SPECIAL SECTION ON AIR CANADA

THE SKIES ARE CLEARING: A CHRONOLOGY OF THE CANADIAN AIRLINE INDUSTRY SAGA

By: Paul Collins
Stikeman Elliott[1]

Introduction

To describe the recent developments in the Canadian airline industry as eventful would be a gross understatement. Within the last year alone, we have witnessed a protracted takeover battle for Air Canada, the acquisition of Canadian Airlines Corporation ("CAC"), the simultaneous rationalization of capacity and introduction of new routes, and a significant initiative by the Minister of Transport to reform the Canadian airlines industry pursuant to recently enacted legislation. The events have been so fast and furious over this period that it is often difficult for one to keep up. The purpose of this article is to provide a synopsis of these events.

Background

This latest chapter in the history of the Canadian airline industry began in January 1999 when CAC initiated discussions with Air Canada concerning the possible merger of the two airlines. AMR Corporation ("AMR"), the parent company of American Airlines, also participated in these discussions as any eventual change in control of Canadian Airlines International Limited ("CAI") would require AMR's approval pursuant to its unanimous shareholders agreement and services contracts. As well, although not known to Air Canada at the time, any change of control of CAI would trigger significant termination payments in favour of AMR pursuant to the services contracts between American and CAI.

These merger negotiations ultimately failed and the parties ceased their discussions by the spring of 1999. Shortly following the failed merger negotiations with CAC, Air Canada approached CAC with an alternative to a full-scale merger. Specifically, on June 23, 1999, Air Canada made an offer for CAC's international routes that included an extensive code sharing arrangement (the "IR Offer"). While CAC was somewhat sceptical about its ability to remain viable without its international routes, it was interested in examining Air Canada's business and financial models on the subject of the IR Offer. Nevertheless, on August 20, 1999, CAC formally rejected the IR Offer.

The Section 47 Order

While the IR Offer remained "on the table", the Minister of Transport (the Honourable David Collenette) commenced an unprecedented process largely in response to the concern expressed by Kevin Benson (then President and Chief Executive Officer of CAC) that stemmed from the precarious financial position of CAC. Specifically, on August 13, 1999, Transport Minister Collenette approached Cabinet for the issuance of an order (the "Order") pursuant to section 47 of the Canada Transportation Act (the "CTA"). Section 47 of the CTA allows Cabinet, on the recommendation of the Minister of Transport, to take any steps necessary to deal with "extraordinary disruptions" of Canada's transportation system where the failure to act "would be contrary to the interests of users and operators of the national transportation system" The steps available to Cabinet include the suspension of the *Competition Act*, to the extent deemed necessary to remedy the extraordinary disruptions facing the transportation system.

Accordingly, on August 13, 1999, the Order was issued and, pursuant to its terms, Cabinet suspended certain provisions of the *Competition Act* on the basis that CAC's financial situation qualified, under the statutory language of the CTA, as an imminent and "... extraordinary disruption to the effective continued operation of the national transportation system". Under the terms of the CTA, the Order was to run for a period of 90 days.

The Order was highly controversial. From the moment it was issued, Air Canada consistently was of the view that it did not exempt a potential acquiring party from the application of the merger pre-notification and merger review provisions of the *Competition Act* regarding any agreement entered into by CAC. That is, Air Canada was of the view that even if CAC had been acquired within the 90-day period in which the Order was effective, the pre-notification and merger review provisions of the *Competition Act* would still have applied. Based on this interpretation, the Commissioner of Competition would retain the right to review any transaction within 3 years of its completion.

The Onex Corporation Bid and Air Canada's Response

Commencing in June 1999, Onex Corporation ("Onex") began to acquire a toe-hold position in Air Canada through a company which it controlled – Airline Industry Revitalization Co. Inc. ("Airco"). Between June and August 1999, Onex acquired approximately 5% of Air Canada, with a total investment of $47 million.

On August 24, 1999, Airco launched an unsolicited (hostile) bid for Air Canada (the "Initial Airco Offer"). Concurrent with this bid, Airco entered into an agreement with AMR in which both parties agreed not to solicit, initiate or encourage any other possible merger or acquisition of Air Canada or CAC. Ultimately, under the Initial Airco Offer, Airco would acquire both Air Canada and CAC and merge them to create the "new Air Canada" Airco initially bid one Airco common share, or $8.25 cash, for each common share or class "A" non-voting common share of Air Canada, subject to certain prorating conditions.

