match Co.* v. *The Queen* (1953), 20 C.P.R. 107 (Que. Q.B., A.S.) - was distinguishable on several grounds, including, that it had been decided under a criminal legislative regime. See, *Nielsen, supra,* note 1 at 227.

[14] *Ibid.* at 226.

[15] R.J. Roberts, "Abuse of Dominant Position: From Bork to Bain and Back Again (But This Time With Extraterritoriality)" in R.S. Khemani & W.T. Stanbury, *Canadian Competition Law and Policy at the Centennery* (Halifax: Institute for Research on Public Policy, 1991 at 337. Interestingly, the Tribunal conceded that the point raised by Professor Roberts was not argued by either party.

[16] *Nielsen, supra,* note 1 at 231.

[17] *Ibid.*

[18] Committee of the House of Commons on Bill C-91, Minutes of Proceedings and Evidence (Ottawa: Queen's Printer, 1986) at 3:8 as quoted in *ibid.* at 229.

[19] In light of the fact that Bill C-67 has now died on the order table, the drafters of any future round of amendments to the Act would be well-advised to follow the suggestion made by Professor Stanbury.

[20] *NutraSweet, supra,* note 1 at 34; *Laidlaw, supra,* note 1 at 333.

[21] *Laidlaw, ibid.* at 342-3.

[22] *Ibid.* at 342-3.

[23] *Ibid.*

[24] *Ibid.* at 265.

[25] A particularly discomforting fact for clients is discovering that all computer records, including electronic mail, can be seized by the Director.

[26] For a discussion related to the merits of competition law compliance programs, see *e.g.* K.E. Thomson, and F. Glowinsky, "A Measure of Avoidance: The Design & Implementation of Competition Law Compliance Programs" (Address to the Canadian Bar Association 1995 Annual Competition Law Conference.); and D. Kaufman, and A. Nikolakakis, "Designing & Implementing an Effective Competition Law Compliance Program" (Address to the Canadian Bar Association Conference, 1993).

[27] For a discussion focused particularly on structuring compliance programs in the context of multi-national corporations, please refer to P. Collins, and D.J. Brown, "'Made in Canada' Antitrust Compliance Programmes and the Canadian Competition Act" (1996) 20 World Competition: Law and Economics Review 37.

[28] *Nielsen, supra*, note 1 at 279.

[29] J. Musgrove, *supra*, note 1 at 60.

[30] A theoretical construct that has gained considerable prominence in recent years, and which may be described as a reformulated and more sophisticated version of traditional "market foreclosure" theories, focuses on the effects that the actions of one firm have on the costs of its actual and potential competitors. The seminal paper in this regard is T. Krattenmaker, and S. Salop, "Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price" 96 Yale L.J. 209. In essence, the raising rivals' cost theory involves a two step analysis. First, one must investigate whether the impugned conduct of the defendant firm led to significantly increased costs for its competitor. Second, assuming that competitors' costs have been raised, the issue is whether the increased costs enabled the excluding firm to exercise market power to obtain supra-competitive profits.

[31] F. Mathewson, and R. Winter, "The Law and Economics of Vertical Restraints" in *The Law and Economics of Competition Policy*, eds. F. Mathewson, M.J. Trebilcock, and M. Walker (The Fraser Institute, 1990) at 111.

[32] *Ibid.* at 109.

[33] For example, panels of the Tribunal hearing cases are composed of judicial and non-judicial members. However, every panel must be chaired by a judicial member. The non-judicial members of the Tribunal may only be appointed after the minister consults with an advisory committee of not more than 10 persons knowledgeable in economics, industry, commerce, or public affairs.

[34] Affidavit of Dr. Ralph A. Winter Sworn September 20, 1994 ("Winter Affidavit"), at 48-49.

[35] *Ibid.* at 5.

[36] *Nielsen, supra,* note 1 at 277.

[37] Winter Affidavit, *supra,* note 34 at 5.

[38] *Standard Fashion Co.* v. *Magrane-Houston Co.*, 42 S. Ct. 360 (1922).

[39] Winter Affidavit, *supra*, note 34 at 60.

[40] Musgrove, *supra*, note 1 at 60.

[41] Winter Affidavit, *supra*, note 34 at 70.

[42] "The Nielsen Case: Was Competition Restored?" forthcoming, Can. Bus. L.J.

[43] *Ibid.* at 9.

[44] *Ibid.* at 1.

[45] *Ibid.*

[46] J. Church, and R. Ware, "Abuse of Dominance Under the 1986 Canadian Competition Act" forthcoming, *The Review of Industrial Organization* 1 at 31.

[47] Further support for this point arises from the fact that the marginal cost curve of scanner-based data presumably would have the characteristics of those associated with a "natural monopoly" which is a common target of regulation.

[48] *Nielsen, supra*, note 1 at 268.

[49] Musgrove, *supra,* note 1 at 60.

[50] It should be noted, however, that a representative of the Grocery Product Manufacturers of Canada ("GPMC") did appear as a witness for the Director. Moreover, the Tribunal placed significant emphasis on the results of a survey of members of the GPMC which implied that countervailing power was not a factor in *Nielsen*. Having said that, the survey was very broadly worded and did not address specific market experiences. In this regard, a more detailed survey would have been more revealing of the dynamics of the market.

[51] Affidavit of Dr. Ralph A. Winter Sworn October 4, 1994 at 2 ("Winter Affidavit II").

[52] For example, in Winter Affidavit II, *ibid.* at 3, Dr. Winter stated the following. "As a factual matter, I understand that the opposite effect has occurred. IRI has been at a competitive disadvantage in the sales of U.S. data to large multinational buyers because it cannot offer scanning data from both Canada and the U.S. Nielsen's monopoly in Canada has an anti-competitive impact beyond the relevant market in this case." By contrast, in the Affidavit of Professor Frank Mathewson sworn September 20, 1994 ("Mathewson Affidavit"), at 10, Professor Mathewson stated as follows. "Another option open to these international manufacturers is to influence favourably the terms and conditions that they receive in Canada through the terms and conditions they are accorded by Nielsen. I understand from Nielsen personnel that such efforts actually occur during contract negotiation."

