COMMENT AND ANALYSIS

RECENT U.S. SUPREME COURT DECISIONS WITH CANADIAN COMPETITION PRACTICE RAMIFICATIONS: THE *EMPAGRAN* AND *INTEL* DECISIONS

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Two recent decisions released by the U.S. Supreme Court in June 2004 have the potential to directly impact competition law practice in Canada. In *F. Hoffman-LaRoche Ltd.* v. *Empagran S.A.*[1], the U.S. Supreme Court put some limits on the ability of foreign purchasers to bring civil actions in the U.S. for damages suffered as a result of anticompetitive conduct outside the United States. In *Intel Corp.* v. *Advanced Micro Devices, Inc.*[2], the U.S. Supreme Court expanded the rights of foreign complainants and plaintiffs to seek discovery in the United States.

In the *Empagran* case, the Court held that foreign purchasers cannot use the U.S. courts to pursue damages for price fixing conspiracies unless the foreign purchasers can demonstrate that their damages are not "independent" of those suffered by purchasers in the United States. In so holding, the *Empagran* decision put to rest the contention that an exception enumerated under the U.S. Foreign Trade Antitrust Improvement Act (the "FTAIA") could apply to provide foreign purchasers with treble damage claims in U.S. courts against foreign companies where they could demonstrate simply that there was "an" effect of the international conspiracy on U.S. commerce.

The U.S. Supreme Court held that the exception of the FTAIA ought to be interpreted to avoid unreasonable interference with the sovereign authority of other nations. As a result, in order to bring themselves within the exception and the jurisdiction of the U.S. courts, foreign plaintiffs must demonstrate that the effect on foreign plaintiffs of the anticompetitive conduct is not independent of the adverse domestic effect on U.S. commerce. The U.S. Supreme Court did not specify when an effect is considered to be independent of the effect on U.S. domestic commerce. While future Canadian plaintiffs will no doubt advance creative interpretations of the decision to enable them to sue in the U.S., it is clear that at least some Canadian plaintiffs will be obliged to pursue their price fixing class actions in Canada.

In *Intel*, the U.S. Supreme Court held that a complainant in a European Commission competition investigation had standing to apply to a U.S. Court for production of documents in the U.S. relevant to its complaint, even though the European Commission had declined to seek the information for its own investigation. The decision may open the door for Canadian plaintiffs in civil actions and complainants in Canadian competition investigations to seek orders from U.S. Courts for discovery, or access to discovery materials from private suits in the United States.

Advanced Micro Devices ("AMD") filed an antitrust complaint against Intel Corp. with the Directorate-General for Competition (the "DG") of the Commission of the European Communities (the "Commission"), alleging that Intel had abused its dominant position in the European market through loyalty rebates, exclusive purchasing agreements, price discrimination and standard-setting cartels. Although AMD had recommended to the DG that it seek documents produced or filed by Intel in a private antitrust suit filed in Alabama, the DG decided not to seek such production. AMD then applied to the District Court for an order directing Intel to produce the documents, relying on a statutory provision enacted in 1964 to encourage U.S. judicial assistance for foreign proceedings.

28 U.S.C. §1782(a) provides that a federal district court "may order" a person residing or found in a district to give testimony or produce documents "for use in a proceeding in a foreign or international tribunal" upon the application of "any interested person." The District Court for the Northern District of California held that §1782(a) did not permit AMD to seek production of the material as a complainant in the EU investigation. The Court of Appeals for the Ninth Circuit reversed that finding, holding that "tribunal" within the meaning of §1782(a) includes ongoing or pending administrative or quasi-judicial proceedings. Since a proceeding that is judicial in nature was likely to follow the DG's investigation, the Ninth Circuit held that there was a pending proceeding in a foreign or international tribunal within the meaning of §1782(a). The Ninth Circuit remanded the application back to the District Court for determination, rejecting Intel's argument that §1782(a) required, as a threshold, that the information sought would have been discoverable in the Commission's investigation.

Intel's appeal to the U.S. Supreme Court was supported by an *amicus* brief from the Commission. The Commission stated that it did not want or need the assistance of the District Court. Further, it characterized its own function as being more in the nature of a prosecuting authority than a Tribunal within the meaning of §1782(a), and that the granting of the relief sought could lead to the disclosure of confidential information, encourage fishing expeditions and undermine the Commission's Leniency Program.

Despite these concerns, the U.S. Supreme Court affirmed the decision of the Ninth Circuit, holding that:

(1) a complainant before the European Commission qualifies as an "interested person" within the meaning of §1782(a);

(2) the Commission is a "tribunal" within the meaning of §1782(a) when it acts as a decision-maker at first instance;

(3) the "proceeding" for which discovery is sought under §1782(a) must be in reasonable contemplation, but need not be "pending" or "imminent"; and

(4) §1782(a) contains no threshold requirement that evidence sought from a federal district court would be discoverable under the law governing the foreign proceeding.

The U.S. Supreme Court rejected the argument that §1782(a) was intended to restrict assistance to litigants in foreign proceedings to seek information that would be discoverable in the litigant's home jurisdiction. In the

Intel case, this would have meant that only the DG could seek the assistance of the U.S. Courts for information that would also be compellable in the Commission's investigation. In rejecting the foreign-discoverability threshold, the Court noted that the domestic tribunal would retain jurisdiction to determine the use to be made of any information produced from the U.S. proceeding in accordance with its own domestic laws.

The U.S. Supreme Court stopped short of granting the order for production, cautioning that §1782(a) authorizes, but does not require, the federal district court to provide judicial assistance to foreign or international tribunals or to "interested persons" abroad. The merits of AMD's application were remanded to the District Court for determination.