Following its review of the Initial Airco Offer, Air Canada's Board of Directors (the "Board") undertook or supported the following steps to be undertaken:

(a) The Board rejected the Initial Airco Offer on the basis that, among other things, the consideration offered was inadequate and the bid effectively transferred Air Canada's value to the shareholders of CAC, Onex and AMR. The Board also rejected all subsequent Airco bids as described further below.

(b) On August 30, 1999, the Board adopted a shareholder rights plan (the "Plan"). The Plan would trigger an issue of rights to Air Canada shareholders if a person or group of associated persons acquired more than 10% of its shares.

(c) On October 19, 1999, Air Canada responded to the Initial Airco Offer in the following manner. First, Air Canada initiated an issuer bid (the "Initial Issuer Bid") for up to 35% of its outstanding common shares and Class "A" non-voting common shares for $12 per share, which at the time was a substantial premium to the Initial Airco Offer. Contemporaneously with the Initial Issuer Bid, Air Canada announced a comprehensive plan for providing value to its shareholders and restructuring Canada's airline industry. The elements of this plan are described immediately below.

(d) In conjunction with its Initial Issuer Bid, Air Canada entered into a master financing agreement with UAL Corporation ("United") and Deutsche Lufthansa AG ("Lufthansa") pursuant to which United and Lufthansa agreed to provide certain funding to Air Canada and to guarantee that a credit facility be put in place by Air Canada. In addition, Air Canada and the Canadian Imperial Bank of Commerce ("CIBC") entered into an amending agreement modifying the credit card agreement entered into between Air Canada and CIBC in January 1995 regarding the issuance of Visa™ cards by CIBC which entitle cardholders to receive membership in Air Canada's Aeroplan™ program and to earn Aeroplan™ mileage points.

(e) On October 19, 1999, Air Canada announced its intention to make an offer for CAC.

In response to the Initial Issuer Bid, on October 28, 1999, Airco revised the Initial Airco Offer by offering either $13 in cash per share or one Airco share for each Air Canada share (the "Amended Airco Offer"). It also revised its proration formula so that a maximum of 46.15% of the total offer would be in cash with the remainder in Airco shares.

On November 2, 1999, Air Canada revised its Initial Issuer Bid and offered $16 per share for up to 36.4% of Air Canada's outstanding shares (the "Amended Issuer Bid").

On November 5, 1999, Airco announced that it would further amend the Amended Airco Offer by (i) revising the consideration payable per Air Canada share to, at the option of the holder, $17.50 in cash or one Airco common share subject to prorating provisions; and (ii) revising such prorating

provisions of the Amended Airco Offer such that a maximum of 37.45% of the consideration payable under the further Amended Airco Offer (the "Second Amended Airco Offer") would be in cash and a maximum of 62.55% of the consideration payable under the Second Amended Airco Offer would be in Airco common shares.

Due to a Court decision, described below, which effectively rendered all Airco offers null and void, the Second Amended Airco Offer was formally withdrawn late on November 5, 1999.

On November 11, 1999, 853350 Alberta Ltd., a corporation owned in part by Air Canada, made an offer to purchase for $2 per share, all of the common shares and non-voting shares of CAC (the "853350 Offer"). The common shares of 853350 are held as to 90% by Mr. Paul Farrar, a Toronto businessman, and as to 10% by Air Canada. Under a funding agreement and a unanimous shareholders' agreement, 853350 and Mr. Farrar, respectively, provided Air Canada with various representations, warranties, covenants and approval rights respecting 853350 and certain major transactions. At that time, Air Canada stated its intention to acquire a controlling interest in 853350 only upon the satisfactory completion of the debt restructuring process pursuant to which the debt and other obligations of CAC would be restructured to a sustainable level.

Administrative and Legislative Reviews

Concurrent with the corporate events discussed above, there were a number of administrative and legislative reviews that were occurring.

Largely due to the controversy surrounding the Order, Minister Collenette established a process to arrive at a Policy Framework for the future of the Canadian airline industry, premised on the existence of a single, national domestic passenger airline carrier, regardless of how this occurred (*i.e.*, whether by the failure of CAC or by way of merger).