[53] One possible explanation for the lack of vocal customer complaints in the context of an abuse of dominance case is that customers may fear retribution by the dominant firm if the decision of the Tribunal does not lead to a competitive alternative.

[54] Mathewson Affidavit, *supra,* note 52 at 20.

[55] Winter Affidavit II, *supra,* note 51 at 3.

REGULATION AND COMPETITION LAW OVERSIGHT OF TELECOMMUNICATIONS MARKETS*

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I. Introduction

This outline considers the regulatory implications of the transition of Canadian telecommunications markets from rate regulation to market-based competition. The rapid pace of innovation and technological change and the increasing globalization of telecommunications markets are placing new demands on the Canadian regulatory and competition law authorities as a result of the following factors:

- these changes are invalidating many long-held regulatory assumptions, *e.g.*, natural monopoly-based assumptions regarding the extent to which regulation, rather than market forces, should govern the terms and conditions of telecommunications services in Canada;

- these changes are providing alternative means by which policy objectives, such as service universality, may be achieved;

- the dynamic nature of the industry and rapid rate of change in telecommunications technologies requires that decisions relating to proposed transactions be made very rapidly; and

- customers' requirements and demands for integrated services are leading industry participants to form alliances and joint ventures, and to cooperate in the development of common standards.

Industry developments are mandating a shift, under the forbearance provisions of the *Telecommunications Act*,[1] from regulation by the Canadian Radio-Television and Telecommunications Commission (the "CRTC") to market-based competition and competitive oversight by the Director of Investigation and Research (the "Director") pursuant to the provisions of the *Competition Act*.[2]

Changes to the regulatory environment will be required to ensure that the Canadian Authorities[3] do not inadvertently impede the efforts of Canadian telecommunications carriers to compete effectively both domestically and internationally. In this regard, potential problems include the over-regulation of the industry, the application of somewhat inconsistent policy objectives advanced by the *Telecommunications Act* and the *Competition Act*, and regulatory delays and uncertainty in the review of telecommunications joint ventures or strategic alliances.

With the signing of the World Trade Organization ("WTO") Agreement on Basic Telecommunications (the "WTO Agreement") this past February, Canada committed to terminate the monopolies currently held by Teleglobe and Telesat with respect to certain international traffic and to permit the use of non-Canadian owned submarine cables and low earth orbit ("LEO") satellites to provide service to Canada. These recent developments highlight the increasingly global scope of markets for telecommunications services.

Recent developments in the telecommunications industry have led to the recognition that the industry and its customers would be better served by a timely transition away from regulation toward market-based competition.

This outline briefly discusses the reasons why the market-based model of competition is increasingly viewed as the most appropriate means of achieving broadly based economic, political and social goals; examines and compares the manner in which the current regimes implemented by the CRTC, the *Competition Act* and the WTO Agreement define and promote the objectives of competition; discusses some of the regulatory challenges which are likely to result from the changes in the industry; and makes some recommendations with respect to the policies which should guide the evolution of the Canadian regulatory environment.

II. Sources and Objectives of Canadian Telecommunications Competition Policy

The *Telecommunications Act*, the *Competition Act* and the WTO Agreement each advance slightly different competition policy objectives. Canadian competition policy in telecommunications is regulated principally by the *Telecommunications Act*. However, the provisions of the *Competition Act* also apply generally to matters not expressly regulated by the CRTC. In addition, the non-criminal (*i.e.*, reviewable matters) provisions of the *Competition Act* may have concurrent application notwithstanding CRTC regulation.[4] The WTO Agreement Reference Paper on Regulatory Safeguards (the "Reference Paper") prescribes a third set of parameters and may be enforced in disputes between different WTO members under the WTO's dispute settlement mechanism.

The principal objectives of Canadian telecommunications policy are set out in section 7 of the *Telecommunications Act*.[5] However, the CRTC's recent public notice relating to *Competition in the Provision of International Telecommunications Services*[6] refers specifically to the policy objectives relating to the efficiency and competitiveness of Canadian national and international telecommunications (subsection 7(c)), to the promotion of the use of Canadian transmission facilities (subsection 7(e)), and to fostering increased reliance on market forces and ensuring that regulation, where required, is efficient and effective (subsection 7(f)), thereby suggesting that economic efficiency may be a factor of particular importance in the area of international telecommunications.

The objectives served by the *Competition Act* are relatively narrow, especially when compared to those set out in the *Telecommunications Act*. Section 1.1, the purpose clause of the *Competition Act*, provides as follows:

> The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

The objectives of the WTO Agreement relate principally to the opening up of domestic telecommunications markets to international competition as part of the trade liberalization contemplated by the General Agreement on Trade in Services ("GATS").

Market-based competition is increasingly recognized as the preferable method of ensuring the efficient allocation of resources and as the best way of increasing the average standard of living of people within the economy.[7] Recent CRTC decisions and Bureau publications, such as the Director's Merger Enforcement Guidelines, have also recognized that the competitive process ensures the most efficient allocation of resources in a free market economy.

However, there are a number of slightly different objectives subsumed within the word "competition". These include:

- the existence and intensity of rivalry;
- the absence of restraints over the economic activities of one entity by another;
- the state of a market in which the individual buyers and sellers do not influence prices by their purchases or sales;
- the existence of fragmented industries and markets which are preserved through the protection of viable, small, locally owned business; or
- the state of affairs in which consumer welfare could not be increased through the imposition of a judicial decree to create an alternative state of affairs.[8]

These different competition objectives are advanced in varying degrees by different provisions in each of the *Competition Act* and the *Telecommunications Act*. Generally speaking, the *Competition Act*, as enforced by the Director and the Bureau, is primarily concerned with the promotion of rivalry and efficiency, whereas the *Telecommunications Act*, as enforced by the CRTC, is concerned to a greater degree with the protection and preservation of market participants and the allocation of revenues and returns among the market participants.

