

CANADIAN COMPETITION RECORD

COMMENT AND ANALYSIS**STALLED ON TAKE-OFF: COMMISSIONER OF COMPETITION
v. AIR CANADA - A COMMENT**

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Background

The *Air Canada* case¹ started with the filing of an application by the Commissioner before the Tribunal on March 5, 2001, and Phase I of the case concluded² with the Tribunal's decision on July 22, 2003. That is, the case began well before September 11, 2001, and Phase I ended while Air Canada was in bankruptcy protection. In between those two events other significant matters affecting the airline industry, including the Iraq war and the SARS crisis, also intervened. And the case thus far represents only Phase I of the abuse of dominance proceeding, Phase II of which may or may not ultimately be pursued against Air Canada. Even Phase I, however, before any appeal, has thus far traversed more than two and a half years and many significant developments in the airline business.

Phase I of the case dealt with whether or not Air Canada had engaged in pricing below avoidable cost. That is an input to the larger question (to be addressed in Phase II) as to whether it engaged in abuse of dominant position under the newly enacted *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service* (the "Airline Regulations").³ In fact, however, because the time period during which Air Canada was alleged to have engaged in such acts straddled the coming into force of those Regulations, the Tribunal proceeded on the basis that activity prior to the coming into force of the Airline Regulations would be evaluated using the previous provisions of Sections 78 and 79 of the Act.

Procedure and Answers to Questions

The application was brought in respect of seven different routes⁴ which Air Canada flew in Eastern Canada, and which were experiencing competition from either WestJet or CanJet. Two such routes (Toronto – Moncton and Montreal – Halifax) were selected as test routes for Phase I.

Rather than dealing with the entire question of abuse of dominance, on consent, Phase I of the hearing dealt only with the question of whether or not Air Canada had been operating below avoidable cost in respect of flights on the two routes.

The four questions agreed by the parties to be addressed by the Tribunal in Phase I of the hearing were, with respect to the two routes in question and for the period between April 1, 2000 and March 5, 2001:

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1. What was the appropriate unit or units of capacity to examine?
2. What categories of costs are avoidable and when do they become avoidable?
3. What is the appropriate time period or periods to examine?
4. What, if any, recognition should be given to “beyond contribution”?

Not to keep readers in suspense, the answers were:

1. The unit of capacity is the schedule flight.
2. The categories of costs that are avoidable are those discussed [in the reasons] beginning at paragraph 197; the avoidable costs so found are avoidable from the outset by virtue of shedding, redeployment or disposal.
3. One month is an appropriate period of time to examine.
4. No recognition should be given to “beyond contribution”.

Phase II of the hearing, if it is reached, will deal with whether or not anticompetitive acts (that is, pricing below avoidable cost) occurred on the other five routes in question, and will address, for all seven routes, the question of control of a relevant market under section 79(1)(a); the question of whether there was a practice of anticompetitive acts; the question of whether the acts were entered into with the necessary purpose under the *Competition Act* (with an eye to legitimate business justifications in that regard); and, finally, will address the question of whether the practice of anticompetitive acts, if indeed engaged in with the appropriate purpose, has or is likely to result in a substantial prevention or lessening of competition. That is, Phase II will contain, if anything, a lot more meat than Phase I.

Given that the Phase I hearing lasted for 40 hearing days and involved almost 500 exhibits, one can understand the desire to set some of the ground rules with respect to the determination of avoidable costs before marshalling the evidence with respect to the other issues, and with respect to all of the routes which were the subject of the proceeding. Nevertheless, given the passage of significant time, it now appears that there is serious doubt as to whether Phase II will ever proceed or, if it does, whether any decision rendered at the end of Phase II will be meaningful, given the ongoing industry changes.

There is always a healthy tension in *Competition Act* proceedings between expedition and thoroughness, but this tension was exacerbated in this case because of the marketplace events noted above, which not only delayed the proceeding but which appear to have altered the foundations of the airline industry in Canada.

In addition to the changed conditions which now exist, it may also be that the period selected by the Commissioner to examine (April 1, 2000 – March 5, 2001) may not be representative of anything. Air Canada, we now know, was on a steep descent into insolvency. In such circumstances, it is not clear what sort of meaningful “predation”

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conclusion one could ever reach. Air Canada was losing a great deal of money, presumably over many of its routes. That may be poor management, but it does not sound to us like classic predation.

As well, at the time of writing Air Canada's restructuring process under the CCAA was still ongoing. A restructured Air Canada may be sufficiently different from the previous entity, and a forward looking order relating to abuse of dominance may have little practical effect. Imposing some sort of penalty on the fundamentally different and virtually insolvent carrier which emerges may not be particularly useful to the health of the airline industry, or to competition.

The Airline Regulations

The Commissioner's application relied in part on the newly enacted section 78(1)(j) of the *Competition Act*, which came into force on July 5, 2000. It provides that one of the enumerated anticompetitive acts in section 78 is:

acts or conduct of a person operating a domestic service, as defined in subsection 55(1) of the *Canada Transportation Act* [that is, a dominant airline] that are specified under paragraph [78]2(a).

Section 78(2)(a) allows for regulation-making power to define a list of such acts.

On August 23, 2000, the regulation permitted by section 78(2)(a) was enacted to provide that the list of anti-competitive acts includes:

(a) operating capacity on a route or routes at fares that do not cover the avoidable cost of providing the service; and (b) increasing capacity on a route or routes at fares that do not cover the avoidable cost of providing the service.

That is, these two types of conduct, as specified by section 78 of the *Competition Act* and the Airline Regulations, define specific anticompetitive acts. Unlike all of the other anticompetitive acts previously listed in section 78, these do not have a stated purpose or object. Of the nine listed anticompetitive acts in section 78 prior to this amendment, four are explicitly stated to be "for the purpose" of in some way impeding, disciplining, eliminating or preventing a competitor or potential competitor; one is stated to be "to discipline or eliminate a competitor"; one is stated to be "to prevent his entry..."; two are stated to be "with the object of" in some way forestalling a competitor; and one is stated to be "to prevent the erosion of existing price levels". That is, all but one of them are for a purpose aimed at a competitor, and all contain within them a stated purpose.

At its heart then, the Phase I proceeding was an exercise in legislative interpretation. Whether or not the Airline Regulations, as part of the scheme of Sections 78/79, make sense, either within the doctrine of abuse of dominance/monopolization or within the doctrine of price predation as it has come to be understood, the Tribunal was faced with a statutory provision which it had to interpret.

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Both parties asked the Tribunal to apply the avoidable cost test, with some consideration of legitimate business justification, to the conduct both before and after the enactment of the Airline Regulations. However, they did so for somewhat different reasons. The Commissioner argued that the conduct of pricing below avoidable cost, as articulated in the newly enacted provisions of section 78, does not, as the other provisions of section 78(1) do, expressly require a showing of anticompetitive purpose. Nevertheless, since the other examples do require that purpose, the Commissioner argued that it was appropriate to conclude that Parliament intended the Airline Regulations to indicate that there is an anti-competitive or predatory purpose (“an anti-competitive purpose is inferred”) whenever a dominant carrier operates below avoidable cost, but subject to the possibility of arguing that there is a legitimate business justification⁵. By contrast, while Air Canada also argued that the test should be the same both before and after the coming into force of the Regulations, it argued that even after the coming into force of the Airline Regulations it is necessary for the Tribunal to interpret the provisions consistently with the principles previously established with respect to the abuse of dominance and predatory pricing provisions, such that even though an anticompetitive purpose is not specified within the provisions, it must be effectively read into those provisions by the Tribunal.

The Tribunal rejected both arguments. It stated that most of the anticompetitive acts found listed in section 78(1)

require an “object”, “design” or “intent” to engage in an exclusionary conduct that is having the effect of augmenting, entrenching or extending market power. The presence of such wording [as noted above] made relevant the concept of legitimate business justification in past Tribunal jurisprudence. However, the Tribunal observes that no such intention is expressly stated in paragraph 78(1)(j) of the Act. In the Tribunal’s view the wording of paragraph 78(1)(j) is clear: once the party fails the avoidable cost test, its conduct constitutes an anticompetitive act.⁶

The Tribunal went on to note that evidence of a legitimate business justification would be relevant, therefore, for the period from April 1, 2000 to August 23, 2000, before section 78(1)(j) of the Act came into force due to the coming into force of the Airline Regulations. After that time, the Tribunal found that no consideration of legitimate business justification could be involved in determining whether anticompetitive acts occurred. It then stated, although without any convincing analysis, that “the Tribunal may, however, consider legitimate justification, among other elements, when determining whether a “practice” of anti-competitive acts has occurred pursuant to s. 79 of the Act”.⁷

That is, the Tribunal seems, at least for the purpose of section 78(1)(j) (and presumably (k)), to be of the view that despite the fact that Parliament (or indeed more properly the Governor-in-Council, since these provisions were established by regulation) did not include a purpose element in the drafting of the provision, nevertheless it is appropriate that there be an anti-competitive purpose, albeit not for there to be an anti-competitive act (as the previous jurisprudence has found), but rather for there to be a practice of anti-competitive acts.

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It seems to us that this conclusion lacks any significant logical justification. Our view is that it is appropriate as a matter of antitrust policy to require that there be an anti-competitive purpose of some sort in a monopolization case. That is, there should and logically must be a place for the consideration of legitimate business justifications. Nevertheless, the logic of including the question of anti-competitive purpose in the practice component of the test escapes us. In truth, it would appear that the drafters of the regulation seem to have erred in its construction. The Tribunal, left with this difficulty, seems to have attempted to remedy it, but the remedy is to our way of thinking unconvincing.

The Avoidable Cost Test

A great deal of the decision is absorbed in seeking to classify types of costs as avoidable or not avoidable. The underlying economic issues are explored in detail in a comparison piece in this issue⁸, but recognizing our comparative disadvantage we do not presume to comment on those issues in detail. The Tribunal determined, as a matter of principle, that the definition of avoidable cost to be used for the purpose of the avoidable cost test under the Airline Regulations is the following:

All costs that can be avoided by not producing the good or service in question. In general, the avoidable cost of offering a service will consist of the variable costs and the product-specific fixed costs that are not sunk.⁹

To us, this statement, while unobjectionable in its circularity, seems to not much advance the debate.

The Tribunal noted that the avoidable cost test does not require a comparison of an incumbent's cost with those of an entrant or potential entrant, nor does it require an assumption that the specific entrant or potential entrant is at least as efficient as the named incumbent. The avoidable cost test compares the incumbent's revenue (price) with its (average) avoidable cost. As long as the former exceeds the latter, any equally-efficient entrant will be able to remain in the marketplace and compete. We note, however, that at such prices an equally efficient competitor will not be able to enter, without foregoing the hope of recouping sunk costs. More efficient rivals will, however, be able to enter. When the incumbent's revenue (price) is below its (average) avoidable cost, then, subject to other concerns, the Tribunal found that it may be inferred that the incumbent is engaged in predatory pricing.¹⁰

Examination of the Costs

It takes an entire page of the Tribunal's decision to list the types of costs that were involved in its analysis. These categories included:

Passenger Expenses
Passenger Commissions
Passenger Acquisition
Food & Supplies
Passenger Insurance

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Aeroplan Charges (including Aeroplan Liability)

Other Passenger Expenses (including Inflight Magazines, Maple Leaf Lounges, Passenger Communications)

Traffic Expenses

Airport Passenger Servicing Labour

Reservation Direct Labour

Cargo Commissions

City Ticketing Direct Labour

Other Traffic Expenses (including Airport Security, Flight Delays, Inflight Entertainment, Revenue Accounting, Cargo Accounting, Cargo Communication, Cargo Loss & Damages)

Capacity Flying

Flight Crew Labour

Flight Crew Cycle

Cabin Crew Labour

Cabin Crew Cycle

Fuel & Oil

Fuel Handling

Maintenance Labour

Maintenance Material

Navigation Fees

Capacity Ground

Passenger Aircraft Servicing Labour

Cargo Aircraft Servicing Labour

Passenger Purchased Terminal Handling

Cargo Purchased Terminal Handling

Commissary Handling

General Terminal Assessments

Landing Fees

Maintenance Labour

Maintenance Material

Other Cargo Expenses (including Cargo Sales Labour, Cargo Trucking, Cargo Pick-up & Delivery)

The parties were in agreement that certain cost items, such as fuel, oil, food and supplies, passenger commissions, passenger acquisition, costs, Aeroplan charges, passenger insurance, cargo commissions, and things of that nature were fully avoidable. They were also in agreement that overhead charges were not avoidable costs. Nevertheless, they remained at odds over some 26 disputed categories of costs.

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Perhaps unavoidably¹¹, the Tribunal's review of the disputed costs was painstaking in its detail and, less unavoidably, in its recapitulation in the reasons. The Tribunal seems to have had some level of frustration with both parties' approaches to these costs, but particularly the Respondents' approach, which varied from its internal memoranda and accounting practices. It is submitted, however, that this should not be a surprise. Costs are characterized and allocated for various reasons in an operating company, but seldom if ever for the purpose of determining whether it is engaged in predatory pricing.

Much of the dispute between the parties turned on whether there really was the ability to save labour costs if a flight were cancelled, in areas such as ticket counters, the baggage handling area, the staff at the Aeroplan Centre and the like. At some point, a lower level of business will mean lower costs in these areas because the airline will need fewer people, but just when that will occur, and how many schedule flights need to be cancelled for there to be a savings, is a devilishly difficult question in practice.

Many of the labour costs (Aeroplan Centre reservation, customer service agents, ticketing, accounting, finance agents, etc.) were argued by Air Canada to be non-avoidable, and found by the Tribunal to be avoidable "mainly through redeployment through passenger recapture". That is, the Tribunal accepted the argument that these people would not have to be laid off, but rather be redeployed, and that the passengers lost on flights on the challenged routes (assuming those flights had been cancelled) would be largely recaptured on other flights or other Air Canada routes, and so the same labour force or roughly the same base labour force would be needed. This is essentially a factual finding, with respect to which we can offer no useful comment.

The fact that this information is so specific to a particular industry, and indeed a particular company, however, is some argument that while the conceptual issue should be articulated by the Tribunal in its reasons, the details of the particular costs need not be so fulsomely explored for the purpose of creating jurisprudence.

While we do not seek to engage in a detailed review of the Tribunal's analysis of particular costs, we note that in some respects the analysis appears to have been approached in a way which suggests a lack of realism. For instance, while the Tribunal appears to recognize that to some degree Air Canada's labour costs were fixed by collective agreements and the like, it stated that: "The payment of overtime also indicates the avoidability of some labour costs"¹². With respect, to imagine that one could reduce labour costs by eliminating all overtime is somewhat unrealistic. Overtime to add new flights is avoidable, but the general flexibility which overtime offers will be required to run a business, particularly a business employing a unionized workforce, even in times of reduced demand for labour.

On the other hand, the Tribunal noted, in our view, persuasively, that since Air Canada commenced new routes or increased service on a large number (approximately 90) routes during the period under investigation, it is reasonable to assume that some of the costs associated with the routes subject to the inquiry could have been transferred to these new routes without the necessity of lay-offs or other significantly disruptive events.

More importantly for the general rule, however, the difficulty which the Tribunal had in categorizing costs (after days and days and days of expert testimony) is, in our view, some evidence that care should be taken in

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asserting the avoidability of such costs and finding predation based on such a conclusion, when the evidence may be that the predator itself might not believe the costs were avoidable. To us, it seems a peculiar conclusion that a firm should be found to have engaged in predation, and perhaps abused a dominant position, on the basis of an ex-post-facto accounting analysis by the Tribunal, when in fact it honestly may have believed that continuing to produce the product (fly the flight) was contributing to its bottom line, particularly in view of Air Canada's status as a network carrier. Indeed, if the case is really that close to call, a conclusion of predation seems an odd outcome.

Air Canada argued that certain costs which it incurred could not be avoided because it was subject to inflexible contracts or other constraints which did not permit it to reduce those costs, even though those costs might have been possible to eliminate for another carrier. The Commissioner challenged this, arguing that it was "no defense" for the incumbent to claim that its avoidable costs are higher as a result of contracts and constraints of its own creation¹³.

In our view, the Commissioner's argument in this regard somewhat misses the logical mark. Unless one were arguing that Air Canada has changed what would otherwise be avoidable costs into unavoidable ones for the purpose of defeating an antitrust challenge, then arguing that Air Canada has planned poorly but that that is not a defense may be a compelling point of rhetoric, but not of logic. Effectively, it presumes that the Commissioner or the Tribunal, or some other body, is better able to see or determine what costs should be avoidable and what contracts should or should not be entered into – what flexibility should or should not be maintained by the carrier – than is the carrier itself. Assuming these costs are not made inflexible for the purpose of avoiding an antitrust challenge – a reasonably safe assumption, we assert – then presumably Air Canada has sought to maintain the greatest possible flexibility consistent with other important goals, such as maintaining labour peace, achieving government approval of certain activities and the like. That it has costs which it cannot "get out of" is a result of it trying to run the airline as efficiently as it could. Perhaps with the benefit of hindsight it is clear that some such decisions were not particularly wise, but to start second guessing those decisions, we submit, would inevitably put the Tribunal in the unenviable position of second guessing virtually all business decisions made. The Tribunal does not appear to have accepted this argument advanced by the Commissioner, which we think is wise. To have done so would have been to accept that the Commissioner can run an airline better than can Air Canada.

Unit of Capacity – A Schedule Flight

The parties disagreed as to the unit of capacity to examine. The Commissioner argued that the schedule flight (for instance, the 9 am one way flight from Toronto to Ottawa) is the appropriate unit of capacity to examine to determine if revenue is above or below avoidable cost. It suggested that the flight should be examined in monthly increments over a period of three or four months, to see if it was operating below avoidable cost for a number of consecutive months. If so, the Commissioner argued that this should constitute an anti-competitive act. Air Canada, by contrast, argued that the route (for instance, all flights from Toronto to Ottawa and back)

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was the appropriate unit of capacity, and that the appropriate time period to examine was over approximately a one year period.

The Tribunal noted that:

The Airline Regulations do not specify a time period for the anti-competitive act. Accordingly, a dominant air carrier commits what is deemed to be an anti-competitive act if, at any time, it operates or increases capacity at fares that do not cover the avoidable cost of providing the service. This suggests that when capacity is operated or increased, each announced fare might be compared with the expected avoidable cost of serving a passenger in that fare class. This avoidable cost test would be applied at the level of the individual seat on an aircraft and would require a separate test for predation on the same individual flight offered at different fares.¹⁴

That – a single seat, or perhaps fare class, – would be the smallest unit of capacity which one might conceivably examine under the avoidable cost test. However, none of the parties favoured that approach. The Commissioner argued that the right unit of capacity was “the uni-directional schedule flight”. Air Canada argued that the appropriate unit of capacity was a city pair route. Air Canada’s argument was based primarily on the wording of the Airline Regulations, which refers to operating capacity on a route or routes.