A number of constituencies participated in the Policy Framework process including the Competition Bureau, the Department of Transportation, and, with respect to issues of ownership and control, the Canadian Transportation Agency (the "Agency"). As a separate but related process, Parliamentary Committees the House Standing Committee on Transport (the "HST Committee") and the Senate Committee on Transport and Communications (the "Senate Committee") held their own hearings to consider the issues.

In response to a request from Mr. Collenette, the Commissioner of Competition released his recommendations for enhancing competition in the Canadian airline industry on October 22, 1999.

On October 26, 1999, Minister Collenette issued his Policy Framework for the restructuring of the Canadian airline industry. This document was intended to set out a general framework for future legislation. In this regard, the Policy Framework addressed matters pertaining to ownership and control, pricing, service to small communities, employment matters and a number of measures to help

foster competition. Under the rubric of competition law, issues such as predatory behaviour, airport access, frequent flyer programs, and travel agency commission overrides were also addressed.

Legal Challenges

Concurrent with the above-noted corporate events and administrative and legislative reviews that were unfolding, legal proceedings were also being invoked by each of Airco and Air Canada. These challenges occurred at both the federal and provincial levels and, at the provincial level, both in Ontario and Quebec provincial courts.

One proceeding involved Onex challenging the decision by the Board to hold its shareholders' meeting on January 7, 2000, rather than the November 8, 1999 date that Airco had requisitioned. Onex complained that Air Canada's decision was a veiled attempt to block the Initial Airco Offer by not allowing shareholders to consider the matter prior to its expiry, and more importantly for Airco, the expiry of the Order. Airco was successful in this challenge.

On September 13, 1999, Air Canada filed an application with the Federal Court seeking a declaration that, among other things, the Order did not exempt any Airco offer from merger review and merger pre-notification under the *Competition Act*. Airco's view was that any merger that occurred during the currency of the Order was forever exempt from review, whereas Air Canada believed that the Order did not oust the Bureau's jurisdiction to review a merger within three years of it closing. Air Canada eventually decided to discontinue its application before the Federal Court, after receiving the Attorney General's factum in which the Attorney General took the position that while the merger review provisions did not apply during the currency of the Order, they would apply immediately thereafter.

Air Canada also initiated a challenge before the Quebec Superior Court related to the legality of the Initial Airco Offer, pursuant to the *Air Canada Public Participation Act* (the "ACPPA") which limited any investor, either alone or in association with other shareholders, from acquiring more than 10% of Air Canada's voting shares. The essence of Air Canada's position before the Quebec Superior Court was that the structure of the Initial Airco Offer was such that it led to the creation of a new class of shares, such that it could acquire effective control of Air Canada without technically acquiring 10% of its voting shares. On September 20, 1999, Air Canada commenced proceedings against Airco seeking to declare the Initial Airco Offer null and void and to enjoin it on the grounds that, among other things, it violated the 10% ownership limit under the ACPPA. On November 5, 1999, Mr. Justice Wery found in Air Canada's favour.

Several hours following the release of Mr. Justice Wery's decision, the Second Amended Airco Offer was formally withdrawn.

Key Developments Following the Withdrawal of the Second Amended Airco Offer

With the withdrawal of the Second Amended Airco Offer, Air Canada's proposal – comprised of the Amended Issuer Bid and the 853350 Offer remained the only one available to be considered. Air Canada proceeded to complete its Amended Issuer Bid. In addition, 853350 took steps toward completing its acquisition of CAC. Air Canada provided 853350 with a binding commitment to provide all of the funds required to complete the 853350 Offer on a secured funding basis. In order to provide CAC with an immediate cash infusion, Air Canada negotiated the transfer of CAI's Tokyo slots and route rights to Air Canada. To date, Air Canada has funded all of its commitments from cash reserves. The 853350 Offer was completed on January 4, 2000 when 853350 took up 82% of CAC's common shares.

Between the withdrawal of the Second Amended Airco Offer and the completion of the 853350 Offer, Air Canada was involved in lengthy negotations with the Commissioner and the Minister of Transport to arrive at an understanding regarding certain undertakings that would be made enforceable under what was then future legislation. A copy of the undertakings (the "Undertakings") provided to the Commissioner by Air Canada and 853350 is available on the Bureau website.