In his submissions to the CRTC respecting the role to be played by competition in the development of the Canadian Information Highway, a former Director has noted that:

> Competition lies at the cornerstone of our free market economy. It brings diversity, choice, freedom of expression and innovation - important ingredients for Canadians as they begin to present their own ideas and cultures to the world over silicon and glass fibre networks and through the electromagnetic spectrum.
>
> If Canada is to compete in the global information economy, its people, firms and institutions must operate to the maximum of their abilities. Free and open competition among content and distribution providers will ensure that the Information Highway operates in an efficient and effective manner to the benefit of all Canadians.[9]

III. Why Regulate Canadian Telecommunications?

Telecommunications regulation has traditionally been viewed as an appropriate means to accomplish desired economic, political and social goals. From an economic perspective, telecommunications, like many other utilities, has historically been viewed as a "natural monopoly". In essence, natural monopolies are characterized by continuously declining average cost curves. In theory, regulation allows a natural monopolist to achieve the efficiencies made possible by its declining cost curve, while protecting its customers from the higher prices which the monopolist would likely otherwise charge.[10]

Regulation has also been used to accomplish the objective of ensuring that telecommunications facilities in Canada remain Canadian-owned and controlled. This policy goal is reflected in the objectives of Canadian telecommunications policy set forth in subsections 7(d) and (e) of the *Telecommunications Act.*

Regulation has also been used to advance the goal of service universality. Canadian telecommunications policy seeks to ensure that reliable and affordable telecommunications services of high quality are accessible to Canadians in both urban and rural areas in all regions of Canada.[11] The goal of universality of local service has in the past been advanced by express transfers from the long distance to the local service segments. In this regard, the regulator seeks to ensure that the rates paid to the monopolist provide a fair rate of return while at the same time permitting "universal [access] to basic telecommunications services at affordable prices".[12]

IV. Market Developments

Market developments may be considered in terms of innovation and technological change, the globalization of markets and the expansion of competition.

A. Innovation and Technological Change

- The traditional view of the local loop as a natural monopoly is either now or will shortly become inapplicable. The growing use of digital wireline and wireless telecommunications systems in place

of incompatible analogue video and telephone communications systems is a product of advances in digital electronics. Over the next few years, the widespread adoption of high-bandwidth digital wireless technologies,[13] together with rapid advances in fibre optics and digital switching,[14] are expected to lead to continuing rapid increases in the level of competition in telecommunications services.

B. Expanding Scale of Telecommunications Markets

- In telecommunications, as in many other areas, trade policy is becoming an increasingly important factor in domestic industrial policy. The development of the information economy, free trade in goods and services, globalization of production, innovation and technological change, and the liberalization of trade and regulatory restrictions on telecommunications, are broadening the scope of telecommunications markets from local to international in size.

- The *North American Free Trade Agreement* ("NAFTA"), other regional agreements and those entered into under the auspices of the WTO, together with the information economy factors described above, are leading to an increasing integration of markets on a North American and international basis.

- Internationally, the WTO Agreement reflects the broad international consensus that competition in telecommunications services is possible, practical and desirable. As part of its commitment under the WTO Agreement, Canada has agreed to terminate the monopolies currently held by Teleglobe and Telesat with respect to certain international traffic and to permit the use of non-Canadian owned submarine cables and LEO satellites to provide service to Canada.

C. Expansion of Competition

- Innovation and technological change, deregulation and the expanding scope and scale of the markets for telecommunications services are resulting in a rapid expansion in the number of competitors providing telecommunications services in Canada, a rapid expansion in the volume and share of services provided by these competitors, substantial price decreases and a rapid expansion in the number of committed new entrants and potential entrants to this industry.

- The past five years have seen a dramatic increase in the number of competitors offering long distance services in Canada. There are now a large number of registered long distance service providers, including a significant number of facilities-based competitors.[15] The prices of long distance service in Canada have fallen dramatically as a result of the vigorous and effective competition for these services.

- As a result of the technological developments discussed above, there are a large number of new entrants in the Canadian telecommunications business. These include PCS licensees, LMCS licensees, cable television operators and Internet telephone service companies.

- The combination of technological developments with the globalization of markets permits international telecommunications companies to be set up almost anywhere in the world. The development of Telegroup Inc. and U.S.A. Global Link Inc., two leading international telephone callback firms, in Fairfield, Iowa highlights the global nature of the industry and the relative independence of such businesses from geographic constraints. (Callback firms use digital switching technology to arbitrage the differences between the high prices charged for international calls originating from certain overseas countries and the relatively low rates charged when the same communication is originated from North America.) In a recent article describing these businesses, a U.S. trade official is quoted as describing the callback phenomenon as "proof that technological improvements will defeat regulatory structure".[16]

V. The Evolving Role of the Regulator in Canadian Telecommunications

Section 34 of the *Telecommunications Act*[17] requires that the CRTC refrain from regulating telecommunications services which are sufficiently competitive to protect the interests of users. For example, the CRTC has decided to refrain from regulating the rates charged for long distance services by the alternative long distance carriers, and from regulating the rates charged by the regional telephone companies (the telcos) for certain of their packet data and frame relay services and for their electronic messaging and information services.[18]

Consequently, in the telecommunications area, the oversight role played by the *Competition Act* is expected to increase and the regulatory role of the *Telecommunications Act* to decrease as technological change and other developments give rise to increased competition.