Ultimately, the Tribunal concluded that the evidence in support of the possibility of predatory conduct at the level of the schedule flight militated in favour of the schedule flight being the relevant unit of capacity. That is, because a new entrant would likely come in with only one, or a few, flights per day to a destination, and Air Canada could meet that threat by dropping prices only on its similarly timed schedule flights. The Tribunal therefore concluded that operating a schedule flight below avoidable cost was an anti-competitive act pursuant to the Airline Regulations, because if one were to examine the question merely at the route level there would be a risk of obscuring predation at the schedule flight level and the dominant carrier might thereby effectively drive the entrant out by pricing below avoidable cost on some flights but above avoidable cost on the route as a whole.

Time Over Which Costs are Avoidable/Time Over Which to Consider Predation

When examining the time period over which the Tribunal must find that operating flights below avoidable cost has occurred, the Commissioner argued that three consecutive one month periods should be examined¹⁵, apparently on the basis that information was available for Air Canada’s systems on a monthly basis and that most of Air Canada’s costs are avoidable within a three month period. Therefore, if Air Canada chose to operate a schedule flight for three consecutive one month periods below avoidable costs, it thereby chose not to avoid those costs it could have avoided by cancelling the flight, and thereby committed an anti-competitive act. Air Canada was, apparently, more vague on the issue, suggesting that roughly a year’s period was more appropriate, having a regard to the fact that demand for flights went up and down over the seasons.

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In considering the question of the relevant time during which a dominant carrier operates capacity at fares below avoidable cost, the Tribunal, rather remarkably, said the following:

The language of the Airline Regulations make it clear that a dominant air carrier commits what is deemed it to be an anti-competitive act when it operates capacity on a route or routes at fares that do not cover the avoidable cost of providing the service. These regulations were developed and put into the Act with the knowledge of the industry conditions and practices and they do not specify a time period for defining what constitutes an anti-competitive act. Accordingly, whenever the dominant carrier operates capacity at fares below avoidable costs of providing the service, it commits an anti-competitive act.

It is, of course, the Commissioner's role to enforce the Airline Regulations and, accordingly, it is the Commissioner's obligation to indicate when fares were below avoidable costs when he alleges that an anti-competitive act or acts occurred during some period in the past. Whether it is three months, one month, one day or one flight departure on a given day, that time period will be the relevant one under the Airline Regulations.¹⁶

With respect, perhaps the Tribunal is correct that, given the wording of the Airline Regulations, any operation, even of a single flight, at fares below its avoidable costs constitutes an anti-competitive act. If so, that points out the bizarre nature of such regulations. However, we cannot think that it is appropriate that it is the Commissioner and only the Commissioner who may define a relevant period. We cannot think that that was the intention of drafters of the Airline Regulations or of the Act.

The relevant period examined, if it is to be meaningful, has to be long enough for the airline to find out that it is operating below avoidable costs and to make a rational decision to make adjustments if indeed that is the logical conclusion to be reached. That must be the minimum period one could select. And surely, that will turn on the facts of the particular case. If a flight is taking off every day for a week with only three seats filled, or every seat filled at a fare of ten dollars, presumably it does not take the airline very long to figure out that it is losing money every time it takes off, and that cancelling the flight, even if it cannot save any labour costs, puts it to the good. We presume, however, that most cases are not so clear; that it takes time to gather information; that it takes time to figure out, in response to new lower priced entry, what the new equilibrium is as to passenger load and fares. Any law or enforcement policy which concludes that anti-competitive conduct is occurring before the airline can reasonably make that assessment, and then compare its revenues to its costs which may be avoided if it reduces capacity, serves very little useful purpose.

In addition to this problem regarding timing, there is also the issue identified by Air Canada that airlines often lose money in low season but make money in high season, and a rational analysis of predation needs to take this into account.

The Tribunal's consideration of this point is made clear, and we believe our objection to it is made clear, by the statement:

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Accordingly, it is an anti-competitive act to operate below avoidable costs in low season. However, the Commissioner has the discretion not to file an application when he determines that the only reason for fares below avoidable costs is seasonality.¹⁷

As well, the Tribunal stated:

...since, in the Tribunal's view, the Airline Regulations permit the Commissioner to conduct the avoidable cost test over a three-month period, the Tribunal accepts that the three-month period suggested by the Commissioner might be appropriate. However, there is no reason for the Tribunal to make a ruling on this question as the Airline Regulations do not specify any time period. This question will be dealt with in Phase II of this hearing when determining if the anti-competitive act or acts constitute a practice pursuant to section 79 of the *Act*.¹⁸

In that latter regard we agree with the Tribunal, insofar as its statement suggests that the relevant time period will depend upon the circumstances applicable. We find it challenging to accept, however, that the Commissioner – a party to the dispute – should be able to unilaterally define the time period which is relevant, and thereby, effectively, create anti-competitive acts, and that the Tribunal is simply left with the question of whether there is a practice to determine a relevant time period in all of the circumstances. The “practice” requirement is now, given this decision of the Tribunal, being weighted with the burden of determining the relevant time period in respect of the particular allegations, (a burden to which it has some logical connection), and also with the burden of determining the question of purpose or legitimate business justification (a matter largely divorced from the concept of a practice).

Beyond Contribution

Beyond contribution is the term used in the airline industry to reflect the revenues obtained from passengers who are brought in on the first leg of a journey on one route, and then continue a second leg on another route, also with the same carrier. The theory is that the passenger would not have flown the second leg with Air Canada if Air Canada had not been able to bring them in to the departure airport for the second leg by operating the first leg, perhaps at a loss. Insofar as the second leg standing alone is profitable, if the first leg was necessary to earn the revenue on the second leg and the first leg is not profitable, in theory there should be some recognition that the first leg was not engaged in for any predatory purpose but rather to make it possible to earn the revenues on the second leg.

In considering this matter of beyond contribution, the Tribunal reached what seems to us to be two different, and to some degree contradictory, conclusions. It found that the revenue of continuing passengers which Air Canada attributes to subsequent legs should in theory be included, once appropriate allowances are made for other matters (such as whether or not the first leg was necessary to put the passengers on the second leg, and whether those passengers displace other passengers and the like), but that in the particular case the burden is on

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Air Canada to prove these matters and it had not. It also apparently found that if it can be properly estimated, beyond contribution could be considered as a legitimate business reason for operating a scheduled flight below avoidable cost, but is not to be included in the calculations of the avoidable cost test. That is, at least at first blush the Tribunal appears to have recognized that beyond contribution could be considered revenue from the flight in determining whether or not the flight is operating above or below avoidable cost. However, the Tribunal also noted that beyond contribution would not be a matter to be included in proving or disproving the anti-competitive act, but rather was to be considered as a legitimate business justification which, as noted above, goes only to the issue of "practice".

To our way of thinking, assuming the difficulties regarding the proof could be addressed satisfactorily, it would be appropriate to attribute some revenue to the first leg if the total fare for two or more legs of the flight would be lost if the first leg were not available. If strict proof of the details necessary for that were not available, then in our view, it might still be appropriate to conclude that beyond contribution represents a legitimate business justification, even if it could not be precisely quantified. Insofar as that is what the Tribunal was alluding to in its reasons¹⁹, we are in sympathy with that approach, but from the reasons we are not confident that this was the Tribunal's position.

Legitimate Business Justification and Predatory Intent

In its conclusion, the Tribunal determined that it could consider legitimate business justifications with respect to whether anti-competitive acts were committed before the coming into force of the Airline Regulations (because, prior to that time, the relevant anti-competitive acts required, as an element, an anti-competitive intent), but thereafter, because of the wording of the Airline Regulations, intent and legitimate business justification become irrelevant to the question of anti-competitive acts. It noted that Air Canada did not expressly present evidence with respect to such justification. Presumably the Tribunal did not conclude that Air Canada's detailed evidence and arguments with respect to the difficulty in knowing what its variable costs were, the challenge of responding in a timely fashion should those costs exceed revenue, the issue of beyond contribution or the impacts of cancelling flights on the network as a whole, were legitimate business justifications for its conduct, even though evidence on these matters, whether one calls them business justifications or not, seems from the decision of the Tribunal to have constituted the heart of the disputed matters before the Tribunal.

Thus, for the period of time prior to the enactment of the Airline Regulations, while evidence of a legitimate business justification was relevant to the determination to be made, the Tribunal found that none was adduced. Regarding the period of time after the coming into effect of the Airline Regulations, the Tribunal found that "no consideration of legitimate business justification can be given when determining whether anticompetitive acts as defined therein have occurred." This was because of the peculiar wording of the Airline Regulations which makes no reference to an anti-competitive purpose. The Tribunal went on to state that it may consider legitimate business justification along with other elements when determining whether a "practice" of anticompetitive acts has occurred pursuant to Section 79 of the *Competition Act*.

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A Brief Comparison to Recent U.S. Jurisprudence

The Tenth Circuit Court of Appeals²⁰ recently ruled on a price predation case involving American Airlines (“AMR”). The Court rendered its decision in approximately thirty paragraphs. The AMR case involved a predation claim against AMR based on its response to the entry of low cost carriers operating from its hub at Dallas/Ft. Worth.

The Department of Justice brought the suit alleging monopolization and attempted monopolization through predatory pricing. AMR was alleged to have engaged in multiple episodes of price predation in four city-pair airline markets, with the ultimate purpose of using the reputation for predatory pricing it earned in order to defend a monopoly at its Dallas/Ft. Worth International Airport hub. The Government’s complaint alleged that AMR: (1) priced its product on the routes in question below cost; and (2) intended to recoup these losses by charging supra-competitive prices either on the four core routes themselves, or on those routes where it stood to exclude competition by means of its reputation for predation.

The District Court granted summary judgment in favour of AMR, finding that the Government did not demonstrate the existence of a genuine issue of material fact as to either of these allegations. The Government appealed.

The Court of Appeal found that AMR responded to competition from low cost carriers (LCCs) with changes in: (1) pricing (matching LCC prices); (2) capacity; and (3) yield management, on four of its routes. The effect of AMR’s increased capacity and lower fares was that the competing LCCs failed to establish a presence, moved their operations, or ceased their separate existence entirely. Once the LCC ceased or moved operations, AMR generally resumed its prior marketing strategy.

The Court of Appeal reviewed the grant of summary judgment *de novo*, applying the same legal standard used by the District Court. The crux of the Government’s argument was that the incremental revenues and costs specifically associated with AMR’s capacity additions demonstrated a loss, and were an attempt to monopolize the four routes in question and deter future potential competitors.

There are two prerequisites to recovery on a predatory pricing claim in U.S. jurisprudence: (1) the prices complained of are below an appropriate measure of costs; and (2) a demonstration that the predation had a dangerous probability of recouping its investment in below-cost prices, without which competition is unharmed.

For predatory pricing cases, the American jurisprudence provides that the ideal measure of costs is marginal cost, because as long as the firm’s prices exceed its marginal costs, each additional sale decreases losses or increases profits. Although average variable cost (AVC) is a good proxy for marginal cost in most cases, there may be times when courts need the flexibility to examine both AVC as well as other proxies for marginal cost in order to evaluate an alleged predatory pricing scheme.

In the AMR case, the Government did not present evidence of its own creation as to the costs AMR experienced in adding capacity. Rather, it drew various cost analyses from AMR’s internal tracking systems. In doing so, it

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presented four different analyses of what it asserted to be the incremental costs experienced by AMR in adding capacity on the routes in question. It chose these four because they were, to a greater or lesser extent, available from AMR systems, and in the Government's submission the multiplicity of approaches acted as a cross-check on the conclusion of the Court.

In examining the construction of these cost tests, the Court concluded that they were not good proxies for marginal or incremental costs. It concluded that two of the tests used by the Government included both incremental and fixed costs. The other two tests treated as costs aspects of profit which the airline chose to forego in order to add the capacity – as did the Competition Tribunal in the *Air Canada* case. Since none of the cost comparisons offered by the Government was an acceptable proxy for marginal costs, the Government's case was rejected by the Court of Appeal.

More interesting for our purposes than the specific reasoning on the cost tests in issue was the attitude which the Court applied to the Government's allegations. The case was dealt with on summary judgment motion by AMR, so all of the factual assumptions favoured the Government. Nevertheless, the Court rejected the Government's case on the basis of the cost test. While the excruciating detail as to the costs examined which is provided by the Tribunal in the *Air Canada* case is not available in the AMR case, from that which is available, it appears the U.S. Court was much less inclined to view AMR's costs as incremental than the Tribunal appears to have been to view many of Air Canada's costs as avoidable. The different approach is particularly noticeable with respect to the treatment of forgone profitability, or opportunity cost as a measure of cost for the purposes of determining predation. As a general rule, we think it would be fair to say that the AMR case proceeded on the basis of fundamental skepticism respecting the Government's allegations of predation, recognizing that a false positive finding of predation discourages low prices; whereas the case before the Tribunal appears to have proceeded on the basis of fairly robust skepticism by the Tribunal of Air Canada's position as to the avoidability of its costs. Some of that skepticism may have been earned by Air Canada, given hints found in the decision, but nevertheless the difference in approach seems to have resulted in the difference in outcome – and one which discourages dominant airlines from lowering their prices.

Some Preliminary Comments

It is reasonably clear from the AMR case that successful predatory pricing cases in the United States will continue to be difficult to make out. This accords with the belief that such behaviour is rare and the danger of "false positives" must be kept in mind in order to minimize harm to consumers.

Given the Canadian law set out in the Airline Regulations, and the Tribunal's decision in the *Air Canada* case, and in particular the Tribunal's willingness to find most costs avoidable via redeployment, and its classification of foregone profit or opportunity costs as true costs, it appears to us that predatory pricing allegations, at least involving airlines, will be much more likely to succeed in this country. The Tribunal found that most of Air Canada's costs were avoidable over a relatively short period of time, which will militate in favour of finding predation.

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With the benefit of some hindsight, it is easy to speculate that almost any change in schedule flights that Air Canada made in the period prior to its reorganization might have trouble standing up to the scrutiny of the avoidable cost test set out by the Tribunal. Indeed, even schedule flights which did not involve any change might have done so. After all, Air Canada was on its way into bankruptcy. But it seems to us that that is a peculiar basis upon which to reach a conclusion of price predation.

Even leaving the peculiar circumstances of Air Canada's insolvency aside, insofar as an anticompetitive act will be found to have occurred regardless of the reasonable business justification, if any, for the conduct, and over any period of time that the Commissioner chooses to define, that seems to us to be inappropriate. As well, rejecting the possibility that beyond contribution would permit a flight to operate above avoidable costs militates in favour of a finding that anticompetitive acts have occurred.

Part of the problem in this case seems to be that, given the Airline Regulations, Air Canada is likely to be found to be engaging in an anticompetitive act on every route it operates against a new entrant. Assuming, for the moment, that prior to the entry of the new competitor it was making money on the flight or route (a questionable assumption at best in these times), as soon as there is entry by a low cost competitor, Air Canada must reduce its prices if it wants anyone to fly with it. If it does, it is quite likely that it is going to be operating below avoidable cost, as the Tribunal has defined it. If it doesn't reduce price, it is going to be flying with empty planes and, once again, operating below avoidable cost.

It would seem, therefore, that to avoid an anticompetitive act, Air Canada's only option would be to immediately withdraw from the flight or route. Yet, that is neither a realistic assumption, nor, it seems to us, a reasonable antitrust outcome. It is one thing to argue that Air Canada ought not to be able to expand output on such routes in a below cost way, or even ought not to be able to significantly undercut a new entrant, but to argue that simply deciding to stay on the route and effectively match (or even not quite match) the new entrant's fares constitutes an anticompetitive act, seems to us to be problematic. This is not necessarily a criticism of the Tribunal's decision in this case – rather it may be a problem with the new Airline Regulations, which appear to approach predation by a dominant carrier in a very heavy-handed way indeed. Of course, we will have to wait for Phase II (if it ever occurs) to determine whether or not that necessarily leads to a finding of abuse of dominance, but even a finding that Air Canada is engaged in anticompetitive acts, insofar as it simply decides not to immediately abandon a route, appears to us to be peculiar.

Another, although we acknowledge less substantive, concern with this decision, as it has been with many Tribunal decisions over the years, is simply its length. There are a relatively small number of Tribunal decisions, and we can understand why, in such circumstances, the Tribunal would consider it appropriate to offer as much guidance as it can on the occasions it has been given to offer such guidance. As well, of course, the parties provide detailed and extensive evidence and submissions, and the Tribunal seeks to do justice to what has been presented to it. While the goal is worthy, the result is very lengthy decisions, the *Air Canada* case being the most recent example. By making the decisions lengthy documents, containing a great deal of recitation of evidence and of the position of the parties, the decisions may become inaccessible to general readers, and to

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some extent the forest may be obscured by the trees. The comparison to the AMR decision in the US is striking. It is modest in length, while addressing many of the same issues and offering pithy legal insight into the reasoning which lead to its conclusions of law and fact. On the other hand, the Tribunal's decision provides voluminous repetition of the arguments outlined by the parties. This is a phenomenon which we have observed before in Canadian antitrust law, and is not peculiar to the Tribunal.²¹ As Canadian antitrust law matures, as it is now in the process of doing, we believe that shorter decisions, asserting principles, but with less emphasis on recitation of the evidence or the arguments of the parties, are likely to be helpful to that maturation.

There is also the question of timeliness of decisions. The Act must produce timely decisions in order to be effective. In retrospect, the Commissioner may wish that he had not agreed to split the case. If he had not, we might now have a final conclusion, subject to appeals. While there is undoubtedly value in the Tribunal's decision in this matter for future cases, if a case takes more than two and a half years to be less than half done, such a regime may not be very helpful to allegedly delicate new entrants.

Finally, there is also the question of whether the Tribunal could fairly be asked to establish a test which will be applicable to all airline predation. Indeed, by splitting the case, the Tribunal was asked to establish a rule applicable to routes and situations of which it had no evidence. Perhaps a schedule flight and predation over a period of one month will be appropriate for those routes – perhaps it will not. As noted in the body of the paper, we are inclined to believe that this unit of capacity and time period may well be appropriate or inappropriate, depending on the particular facts. Of course the first case under a new provision, and the first case in an industry, will tend to answer many of the questions which will arise in future cases – but to attempt, by way of a split case, to provide definitive answers to these questions which will be binding across all the routes may have been asking the Tribunal to do more than it can fairly do.

Notes

¹ *Commissioner of Competition v. Air Canada* (2003), 26 CPR (4th) 476 (Competition Tribunal).

² Subject to a self-imposed stay, pending Air Canada's anticipated emergence from creditor protection.

³ SOR/2000-324.