In the letter of the Commissioner accompanying the Undertakings, the Commissioner stated as follows:

> ...the key question under the merger provisions of the *Competition Act* is whether there is a competitively preferable alternative, under the existing regulatory framework, to the proposed transaction. In considering this question, due regard must be given both to Canadian's financial situation and to the undertakings provided by Air Canada and the Offeror (the "Undertakings" – see attached Annex A).
>
> The Bureau has concluded that Canadian is facing imminent insolvency, necessitating the need for urgent action. The Bureau also acknowledges that there is not likely to be a competitively preferable purchaser of Canadian in the absence of the proposed transaction. Given this situation, and on the basis of the Undertakings provided by Air Canada and the Offeror, the Bureau does not consider that there is a competitively preferable alternative to the proposed transaction. In other words, the proposed transaction with the Undertakings is preferable to the liquidation of Canadian. (emphasis added)

Recent developments under the *Companies' Creditors Arrangement Act* ("CCAA") demonstrate the correctness of the Commissioner's conclusions regarding the financial state of CAC.

Undertakings of Air Canada to the Commissioner

The following provides a summary of the Undertakings:

(a) In an effort to address issues related to airport facilities, Air Canada made certain undertakings related to majority-in-interest rights and the so-called "Chicago Formula" which, in the view of the Commissioner, provided an advantage to Air Canada in certain Canadian airports. In an effort to address these concerns related to airport facilities, the Commissioner required Air Canada to make available certain facilities at specific Canadian airports. Air Canada also undertook that it would make available aircraft that were surplus to its and CAC's reasonable operating requirements, for purchase by Canadian air carriers at prices equal to the value of such aircraft determined by qualified appraisers selected by Air Canada.

(b) In the context of travel agent commission overrides, Air Canada undertook that the trigger mechanism by which travel agents qualified for incentive override commissions offered by Air Canada and CAC would not be based in any manner on sales for domestic flights, but, rather, solely on transborder and international route revenues. However, after qualifying for such overrides, the agents could be paid incentive override commissions for domestic flights, calculated on a straight-line percentage basis as applied to the travel agents' domestic revenue volumes and not on a market share target basis.

(c) Air Canada also made extensive undertakings related to the sale of frequent flyer plan points so as to address the Commissioner's concern that such plans have the ability to act as a significant barrier to entry.

(d) Pursuant to the Undertakings, Air Canada became obligated to enter into (i) interlining agreements in accordance with IATA standards; and (ii) in good faith, negotiate joint fare agreements (as defined in the Undertakings) on commercially reasonable terms, in connection with such interlining agreements, with any Canadian air carrier that so requests, subject to certain procedural and safety-oriented conditions.

(e) As part of its counterproposal to the Initial Airco Offer and those which followed, Air Canada proposed the establishment of an eastern Canadian discount carrier to be operated out of the John C. Munro Hamilton International Airport. In the Undertakings, the Commissioner required, among other things, that Air Canada defer this initiative, conditional on whether a rival air carrier seeks to establish such a service in Hamilton and on the identity of any such rival carrier.

(f) Air Canada also made certain concessions regarding the availability of slots at Lester B. Pearson Airport in Toronto. These commitments varied, depending on whether Canadian Regional would be sold. A potential divestiture of Canadian Regional constituted the final substantive undertaking.

Undertakings of Air Canada and 853350 Alberta Ltd. to the Minister of Transport

By way of letter dated December 21, 1999, Air Canada and 853350 made certain commitments to Transport Minister Collenette related to employment matters and service to small communities. In a responding letter from Transport Minister Collenette, the Government of Canada permitted the acquisition by 853350 of CAC, subject to a number of qualifications.

Bill C-26

On February 17, 2000, the Minister of Transport introduced in the House of Commons Bill C-26, An Act to Amend the *Canada Transportation Act*, the *Competition Act*, the *Competition Tribunal Act*, and the *Air Canada Public Participation Act* and to amend any other act in consequence. As described in a commentary providing the legislative history of Bill C-26:

> This legislative initiative is the final step in a four-step process, of which the first step took place on August 13, 1999, when the Governor in Council issued an order pursuant to section 47 of the *Canada Transportation Act* to establish a 90-day process to facilitate the orderly restructuring of Canada's airline industry in light of the financial position of Canadian Airlines International Limited.

The second step occurred on October 26, 1999, with the Minister of Transport's release of the Government's Policy Framework. The third step involved the Minister of Transport's December 21, 1999 announcement that, with the Undertakings made by Air Canada to the Commissioner, the Federal Government was prepared to approve the 853350 Offer to purchase CAC.