In holding that a complainant in a European Commission investigation was an "interested person" within the meaning of §1782(a), the U.S. Supreme Court noted that a complainant in Commission proceedings has "significant procedural rights", including the right to submit information in support of the complaint to the DG, and the right to seek judicial review of the Commission's disposition of a complaint. In Canada, although a complainant has a right to submit information in support of its complaint to the Competition Bureau, a complainant does not have standing to apply for judicial review of either the Commissioner's decision to cease an inquiry, the Competition Tribunal's disposition of an application brought by the Commissioner for civilly reviewable matters, or to appeal a finding of a court in criminal proceedings. However, complainants regularly seek, and are frequently granted, intervener status in Tribunal proceedings, with some participatory rights within the discretion of the Tribunal.

The *Intel* decision may open the door to complainants in Canadian competition investigations, who may also be contemplating a private action for damages or a private application to the Tribunal, to seek discovery or to seek access to discovery from parallel U.S. litigation, even where the Bureau is not seeking the information in order to support their own investigation.

The *Intel* decision should be read in conjunction with the Ontario decisions in the Vitamins class proceedings, which permitted the plaintiffs to use the U.S. courts to seek access to confidential discovery evidence in parallel proceedings in the United States. In *Ford* v. *F. Hoffman-LaRoche Ltd.*[3], Ontario courts refused to prohibit Ontario plaintiffs from proceeding with a motion in a U.S. court seeking access to discovery in parallel U.S. actions. If successful on their U.S. motion, the Ontario plaintiffs would be permitted to use U.S. discovery evidence to further their class proceeding pending in Ontario, before the class proceeding had been certified in Ontario, and before their discovery rights in the Ontario class proceeding were operative. The Ontario Divisional Court held that because the Ontario Court retains jurisdiction regarding the admissibility of any information obtained from the U.S. proceeding, it was inappropriate for the Ontario Court to interfere with the exercise of the U.S. courts' jurisdiction. The Ontario Court of Appeal affirmed the Divisional Court's decision and the Supreme Court of Canada denied leave to appeal.

Thus, we have the U.S. Supreme Court in *Intel* suggesting that the U.S. Courts will be receptive to discovery requests from foreign complaints, and the Ontario Courts saying that they will not prevent Canadian complainants

from pursuing these avenues. It will be interesting to see whether complainants in Canadian competition investigations will seek to use §1782(a). It could be an attractive option for complainants who are also plaintiffs or potential plaintiffs in class proceedings.

Notes

[1] 124 S. Ct. 2359 (2004).
[2] 124 S. Ct. 2466 (2004).
[3] *Ford* v. *F. Hoffman-LaRoche Ltd.* [2003] O.J. No. 868 (Ont. C.A.) affirming [2002] O.J. No. 1400 (Div. Ct.). Leave to appeal to the Supreme Court of Canada denied [2003] S.C.C.A. No. 245 (S.C.C.).

CANADIAN COMPETITION RECORD

THE CASE FOR SINGLE-JURISDICTIONAL TREATMENT OF TRANSNATIONAL MERGERS

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Introduction

On July 3, 2001, the European Commission announced its decision to prohibit the proposed acquisition of Honeywell by General Electric ("GE"). Following a four-month investigation (eight months after the initial merger announcement), the Commission concluded that the merger would "... create dominant positions in several markets and that the remedies proposed by GE were insufficient to resolve the concerns resulting from the proposed acquisition of Honeywell" (European Commission, 2001). As the U.S. Justice Department had previously approved the merger subject to a relatively minor divestiture, the decision was the source of much controversy, precipitating criticism and allegations of protectionism from U.S. economists (e.g., Varian, 2001), politicians,[1] and antitrust authorities (e.g., Kolasky, 2001). Even though the proposed merger involved two U.S. companies, without the European Commission's approval, GE was forced to abandon its acquisition of Honeywell.[2]

The controversy surrounding the divergent outcomes of the U.S. and EU competition authorities with respect to GE/Honeywell highlights a growing impediment to firms developing global business strategies. While increasing globalization has naturally led to a proliferation of transnational corporations and transnational mergers,[3] merger review has become increasingly fragmented with the proliferation of merger notification regimes. This paper examines the problem of multijurisdictional merger enforcement and proposes a framework for a solution.

The Proliferation of Cross-Border Merger Activity and Merger Notification Regimes

The economic expansion of the 1990s gave rise to the largest merger wave in history. Between 1992 and 1999, the total world-wide value of mergers and acquisitions increased at an annual rate of 35.7%, from $231 billion to $1,964 billion (Pryor, 2001). In an effort to restructure in the face of increasing globalization, many multinational corporations have turned to cross-border mergers (OECD, 2001a). Consequently, cross-border merger activity accounted for a large proportion of the total; the world-wide recorded value of cross-border mergers and acquisitions increased from $81 billion (35% of the total) in 1992 to $792 billion (40% of the total) in 1999 (OECD, 2001b).

This rise in cross-border merger activity has corresponded with the proliferation of merger regimes. As nations have come to recognize the importance of competition in promoting economic well-being, they have established antitrust laws as a means of preserving competitive markets. Thus, while in 1990 there were approximately a dozen merger notification regimes, today there are over 60 (Rowley/Wakil/Campbell, 2000). Given the rapid rise in the number of merger regimes and in cross-border merger activity, it is, perhaps, a surprise that there have not been many more controversial merger decisions such as occurred with GE/Honeywell.[4]

Impediments to Multijurisdictional Mergers

The current fragmented system of merger enforcement imposes substantial impediments on firms undertaking multijurisdictional mergers. These impediments come with a potentially high cost. The ultimate objective of merger review is the protection of consumers through the preservation of competition. Therefore, while anticompetitive mergers should be prohibited, it is imperative that the merger review process does not impose too great an opportunity cost on firms seeking to merge; otherwise, these firms may choose not to pursue mergers which are procompetitive or enhance efficiency.[5]