The federal government's Convergence Policy Statement[19] sets out the federal government's policies with respect to competition in telecommunications facilities, products and services and the relationship between competition and the promotion of Canadian content. The Convergence Policy Statement contemplates the direct competition between the telcos and cable television companies subsequently introduced by the CRTC in its May 1997 local competition decisions.[20]

Recent CRTC decisions which have had a significant effect on competition in the telecommunications industry include:

- CRTC 92-12, *Competition in the Provision of Public Long Distance Voice Telephone Services and Related Resale and Sharing Issues*,[21] in which the CRTC opened up public long distance telephone services to facilities-based competition on an equal access basis. This decision

required that long distance competitors pay access costs as a contribution to local service costs;

- CRTC 94-14, *Forbearance Sale of Terminal Equipment by Canadian Carriers*,[22] in which the CRTC decided to substantially refrain from regulating the prices and terms of sale of terminal equipment by Canadian carriers;

- CRTC 94-17, *Equal Access - Marketing Information*,[23] in which the CRTC ordered the telcos to send out a billing insert, which had been drafted by the CRTC, containing information about long distance competition and describing the process and consequences of switching to an alternative long distance supplier;

- CRTC 94-19, *Review of Regulatory Framework*,[24] in which the CRTC established the framework for the transition of local services from a rate base/rate of return regulation model to price cap regulation, and ultimately, to competition for such services, and provided for rate rebalancing pursuant to which local rates would be increased by a total of $6.00 per month in a series of staged increases (an aspect of the decision which was overturned by the federal Cabinet). CRTC 94-19 recognized that fundamental changes to the Canadian regulatory framework were required if Canadians were to fully benefit from the advances in telecommunications technology. The new framework was intended to reduce technical, regulatory and economic barriers to entry and to place a much greater reliance upon market forces and competition. The rebalancing of the rates for long distance and local service, which the CRTC described as being "necessary if Canadians are to benefit fully from increased competition and if bypass opportunities and the potential for uneconomic entry are to be reduced", is a central element of this new framework. CRTC 94-19 also contemplated CRTC forbearance with respect to the rates charged by the telcos for long distance services and the entry of the telcos into the business of providing content as well as carriage;

- CRTC 95-13, *Access to Telephone Company Support Structures*,[25] in which the CRTC imposed a general obligation on the telcos to make their support structures (conduits and poles) available to carry the cables and facilities of competing telecommunications carriers and cable television companies, except where technical or safety reasons would preclude such cooperation;

- CRTC 95-19, *Forbearance - Services Provided by Non-Dominant Canadian Carriers*,[26] in which the CRTC decided to substantially refrain from regulating the facilities-based long distance services offered by non-telco competitors, subject to continuing requirements that these alternative carriers offer the use of their facilities to others on a non-discriminatory resale basis, and to continuing restrictions on the bypass of Canadian services and facilities;

- CRTC 95-21, *Implementation of the Regulatory Framework - Splitting of the Rate Base and Related Issues*,[27] in which, as directed by the federal Cabinet, the CRTC reconsidered the rate rebalancing provided for in CRTC 94-19 and allocated certain additional costs from the telcos' local segment to their long distance segment;

- CRTC 96-130, *Stentor Forbearance of Regulation of Packet Data Services*,[28] in which the CRTC decided to substantially refrain from regulating the packet data and frame relay services offered by the Stentor companies;

- CRTC 97-8, *Local Competition - Local Unbundling and Interconnection*,[29] in which the CRTC specified the terms and conditions for local competition; and

- CRTC 97-9, *Price Cap Regulation and Related Issues*,[30] in which the CRTC established the terms of the price cap regulatory regime which is to apply to the local services offered by the Stentor companies.

Although these recent CRTC telecom decisions appear to reflect its and the federal government's acceptance of the need for market forces and competition, rather than regulation, to serve as the primary protection of Canadians' interests in an efficient and internationally competitive domestic telecommunications system, recent comments of the CRTC Chairperson[31] and the CRTC's recently released Telecom Public Notice *Competition in the Provision of International Telecommunications Services*[32] suggest that the CRTC will continue to play a very substantial role in the regulation of telecommunications, with a view to ensuring that competition is sustainable.

VI. The Role of the Competition Bureau

Subject to the possible application of the regulated conduct defence, discussed below, the *Competition Act* applies generally to all businesses in Canada.

Criminal offences under the *Competition Act* include bid-rigging, price maintenance, discriminatory and/or predatory pricing, misleading advertising and anti-competitive conspiracies. Prosecutions under these provisions are heard in the criminal courts and require that the Crown prove the offence beyond a reasonable doubt. Penalties include fines or imprisonment, or both. Individuals as well as companies can face conviction. Prohibition orders and interim injunctions may also be obtained from the court upon application by the Attorney General.

Non-criminal reviewable matters, including mergers, abuse of dominant position, tied selling, exclusive dealing, refusal to deal and market restriction, may be challenged by the Director before the Tribunal. The Tribunal, which is comprised of federal court judges and lay members (typically selected for their economic

or business expertise and experience), decides cases on a civil standard of proof. The Tribunal has the power to issue interim injunctions and a wide range of orders but does not have the ability to impose penal sanctions or to award damages.

A private right of civil action is available in respect of violations of the criminal provisions of the *Competition Act* or a failure to comply with an order made under the *Competition Act* by the Tribunal or a court. Anyone who has suffered losses or damages as a result of such anti-competitive behaviour may recover an amount equal to the losses or damages suffered.