The amendments in Bill C-26 can be summarized as follows:

(a) Bill C-26 authorizes the Governor-in-Council to approve mergers and acquisitions within the airline industry following review by the Minister of Transport, the Commissioner and the Agency;

(b) Bill C-26 increases the authority of the Agency to review passenger fares and cargo rates on so-called monopoly routes; to roll back any unreasonable fare, fare increase, cargo rate or cargo rate increase; and to order refunds if feasible;

(c) it restores the Agency's authority to review domestic terms and conditions of carriage related to such matters as lost baggage, the "bumping" of passengers, and services to the disabled, and to suspend, disallow or require substitutions to the terms and conditions, as well as to order compensation of expenses for those adversely affected;

(d) to increase substantially the notice period in the event of exit in cases of major passenger seating capacity reduction resulting from discontinuance of services on any domestic route; and

(e) to prohibit exclusive use clauses in confidential contracts for domestic services.

On July 5, 2000, Transport Minister David Collenette announced the coming into force of Bill C-26. At the time of writing, the proposed regulations accompanying Bill C-26 remain in draft form.

The Process under the *Companies' Creditors Arrangement Act*

On March 24, 2000, the Alberta Court of Queen's Bench granted protection to Canadian from its creditors under the *Companies Creditors Arrangement Act* ("CCAA"). Air Canada sponsored a Plan of Compromise and Arrangement (the "Plan") which provided for Canadian to restructure its debt and for CAI to reorganize its share capital. The Plan was approved by majority votes of the separate classes of Canadian's creditors and was sanctioned by the Court by Order made June 27, 2000. The transactions contemplated in the Plan closed on July 5, 2000, at which time CAI became a wholly-owned subsidiary of Air Canada.

Conclusion

While one could not reasonably expect the immediate future of the Canadian airline industry to be as eventful as it has been over the course of the past year, the ongoing evolution of this industry will ensure that interesting times remain ahead.

Notes

1 Stikeman Elliott represented Air Canada throughout the events described in this article.

BAD POLICY, BAD LAW: BILL C-26 AMENDMENTS TO THE *COMPETITION ACT* ON AIRLINE PREDATION

By: Margaret Sanderson and Michael J. Trebilcock
Charles River Associates, Toronto

Editor's Note: Bill C-26 received Royal Assent on June 29, 2000 and came into force on July 5, 2000.

Introduction

The unprecedented activity in the Canadian airline industry is poised to infect more than travelers' wallets. It may also lead to fundamental changes in the manner in which competition law is enforced in Canada. Bill C-26, which currently is the subject of Parliamentary Committee hearings, proposes granting extraordinary interim relief powers to the Commissioner of Competition in respect of dealing with complaints of predatory conduct in the airline industry. These proposals follow closely recommendations by the Commissioner to the Minister of Transport in a letter of October 22, 1999. Such powers if approved could lead to pressure for similar treatment in other industries.[1]

We believe the proposed amendments to the *Competition Act* in respect of interim relief for allegations of predation in the airline industry are inappropriate, given that they may ultimately lead to higher prices for consumers. Such an outcome is perverse, in light of the fact that the main concern in approving the merger of Air Canada and Canadian Airlines International without simultaneously improving the conditions for foreign competition in Canada is that the merger will lead to excessive pricing and poor service for Canadian travelers. Thus, the proposed amendments are acting in the exact opposite direction of the legislation's overall goal.

In practice, it is very difficult to distinguish predatory pricing from legitimate (perhaps even aggressive) competitive pricing strategies that competition law is intended to promote. In general, predatory strategies are costly to the predator. In order to gain the benefit of potentially higher profits in a less competitive market in the future, the predator must forego profits in the period during which predatory activity is being engaged. The costs of predating are greater, the larger is the market share of the predator because more products or services are sold at a loss. Higher profits can be earned in the future only if market power is sustained. Yet higher profits may be uncertain because the predator knows that supra-competitive pricing invites entry or expansion of existing rivals. Empirical economic evidence indicates that true predatory conduct is rarely attempted and even less frequently successful.

Thus, it is extremely important to analyse complaints of predatory conduct carefully and with a clear focus on consumer welfare as opposed to the welfare of competitors. Dynamic competitive markets will inevitably result in inefficient firms losing revenue, market share and even exiting. However, these are not good reasons for preventing firms from lowering their prices, since low prices are to the benefit of consumers. We believe Bill C-26, in its current context, may have this perverse effect.