⁴ St. John's – Halifax Toronto/Hamilton – Fredericton
 Montreal – Halifax Toronto/Hamilton – St. John
 Ottawa – Halifax Toronto/Hamilton – Charlottetown
 Toronto/Hamilton – Moncton

⁵ *Supra* note 1 at 503-504.

⁶ *Supra* note 1 at 505.

⁷ *Ibid.*

⁸ D.G. McFetridge, "The Commissioner of Competition v. Air Canada: Phase I" in this issue of the *Record*.

⁹ *Supra* note 1 at 509.

¹⁰ *Supra* note 1 at 511.

¹¹ Pun intended – lets see who reads footnotes.

¹² *Supra* note 1 at 524.

¹³ *Supra* note 1 at 498.

¹⁴ *Supra* note 1 at 529.

¹⁵ *Supra* note 1 at 497, 532-534.

¹⁶ *Supra* note 1 at 537.

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¹⁷ *Supra* note 1 at 539.

¹⁸ *Supra* note 1 at 538.

¹⁹ *Supra* note 1 at 559.

²⁰ *U.S. v. AMR Corp.*, 335 F. 3d 1109 (10th Cir., 2003).

²¹ See J.B. Musgrove, "The *Caterpillar* Decision: An Unsatisfying Result for Competition Law" (1994) 15:2 Can. Comp. Rec. 51 at 61.

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THE COMMISSIONER OF COMPETITION v. AIR CANADA: PHASE I

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Introduction

On March 5, 2001, the Commissioner of Competition filed a notice of application under section 79 of the *Competition Act* and the *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service* (the "Airline Regulations") alleging abuse of dominant position by Air Canada. According to the application, during the period of April 1, 2000 - March 5, 2001, Air Canada responded to the entry of WestJet Airlines and CanJet Airlines on seven city-pair routes in eastern Canada by increasing its capacity and/or decreasing its fares, in a manner that did not cover the avoidable cost of operating the flights on these routes, in violation of paragraphs 1(a) and 1(b) of the Airline Regulations. The Commissioner's application sought a remedial order from the Tribunal prohibiting Air Canada from operating or increasing capacity at fares that do not cover the avoidable cost of providing service on the seven routes and from engaging in a policy of matching fares offered by competitors on these routes without regard to the effect of this policy on Air Canada's profitability and with the foreseeable effect of rendering competitors unprofitable.

On May 15, 2001, at the request of the parties, the Tribunal ordered that the application be heard in two phases: Phase I, to deal with the application of the avoidable cost test to two sample routes, Toronto – Moncton and Montreal – Halifax from the period of April 1, 2000 to March 5, 2001, and with four questions relating to how the avoidable cost test should be applied:

- (a) What is the appropriate unit or units of capacity to examine?
- (b) What categories of costs are avoidable and when do they become avoidable?
- (c) What is the appropriate time period or periods to examine?
- (d) What, if any, recognition should be given to "beyond contribution"?

The matters to be resolved in Phase II include (i) whether Air Canada engaged in anti-competitive acts on the other five routes; (ii) whether Air Canada was in substantial or complete control of the market; and (iii) whether the practice of anti-competitive acts is likely to result in a substantial prevention or lessening of competition.

On July 22, 2003, the Tribunal released its Phase I decision.¹ The Tribunal's findings were that, for the purpose of conducting the avoidable cost test:

- (a) The appropriate unit or units of capacity to examine is the schedule flight, that is, the test is to compare revenues and avoidable costs on individual, unidirectional scheduled flights;

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- (b) All of Air Canada's operating costs (90 percent of its total costs) are avoidable, by one means or another, from the outset (from the moment a flight is cancelled);
- (c) The appropriate time period or periods over which to compare revenues with avoidable costs is one month;
- (d) The "beyond contribution" (the contribution of passengers on a flight to the profitability of connecting Air Canada flights) should not be included in the revenue of a flight.²

On the basis of this interpretation of the avoidable cost test, the Tribunal found that Air Canada operated or increased capacity at fares that did not cover the avoidable costs of providing the service on both the Toronto – Moncton and Halifax – Montreal routes during the period July 1, 2000 - March 5, 2001, thereby committing anti-competitive acts.³

Tests for predatory pricing have been the subject of a vast amount of scholarly and professional commentary. Although it is unlikely to have much impact beyond the present Canadian airline industry, the Tribunal's decision is novel in some significant respects, most notably in its method of determining whether a cost item is avoidable. For this and other reasons, it may be controversial. It may also be difficult for Air Canada to abide by the code of conduct that is implied by the Tribunal's decision. It is more stringent than the Commissioner sought and it leaves him with considerable discretionary power. Thus, the Tribunal's decision merits comment from a number of perspectives. The following commentary focuses on the decision's underlying economic reasoning.

The Avoidable Cost Test

The Airline Regulations define operating or increasing capacity on a route at fares that do not cover avoidable cost as an anti-competitive act. The Commissioner and Air Canada agreed that the determination of whether capacity has been operated on a route at fares that do not cover avoidable cost requires a quantitative test in the form of a comparison of revenues and avoidable costs. They also agreed that the avoidable cost test proposed by one of Air Canada's economics experts, Professor Baumol, is the test they wished to apply.⁴

The article in which Professor Baumol proposes his avoidable cost test is essentially a rehabilitation and refinement of the Areeda-Turner test which is central to U.S. jurisprudence on predatory pricing. The essence of the Areeda-Turner approach is that sales at prices below marginal cost involve a sacrifice of profits that is irrational unless the profits foregone can subsequently be recouped possibly as a result of diminished competition.⁵ The application of the Areeda-Turner test requires a comparison of the marginal cost of the product involved with its price. Given the difficulty of measuring marginal cost, average variable cost was used as a proxy. Professor Baumol pointed out that average variable cost belongs in an Areeda-Turner type test on its own merits for the reason that at prices below average variable cost, the loss-minimizing strategy is to shut production down. Professor Baumol went on to note that average variable cost is not well-defined for a multi-product firm and that in this case the appropriate cost concept is average avoidable cost.

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The Tribunal interpreted Professor Baumol's proposed test as follows:

The avoidable cost test for predation determines whether a firm's revenue (price) is above or below its (average) avoidable cost. As discussed by Dr. Baumol, the multiproduct enterprise will rationally continue to produce a given product as long as the revenue from the sale of that product exceeds the product's avoidable costs. If the cost-savings achieved by exit exceed the revenue foregone, then the firm will terminate production of that product. Since no enterprise will rationally set the price per unit of any of its products below their respective (average) avoidable costs in the pursuit of maximum short-term profits, deviations from this rational pricing behaviour may be predatory.⁶

Unit of Capacity

The avoidable cost test must be applied to a specific price/output decision. In the case of markets for transportation services, there are several possible output decisions to consider. In the case of passenger transportation (bus, train and airplane) the candidates include: offering an additional seat on a scheduled departure between a given pair of cities; offering an additional departure between a given pair of cities and; serving an additional city-pair market.

The Commissioner argued that the avoidable cost test should be applied to individual flights (e.g. Ottawa-Toronto, 7 AM). The Commissioner reasoned that applying the test at a higher level of aggregation could obscure predatory conduct which could occur at the individual flight level and that Air Canada measures profitability and makes capacity decisions at the flight level.

Air Canada argued that the appropriate unit of capacity is the route or city-pair market or, put another way, that the relevant question is whether the revenues it derives from a route cover the avoidable costs of operating the route.⁷ Air Canada's expert economists argued that an airline can never change just one flight so that the relevant increment or decrement of capacity is always more than one flight. They also argued that if revenues cover avoidable costs in the city-pair market (route) as a whole, the failure of some individual flights operated by the dominant incumbent to cover avoidable cost should not deter an equally efficient competitor or entrant.⁸ It is certainly the case that in a homogeneous product market, a classical predatory campaign cannot be built on isolated below-cost sales. An equally efficient entrant could profitably compete for the market as a whole or for all sales made at prices at or above avoidable cost.

Below-cost sales in a portion of the market make more sense as a predatory strategy if the product is differentiated. If, for example, scheduled flights are differentiated by departure time, a predator might price below avoidable cost on a flight with a departure time adjacent to that of the intended victim while the predator's other flights on the route continue to cover avoidable cost.⁹ In this case, however, something more would have to be known about the alleged predatory flight. For example, the failure of a flight at 10 AM to cover avoidable cost when a flight at 3 PM does cover avoidable cost and the alleged victim's flight departs at 5:30 PM may say more about the weakness of the avoidable cost measure than it does about the existence of a predatory strategy.

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The Tribunal agreed with the Commissioner's argument. It held that operating any flight below its avoidable cost is an anti-competitive act under the Airline Regulations and that the characteristics of the flight and the profitability of the market as a whole are irrelevant to this determination. These factors may be considered, however, when determining whether any anti-competitive act is part of a practice likely to lessen competition substantially as is required under section 79.¹⁰

Avoidable Costs

The Tribunal defined avoidable costs as all costs that can be avoided by not producing the good or service in question. It further defined avoidable costs as consisting of variable costs and the product-specific fixed costs that are not sunk.¹¹

Intuitively, the cost of an action is avoidable if it is not incurred if that action is not taken. The Commissioner and the Tribunal define costs that are not incurred if an action is not taken as being inherently avoidable or avoidable outright. The Tribunal also labels these costs as costs that can be shed if an action is not taken. One view of the avoidable cost test is it should compare the revenue derived from a product with costs that would be avoided outright if the product were not offered. The Commissioner advocated and the Tribunal ultimately adopted a much broader approach. The Commissioner argued that costs that are not inherently avoidable could nevertheless be treated as if they were. This has the effect of raising the estimated magnitude of Air Canada's avoidable costs significantly, thus making the avoidable cost test much more difficult for it to pass. This is likely to be the most controversial aspect of the Tribunal's decision.

Both the Commissioner and Air Canada based their avoidable cost estimates on data provided in Air Canada's 328 Report. This report shows all of Air Canada's costs on a per flight basis. Some of these costs were measured directly at the flight level while others were measured at higher levels of aggregation and prorated to the flight level using various cost drivers. For example, station labour costs at the Toronto airport might be prorated to flights operating out of Toronto on the basis of the share of Toronto-originating passengers accounted for by each flight.

The 328 Report characterized all of Air Canada's costs with the exception of aircraft ownership and insurance and overhead as variable.¹² Whether these costs can also be regarded as avoidable for purposes of the application of the avoidable cost test was a matter of dispute between Air Canada and the Commissioner. Air Canada conceded that seventeen of the cost items listed in the 328 Report could be treated as inherently avoidable in the event of the cancellation of the flight involved.¹³ These costs account for 38 percent of Air Canada's fully allocated costs on the two routes involved.¹⁴ For his part, the Commissioner conceded that the overhead line item in the 328 Report is not avoidable.

Air Canada argued that the remaining 26 cost items in the 328 Report would not be shed (avoided outright) if a flight were cancelled and are thus not avoidable for purposes of the test. These 26 cost items were grouped into five categories: (1) system labour costs, (2) station labour costs, (3) aircraft labour costs, (4) non-labour system and sunk costs, and (5) aircraft ownership and insurance costs.¹⁵ The Commissioner argued that while these 26

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cost items might not necessarily be shed in the event that a flight is cancelled, they can be treated as if they were avoidable for purposes of the application of the avoidable cost test. The Commissioner argued and the Tribunal largely agreed that these 26 cost items could be deemed to be avoidable by other means, these means being passenger recapture, resource redeployment and asset disposal.¹⁶

The 43 cost items the Tribunal decided to treat as avoidable for purpose of the test account for 90 percent of Air Canada's total costs and apparently all of its operating costs¹⁷ (including aircraft ownership costs). These costs are measured at various levels of aggregation and then prorated to individual flights. In the balance of this commentary, the cost per flight which is obtained by allocating all but overhead costs to individual flights will be called the flight's Fully Allocated Operating Cost ("FAOC").

The process by which the Commissioner and the Tribunal converted cost items that are not inherently avoidable into avoidable costs is intriguing. The Commissioner proposed defining the avoidable cost of a flight as its inherently avoidable cost plus the additional profits (but not losses) that might be realized elsewhere in the dominant carrier's network if the flight in question were cancelled. The Commissioner argued that profits would be realized on other flights in the hypothetical event of a cancellation because passengers could be rebooked on the dominant carrier's other flights (recapture), equipment and personnel redeployed to offer additional (profitable) flights on other routes (redeployment) and aircraft could be subleased or sold (disposal). For these reasons, the opportunity cost of a flight could exceed its inherently avoidable cost and as will be explained below, could also be greater than, less than or the same as its FAOC. The opportunity cost of a flight could also be less than its inherently avoidable cost if the possibility of lost profits elsewhere in the network were considered. The Commissioner argues implicitly that the possibilities for recapture, redeployment and disposal are such that the opportunity cost of a flight is just equal to its FAOC. This yields what appears to be a bright line (Revenue minus FAOC) test. In fact, the line is not that bright, depending as it does on hypothetical and presumably changing possibilities for recapture, profitable redeployment and disposal.

Recapture

The dominant carrier may recapture passengers from a flight it cancels if they take other flights it offers on the same route or reconnect with it for subsequent legs of their journey. This does not imply that costs other than those which are not inherently avoidable are shed when a flight is cancelled. What recapture does imply is that the opportunity cost of continuing to offer a flight may be higher than the inherently avoidable cost and that opportunity cost depends on the extent of recapture rather than on the magnitude of the costs involved.

Consider the following simple example. A flight carries 50 passengers who pay \$100 each yielding revenues of \$5000. Assume the fully allocated cost of the flight is \$6000. Of this, a variable cost of \$20 per passenger (\$1000) and a flight specific fixed cost of \$2000 are avoidable outright if the flight is cancelled. Thus, the flight is covering its inherently avoidable cost of \$3000 but not covering its \$6000 fully allocated cost. If the flight were cancelled, suppose initially that all 50 passengers would take other flights offered on this route by the dominant carrier. The additional contribution to profit on these other flights is the \$5000 in fare revenue less \$1000 in additional variable cost (50 X \$20) on these other flights or \$4000. The opportunity cost of continuing

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to offer the flight in question rather than cancel it is the sum of the costs which would be avoided outright (\$3000) and the \$4000 additional profit earned on the remaining flights on the route or \$7000. This exceeds the fully allocated operating cost of \$6000. Cancelling this flight would result in a profit increase of \$2000.¹⁸

Suppose now only 37 of the 50 passengers are recaptured. The others choose not to fly or are lost to other carriers. The additional contribution to profit on other flights due to recapture is now \$3700 (37 X \$100) less \$740 (37 X \$20) in additional variable cost or \$2960. The opportunity cost of continuing to offer the flight in question rather than cancel it is the sum of the costs which would be avoided outright (\$3000) and the \$2960 in additional profit earned on the remaining flights on the route or \$5960. The profit from cancelling the flight is the excess of its opportunity cost over its revenue or \$960. The \$5960 opportunity cost of offering the flight is very close to fully allocated operating cost (\$6000) but this is a coincidence. The opportunity cost of offering this flight depends strictly on its inherently avoidable cost and the number of passengers recaptured in the event of cancellation. If conditions become still less favourable to recapture, the opportunity cost of offering the flight will decline regardless of what happens to fully allocated operating cost. If, for example, only 20 of the 50 passengers can be recaptured in the event of cancellation, the additional contribution to profit on the remaining flights is \$1600 and the opportunity cost of continuing to offer the flight will be \$4600 which is less than the \$5000 in revenue it yields. Notwithstanding its \$6000 fully allocated accounting cost, cancelling this flight would reduce profits by \$400.

The important lesson to draw from this example is that the possibility of recapture raises the opportunity cost of maintaining a flight above its inherently avoidable cost but the extent to which it does so depends on the probability of recapture and this will vary with market circumstances. The opportunity cost of maintaining a flight does not depend on the fully allocated cost of that flight and there is no reason why these two costs should be the same.

It is also apparent that recapture can play a powerful role in raising the opportunity cost of offering a flight. Recapture may also finesse otherwise difficult timing issues. Inherently avoidable costs may not be avoided immediately upon cancellation of a flight while recapture can take place immediately (at the outset) if passengers are rebooked on other flights offered by the dominant carrier. The assumption of full recapture was apparently instrumental in the Tribunal's decision that Air Canada had engaged in anti-competitive acts on the Toronto – Moncton and Montreal – Halifax routes. According to the Tribunal, the Commissioner's expert "relied heavily" on recapture as the basis for his conclusion that Air Canada's fully allocated operating cost was avoidable in its entirety within one month.¹⁹

Given the central role recapture is likely to play, a useful code of conduct should contain indicia of likely extent of recapture. The Tribunal cited the following general indicators of the likely extent of recapture:

... the number of flights, historical load factors, the number of passengers, and importantly, the number of flights offered by competing air carriers.²⁰

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It is not only the number of flights offered by competing carriers, it is also the number of flights they would offer in the event of a cancellation by the dominant carrier. If a cancellation is replaced by competitor, recapture could be zero. Presumably, relevant evidence would also include the extent to which passengers either decide not to travel or change mode as flight frequencies decrease. The Tribunal also cited testimony to the effect that “spill” becomes a factor at load factors in excess of 70-75 percent.²¹ At load factors in excess of 70-75 percent, full recapture of all passengers on a cancelled flight is apparently unlikely. This must be considered jointly with the possible decrement in capacity. For example, if spill problems became very serious at load factors of 0.8 and five flights per day were being operated on a route, then cancelling one flight would lead to very serious spill problems for any initial load factor over 0.64.

In its application of the avoidable cost test to the Toronto – Moncton and Montreal – Halifax routes, the Tribunal observed that there may have been certain months where full recapture was not possible. The Tribunal nevertheless accepted the assumption of full recapture as the basis for the avoidable cost test.²²

Redeployment

The cancellation of a flight by the dominant carrier theoretically frees up resources to offer additional service on other routes in its network. This is called redeployment. It is apparent that, despite the use of the term “avoidability through redeployment” by the Commissioner and the Tribunal, redeploying resources does not lead to the shedding of any costs. Nevertheless, it is a relevant consideration from an opportunity cost perspective, although probably a less important one than recapture.

Consider the following simple example. A flight carries 50 passengers who pay \$100 each yielding revenues of \$5000. Assume the fully allocated cost of the flight is \$6000. Of this, a variable cost of \$20 per passenger (\$1000) and a flight specific fixed cost of \$2000 is avoidable outright if the flight is cancelled. This flight covers its inherently avoidable cost but not its fully allocated cost. Suppose it could be cancelled and the personnel and equipment involved redeployed to a new flight. Assume that there is no recapture of passengers from the cancelled flight and that the new flight also attracts 50 passengers at \$100 per passenger. The opportunity cost of maintaining the first flight is the \$3000 in inherently avoidable cost that would be saved plus the \$2000 excess of revenue over inherently avoidable cost on the new flight or \$5000. So even though the first flight is not covering its fully allocated operating cost, it is covering its opportunity cost. Intuitively this is because the alternative flight would yield the same contribution as the cancelled flight. If the best alternative were better than the candidate flight, attracting, say, 62 passengers and yielding \$6200 in revenue, the opportunity cost of maintaining the first flight would be \$5960 ($\$3000 + (6200 - (2000 + 1240))$) which is very close to its fully allocated operating cost but this is, again, entirely coincidental.

