COMMENT AND ANALYSIS

INNOVATION, GROWTH AND PROSPERITY: A FRAMEWORK FOR AMENDING CANADA'S CONSPIRACY LAWS

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Introduction

In this article, we develop an analytical framework for amending Canada's principal law governing collaborations among competitors: section 45 of the *Competition Act*. We provide, in essence, a response to recent proposals to amend section 45.[1] We do so with three preliminary observations in mind. First, that "productivity, wealth and capacity to create jobs in Canada are all more vulnerable than they should be, because Canada's innovation performance is weaker than in most industrialized countries."[2] Second, that Canada has recently signed on to (in fact, has taken a leading role in) the newly formed International Competition Network ("ICN"). The mandate of the ICN is to promote more efficient and effective antitrust enforcement worldwide and to facilitate procedural and substantive convergence in antitrust enforcement. Third, that Canada's ability to enter into certain reciprocal enforcement treaties with foreign nations under currently proposed amendments to the Act requires, as a precondition, that the laws of such foreign nations be "substantially similar" to those of Canada.[3] These observations provide context within which to consider changes to section 45, and suggest that any such changes should be enacted with a view to facilitating innovation, growth, and greater prosperity, while at the same time recognising Canada's commitment to greater international convergence, particularly with its main trading partners.

Recent proposals to amend section 45 of the Act have focused on certain elements of the anti-cartel laws of other jurisdictions,[4] most notably components of pre-clearance and block exemptions in the laws of the EU[5] and the *per se* treatment of certain restraints as appears, at least in theory, under U.S. law.[6] Moreover, proposals to amend section 45 appear to be motivated by a perception that it is ineffective.[7] It has been argued that section 45 too easily permits the defence of hard core cartel cases, and too easily condemns potentially pro-competitive or efficient agreements between competitors.[8]

In this paper, we argue: (i) that section 45 is effective in prosecuting cases, particularly hard core cartel cases; however, to the extent that it fails to permit a consideration of pro-competitive justifications for agreements between competitors, it requires amendment; (ii) that it would be unworkable, unnecessary, and contrary to trends taking place with Canada's major trading partners, to create statutorily pre-defined categories of *per se* illegal agreements;[9] (iii) that the word "unduly" should not be removed,[10] unless another market power screen is put in place for all agreements; and (iv) that it would be undesirable to create a regime of pre-clearance for any such agreements, especially when a key trading partner such as the EU seems to be moving away from this type of regime.[11]

Section 45 Is Effective – Particularly in Hard Core Cartel Cases

In a recent speech,[12] the Commissioner observed that "while Canada has enjoyed some recent success in [section 45 prosecutions], including record fines in a number of cases involving international conspiracies, this has been primarily accomplished through an effective immunity program and guilty pleas".[13] The Commissioner refers to two recent articles which note respectively that "[c]ases brought to court have produced very different results . . . since 1980, 17 out of the 20 contested conspiracy cases had resulted in acquittals or dismissals" and "since 1975, of the 7 litigated cases that did not involve a monopoly or 'virtual monopoly', the Crown lost every case".[14] Others have made similar observations in their calls to toughen up section 45. [15]

The win/loss ratio of parties to litigated cases, however, is not likely to be an accurate barometer of whether a law is effective. Litigated cases are essentially borderline cases by their very nature (or they would have settled) and there is always uncertainty over whether a case should go one way or the other. That is why these cases tend to go to court. That is the function of litigation – to provide *ex post* certainty in close cases and to develop a body of jurisprudence to guide future conduct. In a world of certainty, parties would not litigate – the parties would know in advance whether they would win or lose and would always settle.[16]

Thus, the number and result of litigated cases is not a barometer of the efficacy of a law, but is rather, at most, an indicator of how much uncertainty there is in the law in general or in the interpretation of the particular facts of each case.[17] As noted by (then) Professor Richard Posner:

> Settlement out of court is cheaper than litigation. So only if each disputant expects to do better in the litigation than the other disputant expects him to do are the parties likely to fail to agree on settlement terms that make them both consider themselves better off compared with how they anticipate faring in litigation. Uncertainty is a necessary condition of such a divergence of estimates. It can either be factual or legal but only legal uncertainty is relevant here. If it is great, there will be much litigation, including much appellate litigation. But since litigation, especially at the appellate level, generates precedents, the upsurge in litigation will lead to a reduction in legal uncertainty. Hence the amount of litigation will fall in the next period.[18] [emphasis added]

Thus, a consideration of contested cases tells us very little, except perhaps that the lack of contested cases may mean the law is actually not that uncertain.

What might be more relevant in examining the efficacy of section 45 is to consider all conspiracy cases as the relevant data universe and to do so over a time frame within which it is possible to compare apples to apples (that is, within a time frame during which the law has been relatively constant). Thus, the fact that since 1980, 17 of the 20 contested conspiracy cases resulted in acquittals or dismissals also tells us very little. The law has changed over that time frame.[19] It has been made easier to prosecute. Subsection 45(2.1) of the Act was enacted in the 1986 amendments to provide that, in establishing a conspiracy, the court could rely on circumstantial evidence even without direct evidence of communication.[20] Had this been the law in 1980, the result in *Atlantic Sugar*[21] may well have been different, given that the subsection was enacted largely with that case in mind.[22]

Similarly, in 1986 subsection 45(2.2) of the Act was added (again in response to *Atlantic Sugar*) regarding the intent component of section 45. That section remained relevant to criminal matters until *PANs*, when the Supreme Court (at least with respect to criminal prosecutions under section 45) held that the fairness of the *Canadian Charter of Rights and Freedoms* required a greater intent component than simply the intent to enter into an agreement – requiring at least objective forseeability of the fact that the agreement would likely lessen competition "unduly".[23] The *PANs* decision, released in 1992, provides greater certainty as to the applicability of section 45 – although in practice it makes convictions tougher for cases that are not hard core cartel cases.

Thus, using a more relevant time frame (one within which the law has been constant), and including all matters under section 45 (not just the litigated tip of the iceberg), the government has in fact secured a record number of convictions and record fines under section 45. Specifically, from 1993 (post *PANs*) to October of 2001, there have been two acquittals, one discharge and 28 convictions – including fines of over $148 million (not even adjusting to present value).[24]

Moreover, it is important to examine the three cases that were litigated and lost by the Crown. In *PANs*, on redetermination, the trial court expressly found that that case did not involve a "hard core cartel".[25] *Bayda* and *Clarke Transport* were each lost based on a lack of evidence. On the facts in *Bayda*, the Crown would have lost even on a *per se* standard, as there was insufficient evidence of an agreement. On appeal, the Court found that the trial judge had been reasonable in concluding that the facts in that case failed the preliminary inquiry committal/discharge test, namely, that no jury could convict "on the basis of a mere scintilla of evidence".[26] In *Clarke Transport*, the Court noted that it wanted "to make it perfectly clear that [its] decision [was] dependent solely upon the evidence adduced" [emphasis added] and that its decision may have been different if the evidence put forward by the Crown had not been "unreliable and inconclusive."[27]

Our point is simply that, in light of the above, section 45 appears to be effective – particularly for hard core cartel cases. If defendants thought they had a chance of acquittal, because of a weak law, one would not expect to see firms consistently entering guilty pleas. Given the record size of fines, one would have thought it would have been worth the fight in some of these cases if the law were ineffective. For example, lawyers and expert fees even for a fully contested case would likely be a small fraction of the fines that have been secured in recent years. Moreover, the government's success cannot be attributed solely to an effective immunity program. Immunity programs do not create convictions in a vacuum. They assist in detecting offences and in generating the evidence to which the law applies – i.e., they do not change the law that applies to that evidence.

In point of fact, however, it is doubtful whether a win/loss analysis of any kind is of much use in determining whether section 45 should in fact be amended. By analogy, the Commissioner has had mixed success in the contested merger cases that have been brought (losing *Hillsdown*[28] and *Southam*,[29] while prevailing in the recent *Waste* case[30]),[31] but has been very successful in securing remedies in every other case that has been resolved at the administrative level.[32] And, the Commissioner has won every abuse case that he has litigated.[33] Yet this has not lead to proposals to amend the merger laws or the abuse laws.[34]

What is instructive from the above is both the effectiveness of the law in prosecuting hard core cartel cases and the likely deterrent effect of the law,[35] which suggests that the vast majority of businesses that have engaged in hard core cartel activity are willing to enter guilty pleas, pay record fines and agree under court prohibition order to modify and monitor their behaviour.[36] In summary, the evidence is far from clear that section 45 is ineffective, particularly with respect to hard core cartel cases.

A Framework of Analysis: Flexibility and Optimal Stopping

As noted above, it is doubtful whether a win/loss analysis is of much use in determining whether section 45 should in fact be amended. A more helpful framework of analysis is to consider: (i) the legal principles that have developed, primarily in the U.S., for the analysis of antitrust cases, which tell us what factors should be analyzed; and (ii) the administrative efficiency of a decision rule or law, which tells us how far the factual inquiry should proceed in each case. We develop this framework below.

What Factors Should be Analyzed: The Need for Flexibility

From an economic perspective, section 45 is broadly designed to ensure that Canada has the benefit of competitive markets. Most competition lawyers and economists would probably agree that competition is generally desirable because it can lead to at least three things:[37] (i) it can facilitate, through private market ordering, the allocation of resources to their most valued use; (ii) it can cause firms to react to competitive pressure by attempting to reduce their costs; and (iii) it can cause firms to introduce new products and new ways of producing existing products which, through the process of competitive diffusion,[38] can force other firms to do the same. All of this leads to benefits for society and for its economic constituents (consumers, firms, etc.).