There are numerous sources of efficiency that can result from mergers. Mergers can enhance productive efficiency by providing firms with economies of scale (declining average costs as output increases) and economies of scope (cost savings resulting from the joint production of two or more products). They can enhance innovation (dynamic efficiency) by allowing firms to share knowledge and combine research and development efforts, and reduce transaction costs by eliminating rent-seeking behaviour of "middle men." Mergers can reduce procurement costs through volume discounts, and reduce the cost of raising capital. Finally, it is argued that mergers can promote operational efficiency (X-efficiency) through the removal of ineffective management and a reallocation of an acquired firm's resources to more productive uses.[6]

Many of these efficiencies will ultimately lead to lower costs or improved products for consumers. Therefore, it is important that the merger review process does not impose impediments that discourage firms from forming such efficiency-enhancing mergers. The most immediate impediment is the filing fees imposed by numerous jurisdictions. The size of these fees varies according to the jurisdiction and often according to the size of the proposed merger. U.S. authorities, for example, charge a fee of $45,000 for transactions valued up to $100 million, $125,000 for transactions valued between $100 million and $500 million, and $250,000 for transactions valued above $500 million.[7] When the merging parties' operations span numerous jurisdictions, the sum of these fees can be significant.[8]

More significant, there are the administrative costs of filing in numerous jurisdictions. These costs include fees for lawyers, economists, and translators, as well as the opportunity cost of management's time and attention being diverted away from ordinary business operations. The costs associated with the filing process are compounded by an extensive divergence in the regulations and procedures required by merger regimes. The differences in procedural requirements include the following:

- There are a variety of threshold tests for filing under various regimes. Some of these thresholds are based on the assets or revenues of the merging parties, while others are based on market shares (bringing the difficulties associated with defining the relevant market to the forefront at a very early stage).

- The various jurisdictions have a variety of filing deadlines, some of which occur very shortly after the announcement of the merger agreement.

- The filing requirements differ significantly, often requiring substantial information even at this early stage (despite the fact that the vast majority of mergers requiring notification pose no problems for the authorities).

- Firms must prepare notification and submit other documents in a variety of languages.

These procedural differences greatly increase the direct and indirect costs to firms facing multijurisdictional merger review and represent major impediments to undertaking mergers across multiple jurisdictions. Jacques Bougie, President and Chief Executive Officer of Alcan Aluminum, summarized the extensive hardships his firm faced over the review of the proposed Alcan-Pechiney-Algroup merger ("APA"):

- There were over 40 countries in which the APA parties had assets and/or revenues that may have triggered merger notification thresholds.

- More than 35 consulting firms provided antitrust advice.

- Two new merger control regimes entered into force between the initial public announcement of the transaction and its completion.

- Sixteen merger notification filings were ultimately made (not counting one post-completion merger filing and two foreign investment filings).

- Over $100,000 in merger notification filing fees were paid.[9]

- Notifications were ultimately submitted in eight different languages: Czech, English, German, Polish, Portuguese, Russian, Spanish, and Turkish.

- It took almost half a year to comply with the U.S. Justice Department's second request.

- As regards the second request, Alcan's Montreal office alone generated 400 boxes of printed material, and one million pages of e-mails and thousands of Pechiney and Alusuisse documents had to be translated from French and German into English (Bougie, 2000).

A more significant impediment arises from the lack of timeliness associated with multijurisdictional merger review. A merger is a strategic investment decision that is a response to the merging parties' economic and competitive environment (Weston, 2001). In the high-tech economy in which many multinational mergers take place, market conditions change rapidly, requiring a quick strategic response. However, in dealing with the complexities of a multitude of merger regimes, firms have to wait months for an authority's decision (it only takes one lagging jurisdiction to hold up the entire process). By this time, even if the merger is approved, the strategic opportunity may be lost. If the merger is not approved, the firms face the opportunity cost of not being able to pursue alternative strategies while the merger was under review. Consider GE/Honeywell. The review

by the two enforcement agencies lasted a full eight months after the initial merger announcement, and this delayed Honeywell's execution of a crucial cost-reducing strategy. Honeywell had just initiated a restructuring program when it agreed to be acquired by GE. The merger put a halt to this program, as management switched focus towards integrating with GE. Honeywell Chairman and Chief Executive, Lawrence A. Bossidy, attributed his company's relatively scant savings in 2001 "to the distraction of Honeywell's aborted takeover by GE, when the company was more focused on integration planning than executing its cost-cutting strategies" (Barrett and Brady, 2001). Delayed decisions prevent firms from moving forward and, thus, represent a significant opportunity cost to firms pursuing merger strategies.

The most significant impediment to multijurisdictional mergers is the uncertainty that is created by divergent substantive frameworks. Before undertaking any strategy, including a merger, businesses must assess the likelihood of success. With numerous merger control regimes, each applying a different set of rules and tests, predicting the outcome of the review process has become much more difficult. Such uncertainty increases the opportunity cost of pursuing multijurisdictional mergers.

Perhaps the greatest source of divergence in merger evaluation are the different prohibitive criteria applied by the various regimes. While some regimes, such as the EU, Germany and Romania apply a market dominance (MD) test, others, such as the U.S., the UK, Canada, New Zealand, and Australia, apply a substantial lessening of competition (SLC) test. Article 2(3) of the EC Merger Regulation, as recently amended, describes the MD test as applied by the EU:

> A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market (European Commission, 2004).

In contrast, the SLC test of section 7 of the *Clayton Act*, as amended by the *Celler-Kefauver Act*, reads:

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital ... of the assets of another person engaged also in commerce where ... the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly (U.S. Department of Justice, 2001).

Thus, while the MD test prohibits mergers which create or strengthen dominant positions, the SLC test aims to prohibit mergers which result in a substantial lessening of competition. The SLC test is generally a more flexible standard which allows for the inclusion of competitive criteria other than the creation of dominance. While, on the surface, there seems to be little to distinguish between the two tests, they can, nevertheless, produce divergent results.