The Commissioner argued and the Tribunal accepted that a cancellation would result in both recapture and redeployment. When a flight is cancelled, the dominant carrier might retain some or all of the passengers who would have taken it and it may also be able to use the personnel and equipment on another route. In this case, the opportunity cost of maintaining a flight would exceed the inherently avoidable cost of that flight for two reasons. Returning to the example given above, a flight carries 50 passengers who pay \$100 each yielding

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revenues of \$5000. Assume the fully allocated cost of the flight is \$6000. Of this, a variable cost of \$20 per passenger (\$1000) and a flight specific fixed cost of \$2000 is avoidable outright if the flight is cancelled. As before, this flight is covering its inherently avoidable cost but not its fully allocated cost. Suppose this flight could be cancelled and the personnel and equipment involved redeployed to a new flight on another route. Assume that half the passengers from the cancelled flight are recaptured and that the new flight also attracts 40 passengers at \$100 per passenger. The opportunity cost of maintaining the cancelled flight is the \$3000 in inherently avoidable cost that would be saved if it were cancelled plus the additional profit of \$2000 realized from passengers recaptured on other flights on the route ($25 \times (100-20)$) plus the \$1200 ($40 \times (100-20) - 2000$) excess of revenue over inherently avoidable cost on the new flight or \$6200. In this example, the combined effects of partial recapture and redeployment raise the opportunity cost of maintaining the flight involved above its revenue and, indeed, above its fully allocated operating cost.

Air Canada argued that there was no evidence that it had profitable redeployment opportunities that were unexploited during the relevant period and that as a practical matter, the possible availability of a redeployment opportunity somewhere in the network does not imply that the personnel and equipment used on a particular flight could readily be diverted to exploit it.²³ Dr. Dorman, an expert witness for Air Canada, testified that according to the calculations of the Commissioner's experts, during an average month, 42 percent of Air Canada's flights fail to cover their avoidable cost. This implies that opportunities for either recapture or profitable redeployment were not generally available.²⁴ Counsel for Air Canada made the point that it is contradictory to argue that Air Canada does not lose any passengers when it cancels a flight (complete recapture) and gains a significant number of new passengers when it adds a new flight (profitable redeployment) on existing routes.

The Tribunal ruled that the Commissioner is under no obligation to demonstrate specific and workable redeployment opportunities. The Tribunal reasoned that since the avoidable cost test proceeds on the basis of an hypothetical flight cancellation, redeployment opportunities could never be more than a matter of speculation and that, as a consequence, it could not require the Commissioner to identify them. Accordingly, the Commissioner is required only to show that redeployment opportunities "... were generally and realistically available at the time of the alleged predation."²⁵

The Tribunal found that sufficient evidence of opportunities for profitable redeployment took the form of commencement of service or decisions to offer service on 52 new routes during the period of alleged predation and increases in service or decisions to increase service on 37 other routes. Although the Tribunal cites no further evidence on this matter, the apparent presumption is that the personnel and equipment in use on the routes on which predation is alleged could have been used instead to provide service on the new routes. The Tribunal also cited evidence to the effect that Air Canada had difficulty finding aircraft for service in the Maritimes during the spring of 2000.²⁶

One might be forgiven for thinking that the opportunities for profitable redeployment declined after September 11, 2001. Not so, according to the Tribunal. The Tribunal cited an Air Canada press release to the effect that

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the carrier had cut employment, reduced its fleet and transferred some equipment to its Tango brand as evidence that Air Canada was under the same “pressure” to improve profitability after 9/11 as it was before.²⁷ This appears to confuse the pressure to do better with the number and quality of opportunities to do better. Moreover, the press release is also consistent with Air Canada’s argument that it exploits all available opportunities for redeployment and that, as a consequence, there was no backlog of opportunities for profitable redeployment of the alleged predatory flights. The Tribunal’s finding that Air Canada was under unrelenting pressure to reduce costs and seek more profitable opportunities also implies that it could neither hide nor sustain profit sacrifices as is required of a successful predator.

As is the case with recapture, the possibility of redeployment can raise the opportunity cost of maintaining an allegedly predatory flight well above its inherently avoidable cost. There are some persuasive arguments against basing inferences of predatory behaviour on hypothetical “what if” scenarios and the U.S. courts have refused to do so (see below). Given the Tribunal’s decision effectively to incorporate opportunity cost considerations in the avoidable cost test, however, the issue for the dominant carrier’s code of conduct is how general evidence that opportunities for redeployment exist can be translated into a quantitative estimate of the opportunity cost of maintaining a particular flight. The Tribunal’s decision leaves the impression that it is willing to accept evidence that the dominant carrier has been reallocating some of its equipment as evidence that an allegedly predatory flight could have been profitably redeployed and that the opportunity cost of maintaining this flight is equal to its FAOC.

Disputed Cost Categories

Air Canada argued that 26 cost items on its 328 Report could not be avoided in the event of a flight cancellation and should not be treated as avoidable for purposes of the avoidable cost test. The Commissioner argued that all of Air Canada’s costs with the exception of the overhead category are avoidable by one means or another within three months.²⁸ The Tribunal examined each of these cost items and made a determination as to whether they were avoidable or not. The Tribunal’s findings with respect to four categories of disputed costs are discussed in this section and its finding regarding aircraft ownership costs are discussed in the next section of this commentary.

To support the argument that the disputed cost items are avoidable, the Commissioner’s experts made use of the concept of a step variable cost. A step variable cost increases with the volume of output but does so in steps rather than continuously. In addition, some minimum level of cost must be incurred if any output is to be produced at all. For example, it might be the case that a carrier’s station costs at an airport are \$1000 per day if between one and five flights per day are offered and \$1500 per day if between six and ten flights per day are offered. This step cost function has two crucial characteristics. First, the carrier may have to cancel as many as five flights per day before any costs are actually shed. Second, any savings from flight cancellations are less than the allocated cost per flight, that is, they are not proportional. For example, if this carrier happened to be operating ten flights per day from this terminal, the fully allocated terminal cost would be \$150 per flight. Even if it cancels five of its ten flights, thus saving \$500 in terminal costs, the saving per flight is only \$100 not \$150.

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It is apparent that to the extent that costs are step variable, the cancellation of an individual flight may not result in the outright avoidance of any of this cost and will certainly not result in the outright avoidance of the fully allocated cost. The Commissioner's experts finesse this problem largely by arguing that these cost items are avoidable by recapture and redeployment. That is, they shift to opportunity cost mode. This allows them to treat step variable costs as avoidable "...even though an assessment of factual circumstances needed to determine avoidability may not be practical."²⁹ As has been argued at length above, the opportunity cost of offering a given flight depends only on the outright or inherently avoidable cost of that flight and the profitability of the alternatives. For this reason, the behaviour of cost items that are not inherently avoidable is irrelevant.

To take an example, the Commissioner's experts opined that labour costs in reservation call centres and city ticket offices are "step variable and avoidable through redeployment." The intuitive question one would normally ask is whether cancellation of a flight from Toronto to Moncton would likely result in a reduction in labour costs (labour shedding) at a city ticket office in either city. In this regard, the Commissioner's experts confined themselves to stating that overtime can be avoided outright. The implication is that the balance of these costs are not inherently avoidable. The Tribunal found, however, that these labour costs are avoidable principally on the basis of "redemption by passenger recapture."³⁰

As explained above, once it is determined that a cost category is not shed in the event of a cancellation, there is no need to consider it further. All that needs to be added to the cost items that are avoided outright is the additional profit derived from recaptured passengers on other flights and the additional profit derived from redeployed resources. These additional profits are not labelled. There is no need to apply them against individual cost categories. All that matters is their aggregate dollar magnitude. The Commissioner argued on the basis of general qualitative evidence regarding possibilities for recapture and redeployment that the dollar magnitude of the additional revenues derived from a hypothetical cancellation of the impugned flights, taken together with the costs that would be avoided outright, is equal to the FAOC of these flights. This could be the case but it depends strictly on what happens to passengers, personnel and equipment in the hypothetical event of a cancellation. The exercise of determining, on an item by item basis, whether a cost that cannot be shed is avoidable by recapture or redeployment is not only pointless but also diverts attention from the nature and quality of the evidence on the value of the alternatives which is, or should be, central to the opportunity cost approach the Tribunal has decided to adopt.

In its examination of the disputed cost items, the Tribunal found that some were avoidable outright and a few were unavoidable but deemed most to be avoidable by recapture and redeployment. That is, opportunities for redeployment and recapture following an hypothetical cancellation are sufficient to yield additional profits on other flights equal to the magnitude of these cost items. The Tribunal's specific findings with respect to the disputed cost items (excluding aircraft ownership costs) are as follows: (1) system labour costs are avoidable by redeployment and recapture plus some outright avoidance of overtime; (2) station labour costs are avoidable by redeployment and recapture;³¹ (3) aircraft labour costs are avoidable outright and through redeployment;³² (4) non-labour system and sunk costs are comprised of eight items or sets of items, four of which are unavoidable, three avoidable by redeployment and one avoidable outright.³³

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Aircraft Ownership

The aircraft ownership cost measure on Air Canada's 328 Report is an imputed cost based on the market lease rate of the aircraft involved and prorated to the flight level. The 328 Report treats aircraft ownership cost as a fixed cost and Air Canada argued that aircraft ownership costs would not be avoidable in the event of a flight cancellation. The Commissioner argued that aircraft ownership costs are avoidable for a variety of reasons. First, aircraft ownership costs would be inherently avoidable if the aircraft could be sold, subleased or returned to the lessor. Failing this, the aircraft could be redeployed. Air Canada responded that the cancellation of a single flight could not result in the disposal of the aircraft involved. The Tribunal commented that disposal was not the only way to avoid aircraft ownership costs in the event of cancellation.³⁴ Air Canada's argument seems equally valid, however, for subleasing, returning to the lessor or any other means of outright cost avoidance.

The Tribunal found that Air Canada could avoid aircraft ownership costs as measured on its 328 Report "... in various ways" in the event of a cancellation although it did not accept the Commissioner's argument that ownership costs could be avoided simply by parking an aircraft.³⁵ With respect to the standard of proof required, the Tribunal reiterated its opinion that the Commissioner need only show that opportunities for redeployment were generally and reasonably available. Insofar as opportunities for disposal, subleasing and returns to the lessor are concerned, the Tribunal found it sufficient that Air Canada had acquired and disposed of aircraft during the period of alleged predation. The evidence the Tribunal cites, however, does not appear to provide strong support for viability of the disposal/sublease/return option:

In addition to new routes and service expansions in the Phase I Period as noted above, Air Canada placed orders for 32 aircraft in 2000 and took delivery of 11

...

During 2001, Air Canada took delivery of 16 aircraft: four Airbus A330-300, four Boeing 767-300, five Airbus A321 and three Airbus A319 aircraft. In addition, by year end 2001, 30 aircraft had been removed from service at the Mainline carrier: one leased Boeing 747-400 scheduled to return to service in 2002, three Boeing 767-300 aircraft subleased to Qantas Airlines, returning to Air Canada in January 2002, four Boeing 767-200 aircraft parked and available for sale or return to the lessor, 13 DC-9 aircraft available for sale, nine Boeing 737-200 aircraft of which four were subleased and five were parked pending either return to lessors or potential sale.³⁶

This evidence appears to indicate that of the 30 aircraft Air Canada had taken out of its fleet by the end of 2001, none were actually sold or returned. Four aircraft were on short-term subleases, four were on subleases of unspecified duration and 22 were parked and/or available for sale or return to the lessor.

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Timing Issues

The Tribunal recognized that there are two basic timing issues.³⁷ The first is the length of time it would take to avoid each type of cost. The second is the time period over which the avoidable cost test should be applied.

The Commissioner argued that “substantially all” of Air Canada’s costs excluding overhead are avoidable within three months. With respect to the second issue, the Commissioner argued that the appropriate period over which to compare revenue with avoidable cost is three months in monthly increments with no allowance for seasonality and that the test should be “forward looking.”³⁸ That is, the test is failed if avoidable cost exceeds revenue for three consecutive months or two if it is deemed likely that the third month (December, for example) will be followed by more months in which the test is failed. The Commissioner also argued that if a cost is avoidable at all, it is deemed to be avoidable throughout the entire period of the test.³⁹ That is, if a cost is avoidable within three months, it is deemed to be avoidable during each of the one month periods in which the test is performed.

Air Canada did not indicate a particular time period over which its costs would be avoidable. It argued that the avoidable cost test should be applied over the period of alleged predation or a year with allowance for seasonality and that avoidable costs include only those costs that are escaped (presumably shed) during the period of the test and only to the extent that they are escaped.⁴⁰

The Tribunal found that the Airline Regulations do not specify a time period for the application of the avoidable cost test. Nor do they specify a grace period for information gathering, filtering out random events or adjusting. According to the Tribunal, “...the obligation on the dominant carrier to keep avoidable cost below revenue is continuous.”⁴¹ It is up to the Commissioner to specify a period during which anti-competitive acts are being performed and this period could be as short as a day or less.⁴² From a prosecutorial perspective, the normal downside of a short predatory period is that avoidable costs become very low. This was not and may never be a problem for the Commissioner because, as is explained below, the Tribunal found that the FAOC of all Air Canada flights on the two sample routes would be instantaneously avoidable in the event of a cancellation. Of course, an anti-competitive act lasting a day might not qualify as a practice as Section 79 requires. With respect to seasonality, the Tribunal was not persuaded by evidence before it that airlines typically show losses during the low season. It opined further that Air Canada should be able to anticipate and respond to seasonal variations in traffic and that, in any event, the Airline Regulations do not provide for a low season exemption.⁴³ The Tribunal declined, as a consequence, to adjust for seasonality when applying the avoidable cost test.

With respect to the time period over which costs can be avoided, the Tribunal characterized the Commissioner’s view that a cost that is avoidable at all is always avoidable as having no time element.⁴⁴ At a number of places in the Decision, the Tribunal notes that the monthly revenue/cost comparisons conducted by the Commissioner may include costs that were not avoidable during the month in question.⁴⁵ At one point it appears to reject this approach.⁴⁶ The Tribunal spared itself the burden of providing further guidance on this matter by interpreting the evidence of the Commissioner’s expert, Dr. West, as implying that Air Canada could avoid all the costs of

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the alleged predatory flights by outright shedding, redeployment or disposal "...from the point of hypothetical cancellation" (i.e. instantaneously).⁴⁷

Beyond Contribution

The beyond contribution of a flight is essentially the profit derived from passengers on that flight who continue on with Air Canada to other destinations. Air Canada argued that the beyond contribution should be included as part of the revenue derived from a flight for purposes of the avoidable cost test. While the beyond contribution is misleading (due to double counting) when viewed from a network perspective, there does not appear to be much dispute that it is relevant to profitability calculations made at the route or flight level and that it should be included in revenues when applying the avoidable cost test.⁴⁸

The Commissioner argued that beyond revenues may be overstated if passengers on connecting flights are displaced and, in any event, such revenues are not lost in the event of a cancellation if the passengers involved take other Air Canada flights (recapture) or if they re-connect with ongoing Air Canada flights to their final destination. The Tribunal concluded that it had no evidence before it regarding what the beyond contribution would be if proper account were taken of recapture, re-connection and displacement.⁴⁹ The Tribunal also appeared to state that in the event that it had this information, it would be dealt with as a business justification rather than as part of the avoidable cost test.⁵⁰

Legitimate Business Justification

The Commissioner argued that failure of the avoidable cost test leads to an inference that an anti-competitive act has been committed but that this inference could be rebutted by evidence of a legitimate business justification, for example, "...a situation where it is necessary to operate a flight at the end of the day to position the aircraft for its next mission" (a so-called "balancing" or "positioning" flight).⁵¹ This is consistent with the avoidable cost test as proposed by Professor Baumol. The Commissioner argued that in the case at hand, however, Air Canada had provided no such evidence.⁵²

The Tribunal found that paragraph 78(1)(j) of the *Competition Act* makes no provision for legitimate business justification. Failure of the avoidable cost test itself constitutes an anti-competitive act. The Tribunal ruled that business justification evidence could be considered in connection with the Phase II determination of whether Air Canada engaged in a practice of anti-competitive acts as is required under Section 79.⁵³

There is a striking lack of symmetry in the Tribunal's approach to opportunity cost evidence. The Tribunal is prepared to incorporate opportunity costs into the avoidable cost test fully when they are positive, that is, when the cancellation of a flight would increase profits derived from other flights, but it flatly rejects the incorporation of opportunity costs into the avoidable cost test when they are negative. The opportunity cost of cancelling a flight could be negative if this increased costs or reduced revenues elsewhere in the network. Thus, qualitative evidence that an aircraft could potentially be used elsewhere is given full weight in the determination of whether an anti-competitive act has occurred while evidence that cancellation of a weakly performing outbound flight

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would require cancellation of a highly profitable return flight is given no weight at all in this determination. Similarly, evidence that cancellation of a flight would require deadheading an empty aircraft back into position is given no weight in the determination of whether an anti-competitive act has been committed and will apparently be considered by the Tribunal only in the context of whether this anti-competitive act constitutes a practice.

Application of the Test

The avoidable cost test as applied by the Tribunal for purposes of its Phase I inquiry compared the monthly revenue (excluding beyond contribution) with the monthly FAOC (essentially all costs other than corporate overhead) for each flight operated by Air Canada on the Toronto – Moncton and Montreal –Halifax routes during the approximate period of alleged predation. Over the period April 2000 - February 2001 inclusive, 43 of the 73 monthly revenue/cost comparisons made for flights on the Toronto – Moncton route showed cost exceeding revenue.⁵⁴ Over the period August 2000 - February 2001 inclusive, 72 of the 111 monthly revenue/cost comparisons made for flights on the Montreal – Halifax route showed cost exceeding revenue.⁵⁵ The Tribunal also cites the results of revenue/cost comparisons made on a departure by departure basis. The Tribunal confined itself to concluding that roughly 60 percent of the flights Air Canada operated on the two routes during the alleged predatory period were anti-competitive. There is no indication in the decision as to whether all Air Canada flights failed the test or as to how many flights would have failed the test for three consecutive months as the Commissioner would have required. Nor is there any indication as to the frequency with which Air Canada flights were failing the test prior to the announcement of entry by WestJet and Canjet.