There is no doubt that restraints which interfere with competition can interfere with these benefits. Sometimes, however, restraints on competition are able to achieve one or more of these goals at lower cost than competition itself.[39] Such agreements can lessen competition between existing rivals and at the same time increase rivalry amongst remaining competitors, such as where two small firms are better able to compete with a larger firm.[40] Thus, strategic alliances, mergers, specialization agreements and other inter-competitor agreements can, in some cases, bring about real social benefits. For example, a strategic alliance might permit the creation of a new product, reduce transaction costs, or create a new market; a merger or specialization agreement might permit firms to reduce their costs. Moreover, horizontal strategic alliances are becoming increasingly important due to globalization and rapidly changing markets, as a recent in-depth study into European industry reveals.[41]

Thus, if we are to re-engineer section 45, it is helpful to start with a principled framework within which to guide future cases in a manner that appreciates the foregoing. A useful starting point is to consider U.S. jurisprudence on this topic, since the U.S. is the birthplace of the *per se*/rule of reason continuum and it has had the most experience in litigating antitrust cases. In a recent case, Justice Breyer of the United States Supreme Court in *California Dental*, provided such a framework. According to Justice Breyer, cases should be analyzed based on:

> [F]our classical, subsidiary antitrust questions: (1) What is the specific restraint at issue? (2) What are its likely anticompetitive effects? (3) Are there offsetting procompetitive justifications? (4) Do the parties have sufficient market power to make a difference?[42]

This formulation is really a synthesis of the rule of reason jurisprudence, and reflective of what the U.S. Supreme Court held in *Professional Engineers*.[43] There the Court engaged in a rule of reason analysis, which it said required in general a balancing of a restraint's anticompetitive and procompetitive effects. In short, this suggests that section 45 should be designed so that it is flexible enough to permit a consideration of these four classical antitrust questions <u>in appropriate cases</u>.

It is also helpful to look at the EU experience. The EU has a very broad anti-cartel provision in Article 81(1) and a notification and exemption regime. After years of experience with this regime, the European Commission ("EC") is now recommending reforms that would abolish the notification and exemption system and would render Article 81(3) (which provides an exemption from Article 81(1)) directly applicable to arrangements without the prior approval of the EC.[44] A movement towards a system by which a restrictive practice is prohibited by Article 81(1), but lawful if it meets the tests in Article 81(3), is, in essence, a movement towards a rule of reason standard. As recently noted by the EC, Article 81(3) "in fact contains all the elements of a 'rule of reason'".[45]

Should Each Question be Asked in Each Case: Optimal Stopping

In the U.S., the above formulation of the rule of reason is not applied (in theory) to hard core price fixing cases. A *per se* rule would stop after question (1) in Breyer's formulation. Indeed, even section 45 does not permit all of Breyer's questions to be addressed.[46] While section 45 addresses items (1), (2) and (4), it does not address item (3) – at least on its face. That is not to say, however, that *per se* rules (or indeed section 45) are poor legal rules. On the contrary, the analysis of agreements between competitors ought to involve a consideration of anticompetitive effects <u>and</u> procompetitive effects – but only where justified.

"Where justified" is an important qualification. It is important because the investigation and prosecution of offences are expensive in terms of the public and private costs imposed in prosecuting and defending these types of cases. In this sense, *per se* rules are really like rules of evidence, which limit the cost of proceedings in situations where the costs of the proceedings and the harm from the alleged conduct are highly unlikely to be outweighed by the benefits of the agreement. In a world of costless enforcement, it would be possible to examine these cases on a case-by-case basis; however, there are costs to analyzing these issues, including costs relating to information asymmetry and uncertainty.[47] And so, the issue in formulating a law like section 45 becomes how to facilitate the analysis while minimizing the costs of doing so. Thus, where the costs to society of investigation and prosecution are high and the expected magnitude of the harm from a restraint is high, an optimal law would prohibit such conduct without a full review of each of Breyer's questions, because the cost of determining benefits is likely to be too high.

That is the *raison d'être* for procedural rules that limit legal inquiries, such as the *per se* illegal treatment of some competitive restraints. In this sense, antitrust law involves the interaction of substantive and procedural rules.

Procedural rules limit the information that may be considered by a decision-maker in deciding on the application of a substantive rule. [48]

Economists have examined such legal rules as "optimal stopping problems".[49] An optimal stopping problem involves information being collected and utilized to make a decision, while recognizing that information gathering is not costless. As such, the goal is to find the optimal level of information to gather and analyze before making a decision. This, in turn, depends on the cost of making an erroneous decision based on too little information. The characterization of agreements as *per se* or rule of reason, is an extension of this analysis, but it relies on having a statutory foundation that is flexible, capable of change over time, and readily applicable in as yet unknown fact patterns.

Is Section 45 Flexible and Optimal?

Applying the above criteria to section 45 yields some important policy implications. First, section 45 (with one important omission, discussed *infra*) is sufficiently flexible to address the Breyer questions, yet produce results that are arrived at in an optimal way. Section 45 permits the trier of fact to address items (1) (identification of the restraint), (2) (anticompetitive effects), and (4) (market power). It does not address item (3) (procompetitive effects) – at least on its face, which is the important omission that we address below.

Second, section 45 permits truncation in its application, and is therefore potentially optimal. In cases of naked price fixing, courts (and indeed the parties) should be able to quickly recognize that there is no defence under the current section 45 – coming, in effect, to a result consistent with applying a *per se* standard to such cases. As noted elsewhere, the rule of reason can often be applied in the "twinkling of an eye"[50] to dismiss hollow efficiency rationales or, in the case of section 45, unjustified claims of a lack of market power. As described in a recent article:

> In some cases, the net effect of the practice challenged may be so obviously harmful or benign that judgment can be rendered, in Areeda's famous phrase, "in the twinkling of an eye." In other cases, the practice may be more ambiguous, but the obvious lack of market power indicates no threat to competition or evidence of actual effects justifies invalidation of the restraint absent a procompetitive justification. Some cases, where the overall effects are ambiguous, may require a full market analysis.[51]

Indeed, support for this proposition comes from the impressive record of convictions amassed by the Crown in recent years.[52] In other words, it is extremely difficult for defence counsel to fashion an argument that an effective cartel does not have market power – by definition an effective cartel will have market power – and if it does not, then the antitrust laws should not care about it – because in the absence of market power the cartel will be ineffective or will dissolve.[53] Moreover, if the "object" of the agreement is egregious (as per *PANs*) then it will be easier to convict. Any other (less harmful) restraints are likely to have other effects or benefits, which ought to be considered because their net effect will not be "so obvious" as to warrant *per se* condemnation.

The Important Exception: The Omission of Procompetitive or Efficiency Effects

While section 45 ought not to be made tougher or less flexible, it needs to be amended to permit a consideration of procompetitive effects.[54] The contribution of production and innovation efficiencies to economic growth and Canada's ability to become more innovative and compete internationally makes this clear. While both the Commissioner and the Federal Court of Appeal have indicated that in interpreting the provisions of the Act, one must have regard to section 1.1 of the Act (which includes as a purpose the efficiency and adaptability of the Canadian economy), section 45 does not expressly provide for a consideration of procompetitive effects or efficiencies.[55] Indeed, past case law would have prohibited that kind of argument.[56] As noted above, section 45 does not permit item (3) (procompetitive effects) – at least on its face – to be addressed. As such, procompetitive or efficient conduct could be chilled by section 45 because it does not allow a weighing of positive effects from agreements between competitors.[57]

As several U.S. cases make clear, this is not an academic observation. For example, in *Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*,[58] the Supreme Court held that the issuance of blanket licences by Broadcast Music (a direct horizontal restriction on price competition among rivals) was not a *per se* violation of section 1 of the *Sherman Act*, because the practice facially appeared to "increase economic efficiency and render markets more, rather than less, competitive". The Supreme Court identified several efficiencies resulting from issuance of the licences, including transaction, monitoring and enforcement cost savings, before remanding the case for consideration under the rule-of-reason test. It is instructive to ask what would have been the result of *BMI* under section 45 or proposals to amend it?

Similarly, in *NCAA* v. *Board of Regents of the University of Oklahoma*, the Supreme Court held that the NCAA's plan for televising football games, which prevented member institutions from competing against each other on the price or kind of television rights that could be offered to broadcasters, was not justified by any "procompetitive efficiencies which enhanced the competitiveness of college football television rights".[59] The Supreme Court noted, however, that if the NCAA's plan had produced procompetitive efficiencies, rather than being a naked restraint on price and output, the plan would have "increase[d] output and reduce[d] the price of televised games".[60] Again, it is instructive to consider whether section 45 (or the proposals to amend it) would be flexible enough to allow this type of analysis?

Our point is that the analysis of agreements between competitors ought to be flexible enough to permit a consideration of anticompetitive effects <u>and</u> procompetitive effects, where cost justified.

The Need for a Market Power Screen

Another issue that has been raised is whether the word "unduly" should be removed from section 45 (see note 11). The word unduly has historically been used to determine whether the parties to an agreement have sufficient market power to contravene section 45, or as Breyer would put it, whether the parties have "sufficient market power to make a difference". As pointed out above, this is also the interpretation of section 45 offered by the Supreme Court in *PANs*. Section 45 does not on its face call for a consideration of the market power of the

parties to an agreement. That is a made-in-Canada judicial creation.[61] Indeed, it is not a productive use of resources to challenge agreements between competitors in the absence of market power.[62] As set out above, an effective cartel will have market power, and if it does not, then the antitrust laws should not care about it – because in the absence of market power the cartel will be ineffective or will dissolve.

So unless parties have market power, they must be engaging in conduct that is efficient or at least not harmful. That has been the function of the word "unduly".[63] As described in *PANs*: "Absent such power, agreements to restrict competition would either benefit the public by allowing small firms to consolidate their position and be more competitive, or dissolve under competitive pressures."[64] If our Supreme Court has endorsed this economic theory and said that it reflects the proper interpretation of the law, we question the wisdom of changing that aspect of it. Moreover, proof of market power is now a fairly routine exercise, one made easier in price fixing cases by evidence of actual (as opposed to likely) price effects from such agreements.[65]

The Statutory Creation of *Per Se* Offences

It is important to note that most proposals to amend section 45 have advocated the U.S. approach of treating certain agreements as *per se* illegal. This is consistent with creating an optimal rule for hard core cases. What is different, however, is that in Canada there seems to be a desire to define these agreements by statute. As recently noted by the ABA Antitrust Section in commenting on Bill-472 (and in cautioning against the creation of statutory *per se* rules in Canada): "[the *Sherman Act*] is a flexible statute that allows the interpretive gloss to evolve over time with changes in the economy and the economic and legal thinking of the day."