Towards a Solution

Given the impediments to multijurisdictional mergers outlined above, the status quo would appear to be grossly inadequate. While a multilateral approach might eventually produce an adequate solution, the problem demands

a more timely response than a negotiated multilateral agreement can provide. Therefore, the U.S. and the EU should conclude an agreement on the single-jurisdictional review of mergers falling under both jurisdictions. This agreement would immediately cover a large portion of cross-border mergers; on average, between 1995 and 1999, the U.S. and the EU accounted for approximately 87% of all outward mergers in OECD countries and approximately 83% of all inward mergers in OECD countries (OECD, 2001a). The agreement would be open to other jurisdictions wishing to participate,[10] and it would go far beyond the cooperation and information-sharing of the many existing bilateral agreements between antitrust authorities. The specific aspects of this proposed agreement are twofold:

1. The EU and the U.S. would have to adopt a common set of procedures and a common substantive evaluative framework. Most important, merger review should be conducted using the SLC test rather than the MD test.

2. Merger review should be conducted solely by the agency of the jurisdiction of the acquiring firm. Other jurisdictions would be invited to provide analyses and opinions when a proposed merger would likely have a significant impact on the markets in those jurisdictions. This participation by other jurisdictions would be restricted to an advisory capacity. This would ensure that the effects of proposed mergers on different relevant geographic markets would be given adequate consideration, while the efficiencies of single-jurisdictional review would be maintained. As a precedent, the 1989 EC Merger Regulation had a provision that created an Advisory Committee on concentrations in Article 19(3-6). This Committee consists of up to two representatives from each member state. In Article 19(6), it is clearly stated that "[t]he Commission shall take the utmost account of the opinion delivered by the Committee."[11]

These recommendations are examined in detail below.

Adoption of a Common Substantive Framework

Mergers must be evaluated under a common substantive approach to reduce the uncertainty associated with the review process. Divergent approaches make it more difficult for firms to predict the outcome of the reviews of their proposed mergers. This uncertainty increases the opportunity cost of merging and, thus, increases the likelihood that firms will decide not to pursue procompetitive or efficiency-enhancing mergers. Therefore, merger review requires a common substantive framework.[12] The most critical element of analysis requiring convergence is the prohibitive criterion. In this regard, merger review should be conducted under the SLC test. There are numerous reasons for choosing the SLC test over the MD test as the common standard for evaluating mergers.

A common argument is that the EU should keep the MD test to maintain a legal continuity.[13] It is felt that a switch to a different benchmark, i.e., from dominance to SLC, would infer a new element of merger evaluation. Consequently, present and future merger cases could no longer be directly compared to the application of merger control in the past under the MD test. This argument loses significance in view of the relatively short period of 13 years experience with the EC Merger Regulation of 1989.[14] Compare this to the more than 50

years of experience with the SLC test under section 7 of the *Clayton Act* of 1914 as amended by the *Celler-Kefauver Act* of 1950.

European officials claim that, from a practical perspective, there is little difference between the application of the market MD test and the SLC test. For example, a recent study by the German Federal Cartel Bureau concluded that:

> The analysis ... of the various competition authorities' decision-making practices with regard to oligopolistic market dominance, vertical integration, and conglomerate mergers does not suggest that applying either the MD criterion or the SLC criterion leads to substantial differences in terms of rigor, flexibility or effectiveness of problematic company mergers (Bundeskartellamt, 2001).

In a 2002 address, Mario Monti, the then EU Competition Commissioner, asserted that "[t]he dominance and SLC standards have produced broadly convergent outcomes, especially in the EU and U.S., in recent years ..." (Monti, 2002). This claim that the two tests produce similar outcomes is used by EU officials to justify the retention of the MD test; however, this belief actually strengthens the argument for dropping the MD test in favour of the SLC test. Even if there are no practical differences between the two tests, a common standard is desirable because it will eliminate the perception among members of the business community of unequal treatment. The removal of this perception will eliminate much of the uncertainty associated with the multinational merger review process. Given their belief that the two tests produce near identical results, EU officials should have no problem in dropping the MD test in favour of the SLC test in order to eliminate this uncertainty and encourage procompetitive mergers.

Despite the claim that there are no substantial differences between the dominance and SLC tests, recent experience has shown that the two tests can produce divergent results, and that there are inherent problems with the application of the MD test. The EU's assessment of GE/Honeywell provides insight into one of the main deficiencies of the MD test, viz. that firms seeking to merge can be penalized for being efficient. In an EU Commission publication, EU officials describe how the Commission was concerned with "GE's current dominant position on the markets for engines for both large commercial and large regional jet aircraft ..." As an example of this dominant position, they made the following statement: "One illustration of this significant competitive advantage enjoyed by GE over its industrial rivals resides in its AAA credit rating which extends to all its subsidiaries and enables them to raise finance cheaper and quicker than competitors" (Giotakos/Petit/Garnier/DeLuyck, 2001). Here, GE's dominant position is described as being the result of efficiency in the form of a superior ability to raise finance. This exposes a contradiction inherent in the application of the MD test: by blocking a merger because a firm is more efficient than its rivals, competition authorities are actually penalizing firms for being exactly how society wants them to be - superior (i.e. efficient) economic performers.

Furthermore, the inability of the MD test to deal with competition-lessening post-merger scenarios without the formation of dominance would become evident in few-firm markets where no firm has a dominant position. A merger between two small to medium-sized rivals might still not create a dominant player, but by reducing the

number of competitors in the market, it might increase the likelihood of collusion. By focusing strictly on dominance, the MD test would tend to neglect a consideration of the potential for such a merger to lead to collective dominance.