Even if one accepts for the purposes of argument that the interim relief currently available under section 33 or section 104 of the Act is insufficient, the proposed amendments contained in Bill C-26 are undesirable, both as a matter of good policy and good law. In this article, we critique the proposed amendments and offer an alternative proposal.

Bill C-26 Interim Relief Amendments

Anti-competitive Practices by Airlines: A new regulation-making power is to be granted to the Governor-in-Council (i.e., the Federal Cabinet), on the recommendation of the Ministers of Industry and Transport, to specify anti-competitive acts or conduct of a domestic air carrier. The definition of an "anti-competitive act" in section 78 of the Act is correspondingly enlarged to include such acts as are specified in those regulations (proposed sections 78(1)(j) and 78(2)). The scope of "anti-competitive acts" that may be included in the regulations is not defined.

The Commissioner is to be given new powers to make temporary orders in regard to anti-competitive acts (including those proscribed under the proposed amendments to section 78) affecting domestic airline services (proposed section 104.1).

Permitted scope of orders: For this purpose, the Commissioner may make such an order prohibiting a person operating a domestic airline service from doing any act or thing that could, in the Commissioner's opinion, constitute an anti-competitive act or requiring such a person to take any steps which the Commissioner considers necessary to prevent injury to competition or harm to another person (proposed section 104.1(1)).

Conditions precedent: The Commissioner must have commenced an inquiry under section 10(1) of the Act in regard to whether the conduct is reviewable under section 79 (abuse of dominant position), and considers that, in the absence of a temporary order: (i) injury to competition that cannot adequately be remedied by the Competition Tribunal is likely to occur; or (ii) a person is likely to be eliminated as a competitor, or suffer a significant loss of market share or revenue or other harm that cannot be adequately remedied by the Tribunal.

No notice necessary: The Commissioner is not required to give notice to any person or to receive any representations before making a temporary order (proposed section 104.1(2)), but must "promptly" thereafter give notice to "every person against whom it was made or who is directly affected by it" (proposed section 104.1(3)).

Duration: A temporary order has effect for 20 days (proposed section 104.1(4)), and may be extended for one or two periods of 30 days each or may be revoked, but if any application is made to the Tribunal under the proposed section 104.1(7) to have a temporary order varied or set aside, then the temporary order has effect until the Tribunal makes an order under that section.

Hearing to vary or set aside: At the hearing of an application to consider whether to vary or set aside a temporary order, the Tribunal must provide the applicant, the Commissioner and any person directly

affected by the temporary order with "a full opportunity to present evidence and make representations before the Tribunal makes an order"

Temporary order not reviewable in any court: Proposed section 104.1(11)(a) provides that "a temporary order made by the Commissioner shall not be questioned or reviewed in any court", and then purports expressly to exclude any power in a court to judicially review or exercise a prerogative remedy that would "question, review, prohibit or restrain the Commissioner in the exercise of the jurisdiction granted by this section".

Enforceable as a Tribunal order: A temporary order made by the Commissioner is "enforceable in the same manner as an order of the Tribunal" (proposed section 104.11(3)(13)).

Proceed expeditiously with hearing: When a temporary order is in place, the Commission is obliged to "proceed as expeditiously as possible to complete the investigation arising out of the conduct in respect of which the temporary order was made" (proposed section 104.11(14)).

Blanket immunity: There is essentially blanket immunity provided to officials for "anything done or omitted to be done in good faith under this section" (proposed section 104.11(15)).

Amendments to the Competition Tribunal Act: A member of the Tribunal sitting alone to be authorized to hear and dispose of any application for review of a temporary order issued by the Commissioner for the purpose described above (proposed section 11(1)).

Critique of the Bill C-26 Amendments

The amendments proposed in Bill C-26 seek to turn the Commissioner's office into both a prosecutor and adjudicator when seeking interim relief for predatory conduct in the airline industry. The traditional burden of proof borne by the plaintiff in interrogatory proceedings is reversed and laid squarely on the defendant rather than the Commissioner as the plaintiff. In our view, this violates legal tenets of due process and hence we would expect that it will provoke a constitutional challenge under section 7 of the *Charter of Rights and Freedoms*, in part because an order of the Commissioner is deemed equivalent to an order of the Tribunal, and hence non-compliance presumably attracts contempt proceedings.[2] As we have noted above, allegations of predation frequently are made that lack merit and hence it is appropriate that the complainant should bear the burden of proof.