As others have pointed out:

> From the jurisdictions surveyed, we conclude that a *per se* criminal prohibition for naked-price fixing cannot be formulated with complete precision, and will unavoidably target potentially pro-competitive arrangements.[66]

In this regard, it is instructive to examine section 1 of the *Sherman Act* and the development of *per se* rules in the U.S. Section 1 simply provides that:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.[67]

The application of *per se* or rule of reason analysis is the judicial creation of an optimal stopping rule – the inquiry being stopped short for agreements that rarely if ever result in benefits, and permitted to proceed where such agreements could produce offsetting procompetitive effects. Notwithstanding the stark language of section 1, the rule of reason was stated in an early antitrust decision by the U.S. Supreme Court as follows:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.[68]

The key, however, is that the *Sherman Act* is flexible enough to permit both the summary disposition of hard core cartel cases and a more thorough inquiry for cases that are less clear. Thus, in Canada, it would be inappropriate to statutorily define certain agreements as *per se* illegal for several reasons.[69] First, it is difficult, in practice, to presume with confidence that a restraint is on its face harmful. A review of even a handful of cases in the U.S. makes this clear. In practice, agreements between competitors that are helpful versus those that are harmful have been difficult to distinguish. Thus, the U.S. approach has led to what are known in the literature as "characterization" disputes. For example, in *Vogel* v. *American Society of Appraisers*,[70] a gem appraiser attempted to charge a flat 1% fee for his work, subject to a minimum fee of $10. As a result, he was expelled from the American Society of Appraisers on grounds that it was "unprofessional and unethical for [an] appraiser to do work for a fixed percentage of the amount of value . . . which he determines at the conclusion of his work". Vogel claimed he lost referrals from members of the society as a result of his expulsion. This would appear to be a group boycott or indirect price fixing. Should it be *per se* illegal?

Judge Posner declined to treat the Society bylaw as illegal *per se*. Although the bylaw had a direct effect on price, Posner J. held that its purpose or likely effect was not to raise price above competitive levels, but rather was to outlaw a method of fee setting that could lead to fraud on customers: the appraiser might have an incentive to over-appraise items in order to maximize fees. This case shows two things. First, it shows that determining whether there should be a *per se* rule applied in any particular case can involve a factual inquiry of the conduct in question very similar to the inquiry held under a rule of reason test. Second, it shows that if under a rule of reason analysis the Society were unable to show that the restraint imposed is such as to merely regulate and perhaps thereby promote competition,[71] a *per se* result would *de facto* follow.

The more recent case of *California Dental*[72] is also instructive. In that case, the California Dental Association ("CDA") was alleged to have barred members from representing that their prices were "low", "reasonable", or "affordable", to have effectively prohibited certain pricing discounts by its members, and to have imposed certain other non-price restraints or guidelines. The Federal Trade Commission treated the CDA's restrictions on price advertising as illegal *per se*. In the alternative, the Commission held the price (as well as the non-price) advertising restrictions to be violations under an abbreviated rule-of-reason analysis. One Commissioner concurred separately, arguing that the Commission should not have applied the *per se* analysis to the limitations on price advertising. Another Commissioner dissented, finding the evidence insufficient to show either that the restrictions had an anticompetitive effect under the rule of reason, or that the CDA had market power.

The Court of Appeals for the Ninth Circuit affirmed, sustaining the Commission's ultimate conclusion on the merits. The Court thought it an error, however, to have applied *per se* analysis to the price advertising restrictions, finding analysis under the rule of reason to be required for all the restrictions. The Court of Appeals explained that the Commission had properly applied an abbreviated or "quick-look" rule of reason analysis designed for restraints that are not *per se* unlawful, but are sufficiently anticompetitive on their face that they do not require a full-blown rule of reason inquiry. On appeal, the U.S. Supreme Court vacated the Court of Appeals' decision and

remanded for a "less-quick-look", finding that the Court of Appeals erred in its application of quick-look analysis in the circumstances.

In its reasoning, the Supreme Court wrote:

> [t]he truth is that our categories of analysis of anticompetitive effect are less fixed than terms like '*per se*', 'quick look', and 'rule of reason' tend to make them appear. We have recognized, for example, that 'there is often no bright line separating *per se* from Rule of Reason analysis,' since 'considerable inquiry into market conditions' may be required before the application of any so-called '*per se*' condemnation is justified. 'Whether the ultimate finding is the product of a presumption or actual market analysis, the essential inquiry remains the same – whether or not the challenged restraint enhances competition.'[73] [citations omitted]

Thus, the uncertainty over the competitive implications of any given restraint will make it difficult to design and implement legislation with sufficient flexibility and precision to determine whether an agreement involves naked collusion or something else.[74] The use of *per se* rules has certainty as an attribute in theory, but legislating whether a type of agreement falls into a category "most of the time" is likely to be unworkable.[75]

<u>Second</u>, the economics of competition policy changes over time and the industries to which the law applies are changing even more rapidly today, and so what may be perceived to be harmful today may turn out to be beneficial in light of changed economic factors and new learning. For example, in the 1977 case of *Continental T.V., Inc.* v. *GTE Sylvania Inc.*,[76] the U.S. Supreme Court relied on efficiencies to find that Sylvania's contractual restriction on where retailers could resell Sylvania products was not a *per se* violation of section 1 of the *Sherman Act*. Only 10 years earlier, in *United States* v. *Arnold, Schwinn & Co.*,[77] the U.S. Supreme Court had held that such restraints were *per se* illegal because they "are so obviously destructive of competition that their mere existence is enough".

<u>Third</u>, in recent years, the trend in the U.S. has been away from presumptions and towards an analysis of actual anticompetitive effects. As recently noted:

The last quarter-century of antitrust has been marked by a journey from presumptions to analysis of competitive effects. The journey has not been a steady one, and it has had its share of detours along the way. But, by and large, <u>presumptions of illegality – many of them the irrebuttable presumptions of *per se* rules – have given way to a more thoughtful analysis of competitive impact</u>. Although *California Dental* does not close the door on truncated rules or stand in the way of attempts to simplify antitrust, it serves as a reminder that <u>efforts to shorten the inquiry cannot come by assuming the answer and requiring defendants to justify their behavior.</u>[78] [emphasis added]

For these reasons, attempting to statutorily create categories of *per se* offences is likely to be over-inclusive and unsatisfactory.

A System of Pre-clearance is Not Likely to be Helpful

The costs and delays that will be imposed on the private sector as well as the Competition Bureau by a pre-clearance regime are likely to make it unworkable. As pointed out above, the EC is moving away from this type of regime. The EC – White Paper found that after 35 years of application:

> A system of prohibition of restrictive practices does not need to have an authorisation system in order to work properly. Other systems exist which, like Community law, are based on the principle that restrictive practices are prohibited, but which do not have a system involving notification and authorisation. A prohibition system does not mean that all restrictive practices must be presumed to be illegal, but rather only those that restrict competition to an appreciable extent and do not satisfy the conditions for exemption.[79]

It would be better to recognize procompetitive effects in section 45 and to clarify the law to the extent that it is unclear in order to better facilitate self-compliance. As noted by the ABA Antitrust Section:

> However, we question whether the benefits of a pre-clearance regime will justify the costs and delays that will be imposed on the private sector as well as the Competition Bureau. It may be noted that other jurisdictions are moving away from this type of procedure. We submit that it would be better to clarify the law to facilitate self-compliance. Businesses in Canada, the U.S. and elsewhere have a long history of relying upon internal compliance programs to promote adherence to the law.[80]

Moreover, a pre-clearance regime may create additional divergence between Canada and its major trading partners. As also noted by the ABA Antitrust Section:

> The Section . . . believes that any amendments must have regard to basic rights and fundamental principles of procedural fairness and should impose only reasonable costs and burdens on economic activity. In this context, there is a growing consensus that greater convergence or compatibility in competition laws among nations can reduce transaction costs and provide greater legal certainty for businesses operating in multiple jurisdictions. In this sense there are some lessons to be learned from the European Union, where a process of "soft" or voluntary harmonisation is underway. While we are not advocating that the goal of convergence requires absolute conformity between Canadian and U.S. laws, we do believe that caution should be exercised in proposing any changes that may increase differences, which may increase transaction costs and uncertainty.[81]

Similarly, according to the EC – White Paper:

> The considerations that led to the adoption of a centralised authorisation system no longer carry the same weight today. . . This White Paper sets out the Commission's thinking, and describes the system it believes is best suited to the Union at the dawn of the twenty-first century. The system has three main elements: the abolition of the system of notification and authorisation to be replaced by a directly applicable exception system; the development of decentralised application of the competition rules; and intensified *ex post* control. The Commission is convinced that only a radical reform of the present system along the lines set out here can ensure the effective application of the competition rules throughout the Community, while easing the administrative burden on undertakings as far as possible, and at the same time providing them with a satisfactory level of legal certainty.[82]

A system of pre-clearance would be an imposition on businesses and, as such, about as ineffective as the registration system currently in place for specialization agreements in section 85, which to date has never been used. In addition, a voluntary system of pre-clearance may become mandatory in practice over time because courts, the Competition Bureau and others may draw a negative inference from the fact that someone did not "voluntarily" notify on the basis that, if someone has nothing to hide, they would have just notified. This is especially the case because "secrecy" is often considered a hallmark of anti-competitive cartels. Whether this negative inference is expressed or not, it may colour perceptions in the future and, in many cases, unfairly, because there are many reasons for parties to keep procompetitive alliances, especially at the proposal stage, confidential.[83]

Conclusion

Section 45 is the centrepiece of Canada's competition legislation.[84] There is no systematic evidence that section 45 is biased against the Crown or that hard core cartels are being permitted to thrive in Canada. In fact, the evidence appears to be the opposite. Moreover, creating statutorily pre-defined categories of *per se* illegal agreements is likely to be an impossible task.[85] Last, a system of pre-clearance for such agreements would appear unnecessary and contrary to recent trends taking place elsewhere toward self-compliance. However, section 45 does fail to permit a consideration of pro-competitive justifications, and in this regard requires amendment, particularly if Canada is to avoid falling further behind other nations in terms of innovation, growth and prosperity.[86]

Notes

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[1] Bill C-472, An Act to Amend the *Competition Act* (conspiracy agreements and right to make private applications), the *Competition Tribunal Act* (costs and summary dispositions) and the *Criminal Code* as a consequence, 48-49 Eliz. II 1999-2000. See also note 4, *infra*.

[2] See "Canadian Firms Seen Lacking in Innovation" *The Globe and Mail* (21 November 2001) B8 citing The Conference Board of Canada, Annual Innovation Report (2001), November 20, 2001.

[3] Regarding the ICN, see www.internationalcompetitionnetwork.com. See www.cba.org for commentary on the international aspects of Bill C-23, including reference to the "substantially similar" requirement therein. Note that while the current proposal in Bill C-23 relates to civil matters (criminal matters being dealt with under MLAT legislation), proposals to change section 45 include a proposal to introduce a "civil", as well as "criminal", track for such conduct: See Gaston Jorré, Presentation to House of Commons Standing Committee on Industry, Science and Technology, Ottawa, January 31, 2002.