United States v. American Airlines

A comparison between the Tribunal's Air Canada Phase I decision and the decisions of the District and Circuit Courts in the American Airlines ("AMR") case in the United States is instructive. The AMR case arose out of competition between AMR and low cost carriers (LCC's) operating out of AMR's Dallas/Ft. Worth hub during the period 1995-97. AMR responded initially to the entry of LCC's with limited fare reductions but subsequently increased flight frequency and aircraft size and offered more widespread fare reductions on the routes involved. The result in each case was that the competing LCC failed to establish a presence and moved or ceased operations after which AMR restored its fares to pre-LCC entry levels.

The Department of Justice filed suit in May 1999 under Section 2 of the *Sherman Act* alleging that AMR's response to LCC competition was anti-competitive and unlawful. Specifically, the Government argued that AMR's capacity increase ("capacity dumping") reduced its profits on the affected routes relative to its initial, more limited response to the LCC's and that this profit reduction made sense only if AMR expected to recoup it by diminishing competition on the affected routes and deterring it on others. AMR responded that its revenues on the affected routes exceeded several measures of variable cost (accounting for between 72 and 80 percent of its total cost on these routes) at all times during the alleged predatory period and moved for summary judgment on the grounds that its competition with LCC's was competition on the merits. The District Court granted the motion for summary judgment in April 2001 on the grounds that the Government had failed to demonstrate a genuine issue of material fact as to whether AMR had priced below an appropriate measure of cost or had a

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dangerous probability of recoupment.⁵⁶ The District Court's order granting summary judgment was affirmed on appeal by the Tenth Circuit Court in July 2003.⁵⁷

Central to the Government's case was the argument that there may be situations in which a market-wide average variable cost test will disguise the nature of predatory conduct. In essence, although AMR covered its variable costs on each route, the additional revenue generated by its capacity increments did not cover the additional cost of that capacity. The Government supported this argument by comparing AMR's route profitability after the capacity expansion with its route profitability after LCC entry but before its capacity expansion. This involved four tests. Two of the tests showed that route revenue (including beyond contribution) minus fully allocated costs became negative and stayed negative after the capacity expansion. The District Court rejected these tests on the grounds that they made use of fully allocated cost which, in its view, was equivalent to employing an average total cost test for predation and therefore invalid as a matter of law. The Circuit Court concurred. A third test showed that route revenue (including beyond contribution) minus variable cost declined after the capacity expansion. The District and Circuit Courts both saw this test as a before-and-after profitability test that: (a) converted foregone profits into costs; (b) indicated only that AMR had failed to maximize short-run profits on the route as a whole and; (c) condemned an activity that may have been profitable as predatory. Both courts found it invalid as a matter of law. The final test compared an estimate of the additional revenue generated by the capacity expansion with an estimate of its incremental cost. The Circuit Court indicated a willingness to consider this test conceptually on the grounds that the cost of incremental capacity could be a better proxy for marginal cost. It ultimately rejected the test because the incremental cost measure developed by the Government's expert included a variety of allocated station-level costs that do not vary proportionately with the level of flight activity on a route.

While the decisions of the District and Circuit Courts in the AMR case will be subject to criticism and the Tribunal has not yet decided whether Air Canada's anti-competitive acts constitute an abuse of dominance, the difference in their respective approaches is worth noting. The U.S. courts applied the average variable cost test at the route level rather than the flight level and included a beyond contribution in revenues. Variable cost measures employed in the test accounted for between 72 and 80 percent of AMR's total costs. Both courts rejected a fully allocated cost measure accounting for between 97 and 99 percent of total costs. They rejected proposed avoidable cost measures containing arbitrarily allocated variable costs. They also rejected any treatment of foregone profits as costs. The courts were aware of and cited an exposition of reputational theories of predation but rejected the Government's test on the grounds that it could not distinguish between the respective deterrent effects of lawful and unlawful competition and that the Government's evidence was consistent with a variety of interpretations.⁵⁸ The Department of Justice itself did not challenge AMR's initial response of maintaining capacity and offering limited competing fare reductions as predatory.

Conclusions

Choosing a test for predatory pricing necessarily involves choosing among imperfect alternatives. It requires choosing the appropriate balance between false positives and false negatives. It requires test criteria that can be

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measured consistently and at a reasonable cost. Cost-based tests such as the average variable cost and the average avoidable cost tests have their critics. They may not catch instances in which marginal revenue or even price is below marginal cost. Some call cost-based tests "a license to prey." Given the potential that false positives have for providing a vehicle for legal harassment of competitors and generally discouraging vigorous competition, cost-based tests might also be described in Churchillian terms as the worst tests except for all the others. In any event, the issue at present is not the choice of an avoidable cost test. Rather, it is how avoidable cost is defined and applied.

The Tribunal's Phase I decision has defined the FAOC of an Air Canada flight as instantaneously avoidable. It has done so essentially on the basis that, as the dominant carrier, Air Canada should always have ready alternatives that would cover this cost. It is committing an anti-competitive act if it fails to find and adopt them. There is no grace period. There may be still better hypothetical alternatives available but the test does not require Air Canada to adopt them. In this sense, it is something less than a short-run profit-maximization test.

The avoidable cost test as defined by the Tribunal appears unconcerned with false positives and is likely to be over-inclusive. It is more a funnel than a screen. As the basis for a code of conduct, it has some distinct shortcomings. As long as a carrier is defined as dominant, that carrier is defined to have engaged in an anti-competitive act whenever it fails to cover its FAOC for a month on any flight. If any route goes sour for any reason, perhaps because of excessive entry by new carriers, the burden is on the dominant carrier to make things right by cancelling its own flights. This is the case regardless of whether competing carriers are covering their own avoidable costs. This is the case whether the dominant carrier takes any pricing or capacity initiatives at all. Depending on how dominance is ultimately defined, this may hold even for situations, which might exist even now, in which Air Canada is not dominant on the route concerned.

It is not clear from the Phase I decision whether the code of conduct will evolve into something more than a requirement to cover FAOC on all flights. The Tribunal has been vague about how changes in opportunities for recapture and redeployment would affect its avoidable cost calculation. Full recapture is apparently to be assumed if load factors average less than 70-75 percent and competitors have relatively few flights on a route. Profitable redeployment is apparently to be assumed regardless of market circumstances as long as Air Canada is under pressure to seek out new opportunities. It may be that the opportunities for recapture and redeployment will simply be assumed sufficient to raise the opportunity cost of a flight up to its FAOC once a carrier is defined as dominant. The Tribunal has also been vague about how it would deal with costs that are not instantaneously avoidable as it assumed is the case for purposes of its Phase I decision. Recapture can be instantaneous and perhaps the Tribunal will rely on opportunities for recapture (which may follow, in turn, from dominance) as a sufficient basis for assuming instantaneous avoidability at all times.

The Tribunal may rectify some of the problems with its avoidable cost test by defining what constitutes a practice of anti-competitive acts more restrictively. The heart of the code of conduct is going to lie in the definition of a practice of anti-competitive acts and in the elaboration of the factors that go to the question of substantial prevention or lessening. That is, the Tribunal may ultimately define a practice as involving three

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consecutive months of failure to cover avoidable cost as the Commissioner advocated. It may allow legitimate business justification considerations such as aircraft repositioning and a properly calculated beyond contribution. It may recognize that any avoidable cost measure is an estimate that should be tested as well as test. In this regard, the Tribunal might recognize that the avoidable cost test might be interpreted in relative as well as absolute terms. That is, failure of the test by the incumbent both before and after entry is threatened says as much about the quality of the test as it does about competition. This will not be resolved until the unspecified future date at which the Tribunal renders its Phase II decision. Otherwise, it is left to the Commissioner's discretion. Until these matters are resolved, the code of conduct for Air Canada appears to require the cancellation of any flight that would fail to cover its FAOC for a period of one month regardless of reason or season.

Notes

- ¹ *Commissioner of Competition v. Air Canada*, 2003 Comp. Trib. 13 (the "Decision").
- ² Decision at para. 337.
- ³ Decision at para. 338.
- ⁴ W.J. Baumol, "Predation and the Logic of the Average Variable Cost Test", (1996) XXXIX(1) *Journal of Law & Economics* 49.
- ⁵ P. Areeda & D. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act" (1975) 88 *Harvard Law Review* 637.
- ⁶ Decision at para. 80.
- ⁷ Decision at para. 38.
- ⁸ Decision at para. 162.
- ⁹ An analogy when competitors are differentiated by geographic location would be section 78(1)(c) of the *Competition Act* which defines freight equalization on the plant of a competitor for purposes of impeding entry as an anti-competitive act.
- ¹⁰ Decision at para. 165.
- ¹¹ Decision at para. 76.
- ¹² Decision at para. 92.
- ¹³ Decision at para. 198.
- ¹⁴ Air Canada's Phase I Closing Argument at para. 139.
- ¹⁵ Decision at para. 199.
- ¹⁶ Decision at para. 88.
- ¹⁷ Air Canada's Phase I Closing Argument at para. 138.
- ¹⁸ This result may be familiar to section 96 veterans. It is equivalent to a plant rationalization in which one plant is closed and its output reallocated to the remaining plants. The net saving is the inherently avoidable plant-specific fixed cost of the closed plant which is \$2000 in this case.
- ¹⁹ Decision at para. 331.
- ²⁰ Decision at para. 118.
- ²¹ Decision at para. 331.
- ²² Decision at para. 333.
- ²³ Decision at para. 124.
- ²⁴ Decision at para. 128.
- ²⁵ Decision at para. 134.
- ²⁶ Decision at para. 135.
- ²⁷ Decision at para. 141.
- ²⁸ Decision at para. 197.
- ²⁹ Decision at para. 101.
- ³⁰ Decision at paras. 201, 203.
- ³¹ Decision at para. 226.
- ³² Decision at para. 232.

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- ³³ Decision at paras. 235, 237, 239, 242, 246, 250, 254, 259.
- ³⁴ Decision at para. 277.
- ³⁵ Decision at paras. 284-5.
- ³⁶ Decision at para. 280.
- ³⁷ Decision at para. 167.
- ³⁸ Decision at para. 168.
- ³⁹ Decision at para. 174.
- ⁴⁰ Decision at paras. 169, 183-4.
- ⁴¹ Decision at para. 196.
- ⁴² Decision at paras. 186-7, 194, 196.
- ⁴³ Decision at paras. 191-3.
- ⁴⁴ Decision at paras. 84, 86.
- ⁴⁵ Decision at paras. 174-5, 195.
- ⁴⁶ Decision at para. 329.
- ⁴⁷ Decision at para. 329.
- ⁴⁸ The profitability measures employed by the United States Department of Justice in its case against American Airlines included the upline/downline contribution in revenues. See *U.S. v. AMR Corporation*, United States Court of Appeals, Tenth Circuit, No.013202. See also A.S. Edlin & J. Farrell, "The American Airlines Case: A Chance to Clarify Predation Policy" Paper CP02-033 (Competition Policy Center, University of California, Berkeley, 2002).
- ⁴⁹ Decision at para. 299.
- ⁵⁰ Decision at para. 301.
- ⁵¹ Decision at para. 50.
- ⁵² Decision at para. 52.
- ⁵³ Decision at paras. 54-5.
- ⁵⁴ Decision at para. 327.
- ⁵⁵ Decision at para. 328.
- ⁵⁶ *U.S. v. AMR Corporation*, Memorandum and Order, United States District Court for the District of Kansas, No.99-1180-JTM.
- ⁵⁷ *U.S. v. AMR Corporation*, *supra* note 48.
- ⁵⁸ P. Bolton, J.F. Brodley and M.H. Riordan, "Predatory Pricing: Strategic Theory and Legal Policy" (2000) 88 *Georgetown Law Journal* 2239.
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IT'S NOT TOO TOUGH FOR THE CROWN TO WIN: THE PROSECUTORIAL TRACK RECORD IS NOT A BASIS FOR AMENDING SECTION 45 OF THE *COMPETITION ACT*

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Commentators have often pointed to prosecutorial failure as justification for amending section 45 of the *Competition Act*³. The “it’s too tough for the Crown to win” argument has re-surfaced in the discussion of further proposed amendments to section 45. In our view, a careful review of the Crown’s track record since the Supreme Court of Canada’s decision in *PANS*⁴ (as well as the Court’s reasons for judgment in that case), shows that the argument is without merit.

Amendment Proposals

In June 2003, the Commissioner of Competition circulated a discussion paper that addressed, among other things, the potential amendment of section 45 of the *Competition Act*⁵. Earlier, the House of Commons Standing Committee on Industry, Science and Technology issued a report that considered this issue.⁶ The merits of amending section 45 were also addressed in three papers commissioned by the Competition Bureau that were released in 2001.⁷

Advocates of amending section 45 often argue that the provision is “under-inclusive” in that it may not adequately cover certain conduct.⁸ The Bureau, in particular, has indicated its concern that it may be too difficult to obtain convictions under section 45 in contested proceedings for “hardcore” cartel activity.⁹ In support of this argument, the Bureau has referred to the Attorney General’s track record in prosecuting section 45.

The difficulty with obtaining convictions has been attributed to the difficulty of proving both the agreement element and the undueness element.¹⁰ With respect to undueness, it appears that a number of commentators favor amending section 45 so that proof of this element would not be required.¹¹ While different commentators take varying approaches, one proposal that seems to have some traction is that section 45 become a *per se* provision such that it would only be necessary to prove an agreement, the purpose or effect of which would be to have a specified anti-competitive effect such as increasing prices.¹²

Implicit in the Bureau’s arguments about the Crown’s lack of success in contested cases under section 45 is the notion that cases that were lost by the Crown should have been won. Accordingly, the Bureau advances the proposal that a *per se* offence is necessary to capture hardcore cartel activity. In assessing the Bureau’s concerns, it is worth considering why cases were lost, both to understand the court’s reasoning and to determine whether these cases involved hardcore cartels. The effectiveness of section 45 should be considered in light of developments since the Supreme Court of Canada’s judgment in *PANS*. As we note below, important statements in *PANS* have not been tested or explored in subsequent cases.

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In this paper we will look at the four contested cases under section 45 in the last dozen years. The Crown secured a conviction in one of these cases. However, a review of the other three cases (two acquittals and a discharge after preliminary hearing) does not indicate that the Crown should have any difficulty in obtaining convictions in hardcore cartel cases. Further, the numerous guilty pleas and a conviction by a jury in what mostly appear to be classic hardcore cartel cases argue for the contrary conclusion.

Hardcore Cartels – A Definition

Before assessing how difficult it may be to prove a hardcore cartel conspiracy, it is necessary to consider what is meant by “hardcore cartel”. There is somewhat of an “I know it when I see it” approach to this issue. Many commentators suggest that there is general support for *per se* treatment of hardcore cartels on the at least implicit basis that they harm society without redeeming social benefit.¹³ The definitional feature of harm to society is likely considered to mean cartel activity where harm is fairly obvious. Presumably, this occurs most frequently in markets where product and geographic markets are readily definable, there is little product differentiation, there are high barriers to entry and the parties to the cartel agreement have high market share on a combined basis. Markets with these features should not be particularly difficult ones in which to prove a section 45 case, under the provision as it is currently worded.

PANS – The Supreme Court of Canada

The seminal case regarding the interpretation of section 45 is the Supreme Court of Canada decision in *PANS*. The appellants were indicted for conspiracy under section 32(1)(c) of the *Combines Investigation Act*, which was the predecessor of section 45(1)(c) of the Act. The accused argued that the provision was unconstitutionally vague due to the use of the word “unduly”. The Nova Scotia Supreme Court, Trial Division granted a motion of the accused and quashed the indictment. The Appeal Division allowed the Crown’s appeal. On appeal to the Supreme Court of Canada, in deciding that the “undueness” inquiry was not unconstitutionally vague, the Court noted that there were 2 major elements to the inquiry: (1) the structure of the market, and (2) the behaviour of the parties to the agreement.

At ¶96, the Court said:

¶96 I will not venture into the intricacies of outlining the relevant market, other than to repeat that it comprises both geographical and product or service aspects, as was stated in *J. W. Mills*, at p. 303. Definition of the relevant market is a fairly circumscribed process, even though it may require considerable inquiry (see *R. v. Metropolitan Toronto Pharmacists’ Association* (1984), 3 C.P.R. (3d) 233 (Ont. H.C.)). [emphasis added]

At ¶109, the Court said:

¶109 Section 32(1)(c) therefore requires, in addition to some market power, some behaviour likely to injure competition. It is the combination of the two that makes a lessening of competition undue. Many combinations are possible.

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For one, market power may come from the agreement. The agreement could either have an “internal” effect, in consolidating the market power of the parties (as is the case with price-fixing) or have an “external” effect, in weakening competition and thus increasing the market power of the parties (as is the case with market-sharing). Market power may also exist independently of the agreement, in which case any anti-competitive effect of the agreement will be suspicious. A particularly injurious behaviour may also trigger liability even if market power is not so considerable. These are only examples of possible combinations of market power and behaviour likely to injure competition that will be “undue” under s. 32(1)(c) of the Act. [emphasis added]

The Supreme Court of Canada has therefore made it clear that if the behavior in question is egregious (such as hardcore cartel activity), a conviction may be entered even where “market power is not so considerable” and that the underlying market definition process is “fairly circumscribed” even though it “**may** require considerable inquiry”. This is because undueness arises from the combination of behavior and market power, an analysis of which provides for a “sliding scale” approach.¹⁴ Hughes and Sanderson have argued that the *PANS* framework provides “considerable scope to prevent anticompetitive collusion while not impeding pro-competitive inter-firm competition.”¹⁵ Likewise, there appears to be some flexibility in defining the relevant market.¹⁶

However, the requirement of less market power for hardcore cartels has received little consideration. Further, there does not seem to be any consideration of whether a less detailed or rigorous analysis of the market is appropriate in the case of hardcore cartels. Regardless of how detailed the assessment was, it seems that it would be easier to prove the market power element of the undueness analysis in a hardcore cartel case. It is difficult to accept the need for amendment without the Supreme Court of Canada’s guidance being tested on this point in the context of contested conspiracy cases.

PANS Trial – The Acquittal

The trial of the accused in *PANS* followed the Supreme Court of Canada decision.¹⁷ The accused were acquitted. In reasons for judgment, the trial judge conducted a detailed analysis using the framework set out by the Supreme Court of Canada.