It is notable that the problems inherent with the MD test led one of the EU's own member countries, the UK, to adopt the SLC test. In justifying its decision to adopt the SLC test, the Competition Policy Directorate of the UK's Department of Trade and Industry wrote:

> We are proposing to introduce a substantial lessening of competition test as we consider this will provide a more effective and flexible tool for control of anticompetitive mergers than an ECMR-style MD test. It fits more naturally with the economically-based analysis undertaken in merger control and is less legalistic. In particular, we note that there has been some uncertainty about the application of the ECMR test to cases of joint or collective dominance. No such difficulty arises with the substantial lessening of competition test (UK Department of Trade and Industry, 2000).

Other non-EU OECD members also adopted the SLC test, including Canada, Australia and New Zealand.

In an effort to modernize its review process, the EU issued its amended Merger Regulation effective as of May 1, 2004. Article 2(3), the section that deals with the application of the prohibitive criterion, was reworded (see above). At first glance, it would appear that there is only a slight difference between the current wording and the 1989 wording which read as follows:

> A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market (European Commission, 1989).

However, the new wording places a greater focus on preventing the impediment of effective competition, which provides for the consideration of anti-competitive effects of a merger other than the creation of dominance. Nevertheless, the revised legislation retains its emphasis on dominance.

While the rewording of this section of the EC Merger Regulation represents a step forward, the emphasis on dominance leaves the perception, if not the reality, of a divergence between the EU and U.S. application of prohibitive criteria. Thus, much of the uncertainty associated with divergent prohibitive criteria for transnational merger review will most likely continue.

Another area in need of substantive convergence in merger analysis is in regards to speculation over the future competitive nature of the market under consideration. There are numerous post-merger scenarios, and often the reviewing authorities assume the worst. This can result in the rejection of mergers which enhance competition or efficiency. The proposed acquisition of McDonnell Douglas ("MDD") by Boeing in 1997 provides an example. The distribution of market shares in terms of backlog orders for large commercial aircraft was as

follows: Boeing 64%, Airbus 30%, and MDD 6% (European Commission, 1997). The European Commission believed that the proposed merger would strengthen Boeing's dominant position, and only under pressure from the U.S. Government, which cited national security interests, did the Commission agree to allow the merger subject to certain conditions (Marfels, 2003). The EU's concerns have proven to be unfounded; by 2002, Airbus' backorders for commercial jets surpassed Boeing's (Talbot, 2002). The dominance that the Commission assumed would be strengthened by the merger has not arisen, as the market has become more competitive, not less.

In contrast, U.S. authorities tend to be wary of such speculation. The following passage from the 1992 U.S. *Horizontal Merger Guidelines* describes the U.S. approach:

> In analyzing the effects of a particular merger ... the Agency is mindful of the difficulties of predicting likely future behaviour based on the types of incomplete and sometimes contradictory information typically generated in merger investigations.[15]

This is the approach that should be adopted for the single-jurisdictional review of multinational mergers. Merger policy differs from other areas of antitrust in that the firms proposing to merge have not been accused of any wrong-doing. As such, when there is uncertainty, it should not be automatically assumed that the firms' intent is anticompetitive. Rather, the proposed merger should be regarded as an investment decision. Consequently, in situations where the future competitive nature of a market following a proposed merger is not clear, business should be given the benefit of the doubt. After all, other antitrust measures remain in place to prevent the abuse of dominance should it arise.

A third area where there is a need for substantive convergence is with respect to concerns raised by competitors. The ultimate objective of competition policy is to protect consumers, not competitors. Because it will enhance the merged firm's competitiveness relative to its rivals, any merger that boosts efficiency will, more likely than not, be a cause of concern for competitors. Thus, arguments against a merger that are raised by competitors are likely to be biased, and they should be viewed with severe caution. Unfortunately, this has not been the case with the Directorate's review under the EC Merger Regulation. In fact, competitors are encouraged to submit their views on mergers during Phase II proceedings under the EC Merger Regulation. For example, in assessing the GE/Honeywell application, the Commission relied on a model of mixed bundling that was advanced by Rolls Royce, a GE rival. A recent analysis by Nalebuff demonstrates that this model was unsuited to analysis of the aircraft and avionics markets (Nalebuff, 2004).

In the U.S., there is a long-standing tradition not to entertain views from competitors. The following excerpt from a speech by William J. Kolasky, Deputy Assistant Attorney General of the Antitrust Division of the U.S. Department of Justice, summarizes how competitor-raised concerns are viewed under the SLC test:

> In the United States, we have relatively little confidence in our ability to make predictions far out into the future and have much more faith in the self-correcting nature of markets. These beliefs lead us to be skeptical of self-interested

> claims by rivals that a merger will lead to their ultimate demise and explain why we demand strong factual and empirical proof before we accept such claims (Kolasky, 2002).

This approach should be adopted by the EU (and other jurisdictions) so that competitor concerns are received with severe skepticism, let alone encouraged.

Single-Jurisdictional Review

Merger review should be conducted by the agency sharing the jurisdiction of the acquiring firm. To ensure that the concerns of the other jurisdiction are met, there should be a transfer of representatives from the other jurisdiction who will actively participate in the merger review process. For example, a merger where one American firm is acquired by another (e.g., GE/Honeywell), would be reviewed in the United States with a transfer of representatives from the European Commission to ensure that the interests of consumers in the European market are protected. A merger where a European firm acquires an American firm (e.g., Daimler-Benz's acquisition of Chrysler) would be reviewed in Europe with a transfer of representatives from the U.S.

As outlined above, the current system of multijurisdictional review raises the opportunity cost of merging in three ways: by imposing significant transaction costs, by reducing the timeliness of a decision, and by increasing the uncertainty of the review process. Single-jurisdictional review will help to lower all of these opportunity costs and, thus, encourage firms to pursue procompetitive and efficiency-enhancing mergers.