[4] See 2001 Invitational Forum on Competition Law, Toronto, 12 October 2001; Public Policy Forum National Consultation on Proposed Amendments to the *Competition Act* and the *Competition Tribunal Act* (2000). See also "Section 45 at the Crossroads" (Remarks by the Commissioner of Competition to the 2001 Invitational Forum on Competition Law, 12 October 2001); R.S. Russell, A.F. Fanaki & D.D. Akman, *Legislative Framework for Amending Section 45 of the Competition Act* (11 April 2001); A. Gourley, *A Report on Canada's Conspiracy Law: 1889-2001 and Beyond* (August 2001); and McCarthy Tétrault, *Proposed Amendments to Section 45 of the Competition Act* (August 2001). Not all commentators are of the view that section 45, or indeed any part of the Act, is in need of amendment. See W. Rowley, "A Seriously Bad Idea" *National Post* (15 November 2001) (in rejecting calls to permit private access to the Tribunal noting: "By world standards, Canada's *Competition Act* is a jewel. Its economic and moral underpinnings are sound, and it is one of the most state-of-the art pieces of competition legislation in the world. It is the envy of many countries."). See also C. Goldman, M. Katz and D. Fruitman,

"The Internationalization of Anti-Cartel Enforcement: A Canadian Perspective", (Paper presented at the 2001 Invitational Forum on Competition Law, 12 October 2001 (questioning the wisdom of several of the proposed amendments to section 45)); and American Bar Association Section of Antitrust Law, "Submission to the Public Policy Forum on the Proposed Amendments to the *Competition Act*", August 2000.

[5] Article 81, Treaty Establishing the European Community as amended by the Treaty of Amsterdam, 1997 O.J. (C340) 173.

[6] §1, *Sherman Act*, 15 U.S.C. §1. Compare *California Dental Assn.* v. *FTC*, FTC Docket No. 9259; 128 F. 3d 720 (9th Cir. 1997); 526 U.C. 756 (S. Ct. 1999) [hereinafter *California Dental*].

[7] See Section 45 at the Crossroads, *supra* note 4.

[8] *Ibid.*

[9] See *California Dental*, *supra* note 6. See also ABA Section of Antitrust Law, *supra* note 4.

[10] For the opposing view, see W.T. Stanbury, "Reforming the Conspiracy Provisions of the *Competition Act*: An Analysis of Bill C-472 and New Proposals" (2000) 20:1 Can. Comp. Rec. 63.

[11] European Commission, *White Paper on Modernization of the Rules Implementing Articles 85 and 86 of the EC Treaty, 1999*, at 5 [hereinafter "EC – White Paper"].

[12] Section 45 at the Crossroads, *supra* note 4.

[13] *Ibid.* at 2.

[14] *Ibid.* at 3. Although Gourley, *supra* note 4 at 2, notes that between 1889 and 1983, the Crown won 75% of the cases that it prosecuted.

[15] See Stanbury, *supra* note 10.

[16] See, regarding the effect of uncertainty on the design of antitrust rules: C.F. Beckner III & S.C. Salop, "Decision Theory and Antitrust Rules", (1999) 67 Antitrust L.J. 41. See also R. Posner, "An Economic Approach to Legal Procedure and Judicial Administration", (1973) 2 J. Legal Stud. 399; L. Kaplow, "The Value of Accuracy in Adjudication", (1994) 23 J. Legal Stud. 307; and B. Facey, "The Future of Looking Back: The Efficient Modeling of Subsequent Review", (Summer 1999) Antitrust Bulletin 519 at 535.

[17] See R.A. Posner, *Economic Analysis of Law*, 3d ed. (Boston: Little, Brown and Company, 1986) at 509-512. The uncertainty may be asymmetrical – it only takes one party to inaccurately estimate its chances of winning to force a litigated result. The party with a systematically better winning record will tend to have better estimated the result *ex ante*.

[18] *Ibid.* at 511.

[19] See *R.* v. *Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606 [hereinafter *PANs*] for a review of the history of section 45 and recent amendments.

[20] See subsection 45(2.1) of the Act.

[21] *Atlantic Sugar Refineries Co.* v. *Attorney-General of Canada*, [1980] 2 S.C.R. 644.

[22] See R.S. Nozick, *The 2001 Annotated Competition Act* (Toronto: Carswell, 2000) at 61.

[23] Section 45(2.2) may remain relevant today in respect of private actions and if a civil track is created, in the sense that there would appear to be no intent requirement in private civil actions, given that the Charter does not apply to cases between civil litigants and so the objective intent requirements developed in the line of cases from *Reference Re Section 94(2) of the Motor Vehicle Act of British Columbia* (1985), 23 C.C.C. (3d) 289 (S.C.C.), and *R.* v. *Vaillancourt*, [1987] 2 S.C.R. 636 (S.C.C.) to *R.* v. *Hess*; *R.* v. *Nguyen*, [1990] 2 S.C.R. 906 (S.C.C.) would not appear to require the imputation of objective forseeability of harm as part of the *mens rea* component of such cases: See B.A. Facey and W.T. Stanbury, "Is the Opportunity to Cartelize a Charter Right in Canada?" (Prepared for the Contemporary Policy Session of the 66th Annual Conference of the Western Economics Association and co-sponsored by the Antitrust Bulletin, Seattle, 1991).

[24] Not including individuals. See Appendix A hereto and Appendix I to Gourley, *supra* note 4. Note that several convictions often relate to the same conspiracy. Moreover, as recently noted by the Competition Bureau "[s]ince 1980, the Bureau has been increasingly active in the enforcement of international cartel activities. During this time it has brought 56 conspiracy cases before the courts, leading to fines totalling more than $165 million. Eighty per cent of these fines occurred within the last two years, as several large multinationals pleaded guilty for their implication in global conspiracies involving vitamins, graphite electrodes and foods additives." See Competition Bureau Press Release, "Competition Bureau Hosting International Cartel Workshop", 26 November 2001, http://strategis.ic.gc.ca/SSG/ct02311e.html.

[25] *R.* v. *Nova Scotia Pharmaceutical Society* (1993), 49 C.P.R. (3d) 289 (N.S.S.C.).

[26] *R.* v. *Bayda and Associates Surveys Inc.* (1997), 78 C.P.R. (3d) 203 (Alta. Q. B.) at 204 [hereinafter *Bayda*].

[27] *R.* v. *Clarke Transport Canada Inc.* (1995), 64 C.P.R. (3d) 290 (Ont. Ct. Gen. Div.) at 325 [hereinafter *Clarke Transport*].

[28] *Canada (Director of Investigation and Research)* v. *Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Comp. Trib.).
[29] *Canada (Director of Investigation and Research)* v. *Southam Inc.* (1992), 43 C.P.R. (3d) 161 (Comp. Trib.).
[30] *Canada (Commissioner of Competition)* v. *Canadian Waste Service Holdings Inc.* (2001), 11 C.P.R. (4th) 425 (Comp. Trib.).
[31] The final decision by the Tribunal in *Canada (Commissioner of Competition)* v. *Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 (Comp. Trib.) has not yet been rendered. While the Commissioner was unsuccessful before the Tribunal, the Federal Court of Appeal agreed with the Commissioner's position that the Tribunal applied the law relating to the efficiency defence in section 96 incorrectly, and remanded the case to the Competition Tribunal. The Redetermination hearing took place on October 9, 2001 to October 15, 2001 in Ottawa.
[32] During the year ended March 31, 2001, the Bureau reviewed 206 notifiable transactions and 255 advance ruling certificate requests. Of those, only 6 required remedies, which were obtained through post-closing restructuring done either by undertakings or by consent order. See page 25 of the Annual Report of the Commissioner of Competition for the year ending March 31, 2001.
[33] Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance Provisions* (2001). See *Canada (Director of Investigation and Research)* v. *NutraSweet Co.* (1990), 32 C.P.R (3d) 1 (Comp. Trib.); *Canada (Director of Investigation and Research)* v. *Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.); *Canada (Director of Investigation and Research)* v. *D & B Companies of Canada Ltd.* (1995), 64 C.P.R. (3d) 216 (Comp. Trib.); *Canada (Director of Investigation and Research)* v. *Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1 (Comp. Trib.); and *Canada (Director of Investigation and Research)* v. *Bank of Montreal* (1996) 68 C.P.R. (3d) 527 (Comp. Trib.).
[34] However, see Bill C-402, An Act to Amend the *Competition Act* (abuse of dominant position), 48-49 Eliz. II, 1999-2000; Bill C-248, An Act to Amend the *Competition Act* (merger efficiencies), 48-49 Eliz. II, 1999-2000; and Bill C-509, An Act to Amend the *Competition Act* (merger efficiencies), 48-49 Eliz. I, 1999-2000.
[35] See M.K. Block et al., "The Deterrent Effect of Antitrust Enforcement" (1981) 89:3 J. Pol. Econ. 429.
[36] See "*Federal Court Imposes a Fine of $1 Million For International Vitamin Conspiracies*", Competition Bureau News Release (30 March 2000); "*Federal Court Imposes A Fine of $5.2 Million for International Vitamin Conspiracies*", Competition Bureau News Release (1 March 2000); "*Federal Court Imposes a Fine of $370,000 for a Foreign-directed Conspiracy Under the Competition Act*", Competition Bureau News Release (26 October 1999); and "*Federal Court Imposes Fines Totalling $88.4 Million for International Vitamin Conspiracies*", Competition Bureau News Release (22 September 1999).
[37] See J.F. Brodley, "The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress", (November 1987) 62 N.Y.U.L. Rev. 1020 for an explanation of the efficiency benefits of competition and the importance of innovation efficiency.
[38] See S.C. Salop and G. Roberts, "Efficiencies in Dynamic Merger Analysis," (1996) 19 World Competition 5.
[39] See P. Crampton, *Mergers and the Competition Act* (Toronto: Carswell, 1990), for a discussion of this in Chapter 7 on merger efficiencies. Note, however, that this approach was rejected by the Federal Court of Appeal *in Canada (Commissioner of Competition)* v. *Superior Propane Inc.*, [2001] 11 C.P.R. (4th) 289 (F.C.A.) [hereinafter *Superior Propane*] at least as a matter of law in interpreting section 96 of the Act.
[40] See R. Pitofsky, "Proposals for Revised U.S. Merger Enforcement in a Global Economy", (1992) 81 Geo. L.J. 196.
[41] See A. Schaub, "EC Competition System – Proposals for Reform", (1999) 22 Fordham Int'l L.J. 853.
[42] *California Dental, supra* note 6 at 1618 (Breyer, J., dissenting). See also J. Kattan, "From Indiana Dentists to California Dental: Presumptions and Competitive Effects in Antitrust Law", (2001) 68 A.L.J. 735 at 752.
[43] See Kattan, *ibid.* at 750; and *National Society of Professional Engineers* v. *United States*, 435 U.S. 679 (1978).
[44] See EC – White Paper, *supra* note 11 at 5.
[45] *Ibid.* at 23.
[46] See *PANs*, *supra* note 19 at 649-650.
[47] See Beckner & Salop, *supra* note 16. See also Posner, *supra* note 16; Kaplow, *supra* note 16; and Facey, *supra* note 16 at 535.
[48] See Beckner & Salop, *ibid.*
[49] See Beckner & Salop, *ibid.*
[50] 7 Phillip Areeda, *Antitrust Law* (Boston: Little, Brown and Company, 1986) ¶ 1508 at 403.