Bill C-26 reverses (for one industry only) the entire institutional model of responsibility that Parliament has developed in the area of competition enforcement. There is currently a clear separation in the Canadian competition law regime between investigation/prosecution and adjudication. To fuse these functions in one body requires a radically different institutional model from the institutional model currently in place, which assigns adjudicative functions to either the courts or the Competition Tribunal. The current institutional framework is the result of a long history and extensive public consultations and debate. To deviate from this well-accepted framework for a single industry risks compromising the coherent set of general principles that is the foundation of a

framework statute such as the *Competition Act* and invites future *ad hoc* arrangements for other industries.

It must be noted that the interim relief in this instance will result in higher prices to consumers. As a result, it is extremely important that the relief is truly temporary, in the event that the Commissioner, in concluding his investigation, has insufficient grounds to launch a full action under section 79. Bill C-26 contemplates a 20-day period for temporary relief, but with the ability to extend this period for up to two additional 30-day periods. Thus, the order may be in place for 80 days, pending an order reversing it by the Competition Tribunal. In the context of airlines, a 80-day suspension of low prices could endure an entire season. With seasonal pricing, this may deny consumers low pricing for much more than a 80-day period, perhaps as much as a year until the next season.

The test proposed in Bill C-26 for establishing whether to make a temporary order is not in keeping with the current abuse of dominance provisions or the Commissioner's articulated enforcement approach to the criminal predatory pricing provisions. Bill C-26 would grant the Commissioner the ability to make a temporary order if either there is harm to competition or harm to another person. Specifically, harm to another person may take the form of likely elimination of a competitor, significant loss of market share, significant loss of revenue or other harm that cannot be adequately remedied by the Tribunal.

Yet, in any competitive dynamic, some firms will lose market share, perhaps significantly – this is an inevitable consequence of the competitive process. To grant these firms protection from competitive forces inevitably reduces the vigour with which firms choose to compete. Thus, both new entrants and incumbent firms have a reduced incentive to lower prices. The end result is that consumers face higher prices than they would have otherwise. This runs completely counter to the current enforcement approach of the Commissioner and of the Competition Tribunal. It is not the intention of the *Competition Act* to protect competitors; rather the Act is intended to protect competition.

In order to deal only with situations where there is harm to competition, as opposed to harm to individual competitors, the Commissioner's *Predatory Pricing Enforcement Guidelines* establish a two-part test based on the economic notion that predatory conduct is not likely to be profitable to a predator, and likewise not harmful to consumers, unless there is an ability subsequently to recoup the losses incurred during the period of predation. This is analogous to the U.S. Supreme Court position which is articulated in *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*[3] It is also the appropriate standard given the insights of the economic literature. In the case of the abuse of dominance provisions, section 79 clearly focuses on predatory conduct when it will have the effect of substantially lessening or preventing competition. Harm to an individual competitor is not sufficient.

An Alternative Interim Relief Proposal

If Parliament wishes to expand upon the interim relief available to the Commissioner under section 104 of the *Competition Act*, we would recommend that amendments along the lines of the revised section 100 procedure for mergers be adopted. Hence, the Commissioner would be able to

make an application to the Competition Tribunal for interim relief either for any Part VIII offence or perhaps only for abuse of dominance. Such relief should be available not only in cases involving allegations of predatory conduct by domestic airlines, but for allegations relating to predatory, exclusionary or disciplinary conduct that is subject to review under section 79 in all industries. There is absolutely no evidence that predatory conduct is more likely in airlines, or more pervasive in this industry than in other network industries (such as telecommunications). While there may be barriers to entry in airlines partially due to regulatory restrictions (e.g. cabotage, foreign ownership) these should be dealt with as an independent concern rather than through concerns over predation. In our view, there is no justification for special interim relief against airlines alone.

As in the revised section 100 provision, the Commissioner would bear the burden of proof. The standard to be met would be the usual standard used for granting interlocutory injunctive relief – that is, there is a serious issue to be tried, irreparable harm would ensue if the interim relief is not granted and that the balance of convenience favours the Commissioner. (This is the standard that the Commissioner proposes for aggrieved parties seeking to overturn the Commissioner's temporary order.)