The trial judge found that there was an agreement.¹⁸ The trial judge also found that the accused had a moderate degree of market power that, while not excessive, was sufficient to permit the accused to behave relatively independently of the market,¹⁹ and that the effect of the combination was an undue lessening of competition in the defined product market.²⁰

With respect to the question of intent, the trial judge found that the Crown had not proved that the accused would or should have known the likely effect of the agreement.²¹ In reaching this conclusion, the Court considered several factors that related to the “intricate and complicated effects of the various dealings between the Society/Association [the accused], the member pharmacies, the Government Plan and the third party insurers, which involved numerous and complicated negotiations, some mandated by law, some not.”²²

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The Court noted that the case “was not a straight price fixing case by any stretch of the imagination.”²³ The accused pharmaceutical association had agreed to set maximum dispensing fees with respect to customers on whose behalf the insurers paid the fees directly. The practice of negotiating maximum allowable tariffs had, in fact, originated with the Nova Scotia government pursuant to a prescription drug insurance plan. The government negotiated maximum fees, which in turn were billed by the pharmacists to the government insurance plan. Fee information was not a secret. Charge reports indicating market price were regularly submitted to the third party insurers.²⁴

While the accused took a common position in their contractual dealings with third party insurers, the fees were negotiated on a voluntary basis. In fact, the third party insurers preferred to negotiate with the association rather than with individual pharmacists. Moreover, the negotiations for maximum tariffs resulted in, among other things, capped billings and “most favoured nation” treatment for third party insurers. Such benefits clearly indicated countervailing market power.

The *PANS Trial* was not a hardcore cartel case. The activities of the accused were not covert. There were clear benefits to the alleged victims, who willingly participated in the negotiations. There also was some government involvement. It would be difficult to say that the acquittal in the unique fact situation of the *PANS Trial* would raise any difficulty for the Crown in prosecuting a hardcore cartel case.

R. v. Clarke Transport

The next contested case following *PANS* was *R. v. Clarke Transport*.²⁵ The Crown lost this case. The Crown alleged a conspiracy with respect to pool car freight forwarding services, and argued that the product market did not include services provided by truckers and rail services.²⁶ The Crown introduced evidence from 17 shippers that were customers of pool car freight forwarding.²⁷ The Court found that many of these witnesses gave evidence that “explicitly show[ed] that direct competition did exist amongst the three industries”.²⁸ The Crown also called one expert witness. The Court noted that the expert was the “fourth in a series of experts whom the Crown had retained with a view to demonstrating that the pool car industry constituted a separate relevant market”.²⁹ Although it does not say so, it would appear that the Court drew a negative inference from this fact as the other three experts were not called. It would also appear that the Crown could reasonably have anticipated difficulties with the alleged product market definition prior to trial. In any event, the Court indicated that it was satisfied that the expert “had approached his task with less than an open mind”.³⁰ The Court had serious doubts about the reliability of his testimony.³¹ It also found that many of the Crown’s expert’s conclusions were based on faulty assumptions, misperceptions, errors, miscalculations and a failure to take into account pertinent facts.³² Not surprisingly, the Court found the Crown’s expert evidence to be of little or no assistance.³³ The Crown called little if any evidence with respect to truckers and rail services.

Against this weak evidence was a “very powerful body of evidence” of “pervasive” inter-industry competition that had been introduced through the Crown’s witnesses.³⁴ The evidence showed that pool car, trucking and intermodal rail industries moved the same kinds of freight, that real and significant competition existed among the three industries for the business of moving that freight and that such competition was pervasive and not

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simply marginal.³⁵ Further, substantial rivalry existed among the three industries as they “constantly vied with each other” for the patronage of customers that required freight forwarding services.³⁶ The Court found that the alleged relevant product market was artificially narrow and should be expanded to include standard over-the-road trucking³⁷ and intermodal rail services.³⁸

While not inherently fatal to the Crown’s case,³⁹ the expanded product market nonetheless led to an acquittal as the Crown was unable to show any effect on competition in the expanded product market. The Court noted that the Crown had opted to focus on the narrow alleged product market.⁴⁰ It appears that the Crown may have had some misgivings about this narrow focus, since it advanced an argument that the accused had arrived at an understanding with truckers to respect each other’s markets and rates.⁴¹ The Court rejected this contention as speculative and unfounded and noted that the Crown made no attempt to elicit any evidence of this understanding from any of the witnesses that it called.⁴²

The Court referred to the evidence in *R. v. Abitibi Power and Paper Co.* which indicated that the accused had at least a 42.4% market share.⁴³ The Court agreed with the Crown that such market share was a good illustration of the kind of “moderate” market power required for the purposes of section 45(1)(c) of the *Competition Act*.⁴⁴

As to the broader product market that included services provided by truckers and intermodal rail operators, the Court noted that little evidence was led concerning the nature and dimensions of these competing industries that formed part of the broader market and that it had “no idea whether the freight forwarding services provided by the pool car industry accounted for 1%, 5%, 10% or 50% of the services provided in the broader market.”⁴⁵

The Court discussed the possibility that pool car operators might have already priced up to the elastic portion of the market demand curve. However, the Court noted that pool car operators were constantly concerned about increases in their cost of transport, and how such increases would affect their ability to remain competitive with truckers and still remain in business.⁴⁶

The Court concluded that “the pool car operators were engaged in active, consistent and pervasive competition with truckers and intermodal rail operators” and, with regard to fixing rates and setting service standards, “the pool car operators were constantly concerned about and mindful of the potential loss of significant portions of business to their major competitors”.⁴⁷ Given the existence of “pervasive” competition, the Court found that the accused did not have the requisite degree of market power. The Court found that the evidence of market power “does not even approach the moderate degree line”.⁴⁸ Concluding on the issue of market power, the Court stated: “Simply put, based on the evidence as a whole, I cannot say that the collective market power of the participants was anything more than negligible”.⁴⁹ It followed that the Court was not satisfied beyond a reasonable doubt that the likely effect of the agreement would be a substantial lessening of competition.⁵⁰

It appears that the Court in *Clarke Transport* had considerable doubt as to whether the parties to the agreement had any market power. Thus, it is difficult to argue that the elements of section 45 are so “under-inclusive” that they failed to capture hardcore cartel activity in this instance. Alternatively, if the behaviour in *Clarke Transport*

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is characterized as a hardcore cartel by proponents of amending section 45 such that it is a *per se* offence, the case itself demonstrates the lack of wisdom of this approach. An admittedly over-inclusive *per se* law would rely on prosecutorial discretion. If that discretion had been available at the time of the *Clarke Transport* trial and exercised in favour of a *per se* prosecution, it seems fairly clear that the innocent would have been convicted.

R. v. Jacques Perreault, Mimeo. and R. v. Bayda and Associates Surveys, Inc.

The two contested cases after *Clarke Transport* do little to advance an argument for section 45 amendment. The first case for consideration is *R. v. Jacques Perreault, Mimeo.*⁵¹ In September 1996, the operator of a driving school, Jacques Perreault, was found guilty of six charges under the Act, including conspiracy to fix prices, price maintenance and predatory pricing with regards to the markets for driving school lessons in Quebec.

Every applicant for a driver's license in Quebec was required to complete a course by an accredited driving school. However, the Quebec government froze the issuance of new licenses for these schools in 1987. Consequently, it was impossible for a new competitor to enter the market for driving school lessons. Moreover, once a competitor left the driving school market, it could only transfer its license to another accredited driving school. As a result, the Crown argued that there were no available substitutes in the market for driving schools.

The Crown alleged that Mr. Perreault conspired with other owners of driving schools to fix the price for lessons at a high level. Mr. Perreault and the other parties to the conspiracy were alleged to have a market share of 94% in the school market, which was local.⁵² Further, Mr. Perreault threatened other driving school owners who did not join the conspiracy, and engaged in predatory pricing to drive these competitors out of the market. Mr. Perreault was convicted and sentenced to one year in jail. Because this was a jury trial, there are no reasons for judgment. However, it would seem from the Court's Reasons for Sentencing that Mr. Perreault's conduct would attract the "particularly injurious" label. In this case, at least, section 45 was apparently sufficient to capture hardcore cartel behaviour.

In *R. v. Bayda & Associates Surveys Inc.*,⁵³ the accused were land surveyors who produced and sold real property reports for residential properties. They were charged under section 45(1)(c) after agreeing to supply these reports at a minimum price of \$325, which was an increase from previous prices. The preliminary hearing judge discharged the accused on the basis that there was no evidence upon which a properly instructed jury could find an agreement.⁵⁴ The judge did not assess whether the agreement unduly lessened competition.⁵⁵ The Crown applied to quash the judge's decision, but this application was dismissed for two reasons. First, the Crown was late in commencing its application, with the Court subsequently finding that it was barred.⁵⁶ Second, the Court found that the preliminary hearing judge had applied the right test and came to a reasonable result (the standard of review being reasonableness, not correctness).⁵⁷

It is difficult to glean from these cases that the "undueness" element of section 45 should be removed: one instance involved a conviction and jail sentence, while the other was dismissed for lack of evidence of an

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agreement. Proof of an agreement would still be necessary even if section 45 was amended to be a *per se* offence.

Convictions Based on Guilty Pleas

Advocates of a *per se* offence under section 45 make reference to numerous acquittals as evidence of the provision's ineffectiveness.⁵⁸ However, if we consider how the conspiracy provision has been applied since the *mens rea* element was clarified in *PANS*, section 45 does not appear as ineffective as reform advocates would suggest. Facey and Assaf point out that, from 1993 (post *PANS*) to October 2001, there have been 28 convictions, with fines of over \$148 million.⁵⁹ During that same period, there have been two acquittals and one discharge, for a conviction rate of approximately 90%. Only the Commissioner knows the number (if any) of section 45 prosecutions that were never brought because the "undueness" element was thought to be too difficult to establish. What is clear, however, is that in the cases that have been pursued, the Crown has been remarkably successful in obtaining convictions through guilty pleas.

Conclusion

The Attorney General's track record in the last dozen years does not support an argument that section 45 should be amended. There have been numerous guilty pleas and, among the cases that were contested, a conviction by a jury.

Examining the three contested cases that did not result in conviction does not change this contention. None of the three lost cases fall into the classic hardcore cartel category. Only one was decided on the basis of undueness.

In the *PANS Trial*, the accused were acquitted because the Crown failed to prove that the accused knew or should have known that the agreement would or would be likely to unduly lessen competition. A *per se* offence in section 45 that revolved around the purpose or effect of an agreement would not likely address this issue. If the accused did not know the unlawful effect, how could they have the unlawful purpose? In any event, the case was not lost on the basis of the undueness test.

In *Bayda*, the accused were discharged after the preliminary hearing on the basis that there was not evidence on which a jury could find an agreement. A *per se* provision is not going to solve that problem for the Crown, unless it will no longer be necessary to prove an agreement in a conspiracy case.

In *Clarke Transport*, the Crown failed to prove the alleged product market and could not prove that there would be an undue lessening of competition in the broader product market defined by the Court. While the case was lost on the basis of the undueness test, the reasons for judgment do not support an argument that this was a classic hardcore cartel case that somehow went wrong. Rather, it appears that the Crown lost in *Clarke Transport* as a result of an unduly aggressive alleged product market definition. It is important to emphasize that after hearing the Crown's best arguments as to competitive effect, the Court found none was proved. A *per*

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se provision might well have allowed for a conviction. However, it would seem to be bad policy to amend section 45 on the basis of *Clarke Transport* when the Crown so clearly failed to demonstrate competitive harm.

With great respect for the Bureau's dedication and professionalism, it is not objectively reasonable to expect that, in the presence of a *per se* provision, the Bureau would invest the resources to conduct the same analysis to determine whether there is any actual competitive harm as would be done if the Crown had to show undue harm. This is an important point, as one of the main "solutions" to the overreach of a *per se* provision is prosecutorial discretion.⁶⁰ It is worth considering the hypothetical situation of section 45 being a *per se* offence at the time of the trial in *Clarke Transport*. Would it really be in the interests of justice that the accused in *Clarke Transport* were convicted of a *per se* criminal offence in light of the circumstance of that case? In our view, the answer is clearly "no".

Further, the meaning of *PANS* has not been explored. When faced with particularly egregious hardcore cartel behavior, the "sliding scale" approach to "undue harm" implies that proof of the requisite level of market power will be easier. This should be tested in the context of a hardcore cartel prosecution before amendment of section 45 is further considered.

In conclusion, it cannot credibly be said that hardcore cartels have gone unpunished in Canada in the past dozen years. It is clear that of the three losses of section 45 prosecutions in that period, two (*PANS Trial* and *Bayda*) would not likely be addressed by amending section 45 such that it be a *per se* provision. The third loss (*Clarke Transport*) is a good example of why courts ought to continue to address the question of whether any harm flows from a conspiratorial agreement. It is too much to rely on prosecutorial discretion and expect the Bureau to get the answer right in every case. This is not a criticism. Rather, it is a recognition that in the context of the enforcement of criminal laws, particularly in the complex area of economic crime, accused should have the right to have the charges proved against them in a court of law. That relatively few exercise this right demonstrates the strength of the law, the generally reliable nature of the Bureau's investigations and the effectiveness of Crown prosecutors. However, amending the law such that reliance is placed on prosecutorial discretion does not provide any comfort for those few persons who can show an impartial court that they are on the receiving end of a defective investigation. These persons should not be sacrificed on the altar of prosecutorial efficiency.

Notes

¹ Partner, Stikeman Elliott LLP.

² Associate, Stikeman Elliott LLP.

³ R.S.C. 1985, c. C-34, as amended.

⁴ *R. v. Nova Scotia Pharmaceutical Society* [1992], 2 S.C.R. 606 ("*PANS*").

⁵ Government of Canada, "Options for Amending the Competition Act: Fostering a Competitive Marketplace" (June 2003).

⁶ House of Commons Standing Committee on Industry, Science and Technology, "A Plan to Modernize Canada's Competition Regime" (April 2003).

⁷ See R.S. Russell, A.F. Fanaki & D.D. Akman, "Legislative Framework for Amending Section 45 of the Competition Act" (April 2001) ("*Borden Ladner Gervais Report*"); McCarthy Tétrault, "Proposed Amendments to Section 45 of the Competition Act" (August 2001) ("*McCarthy Tétrault Report*"); and A. Gourley, "A Report on Canada's Conspiracy Law: 1889-2002 and Beyond" (August 2001) ("*Macleod Dixon Report*").

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⁸ Several papers argue that the current form of section 45 is “under-inclusive” and thereby fails to capture criminal conduct. See J. Quinn, M. Nicholson, C. Hersh & P. Watson, “Reforming Canada’s Conspiracy Laws: Towards a Workable Proposal” (Competition Law Invitational Forum, November 2003) (“Quinn et al”); C.S. Goldman & R.E. Kwinter, “International Hard-Core Cartel Enforcement and Possible Reform of Section 45 of the Competition Act” (CBA Annual Fall Conference on Competition Law, October 2002); and R.W. McCrone, “Reform of Section 45 of the Competition Act, A Bureau Review” (CBA Annual Fall Conference on Competition Law, October 2002). Two earlier articles advocating the amendment of the conspiracy law are: P.L. Warner & M.J. Trebilcock, “Rethinking Price-Fixing Law”, (1993) McGill Law Journal, Vol. 38, and J.T. Kennish & T.W. Ross, “Towards a New Approach to Agreements Between Competitors”, (1997) Canadian Business Law Journal, Vol. 28. These articles also proposed a “dual-track” approach to the conspiracy provisions.

⁹ See H. Chandler & R. Jackson, “Beyond Merriment and Diversion: The Treatment of Conspiracies under Canada’s Competition Act” (Roundtable Discussion on *Competition Act* Amendments - Insight Conference, May 2000) (“Chandler & Jackson”); and R. Pierce, “Reform of Section 45 – The Bureau’s Perspective” (Competition Law Invitational Forum, May 2002) (“Pierce”).

¹⁰ See Chandler & Jackson, *ibid.* and Quinn et al, *supra* note 8.

¹¹ See Borden Ladner Gervais Report, *supra* note 7 at 61 and Chandler & Jackson, *ibid.* at 5.

¹² See Pierce, *supra* note 9 where he states at 5: “We believe that certain categories of competitor agreements are almost always harmful to competition and, therefore, should be made unlawful without the need to prove that competition would be prevented or lessened unduly. Potentially, these include agreements aimed at fixing prices, allocating markets or customers, restricting supply, or preventing entry or expansion of a firm in a market.”

¹³ Macleod Dixon Report, *supra* note 7 at 8-11; McCarthy Tétrault Report, *supra* note 7 at 11-12 and Borden Ladner Gervais Report, *supra* note 7 at 60-61. For a discussion of the impediments of a *per se* approach, see L.A.W. Hunter & D. Royal, “Section 45 Amendments: A Cure Worse than the Disease?” (Competition Law Invitational Forum, May 2002).

¹⁴ CBA National Competition Law Section, “Submission on Reform of Section 45 of the *Competition Act* (Conspiracy)” (February 2003) (“CBA Submission”) at fn. 29.

¹⁵ P. Hughes & M. Sanderson, “Conspiracy Law and Jurisprudence in Canada: Towards an Economic Approach”, (1998) Review of Industrial Organization, Vol.13, No.1-2 at 162 (“Hughes & Sanderson”).

¹⁶ D. McPetridge, “Horizontal Agreements as Reviewable Practices” (CBA Annual Fall Conference on Competition Law, October 2002) at 13. See also Hughes & Sanderson, *ibid.* at 171.

¹⁷ *R. v. Nova Scotia Pharmaceutical Society* (1993), 49 C.P.R. (3d) 289 (N.S.S.C.) (“*PANS Trial*”).

¹⁸ *Ibid.* at 313-314.

¹⁹ *Ibid.* at 326.

²⁰ *Ibid.* at 329.

²¹ *Ibid.* at 335-336.

²² *Ibid.* at 336.

²³ *Ibid.* at 335.

²⁴ *Ibid.* at 305-306, 334.

²⁵ *R. v. Clarke Transport* (1995), 64 C.P.R. (3d) 289 (Ont.Ct.Gen.Div.) (“*Clarke Transport*”).

²⁶ *Ibid.* at 290.

²⁷ *Ibid.* at 316.

²⁸ *Ibid.* at 317.

²⁹ *Ibid.* at 317.

³⁰ *Ibid.* at 317.

³¹ *Ibid.* at 318.

³² *Ibid.* at 318.

³³ *Ibid.* at 318.

³⁴ *Ibid.* at 318 and 319. It was noted at 291 that the defence chose not to call evidence.

³⁵ *Ibid.* at 315.

³⁶ *Ibid.* at 315-316.

³⁷ *Ibid.* at 319. The Court noted at 318 that it was absurd to suggest that airline transport existed in the same product market as the pool car industry. The Court also noted at 318 its inclination to view the expedited over-the-road trucking industry and the pool car industry as separate product markets. However, at 318-319 the Court held that it was unnecessary to resolve this issue. Expedited trucking formed part of the freight forwarding service provided by truckers, which included standard over-the-road trucking.

³⁸ *Ibid.* at 319.

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³⁹ *Ibid* at 308-309. The Court said that, as a matter of law, it could still be possible to show the requisite effect on competition in an expanded product market

⁴⁰ *Ibid.* at 319.

⁴¹ *Ibid.* at 299.