[51] T.C. Arthur, "A Workable Rule of Reason: A Less Ambitious Antitrust Role for the Federal Courts", (2000) 68 A.L.J. 337 at 360, citing 7 Phillip Areeda, *Antitrust Law*, *ibid.*, ¶ 1507c at 399 ff.
[52] See Appendix A hereto.
[53] See *PANs*, *supra* note 19 at 653.
[54] See T. Kennish and T.W. Ross, "Toward a New Canadian Approach to Agreements Between Competitors", (1997) 28 Can. Bus. L. J. 22.
[55] See Section 45 at the Crossroads, *supra* note 4; and *Superior Propane, supra* note 39.
[56] See PANs, *supra* note 19 at 650.
[57] See Russell, Fanaki & Akman, *supra* note 4; Gourley, *supra* note 4; and McCarthy Tétrault, *supra* note 4.
[58] 441 U.S. 1 (S. Ct. 1979) [hereinafter *BMI*].
[59] 468 U.S. 85 (1984) [hereinafter *NCAA*].
[60] *Ibid.* at 114. Lower courts, following *BMI* and *NCAA*, generally recognize that efficiencies can have a significant impact on competition. See, e.g., *SCFC ILC, Inc.* v. *Visa USA, Inc.*, 36 F.3d 958 (10th Cir. 1994), cert. denied, 115 S. Ct. 2600 (1995).
[61] See *PANs*, *supra* note 19; and *Clarke Transport*, *supra* note 27.
[62] See P. Warner and M. Trebilcock, "Rethinking Price-Fixing Law" (1993) 38 McGill L.J. 679; see Kattan, *supra* note 42. See also Stanbury, *supra* note 10.
[63] Kennish and Ross, *supra* note 54.
[64] See *PANs*, *supra* note 19 at 34.
[65] See Competition Bureau, *Intellectual Property Enforcement Guidelines* (2000). See also S.C. Salop, "The First Principles Approach to Antitrust, Kodak, and Antitrust at the Millennium", (2000) 68 A.L.J. 187.
[66] Warner and Trebilcock, *supra* note 62 at 716.
[67] §1, *Sherman Act*, 15 U.S.C. §1. See also Arthur, *supra* note 51, and articles in the Antitrust Law Journal, Vol. 68 (2000) and the "Symposium: The Future of the Rule of Reason" for a history of the development of *per se* versus rule of reason analysis in the U.S.
[68] *Chicago Board of Trade* v. *United States*, 38 S. Ct. 242 (1918) at 244. See also Arthur, *supra* note 51 for a detailed history of the development of *per se* and rule of reason analysis.
[69] See Warner and Trebilcock, *supra* note 62. See, however, Russell, Fanaki & Akman, *supra* note 4; Gourley, *supra* note 4; and McCarthy Tétrault, *supra* note 4 for a contrary view.
[70] 744 F.2d 598 (7th Cir. 1984) at 599.
[71] As per *Chicago Board of Trade*, *supra* note 68.
[72] *Supra* note 6.
[73] *Ibid.* at 779-80.
[74] See ABA Section of Antitrust Law, *supra* note 4 at 8, reaching the same conclusion.
[75] *Ibid.* at 11.
[76] 433 U.S. 36 (S. Ct. 1977).
[77] 388 U.S. 365 (S. Ct. 1967).
[78] Kattan, *supra* note 42 at 752.
[79] See EC – White Paper, *supra* note 11 at 21
[80] ABA Section of Antitrust Law, *supra* note 4 at 13.
[81] *Ibid.* at 3.
[82] EC – White Paper, *supra* note 11 at 46.
[83] See Kennish and Ross, *supra* note 54 at 61.
[84] See Stanbury, *supra* note 10.
[85] See *California Dental*, *supra* note 6. See also ABA Section of Antitrust Law, *supra* note 4.
[86] See *The Globe and Mail*, *supra* note 2.

APPENDIX A
Section 45 convictions: 1993 - 2001

COMPANY	PRODUCT	DATE	FINE AMOUNT
Canada Pipe Company Ltd.	Pipe	September 27, 1995	$ 2,500,000
Lafarge Canada Inc.	Ready Mix Concrete	August 19, 1996	$ 1,833,000
Ciment St-Laurent Inc.	Ready Mix Concrete	August 19, 1996	$ 1,833,000
Ciment Québec Inc.	Ready Mix Concrete	August 19, 1996	$ 1,733,000
Archer Daniels Midland Company	Lysine	May 27, 1998	$ 14,000,000
Ajinomoto Co. Inc.	Lysine	July 23, 1998	$ 3,500,000
Haarmann & Reimer Corporation	Citric Acid	October 21, 1998	$ 4,700,000
Jungbunzlauer International A.G.	Citric Acid	October 21, 1998	$ 1,900,000
F. Hoffman-LaRoche Ltd.	Bulk Vitamins	September 22, 1999	$ 48,000,000
BASF Aktiengesellschaft	Bulk Vitamins	September 22, 1999	$ 18,000,000
Rhône-Poulenc S.A.	Bulk Vitamins	September 22, 1999	$ 14,000,000
Daiichi Pharmaceutical Co., Ltd.	Bulk Vitamins	September 22, 1999	$ 2,500,000
F. Hoffman-Laroche Ltd.	Citric Acid	September 22, 1999	$ 2,900,000
Hoechst AG	Sorbates	October 26, 1999	$ 2,500,000
Takeda Chemical Industries, Ltd.	Bulk Vitamins	March 1, 2000	$ 5,200,000
Merck KgaA	Bulk Vitamins	March 30, 2000	$ 1,000,000
Daicel Chemical Industries, Ltd.	Sorbates	September 19, 2000	$ 2,460,000
SGL Carbon Aktiengesellschaft	Graphite Electrodes	July 18, 2000	$ 12,500,000
Daicel Chemical Industries, Ltd.	Sorbates	September 19, 2000	$ 2,460,000
5 Montreal Snow Removal Companies: 1) La cie de pavage d'asphalte Beaver 2) Excavation Loiselle et frères Inc. 3) Giguère et Geoffroy Inc. 4) Nepcon Inc. 5) Roxboro Excavation Inc.	Snow Removal	October 24, 2000	$ 1,000,000
Tokai Carbon Co. Ltd.	Graphite Electrodes	February 5, 2001	$ 250,000
Carbone of America Industries Corp.	Isostatic Graphite	March 1, 2001	$ 300,000
Ueno Fine Chemicals Industry	Sorbates	July 30, 2001	$ 1,250,000
Pfizer Inc.	Sodium Erythorbate	October 24, 2001	$ 1,500,000
TOTAL			**$147,819,000**[1]

Source: Competition Bureau website (www.competition.ic.gc.ca)

1 This figure does not include fines against individuals.

COMMENTS ON THE *SUPERIOR PROPANE* CASE

By: David Tadmor[1]
Caspi & Co., Israel

This is a comment on the case between the Commissioner of Competition and Superior Propane Inc. and ICG Propane Inc.[2] Since the decision by the Competition Tribunal and the subsequent appeal before the Federal Court of Appeal[3], where the Tribunal's decision was reversed in part and remanded, the Tribunal has reconsidered the case but no decision has yet been announced.

My point of view on the case is that of a regulator – now an ex-regulator – who has struggled with similar issues during his four years in office. This is why I have made in this comment no effort to reference the wide body of writing in which similar or comparable arguments have previously been made and applied elsewhere. There is no doubt in my mind that members of the Tribunal and of the Federal Court of Appeal are well familiar with the principles I apply in this comment; nevertheless, I believe they have erred in their decision.

In the *Propane Decision*, the Tribunal has reached what I believe to be an impossible conclusion: it blessed a merger of the two ardent competitors in Canada's propane market into one dominant monopoly, asserting the merger would likely increase efficiency and prove beneficial to the Canadian economy as a whole. This conclusion was reached although the relevant market was not argued nor was it found to be a natural monopoly market; although the relevant market is typified by unusually high barriers to entry; and although the merged monopoly is fully expected to obtain ample market power through the merger and to exploit it to the best of its ability.

In this comment I explain why in my opinion the *Propane Decision* is fundamentally flawed. I argue that the decision applies a wrong standard, the "total surplus standard", to review merger transactions. The total surplus standard is essentially an efficiency standard that does not require the passing on of efficiencies generated by a merger to consumers, and that ignores wealth transfer consequences of a merger. In my view, the resulting analysis by the Tribunal is indefensible, being harmful to consumers and contrary to the foundations on which competition analysis and practice are generally based.

Moreover, I argue that calculations undertaken by the Tribunal in the *Propane Decision* to compute total surplus consequences of the merger (efficiency gains less applicable deadweight loss) were in several key respects erroneous or incomplete.

A Brief Overview

Let us review the unusual circumstances of this merger transaction between Canada's two major propane providers.

Consider the markets in which the merger takes place. The Tribunal found the relevant competition market to be "retail propane," excluding other fuels. The Commissioner argued, and the Tribunal agreed, that propane markets are local geographical markets. The Commissioner argued that in 17 local propane markets the merged

entity will hold a combined market share of between 95 and 100 percent, in 32 markets it will have a combined market share in excess of 80 percent, in 46 markets it will have a combined market share of 70 percent, and in 66 markets it will have a combined market share in excess of 60 percent. The Tribunal stated in its decision "it can rely on these results and conclusions for the purpose of determining whether the merger will result in a likely substantial prevention or lessening of competition," and concluded: "the merger is likely to lessen competition substantially in many local markets." The Tribunal further identified the "national account coordination services" as a separate product market over which market power could also be exercised by the merged entity and noted the two merging firms were the only competitors in this market as well.