Consistent with the current relief available under section 100, at least 48 hours notice of an application for an interim order would need to be given by the Commissioner or on his behalf, along with provisions for an *ex parte* application under the same requirements as exist for section 100[4]. In the scheme proposed in Bill C-26, it is specifically provided that the Commissioner is not required to give notice prior to making a temporary order (at 104.1(2)). This dispensation (along with immunity from judicial review) violates conventional understandings of due process, invites Charter challenges that are likely to leave the status of the provisions mired in legal uncertainty for years, and hardly seems in accordance with the Commissioner's professed objectives of "transparency, fairness and predictability". Moreover, it stands in stark contrast to the requirements in the proposed amendments where the Tribunal is required to provide the applicant, the Commissioner and any person directly affected by the temporary order with a full opportunity to present evidence.

In determining whether to grant an interim order, we propose that the Commissioner should be required to establish that there will likely be harm to competition, as required by section 79 of the Act. In our opinion, it is not sufficient to establish that a particular competitor may be harmed by a low pricing policy. Section 79 clearly requires establishment that competition is likely to be substantially lessened or prevented. It is not sufficient under section 79 to establish irreparable harm to a competitor – irreparable harm to competition (i.e. consumers) must be established. This is also consistent with the manner in which the Commissioner enforces the predatory pricing provisions as set forth in the *Predatory Pricing Enforcement Guidelines*. Notwithstanding the reference to "or eliminating a competitor" in section 50(1)(c) of the Act, the Bureau has articulated an enforcement approach that focuses primarily on the "substantial lessening of competition" requirement of section 50(1)(c). This is the appropriate enforcement emphasis. There is absolutely no reason to change it.

We would add that, in our view, private parties should be given the right directly to initiate proceedings before the Competition Tribunal, including applications for interim relief, so that they are not wholly dependent on the Commissioner for relief from abuse of dominance (as is currently the case). If particular competitors' fear suffering irreparable harm due to predatory practices of an incumbent, it would seem sensible to provide such parties with private rights of access to the Tribunal to remedy the situation. While this represents a fundamental change in the existing law, it would not violate parties' rights of due legal process nor represent a meshing of investigation and adjudication in one body as in Bill C-26.

If our alternative proposal is adopted, as described above, there is no longer any need to amend section 78(1) of the Act by adding paragraph (j), as proposed in Bill C-26. We do not believe that this omission is problematic for two reasons. First, the Competition Tribunal has provided a broad definition of anti-competitive act in jurisprudence related to section 79. Thus, any act that has a purpose that is "predatory, exclusionary or disciplinary" may be captured in section 78. Second, if the Commissioner believes that still greater certainty is needed, it is within his power to propose revisions to the Bureau's *Predatory Pricing Enforcement Guidelines* that indicate by way of example (as the Bureau has done in other Guidelines) how the Bureau will enforce the existing predation laws with respect to the airline industry (recognizing that ultimate interpretive and adjudicative authority resides with the courts or the Competition Tribunal).

We conclude that the proposed amendments to the *Competition Act* are inappropriate and will likely result in higher prices to consumers than would otherwise exist – the exact opposite of the legislation's overall goal – as well as violating fundamental due process values. As a result, the proposed amendments represent bad policy and bad law. We believe that our proposals offer preferable alternatives to Parliament in this regard.

Notes

1 Private member Mr. McTeague's Bill C-472 would extend the interim relief framework proposed in Bill C-26 beyond the airline industry. In his April 13, 2000 Statement to the House of Commons Standing Committee on Industry, Commissioner Konrad von Finckenstein indicated that Minister John Manley agrees with the principles behind Mr. McTeague's and others' private members' bills and is contemplating rolling them into a government bill.

2 This view is also held by the Executive Committee of the National Competition Law Section of the Canadian Bar Association, who have provided a submission on Bill C-26 to the House of Commons Transport Standing Committee.

3 509 U.S. 209 (1993)

4 Under section 100(2) "at least forty-eight hours notice of an application for an interim order under subsection (1) shall be given by or on behalf of the Commissioner to each person against whom the order is sought.

(3) Where the Tribunal is satisfied, in respect of an application for an interim order under paragraph (1)(b), that (a) subsection (2) cannot reasonably be complied with, or (b) the urgency of the situation is such that service of notice in accordance with subsection (2) would not be in the public interest, it may proceed with the application *ex parte*."