Single-jurisdictional review will significantly reduce the transaction costs currently associated with multijurisdictional review. Filing fees will only have to be paid to one jurisdiction, and firms will avoid the administrative costs associated with the duplication of documents and their translation into numerous different languages. Additionally, firms will save on the cost of fees for lawyers and other analysts whose expertise is currently required to help firms navigate the complexities of filing in numerous jurisdictions.

Under the current system of multijurisdictional review, a merger can be delayed by a single agency's concerns or simply because the agency is unable to make a timely decision. Under single-jurisdictional review, the merging partners need only to wait for one agency's decision. Therefore, in most cases, the timeliness of merger review will improve significantly, thus reducing the opportunity cost of delay. If the merger is to be approved, a timely decision will allow the merging partners to move forward with the process of integrating their operations. If the merger is to be rejected, a timely decision will allow the firms to quickly move on to alternative strategies.

Single-jurisdictional review will greatly reduce the uncertainty associated with the merger review process. Under multijurisdictional review (particularly with diverse procedural and substantive approaches), it is often difficult to predict the outcome of the review process. Given the substantial transaction costs involved and the opportunity costs associated with delay, such uncertainty makes firms less likely to pursue mergers, even those mergers which would otherwise have been approved. Single-jurisdictional review, combined with a set of common

substantive procedures, will greatly reduce this uncertainty, thus making it more likely that firms will pursue pro-competitive mergers.

Single-jurisdictional review does not necessarily imply a lessening of control by the competition authorities. Under the current system, a merger that is reviewed in numerous jurisdictions can be blocked by just one dissenting agency. Multijurisdictional enforcement ensures that the ultimate decision will be made by the most restrictive jurisdiction, not necessarily the one that provides the most accurate analysis. This essentially takes control away from agencies that approve of the merger. Under single-jurisdictional review, however, there will be no potential for this to occur as there will be only a single review. Thus, single-jurisdictional review does not imply that agencies will be ceding control of the review process.

Agencies will receive other advantages from single-jurisdictional review. Duplication of analysis by multiple agencies will be avoided. Not only will this reduce costs, but it will free up agencies' resources and manpower to conduct more thorough and timely analyses of the mergers remaining under their review. Furthermore, the review process should be enhanced by an improved access to information. Typically, an agency in the same jurisdiction in which the acquiring firm is based will have the best access to information on that firm. Even with the current system of bilateral agreements, privacy laws require consent from firms under review before certain information is transferred from one jurisdiction to another. Avoiding this procedure should significantly expedite the merger review process.

One potential concern with this proposal for single-jurisdictional review is that the competitive effects of a proposed merger may differ across different relevant geographic markets. For example, a merger being reviewed in the EU may pose no concerns for the European market, but because of different market conditions, it may result in a substantial lessening of competition in the U.S. market. In a case such as this, U.S. antitrust officials will want to ensure that the interests of U.S. consumers are protected. This is the rationale for providing other jurisdictions where the merger would likely have a significant impact with the opportunity to provide advisory opinions. In this example, American antitrust officials would provide advice to the European Commission on aspects of the merger specifically related to the U.S. market. The ultimate decision can accommodate geographic differences, as it need not be limited to an acceptance or rejection, but could be an acceptance conditional on divestiture of assets to alleviate anticompetitive concerns in different relevant geographic markets; this is already common practice in merger review. The participation of other jurisdictions will also help alleviate concerns of political interference in the merger review process.

Conclusion

By themselves, mergers are not anticompetitive acts, but rather, are strategic investment decisions. Thus, while it is important that competition authorities are vigilant in restricting mergers which will result in a substantial lessening of competition, it is equally important that merger review does not dissuade firms from pursuing mergers which, otherwise, would have been procompetitive or efficiency-enhancing. The current system of multijurisdictional merger review is, therefore, unacceptable, as it imposes substantial prohibitive costs on firms seeking to form transnational mergers. These costs include the real transaction costs of responding to the

requirements of filing in numerous jurisdictions and, more important, the opportunity costs associated with the increased risk and uncertainty arising from the application of divergent review frameworks.

The proposal outlined above calls for the single-jurisdictional review of transnational mergers along with a common substantive review framework. These suggestions would result in a significant reduction in the costs to firms seeking approval of transnational mergers and in the uncertainty associated with the review process and, therefore, would remove many of the impediments that firms pursuing procompetitive mergers currently face.

Such change would ultimately be in the best interests of consumers who would then reap the benefits of enhanced competition and efficiency. The business community also stands to gain from a more streamlined approach to the review of transnational mergers. Thus, the business community should take the initiative to encourage policy-makers to invoke the change that is required.

Notes

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[1] In a June 19, 2001 letter to EU officials, Senator John Rockefeller, chairman of the Senate Commerce Committee's aviation subcommittee issued the following warning: "If it appears that the European Commission is unfairly blocking mergers between U.S. companies principally to protect the position of European competitors, then the subcommittee will need to re-examine the open market the U.S. has maintained for those sorts of acquisitions" (Wilke, 2001).

[2] This was not the first instance where a proposed merger of firms from one jurisdiction faced opposition from the authorities in another jurisdiction. In 2000, Air Liquide and BOC, two European firms, abandoned their merger plans in view of likely opposition from the Federal Trade Commission (Simons, 2002).

[3] From now on we will use "mergers" to refer to transnational mergers involving multijurisdictional review.

[4] GE/Honeywell is not the first controversial merger decision involving the EU and U.S. authorities. The proposed acquisition of McDonnell Douglas by Boeing posed no problem for the Federal Trade Commission, but raised concern in the EU. Only under considerable pressure from the U.S. government, which cited national security interests, did the Commission allow the merger under certain conditions (Marfels, 2003).

[5] Indeed, the majority of mergers raise no anticompetitive concerns.