The merger weds two companies holding together 70% of all national propane sales, which by their own judgment are each other's true competition: "[t]he Commissioner points out that . . . [b]ased on its internal documents, Superior refers to ICG as its "key-most" important competitor, to ICG's low prices and its low costs, that ICG uses discounted price to acquire new customers, etc." Moreover, stated the Tribunal, ". . . [t]he evidence before the Tribunal shows that ICG actively solicits customers from among the largest consumers and through specialised programs, that consumers from various end-uses recognize ICG as an alternative, [and] that consumers use ICG to negotiate prices with Superior . . ." The Tribunal specifically notes that substantial prevention of competition will result from the merger, generally and regionally. For example, with respect to one region it noted: "[i]n light of ICG's plans to vigorously expand its activities in Atlantic Canada and in the absence of any evidence to the contrary, the Tribunal is of the view that there will likely be a substantial prevention of competition in Atlantic Canada as a result of the merger."

Consider the consequences of the merger in terms of barriers to entry and the resulting market power. Barriers to entry will be very high subsequent to the merger. (i) It is generally difficult and expensive to switch from propane to other forms of fuel because of sunk costs in equipment; it would take a long-term price increase of 50%, perhaps more, to justify equipment conversion from propane to other types of fuel. (ii) The product is not simply a commodity; as noted by the Tribunal, propane is differentiated among providers based on "reputation, length of time in the business, the terms and conditions they offer to customers, the ability to meet a customer's needs at multiple locations, etc." (iii) The propane market was found by the Tribunal to be of stable demand and modest growth, therefore any new entrant will have to focus primarily on existing propane users – who would be deterred by high switching costs – as its cliental base. (iv) It was found that typical contractual arrangements in the propane market include long-term contracts, automatic renewal provisions, exclusivity provisions, termination fees and "meet or beat" and "right of first refusal" clauses. These agreements – perhaps problematic under sections 77 and 79 of the *Competition Act* – were not abolished as a condition to the approval of the merger and continue to represent existing industry practices.

Inelastic demand and low cross–elasticity of supply supplement these steep barriers to entry. Demand for propane is relatively inelastic with respect to changes in its price, i.e., consumers reduce their consumption of propane only slightly when the price rises. On the supply side there is no potential entrant into the market: "even very large and sophisticated companies may not be able to enter the propane distribution business profitably," the Tribunal noted. It eloquently summarized: "the Tribunal believes that there is insufficient evidence to demonstrate

that there will be effective remaining competition capable of constraining the exercise of market power by the merged entity."

In spite of these clear and harsh findings as to the probable effects of the propane merger, including the exceptionally high measure of market power that would likely result from the merger, the Tribunal approved the propane merger. In brief, the Tribunal concluded that cost savings (efficiencies) for the newly-formed monopoly were larger than the expected deadweight loss to the economy resulting from the merger into monopoly and the expected resulting use of market power; and that total surplus is the proper standard to be applied under Canadian competition law in merger cases, hence there is no need to demonstrate that such efficiencies are passed on to consumers nor is there any harm in reducing consumer surplus through the use of monopoly market power. The Tribunal further found Canadian law indifferent to the resulting increase in producer surplus at the expense of consumers.

In other words, the Tribunal concluded that Canadian law favours a merger to monopoly – even if cross elasticity of demand is very low, cross elasticity of supply is very low and the resulting monopoly will possess very strong market power – provided cost savings to the merging parties are expected to exceed all deadweight loss arising from the probable increase in price to the public.

Back to Basics: Fundamental Antitrust Principles

The *Propane Decision* creates a monopoly of the kind antitrust laws were set out to prevent. The basic premise of antitrust is that competitive markets are more efficient than monopoly markets. From this general truth stems another: that the long-term positive effects of a competitive market will outweigh cost savings derived from business combinations that create monopolies holding market power. Consequently, antitrust laws prohibit business combinations that result in the elimination of competition.

Not so the *Propane Decision*. The Tribunal created by its decision a monopoly that holds ample market power, asserting that savings generated from merging the only two firms competing in the applicable market into one monopoly outweigh all negative consequences flowing from the elimination of competition. In other words, the Tribunal concluded that on a long term basis the market would be more efficient if served by a monopoly than if served by competing firms.

Can this be true? It is generally recognized that on a long term basis a single firm can more efficiently serve a market than two or more competing firms only where it is a natural monopoly market. In a natural monopoly market the cost function is sub-additive, which means that it is cheaper to have one firm that produces total industrial output.[4]

There seem to be only three options here:

Propane retailing is a natural monopoly, hence one firm will better serve the market than two competing firms and the merger should not be blocked. This, however, is not a likely proposition. To begin with, there are good reasons to assert that propane retailing is not a natural monopoly whatsoever; if it were, economic theory predicts

that a competitive process in this industry would have resulted over time in sustained losses to participating firms, yet this generally is not the case in propane industries. In Canada, competition did exist prior to the merger and continues to exist (at least for the time being) in some regional propane markets following the merger. In other countries – even small countries – there seems to be no support for the proposition that propane retailing cannot sustain itself in a competitive environment. Indeed, the shrinking list of widely recognized natural monopolies does not include propane retailing. In any event, the Tribunal itself neither suggested nor hinted in its decision that propane distribution in Canada is a natural monopoly, thus the *Propane Decision* cannot be substantiated on this hypothetical basis.

A new type of entity has been discovered by the Tribunal: a total monopoly holding ample market power, yet more efficient than the competing firms of which it is now comprised, and able to promote public welfare more than the competitive market in which its components previously operated. Indeed, if you do not ascribe to the proposition that propane retailing in Canada is a natural monopoly, yet you agree with the result reached by the Tribunal, you are inescapably bound to conclude that such a new and exciting monopoly has indeed been discovered in Canada.

I do not believe this scenario to be plausible. Moreover, remember that this newly formed total monopoly will be operating (as noted by the Tribunal) in a market typified by very low cross elasticity of demand and supply, very high barriers to entry and consumer inability to significantly reduce consumption following a considerable increase in price; it will also have the power (and is predicted by the Tribunal) to raise prices and restrict outputs and every reason to do so. The impossibility, in terms of antitrust theory, of the result reached by the Tribunal leads me to believe it erred in its decision.

The Tribunal erred in its analysis – clearly, this is my preferred option.

There are additional aspects to this discussion, however. In addition to the general arguments made above, I will now point to several specific errors that can be found in the *Propane Decision*.

Errors in Fact and Theory

Not Calculating Efficiencies and Losses in Each Local Market

Canadian propane markets were found by the Tribunal to be local in nature. Accordingly, in its analysis the Tribunal assumed the probable influence of the merger on propane prices in each local market (or at least for each local market category). When calculating merger-related deadweight loss and efficiencies, however, the Tribunal approached all regions as one when concluding that in the aggregate efficiencies were greater than the contemplated deadweight loss.

Regional markets call for regional analyses and regional remedies if the correct economic conclusion is to be obtained. To illustrate, it is conceivable that efficiencies arising from the merger in the 16 monopoly markets were smaller then those obtained in other markets because the two merging firms had already achieved separately

scale economies in those markets; being a merger of two firms comprising an oligopoly market, the deadweight loss resulting from the merger may have been greater than in other markets.

To think of another illustration, in this merger the two major competitors in Canada's propane markets became one. The Tribunal did not consider or calculate the probable impact of the merger on local markets in which one of the merged companies held a dominant position prior to the merger. Because each of the two companies was probably the other's greatest if not only potential competitor in such local markets, the merger may well have additional local adverse consequences that were not taken into account by the Tribunal.

In short, to correctly calculate the total surplus impact of the merger, the Tribunal should have reviewed evidence on the efficiencies/deadweight loss in each local propane market. Such a review may have revealed that (i) the total aggregate calculation was incorrect or (ii) the merger could be approved only if conditioned upon effective divestitures being undertaken in quite a few local markets. As they stand, calculations made by the Tribunal are incomplete and probably incorrect.

Planning and Litigation Costs; Tax Savings

The Tribunal refused to recognize merger planning costs or the cost of litigating a merger in its efficiencies calculation, arguing they are expended independently of whether the merger succeeds or creates efficiencies. The purpose of the analysis, stated the Tribunal, "is not to determine whether shareholders will be better off at the expense of consumers, but rather whether the economy gains more resources than it loses through the transaction." However, as for all other assets, in order to determine whether a merger has positive net effects on the economy one must include all production costs. It is difficult to understand why planning and litigation costs, which are an integral part of "producing" mergers, should be excluded from the calculation.

On the other hand, the Tribunal included in its efficiencies calculation tax savings resulting from the merger.[5] Under the total surplus standard this seems rather hard to justify. Tax savings can hardly be described as resources that the economy gains through a merger, and their inclusion in the list of "efficiencies" can result in peculiar consequences indeed.

Static Rather Than Dynamic Analysis

The Tribunal assumed in its analysis of savings generated by the merger ongoing efficiency gains; in a merger to monopoly this assumption seems flawed, as there is no reason to assume <u>ongoing</u> efficiency gains in a <u>noncompetitive</u> environment. In this case, the combination of high barriers to entry and inelastic demand yields an incontestable monopoly, and as competition subsides so will the pressure to maintain an efficient business.

Moreover, to assess long-term deadweight losses resulting from a merger to monopoly one must assume various scenarios and apply to them magnitude/probability calculations. Circumstances <u>will</u> change – they always do – and they <u>will</u> give rise to new and better opportunities to exploit the ample market power created through the merger; those opportunities, in turn, will increase the measure of deadweight loss to the economy as a whole.

Conversely, the Tribunal took a snapshot of the circumstances at the time of the merger, calculated what it found to be the deadweight loss at such time and for no good reason assumed it to be the measure of deadweight loss in years to come. This cannot be right. As circumstances change so will the amount of deadweight loss; for example, a rise in the cost of alternative energy sources will likely increase the amount of deadweight loss resulting from the merger, as it will provide to the merged monopoly new opportunities to exploit its Tribunal-blessed market power. Granted, such dynamic, forward-looking magnitude/probability analyses are highly speculative, but this is only another reason why antitrust agencies do not and should not create monopolies based on static snapshot analyses of circumstances prevailing at the time of the merger.