⁴² *Ibid.* at 299-300. Apparently while being cross-examined, one witness gave evidence to this effect, indicating that he had done some "rate checking" However, the Court noted that there was no evidence that such rate checking was premised on an arrangement or understanding between the pool car operators and the truckers. The Court stated that the Crown "made no effort to elicit an explanation from him."

⁴³ (1960), 131 C.C.C. 201 (Q.C. Q.B.).

⁴⁴ *Clarke Transport, supra* note 25 at 321.

⁴⁵ *Ibid.* at 321.

⁴⁶ *Ibid.* at 323-324. This would indicate thin margins. Lack of margin is an indicator (but not more) of a lack of market power.

⁴⁷ *Ibid.* at 323.

⁴⁸ *Ibid.* at 325.

⁴⁹ *Ibid.* at 325.

⁵⁰ *Ibid.* at 325. The Court used the terms "unduly" and "substantially" interchangeably throughout the judgment. At the onset of the undueness analysis, the Court stated that the Crown bore the onus of establishing, beyond a reasonable doubt, that the likely effect of the agreement would be "the substantial lessening of competition such that it could be said to be undue" (emphasis added) (p. 300). The Court later concluded that it was not "satisfied beyond a reasonable doubt that the likely effect of the agreement would be the substantial lessening of competition" (emphasis added) (p. 324). Yet the Court clearly applied the test for "undueness" that was outlined by the Supreme Court in *PANS* and applied by the trial judge in the *PANS Trial*. Consequently, it is arguable that the Court in *Clarke Transport* conflated the test for "undue lessening of competition" with "substantial lessening of competition". This description of the test may not be correct. Undueness necessarily includes an intent element. In contrast, intent should be irrelevant in a section 92 case where the substantial lessening of competition test is used. In the context of *Clarke Transport*, the distinction probably did not matter. The Court was clearly convinced that the Crown failed to prove that the accused had market power.

⁵¹ *R. v. Jacques Perreault, Mimeo.*, Quebec Superior Court, (Trial Division), Court File No. 450-27-005489-893, Reasons for Sentence, September 9, 1996 ("*Perreault*"). Since this case was a jury trial, reasons for judgment are not available.

⁵² *Perreault, ibid.* at 7.

⁵³ (1997), 78 C.P.R. (3d) 203 (Alta. Q.B.) ("*Bayda*").

⁵⁴ *Ibid.* at 206.

⁵⁵ *Ibid.* at 218.

⁵⁶ *Ibid.* at 216-217. The Crown's application was dismissed due to time limitations. There was no further analysis of the "undueness" element under the conspiracy charges.

⁵⁷ *Ibid.* at 220.

⁵⁸ See *Chandler & Jackson, supra* note 9 at 2, and *Quinn et al, supra* note 8 at 12.

⁵⁹ B. Facey & D. Assaf, "Innovation, Growth and Prosperity: A Framework for Amending Canada's Conspiracy Laws" (2001-2002) 20:4 *Can. Comp. Rec.* 61 at 63.

⁶⁰ As noted by the Canadian Bar Association National Competition Law Section Task Force on Section 45, prosecutorial discretion is exercised by the Attorney General, not the Commissioner. However, since essentially all recommendations to prosecute section 45 cases are likely to come from the Commissioner, the Commissioner's exercise of discretion to not refer a matter to the Attorney General may practically amount to the same thing. See CBA Competition Law Section, "Section 45 Amendments Task Force Report" (2003) 21:3 *Can. Comp. Rec.* 27 at 34-35.

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**FROM SUPERIOR PROPANE TO BILL C-249:
THE CONSEQUENCES OF INFORMED IGNORANCE?***

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Introduction

In their article in the previous issue of the *Record*, Ross & Winter (2003:8) opine that the Section 96 test applied by the Competition Tribunal in its redetermination decision in *Superior Propane* “is well reasoned and leaves us with a legal merger standard that is coherent, appropriate, and as predictable as one could reasonably hope for.” Second, they argue for a method of assessing mergers vis-à-vis Section 96 that seems, depending on how it is interpreted, almost identical to the third step of the Balancing Weights Approach advanced in Townley (1999), a methodology that found some favour with the first Federal Court of Appeal decision in this case. Third, they describe Bill C-249 as “misguided and potentially dangerous.”

Although we take issue with some parts of the Ross & Winter treatment of the welfare economics of mergers, we agree with others and, indeed, have made many of the same points elsewhere, albeit with varying degrees of formality.¹ Still, their support for a robust welfare economics approach to merger policy is welcome. Nevertheless, we do not agree with their view that the Tribunal formulated a method that captures all of the essentials of the welfaristic approach these authors now advocate.² Also, we think the improvement they suggest may be a step backward. While we share their opinion of Bill C-249 and view the final outcome of *Superior Propane* as providing no basis for amending the *Competition Act*, we think this legislation and the political process leading to it raise additional concerns.

Bill C-249 proceeded from the House of Commons to the Senate in the fall of 2003 where it was examined by the Standing Senate Committee on Banking, Trade and Commerce. In a letter of 13 November 2003 from the Chair of that committee to the then Minister of Industry, Allan Rock, Senator Richard Kroft refers to ongoing consultations regarding other aspects of the *Competition Act* and that C-249 could become part of them. He opines, “[S]uch consultations may be appropriate prior to our committee continuing further consideration of this bill.”³ Bill C-249 received second reading in the Senate on April 1, 2004 and was referred to the Standing Senate Committee on Banking, Trade and Commerce. As we are not sure if C-249 will continue to stand alone or become part of a broader package of amendments, for convenience we will use “C-249” in a general sense, to mean both current and future forms of the same ilk.

In the following section, we set out the essential welfare economics problem vis-à-vis the Section 96 trade-off and the properties of various ways to address it. We then review and assess the Competition Tribunal’s method of dealing with distributional impacts in *Superior Propane*. We wish to make clear that, in the absence of evidence regarding producer surplus deadweight loss due to the *Superior Propane* merger, we would have been very surprised had the Tribunal reversed its original decision on redetermination.⁴ Our view is that while the

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Tribunal's method is lacking in some respects, it would be a simple matter to put it right. In the section entitled "The Ross & Winter Proposal", we explain why we think the method advocated in Ross & Winter (2003) to deal with distributional impacts is, at best, not an improvement on the Balancing Weights Approach. Then, in "The Legislative Reaction", we augment these authors' view of Bill C-249 and those expressed in Holsten (2003) regarding the political process leading to it by examining (a) the quality and quantity of information acted upon, (b) the dubious link between the language of the bill and the intent expressed by its supporters in committee, and (c) the practice and sense of distinguishing legislative and administrative merger standards. The final section concludes.

The Essential Aggregation Problem

If we adopt the view that an ideal merger rule would allow mergers that enhance the well-being of Canadians and disallow those that would diminish it, the task becomes how to get as close to this ideal as possible subject to informational constraints.⁵ This task becomes difficult in the case of a cost-saving, price-increasing merger because it would result in gainers and losers.⁶ This is not a new problem, and it must be addressed whenever an act or policy would create winners and losers in the absence of a mechanism that provides actual (as opposed to hypothetical) compensation to losers.⁷ The essential problem is one of aggregation; how to add up measurable dollar gains and losses in order to best assess whether the aggregate dollar value indicates an increase or decrease in social welfare. This is a mathematical problem in need of at least one ethical assumption in order to be made tractable. A number of methods, each necessarily resting on some value judgment, have been proposed and/or used to address this aggregation problem in the absence of full information.⁸

- A Price Standard disallows any merger that would diminish the well-being (utility) of consumers regardless of the magnitude of gains to producers.⁹ This standard involves arbitrarily imputing zero distributional weight to producers relative to consumers. That is, we are to act on a belief that an extra dollar in the hands of a shareholder represents no social benefit. The potential for this rule to disallow mergers that would enhance social welfare is well-known.¹⁰
- The Total Surplus Standard treats gains and losses symmetrically, as if simply summing dollar gains and losses is equivalent to summing individuals' utility gains and losses. This would only be valid if all individuals valued dollars at the margin equally, but this need not be so. Of relevance is that if those who would gain by a merger are wealthier than those who would lose, satisfaction of the Total Surplus Standard may not indicate an increase in aggregate well-being (social welfare). This rule arbitrarily assigns equal distributional weights to consumers and producers, and thus it has the potential to allow welfare-diminishing mergers.
- The difference between the Total Surplus Standard and the Consumer Surplus Standard is that the former counts those losses of consumers that are transferred to producers (because of higher prices) as offsetting gains, whereas the latter counts them only as losses to consumers. Thus extra dollars in the pockets of producers as a result of efficiencies count socially, but those arising from the exploitation of

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market power do not. Again, how the Consumer Surplus Standard treats distributional impacts is quite arbitrary, and its lack of foundation in welfare economics has been thoroughly documented.¹¹

Townley's Balancing Weights Approach differs from the above because it rejects the arbitrary weighting of relative distributional impacts.¹² It is an approach to the basic aggregation problem that would cause members of the Tribunal to focus on the essential efficiency-equity trade-off in light of case-specific evidence regarding a merger's distributional impacts. All of the Price, Total Surplus and Consumer Surplus Standards involve a value judgment with respect to this trade-off, but none of them does so in light of the evidence of the specific merger in question. That is, they lack the flexibility required to make an informed value judgment.¹³ Because the Balancing Weights Approach is not arbitrary in this sense, it has the greatest potential to treat distributional impacts as egregious (negligible) only when, in fact, they are egregious (negligible).

In its simplest form, the Balancing Weights Approach involves an assessment of whether or not a specific merger would have adverse distributional impacts and, if so, a determination of their strength relative to efficiency gains.¹⁴ In the first relative assessment, the distributional consequences of a merger would likely only be considered adverse if those who would lose were less wealthy than those who would gain. If gainers and losers were all poor or all wealthy, the Tribunal would likely have a basis for assuming that all individuals' social marginal utilities of income were close enough to being equal to apply, in essence, the Total Surplus Standard. However, if these distributional impacts were deemed adverse based on the evidence, according to the Balancing Weights Approach they would have to be assessed relative to the merger's efficiency impacts. Obviously, the smaller the efficiencies or the more egregious the distributional impacts, the more likely the merger would be rejected. Importantly, the process requires two relative judgments: one to determine the nature of the merger's impact on equity, and the second to assess equity impacts versus efficiency ones.

Care should be taken, however, to interpret the Balancing Weights Approach correctly because it rests on an assumption from which it follows that the sole justification for differential distributional weights resides in income or wealth differences.¹⁵ When Ross & Winter (2003:10) state that the "basis of different weights must lie in the difference in the wealth levels of shareholders and consumers" [emphasis added], it should be appreciated that this follows only if Townley's non-discrimination assumption is invoked.¹⁶ Although many would think it reasonable that differential weights not be assigned on the basis of non-wealth factors in the context of antitrust enforcement, and thus reveal a specific view of distributive justice,¹⁷ we emphasize that it is an assumption and not an absolute truth.¹⁸ Although seemingly unrecognized, this assumption may lie at the heart of some of the debate surrounding Section 96. For example, Ross & Winter (2003:10) state: "Nothing in the labels 'consumer' and 'shareholder' inherently justifies different weights." Although we may agree that nothing in these labels should justify such differential treatment, it would appear that supporters of Bill C-249 think differently and are prepared to discriminate on this basis.

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The Tribunal's Method

Five paragraphs in the Redetermination decision capture the Tribunal's methodology with respect to distributional impacts and their assessment vis-à-vis net efficiencies attributable to the merger. Respectively, they are paragraphs 110, 111, 368, 370 and 371:

In the Tribunal's view, the correct weight should be established by society or should reflect social attitudes toward equity among different income classes. There may be several sources from which the proper weighting can be inferred, one such being the tax system, which is explicitly, although not solely, concerned with equity. It is clear that the prevailing system of taxation in Canada does reflect a social consensus about the desirability of imposing burdens on different income classes. If tax rates are progressive with respect to income, then society has decided that the marginal dollar of income is worth less to the high-income taxpayer than it is to the low-income taxpayer. If, for example, the lowest tax rate is 20 percent and the highest is 50 percent, there is clear indication that low-income individuals are favoured over high-income individuals; assigning a weight of 1.0 to the latter group, the corresponding weight on the former would be 2.5.

Based on their recent review of the literature for the Canadian Tax Foundation, Professors Boadway and Kitchen conclude that:

...Taken overall, the tax system seems to be roughly proportional to income. This does not imply that government policy considered more generally is not redistributive. Much of what governments do on the expenditure side of the budget appears to be motivated by redistributive objectives, and it seems that a substantial amount of redistribution does, in fact, take place through expenditure programs – a consideration that further weakens the case for a highly progressive income tax structure.

(See R. Boadway and H. Kitchen, *Canadian Tax Policy*, Paper No. 103, 3rd edition, Canadian Tax Foundation, 1999 at 45.)

The Tribunal notes that it is possible to quantify the adverse redistributive effects of the transfer on household consumers of bottled propane in the lowest-income quintile based on the evidence of Professor Townley and Professor Ward. As there are approximately 102,465 consuming households in that group, and as the average expenditure per consuming household in that group is \$277 per year (Townley report, exhibit A-2081, Table 2), total sales to that group are approximately \$28.4 million per annum. Since the Commissioner's measured deadweight loss assumes a demand elasticity of -1.5 and a price increase to residential consumers in general of 11 percent (Commissioner's Memorandum

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on Redetermination Proceedings, Appendix A), the transfer is 9.2 percent of sales (Ward report, exhibit A-2059, Table 8). Accordingly, on the Commissioner's evidence, the measured adverse redistributive effect on that group is approximately \$2.6 million. This estimate assumes that all propane consumed by households in this group is for essential purposes.

Having assessed the measured adverse redistributive effect based on the evidence, it remains for the Tribunal to decide how to combine it with the measured deadweight loss of \$3 million and the maximum deadweight loss attributable to changes in the merged company's product line of \$3 million. Weighting redistributive effects equally with efficiency losses, the three effects would be added together to produce a maximum total effect of approximately \$8.6 million.

However, there is no statutory basis under the Act (or in U.S. antitrust law) for assuming such equal weighting: perhaps the adverse redistributive effects should weigh twice as heavily as efficiency losses, in which case the three weighted effects would not exceed \$11.2 million. Alternatively, since efficiency concerns are paramount in merger review, perhaps adverse redistributive effects should be weighted half as much as deadweight losses. In the instant case, it is clear that the adverse redistributive effects are, on the evidence, quite small. Accordingly, the Tribunal is of the view that under any reasonable weighting scheme, the gains in efficiency of \$29.2 million are greater than and offset all of the effects of lessening and prevention of competition attributable to the merger under review.

We appreciate the difficulty of the Tribunal's task, especially as it was not eager to assess distributional impacts and had made some effort to explain why such should not be part of the Section 96 balancing exercise. Moreover, it did not help that the Commissioner of Competition had abandoned his original approach to distributional impacts after the first Federal Court of Appeal ruling. As Ross & Winter (2003: 17) note: "To the surprise of many observers as well as the Tribunal, the Commissioner abandoned the balancing weights approach (i.e. the welfare weights standard) that he had adopted in the first hearing through his expert, Dr. Townley; the Court of Appeal had commented favourably upon the balancing weights approach, stating that it would be consistent with its ruling." Indeed, the Commissioner argued along the lines of a Consumer Surplus Standard (coupled with a "burden of proof" argument) previously rejected by his own witness.¹⁹ Still, there are some key elements to any welfare economics approach to Section 96 analysis, and the question for us is whether they were captured by the Tribunal's method.

One problem is that the Tribunal's assessment of the merger's distributional impacts was not a relative one based on case-specific information. Whereas it did take into account the situation of those who would lose based on the evidence, it did not assess it relative to the circumstances of those who would gain.²⁰ Principal gainers were identified in the original Tribunal decision at paragraph 330:

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Superior is managed by Superior Management Services Limited Partnership (“SMS”) which acquired the obligations and benefits (the “Management Agreement”) of managing Superior from the previous manager, Union Pacific Resources Inc., in May 1998 for \$5 million (Cole-Kearney Report Compendium Binder: confidential exhibit CR-114, tab A1, appendix B). Superior Incentive Trust (“Incentive Trust”), which holds the class A units of SMS, receives distributions thereon of the management fees which Superior pays to SMS pursuant to the Management Agreement. The management group of Superior (Grant Billing, Mark Schweitzer and Geoff Mackey) owns 28 percent of Incentive Trust’s units and hence is entitled to 28 percent of the distributions made by Incentive Trust. A group of investors, Enterprise Capital Management Inc. (the “Enterprise investors”), owns the remaining 72 percent of Incentive Trust’s units.

Instead of relying on case-specific evidence regarding gainers, which we acknowledge was limited, the Tribunal appealed to the work of Professors Boadway and Kitchen, whose analysis is based on aggregates. As Mathewson & Winter (2000:90) confirm, “If one were to incorporate redistributive effects in merger analysis, then it would be necessary to consider not just the wealth of consumers but also the wealth of the shareholders of the merging firms.” Essentially, the Tribunal treated those who gained as if they were considerably wealthier than those who would lose because of the merger. We note that if losers are treated as poor in the extreme relative to gainers, and equity impacts are still judged to be dominated by efficiency ones, the result may be judged fairly to be robust. Although it likely mattered little given the values used for deadweight loss and efficiencies attributed to the merger, the Tribunal’s approach lacks the specific, relative assessment required to address the essential aggregation problem. In another case where the evidence indicates, for example, negligible adverse distributional impacts, presumably we would not wish to employ the Tribunal’s method.²¹

A second reservation concerning the Tribunal’s procedure is their appeal to observed marginal income tax rates in order to infer welfare weights for different income groups. This is somewhat hazardous as these rates do not reveal purely distributional objectives. A tax-and-transfer system is the result of a joint optimization problem involving efficiency, equity and transaction cost objectives. That is, the observed tax schedule is the product of a series of trade-offs, and thus its properties should not be attributed to a single social objective. Further, as noted in Townley (2003), the extent to which governments attempt to mitigate and prevent adverse distributional impacts in public sector project evaluation and implementation argues away from the Potential Pareto Improvement Criterion and toward the Pareto Improvement Criterion as the revealed public interest test of choice.

A third concern is that the Tribunal attempted to “quantify the adverse redistributive effects of the transfer” rather than account for all the gains and losses of the affected parties. A basic problem with the Consumer Surplus Standard is that it accords different social values of dollars flowing to producers depending on their source. The Tribunal’s method, essentially, compounds this problem. Regarding the transfer only, they treat the dollars lost by consumers as being worth more than those gained by producers. However, they treat the rest of consumers’ losses (consumer surplus deadweight loss) symmetrically with producers’ gains from efficiencies.