The Director has long recognized the vital importance of efficient domestic telecommunications services to Canadian industry's ability to achieve and maintain international competitiveness, and has made the efficient operation of Canada's telecommunications industry a Bureau priority. In addition to intervening in numerous CRTC hearings[33] and making substantial submissions with respect to the major CRTC decisions referred to in the previous section,[34] recent investigations and activities of the Director and the Bureau with respect to telecommunications-related matters include:

- the review, completed at the beginning of 1995, of the acquisition of Edmonton Telephone Corporation by Telus Corporation. In his news release respecting this transaction, the Director referred to the potential emergence of competitive alternatives, both from cable companies and wireless technologies, such as cellular and PCS, as an important factor in his assessment and also arranged that Telus would provide open access to communications space on hydro and telephone support structures pending the release of the CRTC's decision on access to such support structures;[35]

- the review, under the civil reviewable matters provisions of the *Competition Act*, of the 1993 reorganization of the Stentor Alliance, the national telecommunications network comprised of Canada's nine regional telcos. After an extensive, three-year examination, the Director concluded that he did not have grounds to challenge the Stentor Alliance under the *Competition Act*. He referred to evidence of competitive entry into long distance markets and the significantly declining rates charged for long distance services as important factors in this decision;[36]

- the consent proceedings and contested application brought before the Tribunal against the publishers of telephone directories in 1994 under the abuse of dominance and other reviewable matters provisions of the *Competition Act*;[37] and

- the consent proceedings brought before the Tribunal against the major Canadian banks and the other charter members of the Interac Association which operates the automated banking machine network in Canada. The consent order required that Interac open its network to

> other potential participants on a non-discriminatory basis and prohibited the imposition of new member entry fees and other barriers to entry.[38]

The Director and the *Competition Act* may be expected to play an increasingly important role in the development of telecommunications competition policy in the future as the CRTC forbears from regulating and moves additional telecommunications services out from under its regulatory regime, such that they become subject to all of the provisions of the *Competition Act.*

In this regard, a former Director summarized the reasons why he favoured the timely elimination of telecommunications regulation in favour of competition, wherever possible, as follows:

> First, competition is better than regulation at creating incentives for innovation, in encouraging the development of new products, services and methods of doing business. Competition is also a better driver to minimize the cost of bringing products and services to consumers.
>
> This is particularly true in telecommunications where rapid technological innovation in computing and bandwidth use is creating an explosion of new products and services offered at increasingly lower prices.
>
> Second, competitive market forces drive the prices of goods and services toward their relative cost of production and minimizes the misallocation of scarce resources. This in turn enhances economic efficiency, generating overall benefits for the Canadian economy.
>
> Again, telecommunications is an excellent example. Being an important input into almost every part of the economy, lower telecommunications costs feed into virtually all other sectors.[39]

In previous cases, a former Director has taken the position that the Tribunal has concurrent jurisdiction with respect to reviewable matters (mergers, abuse of dominant position, refusal to deal, tied selling, exclusive dealing, etc.) notwithstanding that a similar issue before the CRTC was the subject of submissions made by that Director to the CRTC.[40] More recently, senior representatives of the Bureau have indicated that as the telecommunications industry progresses towards greater competition, the Bureau's role will shift away from policy intervention toward a greater role in enforcement activity.[41]

Moreover, the Bureau has indicated that, in addition to carefully examining mergers and other transactions between telecommunications companies, it will be considering misleading advertising and deceptive marketing practices and watching for possible collusion between competitors as part of its expanding role in enforcement activities.[42]

VII. The WTO Reference Paper

The WTO Agreement was concluded in February 1997 after nearly three years of negotiations. Sixty-nine governments representing over 90% of the world's telecommunications revenues[43] have signed the WTO Agreement. In addition, 63 countries have adopted, in whole or in part, the Reference Paper, a document which prescribes a common minimum set of regulatory provisions which may be enforced through the

WTO's dispute resolution mechanism. The signatories are committed to establishing independent regulatory bodies, guaranteeing interconnection with existing networks at fair prices, forbidding cross-subsidization and other anti-competitive practices and guaranteeing transparency in government regulation and licensing decisions.

The WTO Agreement also contemplates that the WTO dispute resolution mechanism would apply where, for example, a foreign service provider is prevented from competing in a signatory member nation. However, there are several limitations. First, there is no private right of action. Only governments can bring complaints to the WTO. This means that private parties will have to secure the support and cooperation of a national government[44] in order to get their matter before the WTO. Conflicting political agendas, resource limitations and other factors such as international comity considerations may affect the level of support that a private complainant may receive. A further drawback is the timeliness of WTO decisions. One commentator has suggested that the entire process could take 12 months or more.[45] Finally, the WTO dispute mechanism is aimed at bringing member states in line where, for example, the member fails to take appropriate action against any competitive conduct carried on by a major supplier (as defined by the reference paper) within that member's jurisdiction. This suggests that the private party will likely have to exhaust all possible domestic remedies before turning to the WTO, a process which could add a further delay.

VIII. Current Regulatory Challenges

While the effects of the recent CRTC decisions and other developments outlined above have generally been pro-competitive, the concurrent application of the *Competition Act*, the *Telecommunications Act* and, more recently, the adoption of the Reference Paper pose a number of significant challenges. Potential problems include the possible over-regulation of the industry; the application of the somewhat inconsistent policy objectives advanced by the *Telecommunications Act*, the *Competition Act* and the Reference Paper; and unnecessary regulatory delays or uncertainty in the review of telecommunications joint ventures or strategic alliances.

A. Concurrent Jurisdiction

- With the adoption of the Reference Paper, Canada has introduced a third regulatory framework and a possible dispute resolution mechanism into Canadian telecommunications. Although the adoption of the Reference Paper may have created some measure of uncertainty with respect to the applicable competition law tests and criteria which would be applied in any dispute brought under the WTO dispute resolution mechanism, it would not appear to add significantly, if at all, to the criteria which must be satisfied in order for the CRTC to grant full forbearance under section 34 of the *Telecommunications Act*. It would also appear, at least for the immediate future, that the CRTC rather than the Bureau and the Tribunal is best equipped to discharge Canada's regulatory obligations under the Reference Paper.[46]

- Former Directors have taken the position that, unless the CRTC has specifically required a respondent to act in a manner inconsistent with the relief sought by the Director, the CRTC's exercise of jurisdiction over the respondent is not a bar to *Competition Act* relief.