Ignoring Adverse Effects of the Merger on Canadian Domestic and Foreign Markets

Propane is not only a household product; it is an industrial input. The Tribunal assumed the merger would raise industry propane prices by 7% and transportation propane prices by 8%. However, the Tribunal ignored in its analysis adverse consequences of the merger to Canadian industries: the merger renders Canadian production more expensive, making it harder for Canadian industries to compete in local and export markets alike. The merger thus causes Canadian industry to become less competitive. Those adverse consequences, which may be significant, are absent from the Tribunal's total surplus calculations.

More than an error in calculation, this outcome seems to have interesting consequences under the *Competition Act*. Subsection 96(2) of the Act provides as follows: "[i]n considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in (a) a significant increase in the real value of exports; or (b) a significant substitution of domestic products for imported products." A merger that raises input prices for Canadian industries is likely to decrease the real value of exports and to contribute, alas, to the substitution of imported products for domestic Canadian products.

Anecdotally, according to the *Propane Decision* "approximately 63 percent of propane produced in Canada is exported to the United States." I assume for the sake of this argument that U.S. propane markets are generally competitive. In these competitive markets no monopoly premium can be charged for Canadian propane. Consequently, following the merger Canadian propane will be sold in U.S. markets for prices lower than those charged in post-merger monopolistic Canadian markets. Cheap Canadian propane will therefore fuel U.S. industries; these industries, in turn, will have an edge when competing with Canadian firms for which the merger has raised production costs!

This is a strange outcome indeed, yet it becomes more peculiar once the merged company itself exports propane to the United States: Canadian consumers, overpaying for propane in their domestic monopolistic market, will find themselves subsidizing U.S. consumers who are acquiring, in their competitive market, cheaper Canadian propane.

This peculiar outcome illustrates the point I have made earlier: limited by the evidence presented, and burdened by the mortal inability to foresee the future, the Tribunal embarked upon an impossible task, namely, an attempt to calculate and quantify all short and long term costs and benefits resulting from the elimination of competition.

Ignoring the Cost of Substantive Regulation that may be Introduced in Monopolized Propane Markets

Utility markets are often monopolistic and almost always regulated. With no competition in or for the market and low cross elasticity of demand, regulation may well be necessary to achieve a "second best" solution. Such regulation is expensive to create and implement and is coupled with a great deal of inherent inefficiency, yet absent competition it may be necessary to control prices, create product diversity and set standards for product and service quality. Massive efforts are being made in many countries to turn monopoly markets into competitive ones because regulation, even where necessary, is a poor substitute for competition.

In its analysis, the Tribunal recognized "there is insufficient evidence to demonstrate that there will be effective remaining competition capable of constraining the exercise of market power by the merged entity." It further evaluated as "slim" the likelihood of a new entrant into the market from the U.S. or from Canada, even if the merged monopoly raises propane prices (as it is expected by the Tribunal to do). The record shows that there is no competition remaining <u>in</u> the market nor is there any competition expected <u>for</u> the market following the merger; it also shows that consumer demand for propane is relatively inelastic.

By turning a competitive market into a monopolistic arena, the Tribunal created a market that will probably have to be regulated in the future. In my mind, it is hardly the role of antitrust agencies to create monopolies that must be regulated to achieve "second best" solutions. The Tribunal also failed to take the probable cost of such regulation into account when attempting to calculate total surplus consequences of the merger. This is a serious omission. Regulation is expensive to create and costly to implement, bearing evident <u>direct</u> costs, as well as <u>indirect</u> costs stemming from inefficiencies that are inherent in all regulatory systems.

To these costs, the cost of increased <u>antitrust</u> scrutiny of Canadian propane markets must also be added. The merged entity now holds monopoly power in many local propane markets; arguably, it might be tempted to use its newly acquired monopoly power, for example, to predate prices in non-monopoly local markets and to price competitors out of those markets; Canadian propane markets now seem very suitable for a successful predation campaign. The merged company might thus become a total monopoly in many local markets <u>additional</u> to the unlucky first sixteen. The merged entity can exploit its Tribunal-blessed monopoly position in other directions as well, mandating enhanced antitrust scrutiny. Again, neither the cost of such anticompetitive actions nor the cost of acting to prevent them was accounted for by the Tribunal.

Arbitrary Figures

A merger to monopoly harms the economy in a variety of ways – prices go up; quantity, quality and variety go down; innovation diminishes. All these should be taken into account when figuring the total surplus consequences of a merger into monopoly. This point was made before the Tribunal by the Commissioner: "[t]he Commissioner further submits that, provided the effects flow from a prevention or lessening of competition resulting from the merger, section 96 does not place any other limitations upon the scope or range of "effects" to be considered, which includes detrimental effects of a merger that will affect consumers such as an increase in prices, a decrease in service, product choice or quality."

The Tribunal concurred that a decline in product quality and diversity should be taken into account but noted that no evidence was brought forth to calculate the loss; for reasons not entirely clear it placed on it a three million dollar value.

It should seem reasonable to suggest that any court or tribunal purporting to calculate all economic consequences to the public stemming from a given transaction should not decide the outcome of a case as if it were an everyday *lis inter partes*. If there was evidence missing from the record, necessary to calculate the cost or benefit to the public resulting from the merger, the Tribunal should have requested the parties to present it in full. I do not suggest the Tribunal erred in this regard under Canadian procedural law, but the resulting calculation suffered. In short, to reach a correct conclusion, non-price effects of a merger must be substantiated, not guessed.

The Impossibility of the Task Undertaken by the Tribunal

I have made an effort to illustrate why any short- or long-term total surplus cost-benefit analysis of a merger into monopoly must be incomplete, inaccurate and highly speculative. Let me add another layer to this argument. It is highly unlikely that any tribunal can calculate in advance all costs and benefits arising from a merger, given that even direct parties to mergers fail again and again in their efforts to do so.

Case in point: most mergers fail. They fail, among other reasons, because there are underestimated substantial costs associated with merging separate businesses into one unit operating efficiently. Should these costs be accounted for when calculating the total surplus consequences of a merger? Of course they should. Can a Tribunal measure these costs before a merger takes place? Probably not. Even parties to the merger, who know the facts best and understand the business far better than any antitrust regulator or tribunal, cannot measure these costs in advance. Were parties to failed mergers able to measure these costs in advance, they probably would not have merged to begin with. These substantial merger-related costs are not reflected in the *Propane Decision*.

The impossibility of the task undertaken by the Tribunal can be further illustrated. In line with its interpretation of the Act as promoting total surplus, the Tribunal sought to identify positive and negative efficiency consequences of the merger. Wealth transfer as such, states the Tribunal, falls outside the calculation: "Since consumers pay more for the quantity of the product at the higher price, they lose some of the surplus they had when they paid the competitive price. A portion of this loss in consumer surplus is realized by the firm and its shareholders in the form of higher profits. Such loss is not a social loss, but rather a redistribution of gains from the merger; real resource use is not affected by this transfer of income." This analysis is not correct. The transfer of wealth affects the economy, for example, because the same amount of money will change in value (utility to the holder) once shifted from an impecunious person to a wealthier one, or *vice versa*. This is the well-known phenomenon referred to as the declining (or increasing) marginal value of money. To quantify economic consequences of a merger into monopoly these changes must also be accounted for and calculated.

Sadly, in practice, any attempt to quantify net gains and losses derived from wealth transfers would be an exercise in futility, which is precisely my point: a legal standard, desirable in theory as it may be, that cannot possibly be proven in a court of law nor be properly calculated, is not a useful standard. As noted earlier, it is no

coincidence that antitrust regulators in other countries make no attempt to evaluate total surplus consequences of business transactions, but rather settle for less ambitious yet obtainable standards; and they do not, under these less ambitious tests, merge competitors into total monopolies, while arguing the irrelevancy of wealth transfers to the process as a whole.

Distorted Antitrust Analysis

Here is another major flaw in the *Propane Decision*: cost savings resulting from the merger, that were recognized by the Tribunal, reflect in part a reduction in outputs and result in a clear loss of consumer choice. In my view, allowing a merged entity to register efficiencies that are achieved through a reduction in outputs is highly objectionable. The shape of a market must be determined through competitive supply and demand forces. Market forces, not regulators, should determine the quantity, quality and diversity of products and services offered to consumers. When a merger into monopoly is blessed by an antitrust regulator (here – the Tribunal) because the merger is found to be "efficient," yet those efficiencies are obtained in whole or in part at the expense of product quantity, quality or diversity, that regulator is leaving antitrust territory, entering the realm of economic regulation of the very nature free market wisdom seeks to prevent.

Antitrust regulators preserve competition in the market. Antitrust regulators do not, and they should not, become planning agencies that determine what markets should look like. They do not and they should not allow competitors to join forces and obtain the monopolistic power to deliver inferior products to consumers simply because those products are cheaper to make. Inferior products are invariably cheaper to manufacture and lowering quality always saves money to manufacturers, but it also reduces the value of these products and services to consumers.

When the Tribunal recognized cost savings in return for lower quality and diversity, it turned itself into a planning agency for the propane market. Unfortunately, this is the outcome of a "total surplus" type analysis, which the Tribunal attempted to apply in the *Propane Decision*. What next – perhaps a merger of all Canadian cigarette manufacturers and suppliers into a single monopoly? There are many savings to be obtained through such a merger, but those are just the beginning: the new cigarette monopoly will possess ample market power, thus immediately restrict outputs and raise prices, causing Canadians to smoke less and become healthier, in turn reducing medical costs and advancing total economic surplus! This mockery of antitrust is no less bizarre than the analysis applied by the Tribunal in the *Propane Decision*. Indeed, if you take seriously total surplus analysis in the manner in which the Tribunal applied it, and if you recognize efficiencies that are based on a reduction in product quantity, quality or diversity, you end up in unchartered territory and become – yet again – the very being antitrust seeks to prevent.

The Appeal

On April 4, 2001, the Federal Court of Appeal handed down its decision, reversing in part the *Propane Decision* and remanding the case to the Tribunal. The Federal Court of Appeal did not take issue with calculations undertaken by the Tribunal. The focus of the *Appeal Decision* was whether the Tribunal was correct when it applied the total surplus standard, and only that standard, when evaluating "the effects of the prevention or lessening of competition" of the merger.

What the Federal Court of Appeal Said

The Federal Court of Appeal agreed with the Tribunal that section 96 of the Act gives "primacy to the statutory objective of economic efficiency, because it provides that, if efficiency gains exceed, and offset, the effects of an anti-competitive merger, the merger must be permitted to proceed, even though it would otherwise be prohibited by section 92." The Court concurred that under section 96, when evaluating a merger the Tribunal must balance the efficiency gains derived from the merger with "effects of the prevention or lessening of competition" which the merger may have.