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Thus, implicitly, the value of a dollar lost by a consumer depends on how it is lost, and the value of a dollar gained by a producer depends on its source. As the marginal utility of a dollar gained or lost by any individual consumer or producer depends on that individual's income (or wealth), it does not make sense that dollars gained or lost by an individual are assigned different values depending on the nature or source of the loss or gain. Therefore, the Tribunal's method shares some of the shortcomings of the Consumer Surplus Standard.

Still, we cannot be too critical of the Tribunal's approach. Without evidence of producer surplus deadweight loss it is unlikely that much precision was required to reach the decision they did. Importantly, they did bring some case-specific evidence to their Section 96 analysis and did make the value judgment and methodology underlying their decision explicit. This is preferred to the application of any arbitrary standard – Total Surplus, Price or Consumer Surplus – each of which carries an implicit value judgment and lacks the flexibility to account for case-specific evidence. If, for some reason, Bill C-249 or a variant of it does not become law, surely some of the shortcomings we have identified can be corrected with little difficulty in a future merger case.

The Ross & Winter proposal

Notably, in their discussion of fixed distributional weights, Ross & Winter assess them as applied to all consumer losses and all producer gains, not just the transfer from consumers to producers, and thus they avoid the Tribunal's pitfall. Nevertheless, we have some problems with their proposed method.

They state (at 15): "Our analysis above indicates that for a typical case, conditioning upon a relative welfare weight 50% higher for the poorest quintile of the population, welfare weights on consumer surplus and profit would be approximately (.508, .492)." Further, they state: "It may well be argued that the adoption of an inflexible standard of (.5, .5) is optimal on three grounds: (1) creating greater certainty in the law; (2) minimizing Tribunal discretion; and (3) reducing the costs of hearings."

If this is their recommendation, even if some set of fixed weights other than (.5, .5) is used, we suggest that Ross & Winter are ignoring a principal finding of the first Federal Court of Appeal decision. Evans J.A. writes (at ¶-140):

Whatever standard is selected (and, for all I know, the same standard may not be equally apposite for all mergers) must be more reflective than the total surplus standard of the different objectives of the *Competition Act*. It should also be sufficiently flexible in its application to enable the Tribunal fully to assess the particular fact situation before it. [emphasis added]

However, it may be that Ross & Winter are not wed to these (or any other) arbitrary weights. They state further (at 15): "The upshot of this practical concern, it may be argued, is that the welfare weights should be set to some objective, default values for most cases or almost all cases, and should deviate from these values only when the justification for doing so is very compelling." Thus, it may be that they mean to use distributional weights of (.508, .492) unless evidence of egregious distributional impacts is adduced. If so, it is difficult to see how this is an improvement on the Balancing Weights Approach which, at the relevant step, would examine if

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there is reason to diverge from the weights implicit in the Total Surplus Standard (0.5 and 0.5 according to the scale adopted by Ross & Winter). Besides, their default set of weights is predicated on “typical” mergers, an arbitrary income distribution measure (quintiles) and assumptions regarding the income elasticities of those affected by the merger. Although we can think of their proposed weighting scheme as providing an allowance for the risk of adverse distributional impacts, essentially it provides only a (slightly) different starting point for the assessment of case-specific evidence regarding such impacts. They state (at 15):

We believe, however, that some allowance must be made for the possible merger cases in which the vast majority of consumers are poor and in which the gain in total surplus is small. These are cases in which the total surplus rule would possibly be reversed by redistribution concerns. Indeed, this is the law after the first Court of Appeal decision that factors such as wealth redistribution must at least be considered; and in our opinion this is appropriate.

This, and more, is accomplished by the Balancing Weights Approach, which the authors (at 9) judge to be “a very appealing method of implementing the weighted surplus standard because it allows the Tribunal to make a decision without having to establish a precise value for the relative weights of consumers and producers, thus potentially reducing the difficulty of their decision and allowing them to avoid unnecessary commitment to a very specific set of weights.” Therefore, we see no reason to diddle with an approach that has already been viewed favourably by the Federal Court of Appeal.

The Legislative Reaction

A widely held view among economists is that had evidence of additional deadweight loss due to pre-existing market power been properly adduced, and had claimed variable cost savings on units produced pre-merger but not post-merger been dismissed, it is likely that Superior Propane’s Section 96 defence would have failed.²² If we were to include the Tribunal’s assessment of adverse distributional impacts, this likelihood would only become stronger.

Of course, had the Commissioner wanted to and been allowed to adduce evidence regarding producer surplus deadweight loss and overstated cost savings at Redetermination, we would not have expected counsel for Superior Propane to be idle. For example, they may have wished to adduce additional evidence with respect to Section 92. Our view is that with a fuller set of information upon which to base the decision, we would be more confident of the public interest being served whatever the outcome. Had the Tribunal’s substantial lessening and prevention of competition (“SLC and SPC”) findings stood, and had the efficiency defence failed on the basis of newly adduced evidence such that an order had been issued, we would see the public interest as having been served. Had, based on additional information, the SLC and SPC findings been overturned at Redetermination, the public interest would also be seen to have been served.

Our concern here is not the outcome of that case as it pertains to propane producers and consumers but, rather, the legislative reaction to it in the form of Bill C-249. The ultimate outcome of *Superior Propane* was seen as a rationale to amend Section 96 by members of the House of Commons Standing Committee on Industry,

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Science and Technology. Had these Members of Parliament been made thoroughly aware of the deficiencies of the Commissioner's prosecution of Section 96²³ – which have been the subject of several published articles – perhaps they would have concluded that no legislative action was required. Indeed, they may have wished to review various facets of this case at some length.

Bill C-249, as amended late in the process by its sponsor, MP Dan McTeague, is:

96.(1) In determining, for the purposes of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may, together with the factors that may be considered by the Tribunal under section 93, have regard to whether the merger or proposed merger has brought about or is likely to bring about gains in efficiency that will provide benefits to consumers, including competitive prices or product choices, and that would not likely be attained in the absence of the merger or proposed merger.

In his criticism of Bill C-249 and the process, Holsten (2003:5) argues that legislative changes “should be preceded by a thorough policy debate” and “receive the thoughtful consideration they deserve.” Certainly, the Committee chose not to hear the views of all interested parties. The Committee's researcher reported the following to the Committee:²⁴

In the last two weeks I was contacted by a number of lawyers and economists who want to make presentations to the committee. [...] There have been about seven people who would like to appear on Bill C-249. I'll just mention that some members thought there was not enough public consultation on such an important amendment to the act.

The Committee chose not to issue an invitation to any of these individuals and voted in favour of Bill C-249 as amended just after the above statement was made. We note that supporters of Bill C-249 were not able to produce a single academic economist willing to voice support for it. As the *Competition Act* is economic framework legislation, we find this telling.

Aside from our view that no legislative action was warranted given the Federal Court of Appeal's first decision, we see problems in addition to those noted by Ross & Winter and Holsten that might have been addressed had this legislation been subjected to a more extensive consultation process. Although several people have expressed strong opinions as to the meaning of Bill C-249, we note that these opinions vary across individuals. Certainly, a perceived lack of clarity of its language, uncertainty as to how it would be applied, the potential for multiple tests for “substantial lessening or prevention of competition” across the *Competition Act* and its backdoor approach to Section 93 are worrisome. Extensive litigation may be required, yet again, to clarify Section 96.

When (or if) that future case is adjudicated, our guess is that someone will look to the legislative intent of the amended Section 96. After all, if the Redetermination decision in *Superior Propane* is any example, much effort – paragraphs 37 through 81 – was devoted to the history and legislative intent of Section 96 of the 1986 Act.

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Unfortunately, they will likely find any link between the language of Bill C-249 and the intent expressed by the Committee rather weak. The Committee's hearing transcripts reveal that the principal motivation for Bill C-249 was the outcome of *Superior Propane*, especially with respect to those geographical markets classified as "monopoly" post-merger.²⁵ Although deficient in itself, at least to economists, an amendment along the lines of "Section 96(1) shall not apply in the case of elimination or near elimination of competition" would have provided more clarity and spoken directly to Committee members' expressed concerns.²⁶

Also, the Committee was not apprised fully of developments in antitrust enforcement elsewhere. For example, whereas the actions of Canadian authorities would diminish the role of efficiencies in merger assessment, their American counterparts are doing what they can to encourage merging firms to claim efficiencies. We note that the consumer interest in efficiencies beyond positive price and quality impacts has been a subject of investigation at the Federal Trade Commission for at least two years.²⁷ Moreover, there is a lack of appreciation that legislated and administrative standards may differ. This is not a novel concept and might be regarded as sensible. For example, although the efficiency standard enunciated in the 1997 U.S. *Horizontal Merger Guidelines* has been interpreted as directing a price standard (also known there as a consumer welfare standard) by several American courts,²⁸ the administrative standard for efficiencies enforced by their antitrust agencies is not fully transparent. Mergers can be declared "not to lessen competition substantially" even when efficiency gains are not sufficient or of the type necessary to offset any real price increase caused by increased market power in the relevant antitrust market. This lack of administrative transparency and the rebuttal treatment of efficiencies by the agencies permit a less restrictive consideration of efficiency gains in the exercise of negative prosecutorial discretion by enforcement agencies. Indeed, Kolasky & Dick (2002) argue that the approach outlined in the *Horizontal Merger Guidelines* should probably be described as a "hybrid consumer welfare/total welfare" standard.²⁹

Translated into our terminology, this American hybrid administrative standard resides somewhere between a Price Standard and a Total Surplus Standard which, of course, form the limits of the Balancing Weights Approach and the evidence-augmented variation suggested by Ross & Winter. In his statement to the Committee, the then Commissioner of Competition stated:³⁰

Bill C-249 in its present form and the proposed amendment, are consistent with the treatment of efficiencies in other jurisdictions. This is particularly important in a multi-jurisdictional context because divergence in merger review can adversely affect the ability of firms to compete internationally. In the US, competition policy serves the interest of consumers.

To the extent that Committee members were swayed by the Commissioner's argument, we note that he offered support for a legislative standard that, according to some American commentators, American authorities are not administering. We suggest that jurisprudence from the *Superior Propane* case gives Canada a sensible legislative standard that the Bureau could administer – the best of both worlds. The upshot is that if the Committee wished to do what the Americans do, perhaps they should have done nothing. Speculation aside, we see this as one

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more reason to view the outcome of the political process to amend Section 96 of the re:*Competition Act* as confused and uninformed.

Conclusion

A thread running through both the *Superior Propane* case and its aftermath concerns the value of information. At the initial hearing, information concerning producer surplus deadweight loss arising from pre-merger market power was disallowed, even though the transcripts reveal that both counsel and the Tribunal were aware of it. At Redetermination, no new evidence was adduced, even though Mathewson & Winter (2000) regarding overstated cost savings and understated deadweight loss had circulated widely prior to it. Had the Tribunal been able to take this information – and any additional information from Superior Propane – into account, we would have felt some confidence that, whatever the outcome of the case, the public interest had been served and, importantly, had been seen to be served.

We do not decry the decision of the Competition Tribunal to disallow this information. Rules are what they are, as are litigation strategies gone awry. However, we point out that the House of Commons Standing Committee on Industry, Science and Technology is not bound by the same rules of evidence as the Tribunal. Nevertheless, is it clear that they adopted Bill C-249 in reaction to *Superior Propane* without an appreciation of the gory details of that case and its prosecution. Indeed, other legislative reforms considered by the Committee have been subject to more extensive consultation. Bad cases can make bad law – as can lack of information.

In our view, amending Section 96 for the wrong reasons (*Superior Propane*) is akin to “throwing out the baby with the bathwater”. Valuable jurisprudence and procedures arose from decisions of both the Competition Tribunal and the Federal Court of Appeal. Having settled on a welfare economics approach to the balancing exercise of Section 96, the Tribunal devised a method of applying it that, although not perfect, requires only minor correction. Legislation like Bill C-249 would leave us with a legislative standard that, if applied, would increase dramatically the probability of disallowing welfare-enhancing mergers to the detriment of Canadians. Of course, given the problems with Bill C-249 we have noted, it would not be surprising if an effort to apply this standard resulted in extensive, costly litigation. Much depends on the Competition Bureau. Optimistically, they may decide to administer the standard flowing from *Superior Propane*, thus distinguishing an accepted administrative standard from a legislative one that lacks informed support.

Notes

* The views and opinions herein are those of the authors and are not purported to be those of their respective organizations, of Industry Canada or of the Government of Canada. The authors thank Brian Facey of Blake, Cassels & Graydon LLP and Dr. Larry Schwartz, formerly of the Competition Tribunal.

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¹ See, for example, Townley (1999), Duhamel & Townley (2003), Duhamel (2003) and Townley (2003).

² Ross & Winter use the term “utilitarianism” while acknowledging (their endnote 3) that they mean “welfarism”. A welfaristic social welfare function can take a very general functional form as all that is required is that social welfare depend on the well-being of

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members of society, usually defined to be individuals or households. A utilitarian social welfare function, as Ross & Winter advise, involves a very specific functional form – a special case of a more general one. We prefer the precise terminology of welfare economics and emphasize the generality of its application.

³ A copy of this letter is available from the corresponding author.

⁴ Mathewson & Winter (2000) estimate total deadweight loss to be 8.5 times the value reported by Michael Ward in his affidavit for the Commissioner when both consumer surplus and producer surplus deadweight loss are included. See Ward (1999).

⁵ This view was posited by Townley in his affidavit in *Superior Propane*, in which the Balancing Weights Approach was first enunciated. See Townley (1999).

⁶ As in Townley (2003), we will treat only the case where the merger involves selling power, setting aside any monopsony power concerns.

⁷ Even if compensatory damages were allowed – where consumers would be compensated for the increase of market power yet the firms' profits still increase – there is still an equity judgment to be made regarding the preferred distribution of economic resources in the economy. As the institutions that enforce competition policy in Canada have not been vested with instruments that can effect such redistribution, this issue has been largely ignored. See Appendix A of Townley (1999) for his treatment of it.

⁸ For a fuller discussion of the welfare economics of various standards see Townley (1999) or Duhamel & Townley (2003). As noted in the latter, “Consumer Surplus Standard”, “Total Surplus Standard” and “Price Standard”, respectively, mean at least four, three and two different things to different people. Here we will use the terminology adopted in those articles and Townley (2003).

⁹ We mean to be as general as possible. “Producers” could be shareholders, bondholders, managers or others depending on the circumstances.

¹⁰ Ross & Winter (2003:10) state: “The price standard, which as mentioned is logically equivalent to selecting the most extreme set of weights, 1 on consumer surplus and 0 on producer surplus, lacks any theoretical support.” In our view, this is not correct. The Pareto Improvement Criterion underlies the Price Standard, and the Potential Pareto Improvement underlies the Total Surplus Standard. See Townley (1999). Still, the drawbacks of both criteria and their associated merger standards are acknowledged.

¹¹ See, especially, Duhamel & Townley (2003).

¹² Ross & Winter (2003:11) appeal to Rawls for an *ex ante* motivation for differential weights, but this is incomplete. In several articles on social choice theory, Harsanyi treats Rawls' veil of ignorance when individuals do not exhibit the degree of risk aversion assumed by Rawls. Applying Harsanyi to merger analysis yields a rule consistent with the Balancing Weights Approach. For example, see Harsanyi (1978).

¹³ As noted elsewhere, none of the above account for all the objectives of Section 1.1. All must be augmented with evaluations of a merger's impacts on other factors including dynamic efficiency, net exports and opportunities for small and medium-size firms.

¹⁴ This step in the approach would only be reached if the merger in question satisfied the Total Surplus Standard but failed to satisfy the Price Standard.

¹⁵ See Appendix A of Townley (1999): “If one believes that one person's well-being is as important as the next person's”

¹⁶ In this sense, the Balancing Weights Approach has an element of arbitrariness.

¹⁷ See Duhamel (2003).

¹⁸ For example, in other contexts governments routinely discriminate on the basis of age, occupation and sex in the pursuit of various social objectives.

¹⁹ At one point in the redetermination proceedings, Nadon J. states: “Are those working at the Commissioner's working on Planet X [...] how many times will they change their mind...” See Redetermination Transcripts, Volume 4, page 665, lines 3-6.

²⁰ Regardless of how weights are normalized, a comparison is required.

²¹ In the draft *Merger Enforcement Guidelines* of March 2004 (Sections 8.25-8.27), the Commissioner of Competition indicates that the “nature” of buyers will be examined, but there is no mention of the income characteristics of producers, thus apparently missing the importance of relative assessments. However, other approaches are invited, so this omission may be corrected.

²² That is, we agree with Mathewson & Winter (2000) and we are not aware of any challenge to their analysis of the deficiencies (with respect to overstated cost savings and omitted producer surplus deadweight loss) they note in the Commissioner's prosecution of the case.

²³ The Commissioner of Competition was not asked by the Committee his view of the likelihood of an order being issued in *Superior Propane* had he adopted a different litigation strategy, perhaps one that incorporated the analysis of Mathewson & Winter. It was not until the next meeting, some days later, that the Committee heard from Professor Tom Ross: “I think that case could well have been

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won on a straight total surplus standard.” MP Dan McTeague actually quoted Mathewson & Winter (2000) to members of the Committee, but not the parts concerning understated deadweight loss and overstated cost savings.

²⁴ Meeting 38 at 1640 hours. The “Minutes and Evidence” of the 37th Parliament, 2nd Session, Standing Committee on Industry, Science and Technology can be found at <http://www.parl.gc.ca/InfoCom/CommitteeMinute.asp?Language=E&Parliament=138&Joint=0&CommitteeID=3270>. The relevant meeting numbers are #33 (31 March 2003), #34 (2 April 2003), #35 (7 April 2003), #37 (9 April 2003) and #38 (28 April 2003). #36 (8 April 2003) was a closed session. We will cite meeting number and time only.

²⁵ We are aware of the discussion of this elusive concept in the Redetermination decision, especially at paragraphs 268 and 269. We mean it in an unsophisticated way; a market occupied by a single seller who can or has made price and quantity decisions in a manner that exploits market power without undue concern for the possibility of entry.

²⁶ Duhamel & Townley (2003:7) put it thus: “[C]onsistent with a *rule of reason* approach, if it is true that the anti-competitive effects of a merger to monopoly are egregious in the extreme, demonstration of this on a case-by-case basis should not be burdensome.” Still, if we had to choose between this language and Bill C-249, we would opt for the former because it has less potential to prevent welfare-enhancing mergers.

²⁷ We are not even sure that the Committee appreciates how the first Federal Court of Appeal’s ruling with respect to the Balancing Weights Approach in *Superior Propane* addressed consumer-interest concerns.

²⁸ For example, see *FTC v. University Health, Inc.* and *FTC v. Tenet Health Care Corp.*

²⁹ Kolasky & Dick (2002) at 31-32.

³⁰ Speaking Notes for Konrad von Finckenstein, Commissioner of Competition, 31 March 2003 at 5.

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