- While it is likely that full CRTC regulation of a telecommunications service would provide a valid defence to charges brought under the criminal provisions of the *Competition Act* with respect to matters that are specifically regulated by the CRTC, such as the setting of prices under tariffs, previous Directors have taken the position that the Director has concurrent jurisdiction under the *Competition Act* with respect to reviewable matters and other matters which have not been specifically regulated by the CRTC.[47]

- The shift in the Bureau's approach from policy intervention toward enforcement activities together with the CRTC's express commitment to actively "referee" telecommunications competition poses the potential danger of over-regulation, as industry participants endeavour to satisfy the requirements of both the CRTC and the Bureau.

B. Inconsistent Policy Objectives

- Although the CRTC, and Canadian telecommunications policy generally, are becoming increasingly attuned to the competition policy objectives which underlie the *Competition Act*, significant differences in approach remain. For example, the CRTC is concerned, to a greater extent than the Director, about the fair treatment and protection of competitors, while the Director is concerned about the protection of competition, rather than individual competitors, and is less concerned than the CRTC about the possibility that some competitors may be unable to survive in a fully competitive market.[48]

- In addition, Canadian telecommunications policy has as one of its objectives the provision of reliable and affordable telecommunication services of high quality to Canadians in both urban and rural areas in all regions in Canada. In contrast, as indicated in a recent speech by a senior Bureau official: "[c]ompetition authorities do not regulate levels of service, quality, prices or profits. Rather, these outcomes are determined by the influence of competitive market forces."[49]

- The Bureau believes a decision to forbear from regulation should attempt to balance the degree to which incumbent telephone companies possess "market power" against the costs of continued regulation. "At some point, presumably well short of perfect competition, the costs of continued regulation will exceed the costs of relying upon market forces."[50] The differences between the policy objectives favoured by the CRTC and the Bureau may be expected to lead these organizations to reach inconsistent decisions with respect to both the need for and the nature of the regulatory intervention which may be appropriate in each case, with the result that industry participants could be forced to satisfy inconsistent regulatory requirements in an increasing number of cases.[51]

C. Regulatory Delays

- The accelerating rate of technological change requires that industry participants be in a position to rapidly respond to market developments. These market realities are incompatible with the lengthy proceedings typically employed by the CRTC. Any requirement that proponents and/or respondents deal with both the CRTC and the Bureau could create delays which would further impair their ability to effectively compete in the increasingly global marketplace.

D. Uncertainty in the Review of Joint Ventures

- Network economics and the increasing specialization that is required in order for companies to lead in the development of telecommunications technologies is leading to an increase in use of joint ventures and alliances to achieve strategic business objectives.[52] Consequently, delays and other sources of regulatory uncertainty with respect to the review of joint ventures may impair firms' ability to compete effectively.

- The small size, relative to the size of the global markets, of the Canadian industry makes it imperative that Canadian businesses be able to quickly enter into joint ventures and strategic alliances without undue regulatory impediments.

- The Director has recognized the pro-competitive potential of joint ventures and has issued enforcement guidelines, in particular, the Strategic Alliances Bulletin (the "Bulletin"), which provide some measure of guidance with respect to the application of the *Competition Act* to joint ventures.

- However, the Bulletin does not provide the type of clear guidance that was hoped for, and it has left a significant "grey zone" where the enforcement mandates under the criminal (*e.g.*, conspiracy and price maintenance) and non-criminal (*e.g.*, mergers, abuse of dominance, tied selling and exclusive dealing) provisions of the *Competition Act* overlap.

- The review and/or prosecution of a joint venture under the *Competition Act* may give rise to criminal liability, civil damages, adverse publicity, possible director or officer liability and investigative expenses. The seriousness of these consequences and the continuing uncertainty with respect to the nature and the result of the Bureau's review of joint ventures is a negative factor which may reduce the attractiveness of potentially efficiency-enhancing joint ventures among competing businesses.

IX. Recommendations

The objectives which should govern the transition from a regulation model to market-based competition are:

- the removal of regulatory requirements which serve to inhibit effective competition or are an unnecessary burden on the Canadian telecommunications industry;
- the clarification of the objectives, *e.g.*, efficiency or the protection of competitors, which are to be advanced by the applicable regulatory framework;
- the reinforcement of the need for regulators to quickly respond to the rapid rate of change in the industry; and
- the clarification of the terms under which joint ventures in the telecommunications industry are to be reviewed.

Notes

* This paper was originally presented at the Insight Conference on Regulating International Telecommunications on November 5-6, 1997. The preparation of this paper was substantially assisted by reference to two papers written by Richard F.D. Corley with Calvin S. Goldman, Q.C., "Competition Law and Policy in Canadian Telecommunications" (1997) 18:1 Can. Comp. Rec. 48 and "The Review of Joint Ventures under the Canadian Competition Act" (copy available from the authors).

1 S.C. 1993, c. 38 (*"Telecommunications Act"*).

2 R.S.C. 1985, c. C-34 (*"Competition Act"*).

3 The term "Canadian Authorities" refers to the CRTC and its staff and/or the Director and his staff at the Competition Bureau (the "Bureau"), as applicable.

4 We note that the extent to which CRTC regulation or forbearance from same may give rise to a "regulated conduct" defence with respect to the non-criminal provisions of the *Competition Act* has yet to be decided by Canadian courts. However, a former Director has taken the position in a previous case that the Competition Tribunal (the "Tribunal") has concurrent jurisdiction with respect to reviewable matters (mergers, abuse of dominant position, refusal to deal, tied selling, exclusive dealing, etc.) notwithstanding that a similar issue is before the CRTC and was the subject of submissions made by the Director to the CRTC (see Director's Reply and Director's Memorandum of Argument filed January 18, 1995 in response to the Notice of Motion dated January 16, 1995 in *Director of Investigation and Research* v. *Tele-Direct (Publications) Inc.*, CT/94-3). The Director has also taken the position that, unless the CRTC has exercised its powers in a manner that specifically requires a respondent to act in a manner inconsistent with the relief sought by the Director, the CRTC's exercise of jurisdiction over the respondent is not a bar to *Competition Act* relief.