[6] Not all of these efficiencies are considered by competition authorities, and the treatment of efficiencies differs from jurisdiction to jurisdiction. For a discussion of the treatment of efficiencies, see "Efficiencies," *Analysis of Merger Guidelines*, International Competition Network Merger Working Group document, 2003 (http://www.international competitionnetwork.org/analysisofmerger.html).

[7] These fees were introduced by the 2001 Amendments to the Hart-Scott-Rodino Act. Previously, a flat fee of $45,000 was charged.

[8] There is no such fee in the EU.

[9] These would have been significantly higher today, as many jurisdictions have recently raised their filing fees.

[10] Given the economic significance of business and investment of EU and U.S. transnationals, there is little doubt that other jurisdictions would want to join such an agreement.

[11] *1989 EC Merger Regulation.*

[12] Recently, there has been some convergence between the EU and U.S. evaluative criteria. Most important has been the EU's decision to consider efficiencies.

[13] In a 2002 speech, Mario Monti, the then EU Competition Commissioner, stated that "[n]ot changing [the MD test] has the additional advantage of preserving the jurisprudence that the Courts have developed all these years in interpreting its meaning and, therefore, in maintaining a high degree of legal certainty" (Monti, 2002).

[14] Effective as of September 1990.

[15] *1992 Horizontal Merger Guidelines*, Section 2.1: Lessening of Competition through Coordinated Interaction (U.S. Department of Justice and the Federal Trade Commission, 1992).

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LILLY v. APOTEX – SKIRMISHES ALONG THE IP/COMPETITION LAW FRONTIER

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Introduction and Background

A recent motion for summary judgment[1] in the Federal Court may represent the most important case to address the interface between competition law and intellectual property ("IP") law to date. Depending upon how the case is ultimately decided (it is currently under appeal), it is likely to represent a significant milestone enroute to establishing the appropriate boundaries between these two legal and economic approaches to promoting a prosperous, efficient economy.

The plaintiff in the case, Eli Lilly and Co. ("Lilly"), which held the original patents on the antibiotic ceflacor, also held patents with respect to production methodologies for its manufacture and with respect to intermediate products used in its production. Lilly commenced an action for patent infringement, in 1997, alleging that Apotex Inc. ("Apotex") infringed the patents owned by Lilly (including those which had been assigned to it) which related to intermediate compounds and processes for preparing intermediates useful in the production of ceflacor.

In 2001, Apotex amended its pleading to allege, by way of counterclaim, that Lilly's conduct violated section 45 of the *Competition Act*, thereby entitling Apotex to damages under section 36. Apotex's allegations centered on the acquisition by Lilly of certain process patents owned by a Japanese company, Shionogi. Its counterclaim provided:

> 18 – Each of the Shionogi Patents describes and claims processes suitable for making intermediates which can be converted to ceflacor by non-infringing processes.
>
> 19 – None of the patents in this action contains a claim to the product ceflacor *per se* or a product-by-process claim for ceflacor. The basic patent for ceflacor and the process for its manufacture was disclosed and claimed in Canadian Letters Patent No. 1,016,537 which patent expired August 30, 1994.
>
> 20 – With the issuance of the four Shionogi Patents, after August 30, 1994 at the latest, Shionogi was entitled to manufacture and sell within Canada ceflacor using the processes covered by its four patents as such processes would not infringe any patents owned by the Plaintiffs.
>
> 21 – Prior to the issuance of the Shionogi Patents, the Plaintiffs enjoyed a monopoly in the Canadian market in respect of the manufacture and sale of ceflacor in Canada.

> 22 – Faced with the prospect of competing with Shionogi for the Canadian ceflacor market, the Plaintiffs acquired the Shionogi Patents from Shionogi in order to prevent competition in the Canadian market.
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> ...
>
> 26 – In particular, Apotex states that the Plaintiffs knowingly conspired, combined, agreed, or arranged among themselves and with Shionogi to acquire the Canadian patents and patent rights granted to Shionogi under the Shionogi patents for the purpose, and with the result, of preventing or impeding other manufacturers from producing or acquiring ceflacor, and so prevent or impede competition in the Canadian market for ceflacor.

Lilly's patent on ceflacor itself expired in 1994, but it had developed process patents with respect to the manufacture of ceflacor. Apparently, Shionogi had also developed process patents for its manufacture. Lilly acquired Shionogi's process patents in 1995. Apotex's complaint was, essentially, that by acquiring the patents from Shionogi, Lilly obtained a second period of patent protection over ceflacor. The logic underlying Apotex's challenge was that these two sets of processes were the only two, or two of only a few known economic methods for the manufacture of ceflacor. Indeed, Mr. Justice Hugessen seems to have proceeded on that assumption when he stated that Lilly was the owner of "the other" process patents useful for the same purpose.[2] This conclusion was also reinforced by the reference, in paragraph 21 of the above-quoted counterclaim, to Lilly's alleged "monopoly". If the Lilly and Shionogi process patents taken together do not represent all or most of the practical methods by which ceflacor may be manufactured, then the decision makes little logical sense, but because the case was decided without evidence being adduced the record is not absolutely clear on the point.

Decision of the Prothonotary

Lilly had opposed the 2001 amendment of Apotex's pleading to add these allegations, relying primarily on the 1991 Federal Court decision in *Molnlycke AB* v. *Kimberly-Clark of Canada Ltd.*,[3] in which the Court struck out allegations of anti-competitive activity based on the assignment of a patent. In that case, the Court found that the assignment of a patent was no more than one aspect of the legitimate exercise of the patentee's monopoly. In the present case, however, the Prothonotary allowed the amendment to the proceeding, holding that the *Molnlycke* decision was distinguishable.