The Federal Court of Appeal, however, rejected the position taken by the Tribunal as to the <u>scope</u> of "effects" that must be balanced against efficiency gains derived from the merger. It concluded the Tribunal "erred in law because it failed to ensure that all the objectives of the *Competition Act*, and the particular circumstances of each merger, could be considered in the balancing exercise mandated by section 96." In this balancing task, the Court determined, the Tribunal must not limit itself to the total surplus rule but must also consider other "effects" of the merger: the "effects" the merger might have on the stated objectives of the Act;[6] the effects the merger might have on the distribution of wealth resulting from the exercise of merger-created market power; and the effects on the interests of consumers including price and choice. The standard applied by the Tribunal must be more "reflective" than the total surplus standard of the different objectives of the *Competition Act*, and should also be "sufficiently flexible" in its application to enable the Tribunal to assess the particular factual situation before it. The Federal Court of Appeal concluded: "the word, "effects", should be interpreted to include all the anti-competitive effects to which a merger found to fall within section 92 in fact gives rise, having regard to <u>all</u> of the statutory purposes set out in section 1.1."

The Federal Court of Appeal thus determined it is not the "total surplus standard" that should be applied by the Tribunal in assessing whether efficiency gains generated by the merger exceed and offset its anti-competitive effects. The balancing act called for in section 96, said the Federal Court of Appeal, is "a more judgmental assessment than is called for by the largely quantitative calculation of deadweight loss." It noted the "balancing weights approach" to which it referred will "no doubt require considerable elaboration and refinement when it comes to be applied to the facts of particular cases."

In its conclusions, the Federal Court of Appeal remanded the case, stating the Tribunal "need only identify and assess "the effects of the prevention or lessening of competition" for the purpose of section 96 and decide whether the efficiencies that the Tribunal has already found to have been proved by the respondents are likely to be greater than, and to offset, those effects."

What the Federal Court of Appeal Did Not Say

The *Appeal Decision* is a step up from the *Propane Decision*, yet in my opinion it leaves much to be desired. In its decision, the Federal Court of Appeal did not confront most of the issues to which I have pointed earlier; and while it should not be blamed for failing to correct errors that were not raised in the appeal or that were outside the scope of its jurisdiction, the major shortcomings of the *Propane Decision* remain virtually intact. The Federal

Court of Appeal did not rule out the possibility of approving a merger into monopoly, did not have anything to say about legal aspects of calculations undertaken by the Tribunal, and did not direct the Tribunal as a matter of law to exclude from its analysis efficiencies that result in the loss of product quality, quantity or diversity.

I think this outcome is unfortunate. The Federal Court of Appeal observed and emphasized that the primary purpose of the Act is to maintain and encourage competition in Canada, as stated in section 1.1; that this primary purpose is not merely a general statement of the legislative rationale that should be subjected to the provisions of section 96; and that the legislative history of section 96 makes it clear that its balancing of "efficiency gains against the "effects" of an anti-competitive merger, should not be interpreted in substantially the same manner as the above clauses [reference is being made here to rejected versions of section 96], which explicitly permitted anti-competitive mergers when the resulting efficiency gains produced <u>net savings of resources for the Canadian economy</u>." Moreover, the Court recognized that the harm to consumers in the form of wealth transfers, less competitive prices and more limited product choices, must be taken into account when balancing efficiencies generated by the merger with the harm to competition it creates. The Federal Court of Appeal further acknowledged that in balancing these factors the Tribunal should apply "judgmental assessment", not simple quantitative calculations.

I wonder whether these were not sufficient grounds for the Federal Court of Appeal to intervene in the *Propane Decision*, to provide that some "effects" stand in such stark contradiction to the primary rationale and purpose of the Act that they overcome the efficiency gains ostensibly generated by a merger, except perhaps in very extreme circumstances. I believe the Court could and should have stated outright that competition laws do not create, allow or endorse mergers into monopoly, and that competition agencies are in no position to dictate how important competition would be for consumers or for the economy as a whole in each set of circumstances.

Failing to specifically prohibit a merger into monopoly, the Federal Court of Appeal also fell short of providing any guidance as to how, as a matter of law, the Tribunal should "balance" between gained efficiencies, on the one hand, and the loss of product diversity, quality or quantity or the transfer of wealth from consumers to producers, on the other hand. What is the "value" of the transfer of wealth? What is the "value" of the loss of consumer choice or of product quality and quantity? How should this "balancing test" be put into operation?

To summarize, the *Appeal Decision* left an open door for the Tribunal to endorse the creation of monopolistic strongholds in previously competitive markets; it also failed to provide much guidance as to how, as a matter of law, merger analysis should be implemented in future cases. As stated by the Federal Court of Appeal, "this Court should not prescribe the "correct" methodology for determining the extent of the anti-competitive effects of a merger. Such a task is beyond the limits of the Court's competence." Unfortunately, the Federal Court of Appeal failed to recognize that the task undertaken by the Tribunal in the *Propane Decision* seems to be outside the competence of <u>any</u> antitrust regulator or tribunal.

Conclusion

The fundamental errors underlying the *Propane Decision* have for the most part little to do with the total surplus standard, which the Tribunal found to apply in merger cases under Canadian law. Simply put, the Tribunal got its calculations wrong, and even under the total surplus standard the *Propane Decision* should not stand.

Yet the total surplus standard is not a good judicial standard. Generally speaking, no court can calculate true total surplus consequences of a complex transaction; hence this desirable standard is impossible to apply. While a total welfare standard has in one form or another been advocated for more than a century, rooted in utilitarian analysis and the old Chicago School tradition, it has never materialized to become a workable guiding policy or rule because it is virtually impossible to measure all consequences of economic actions. This problem is largely avoided where the legal standard applied to a merger is the "substantial lessening of competition" test. It is also avoided where a merger can be approved based on the efficiencies it generates provided the efficiencies are passed on to consumers. This good requirement has two major benefits. Firstly, it implicitly requires a post-merger competitive market, because - generally speaking - only (actual or potential) competition can guaranty that savings generated through a merger will in fact be passed on to consumers. Secondly, it limits the calculations to those savings and to other efficiencies resulting from a merger that are in fact expected to pass on to consumers – a more manageable approach indeed.

One may question whether Canadian law mandates the total surplus standard in the manner applied by the Tribunal. There seem to be two issues here. The first: are distributional considerations included in the objectives of the Act, i.e., can the Tribunal, for example, approve a noncompetitive merger simply because it has "positive" distributional consequences. I think the answer to this question is clearly negative. The second: is the Act neutral to the inevitable distributional consequences that arise from a merger into monopoly? A negative reply to the first question does not necessarily imply a positive reply to the second. Subsection 96(3) of the Act provides that "For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons." It flows from the section that one may not rely on wealth transfers as the sole justification for a noncompetitive merger ("by reason only of a redistribution of income . . ."), but this does not necessarily imply that redistribution of income brought about through the use (or abuse) of market power is completely outside the scope of merger analysis. Nor is it, in my opinion, a license for the Tribunal to create monopolies that can induce transfers of consumer surplus through the exercise of market power – monopolies the creation of which is so clearly harmful to their consumers and so counterintuitive to the most basic goals of competition laws worldwide.

Efficiency analysis engages the attention of competition agencies in many countries and efficiency defense in merger cases is widely discussed and in some jurisdictions actively applied. The position taken by the Tribunal and the Federal Court of Appeal deviates considerably from the application of the efficiency defense in other jurisdictions, in my opinion not for the better. All agree that competition rests in the heart of the Act,[7] yet the Tribunal reached a result more remote than any other from the term "competitive economy," and the Federal Court of Appeal did not move to prevent it: a monopoly holding market power, in a market typified by low cross

elasticity of demand and supply, very high barriers to entry and inability to significantly reduce consumption following a considerable increase in price.

As noted above, I think the Tribunal reached, and the Federal Court of Appeal left the door wide open to, an impossible conclusion: that a merger into a non-natural monopoly of two competing firms has superior long-term consequences compared with the state of competition that preceded the merger. This conclusion was based on calculations that in many respects are incorrect. A more modest and cautious approach is clearly required here, which even now can be applied by the Tribunal: "If there are efficiencies, they should be taken into account in close cases (and not when the merger leads to monopoly or near-monopoly), at least where proof of those efficiencies is relatively clear, the benefits are likely to be passed on to consumers, and the efficiencies cannot be achieved in a substantially less anti-competitive way."[8]

Notes

[1] Dr. David E. Tadmor is the former General Director of the Israel Antitrust Authority ("IAA"); he left the IAA in 2001 after four years in office and is currently a senior partner at the law firm of Caspi & Co. in Israel. The author wishes to thank Mr. Menachem Perlman, Chief Economist and Deputy General Director at the IAA, and Dr. Barak Orbach of Cleary, Gottlieb, Steen and Hamilton in New York City, for their useful advice and comments. Comments and questions to the author can be sent to *david@tadmor.cc*.

[2] *Canada (Commissioner of Competition)* v. *Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 [hereinafter the *Propane Decision*].

[3] *Canada (Commissioner of Competition)* v. *Superior Propane Inc.* (2001), 11 C.P.R. (4th) 289 [hereinafter the *Appeal Decision*].

[4] Other exceptions to the general rule stated above may exist, particularly in highly innovative technology markets, but those have no relevance to the *Propane Decision*.

[5] It did so despite its own analysis; see paragraph 376 of the *Propane Decision*.

[6] Those objectives, set forth in section 1.1, are "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...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 Federal Court of Appeal agreed that the objectives of the Act are more "economic" than "legal" in nature, but emphasized that higher prices, which consumers will have to pay as a result of the merger, or the impact of the merger on small and medium businesses, fall well within the "economic" nature of the Act. The Court further recognized that not all of the objectives set forth in 1.1 can necessarily be served at the same time.

[7] Section 1.1 states that the purpose of the Act is to "maintain and encourage competition in Canada." The Tribunal agreed: "The Act seeks to obtain the benefits of a competitive economy," as well as "competitive consumer prices and product choices"; it noted that "[t]he true goal specified in the purpose clause is the maintenance and encouragement of competition."

[8] R. Pitofsky, "EU and U.S. Approaches to International Mergers — Views from the U.S. Federal Trade Commission" (Address to the EC Merger Control 10th Anniversary Conference, Brussels, Belgium, 14-15 September 2000).