5 Section 7 provides as follows:

7. It is hereby affirmed that telecommunications performs an essential role in the maintenance of Canada's identity and sovereignty and that the Canadian telecommunications policy has as its objectives

(a) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions;

(b) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada;

(c) to enhance the efficiency and competitiveness at the national and international levels of Canadian telecommunications;

(d) to promote the ownership and control of Canadian carriers by Canadians;

(e) to promote the use of Canadian transmission facilities for telecommunications within Canada and between Canada and points outside Canada;

(f) to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective;

(g) to stimulate research and development in Canada in the field of telecommunications and to encourage innovation in the provision of telecommunications services;

(h) to respond to the economic and social requirements of users of telecommunications services; and

(i) to contribute to the protection of the privacy of persons.

[6] Telecom Public Notice 97-34, *Competition in the Provision of International Telecommunication Services* (October 2, 1997) (C.R.T.C.).

[7] P. Crampton, "Alternative Approaches to Competition Law" (1994) 17 World Competition 55 at 56.

[8] R.H. Bork, *The Antitrust Paradox* (New York: The Free Press, 1993) at 58-61.

[9] G.N. Addy, Director of Investigation and Research (Address to the Canadian Radio-Television and Telecommunications Commission, 16 March 1995) at 6.

[10] L. Sherman, "Changing Public Policy and Telecommunications in Canada", in S. Globerman, W.T. Stanbury & T. Wilson, eds., *The Future of Telecommunications Policy in Canada* (Toronto: University of British Columbia and University of Toronto, 1995) at 15. "Traditionally, [CRTC] regulation has been a proxy for competitive markets, to ensure that companies did not abuse their monopoly position by either seeking to earn more than the overall rate of return that investors would require from competitive businesses facing comparable risks, or by charging unreasonable rates, or by unjustly discriminating between customers or traffic." See also *supra*, note 6.

[11] Section 7(b) of the *Telecommunications Act.*

[12] *Supra*, note 10 at 17.

[13] New digital wireless technologies, including Local Multipoint Communications Systems ("LMCS"), Personal Communications Services ("PCS"), digital cellular, LEO satellites, geosynchronous Direct to Home ("DTH") satellites, and Multichannel Multipoint Distribution Systems ("MMDS"), will provide low cost digital bandwidth to and from end-users, and will allow new competitors to bypass the low speed, analogue local loop operated by the telephone companies.

[14] Rapid advances in fibre optics and digital switching technologies, which are reflected in the rapid growth in the use of the Asynchronous Transfer Mode ("ATM") and Internet packet switching protocols and the development of high speed Internet cable modems, are facilitating the rapid expansion of competition in the wireline side of the telecommunications industry.

[15] Facilities-based service providers include AT&T, Sprint, fONOROLA, Westel and Rogers Network Services. In addition, cable companies such as Videotron, Shaw and Fundy Cable, and electric utilities have extensive transmission networks and have either begun to provide or have the ability to provide telecommunications services.

[16] P. Maass, "Welcome to Silicorn Valley: Fairfield, Iowa that is. Home of some of the wily callback companies that broke the back of outrageous overseas phone rates, and that are now turning themselves into virtual phone companies to battle the telco giants" (1997) 130 Wired 182.

[17] Subsection 34(2) of the *Telecommunications Act* provides that, where "the Commission finds as a question of fact that a telecommunications service or class of services provided by a Canadian carrier is or will be subject to competition sufficient to protect the interests of users, the Commission shall make a determination to refrain, to the extent that it considers appropriate, ... from the exercise of any power ... in relation to the service or class of services".

[18] See Telecom Decision No. 95-19 (C.R.T.C.) and Telecom Order No. 96-130 (C.R.T.C.), discussed *infra*.

[19] See Government of Canada, "Convergence Policy Statement" (6 August 1996) and Government of Canada, News Release, "Competition and Culture Set to Gain in Convergence Policy Framework" (6 August 1996).

[20] The Convergence Policy Statement, *ibid.*, also contemplates that:

(a) cooperation or sharing of facilities between cable licensees and telecommunications carriers would be permitted;

(b) the telecommunications facilities of cable companies, beyond that used by the licensee for the carriage of broadcasting services, to the extent practicable, would be made available for lease, resale and sharing by service providers and other carriers on a non-discriminatory basis;

(c) facilities and capacity, including the use of support structures, would, to the extent practicable, be made available to other users;

(d) regulation should prevent cross-subsidization and other forms of anti-competitive behaviour; and

(e) regulation would permit consumers to use the telephone and cable wires within their homes to obtain services from any combination of suppliers they choose.

[21] June 12, 1992.

[22] August 4, 1994.

[23] August 24, 1994.
[24] September 16, 1994.
[25] June 22, 1995.
[26] September 8, 1995.
[27] October 31, 1995.
[28] February 19, 1995.
[29] May 1, 1997.
[30] *Ibid.*
[31] Françoise Bertrand, "Choice Competition and Convergence for Canada" (Address to the 1997 Canadian Telecommunications SuperConference, 9 May 1997) [unpublished] at 9. "Clearly, the [CRTC] must also adapt to the new competitive environment in which the industries it regulates, or exempts from regulation, evolve. We will rely increasingly on market forces as competitive forces take hold, and we will not hesitate to get out of the way. Still, it is also clear that for the next few years at least, the presence of the [CRTC] with its technical expertise and experience will be needed to foster the environment we are seeking. *But then, I also see a need, for some time, for an expert referee to ensure that the competition is sustainable and to see that the interests of consumers and citizens are protected. This is our prime responsibility. Clearly, in an increasingly deregulated environment, the role of the [CRTC] as a referee is not likely to end in the near future*" (emphasis added).
[32] In Telecom Public Notice CRTC 97-34, *supra*, note 6, the CRTC has requested proposals and comments "as to which classes of international services and international service providers, if any, should be subject to licensing requirements". The CRTC adds that "licence conditions should not constitute a barrier to entry, but rather ensure that the regulatory regime put in place with regard to international services is respected by service providers".
[33] The CRTC has largely adopted the "market power" paradigm, advocated by the Director, as the basis for determining whether the services provided by Canadian carriers will be subject to sufficient competition to protect the interests of users (as required for the CRTC to forbear under s. 34 of the *Telecommunications Act*) and has specifically referred to the Director's Merger Enforcement Guidelines for guidance with respect to market definition and market power issues. (For example, see Part III, CRTC Telecom 94-19, *supra*, note 24, respecting the CRTC's test of forbearance.) The Director has also intervened and made submissions to the federal Cabinet in respect of telecom and broadcast decisions that have been appealed to the Cabinet, and to the CRTC in respect of matters reconsidered by the CRTC.
[34] For example, see the Director's submissions of April 13, 1993, January 17, 1994 and February 7, 1994, in the *Regulatory Framework* proceedings leading to CRTC 94-19. The Director is also intervening in the pending proceedings in which the CRTC is to consider whether it should refrain from regulating the telcos' long distance services.
[35] Bureau of Competition Policy, News Release, "Director of Investigation and Research Will Not Challenge Telus Corporation's Acquisition of Edmonton Telephone Corporation" (28 February 1995).
[36] Competition Bureau, News Release, "Director Announces Results of *Competition Act* Review of Stentor" (22 February 1996); and Competition Bureau, Backgrounder, "Director Announces Results of *Competition Act* Review of Stentor" (22 February 1996).
[37] The consent proceeding concerned an alleged practice of anti-competitive acts relating to the sale of national advertising in telephone directories. See Bureau of Competition Policy, News Release, "Director Brings Consent Order Before Competition Tribunal Regarding Yellow Pages Publishers" (20 September 1994). The contested application was filed on December 22, 1994 and the Tribunal's decision was finally issued on February 26, 1997. This latter case related to the publication and sale of advertising in telephone directories.
[38] See, Competition Bureau, Competition Communiqué, "Competition Bureau's Solution in the Interac Case Paves the Way for Business and Consumer Benefits" (19 July 1996).
[39] G.N. Addy, "Local Competition: What Does it Mean in Canada" (Luncheon Address to the Canadian Institute Local Telecommunications Services Conference, 1 April 1996) [unpublished].
[40] See Director's reply and the Director's memorandum of argument filed January 18, 1995 in respect to the notice of motion dated January 16, 1995 in *Director of Investigation and Research* v. *Tele-Direct (Publications) Inc.*, CT/94-3.
[41] Francine Matte, Q.C., Senior Deputy Director of Investigation and Research, "Competition Policy in Canada: Objectives, Links with other Government Policies and Current Challenges" (Address to the Competition Workshop Robert Schuman Centre, European University Institute, 13 June 1997) [unpublished] at 13. "Considerable progress is being made to open Canadian telecommunications markets to greater competition and reducing the level of regulation. In light of this, the Bureau is shifting its emphasis away from regulatory and policy interventions, toward greater enforcement activity, including merger and other restructuring issues which are emerging in the transition period to competitive market."

[42] Gilles Ménard, Deputy Director of Investigation and Research, Competition Bureau, "The Changing Interface of Regulation and Competition Law in Canadian Telecommunications" (Angus Telemanagement Conference - Reinventing Canadian Telecom, 30 April 1997) [unpublished] at 9. "Issues which have arisen in the long distance sector relating to advertising claims as to consumer savings and discounts, performance and technical standards and so-called 'slamming' practices may carry over with the introduction of local competition and will have to be addressed under the *Competition Act* where they raise an issue."

[43] Revenues are currently estimated at approximately $880 billion. This figure is expected to double or triple over the next 10 years.

[44] Some of the larger international players may benefit from the ability to "shop around" for a friendly government willing to support them.

[45] "Simplified, the process works as follows: first a complaint must be brought against another WTO member. Second, the parties must consult for a period to see if a negotiated solution is possible. Third, if the consultation is unsuccessful, the parties may ask for a panel to be formed by the Dispute Settlement Body. The panel will issue a report. A number of comment periods follow, after which the final report is released to the parties and the WTO membership. If the parties object to the report, they may appeal and an appellate panel must find on the original panel's findings. This appellate panel finding must then be adopted by the Dispute Settlement Body. At best, the entire process could take 12 months. Most anticipate that the resolution of complex complaints will take substantially longer." M.S. Shears, "International Liberalization: The WTO and Implications for E.U. Markets and Regulation" 25 I.B.L. 300.

[46] A press release issued by Industry Canada on February 4, 1997 indicated that the CRTC, by way of a new licensing regime, would establish conditions of operation applicable to all international service providers.

[47] However, a recent decision of the Ontario Court (General Division), *Re Law Society of Upper Canada and Attorney General of Canada* (1996), 28 O.R. (3d) 460, granted the applicant Law Society a declaration that the regulated conduct exemption precluded the Director from investigating the Law Society's insurance business.

[48] *Supra*, note 42 at 4. Gilles Ménard illustrated the differences in the policies of the CRTC and the Bureau using a sports analogy: "regulators have a tendency not only to want to set the rules of the game, but to referee it in a fashion that all participants come out as winners. As a competition authority, we are not concerned about who wins and who loses. We are concerned with ensuring that participants don't fix the result of the game among themselves, buy up their opponents or create barriers to potential challengers."

[49] *Ibid.*

[50] *Ibid.* at 3.

[51] In addition, concurrent jurisdiction is leading complainants to file complaints with both the CRTC and the Competition Bureau, and the participants to make submissions to both agencies, in an increasing number of cases.

[52] *Supra*, note 42 at 9. The Bureau recognizes that telecommunications deregulation is likely to be accompanied by a degree of industry restructuring through mergers and acquisitions and the formation of strategic alliances, and also recognizes that strategic alliances are going to become increasingly common as firms seek to partner with other firms in a rapidly changing competitive environment.

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