The Prothonotary distinguished the *Molnlycke* decision on the basis that the facts in that case were different in a number of important respects, and allowed Apotex to advance a counterclaim based on section 45 of the *Competition Act*. The Prothonotary stated:

> *Molnlycke* may be distinguished on several counts. The case involved an appeal by a foreign company with no presence in Canada from the refusal of the Trial Division to set aside an *ex parte* order for service *ex juris* of notice of the statement of defence and counterclaim of Proctor & Gamble who alleged

> conspiracy by the plaintiff in contravention of the *Competition Act*. Because *Molnlycke* was out of the jurisdiction of the Court, former Rule 307(1) applied. That Rule required, for service *ex juris* to be permitted, that the serving party have "a good cause of action", not merely the assertion of an arguable cause of action. In allowing the appeal and setting aside the order for service *ex juris*, Mahoney J.A. for the Court of Appeal found, by looking to the evidence, that there was not a good cause of action. Thus, in the circumstances of *Molnlycke* a different test applied, one which permitted a weighing of the evidence to determine whether a good cause of action arose.[4]
>
> ...
>
> *Molnlycke* also involved the acquisition and enforcement of a single patent, which is to be distinguished from the case at bar, on that basis, and on the basis of the pleadings and allegations as a whole.[5]

Decision of the Trial Division

Lilly appealed the decision of the Prothonotary. On appeal the Court (Mr. Justice Hugessen), in overturning the Prothonotary's decision, quoted approvingly from the *Molnlycke* decision as follows:

> Certainly, the existence of a patent is apt to limit, lessen, restrain or injure competition – monopolies do – but its issuance and the inherent impairment of competition has been expressly provided for by an act of Parliament...it is the existence of the patent, not the manner in which it was obtained or how and by whom its monopoly is agreed to be enforced and offended, that impairs competition. ...Parliament has, in the Patent Act, defined a "due" impairment of competition. In my opinion, as a matter of law, it is not arguable that the impairment of competition inherent in the exercise of rights expressly provided by that Act – the obtaining of a patent or re-issue of a patent, its assignment and action by the assignee to enforce its monopoly – can be undue. It follows that undue impairment of competition cannot be inferred from the evidence of the exercise of those rights alone.[6]

Justice Hugessen disagreed with the bases upon which the Prothonotary distinguished the *Molnlycke* case. He was of the view that the Federal Court of Appeal in *Molnlycke* set out a general rule that there could be no cause of action under the *Competition Act* in a simple assignment of patent rights. He also concluded that since there could be no claim under the *Competition Act* in such a case, the difference between a "good" and an "arguable" cause of action was moot. He went on to state:

> Everyone who obtains a patent, whether by issue or by assignment, does so for the purpose of obtaining a monopoly which, by definition, is a lessening of competition. That monopoly is one that is legally sanctioned and simply cannot, as a matter of law, result in the lessening of competition being "undue" during the life of the patent.[7]

He concluded:

> The cause of action asserted in the impugned paragraphs is simply a nullity. It should never have seen the light of day and the Court should spend no more time on it.[8]

With that, the paragraphs in the Statement of Defence and Counterclaim were struck out as against Lilly, and the Counterclaim against Shionogi was dismissed with costs.

The Appeal and Subsequent Submissions

An appeal from the decision of Mr. Justice Hugessen was heard on May 11, 2004, and was under reserve at the time of writing. [Editor's Note: The Federal Court of Appeal's decision was released on June 14, 2004. See Authors' Postscript I. The case was referred back to Mr. Justice Hugessen for further consideration and his reasons were released on October 20, 2004. See Authors' Postscript II.] However, on May 17, 2004, while the appeal was under reserve, Mr. Justice Rothstein of the Federal Court of Appeal, who sat on the appeal panel, ordered that the parties file brief submissions as to whether the decision in the *Molnlycke* case overlooked section 32(1) of the *Competition Act* and, if so, whether that decision was "manifestly wrong".

On May 21, 2004, Apotex filed its submission on the point. It noted that the decision in *Molnlycke*, if confined to its own facts, was not manifestly wrong, but if portions of the *Molnlycke* reasoning quoted above[9] purported to establish a principle applicable in respect of section 32 of the *Competition Act*, then the *Molnlycke* decision was manifestly wrong, as section 32 of the *Competition Act* expressly contemplates that the exercise of rights under a patent can result in an undue impairment of competition.

Apotex noted in its submissions that:

> The definition of "undue impairment" set out by the Court in *Molnlycke* can be read as a statement of principle that admits of no exception in any circumstances, and as such, it is necessarily incorrect since section 32 specifically provides that the exercise of those rights granted by the *Patent Act* can "prevent or lessen, unduly, competition" in a variety of ways.

Apotex also noted that the focus in *Molnlycke* was on the effect of the assigned patent alone, and on that basis it was distinguishable from the situation in the current *Lilly* v. *Apotex* dispute, which involved a combination of different patents. Finally, it is notable that the Apotex submissions (and indeed, those of Lilly and Shionogi, noted below) made specific reference to the *Intellectual Property Enforcement Guidelines* issued by the Competition Bureau in 2000[10], something which no reported decision since the issuance of the Guidelines – including the various decisions in the *Lilly* v. *Apotex* case to date – have made reference to.

On May 28, both Lilly and Shionogi provided their submissions in response to the Order of Mr. Justice Rothstein. Both agreed with Apotex that, since section 32 was not directly implicated in the *Molnlycke* case, that case was not incorrectly decided. Lilly went further, arguing that to successfully invoke section 32 of the *Competition*

Act, the Attorney General would have to demonstrate more than the mere exercise of patent rights. It argued, citing *Apotex* v. *Wellcome Foundation*[11], although only for the proposition that the *Patent Act* grants a limited monopoly for a limited time, that "the mere assignment of patents that is expressly allowed under the *Patent Act* cannot be considered to be undue under the *Competition Act*"; and it argued, based on *Society of Composers, Authors and Music Publishers of Canada* v. *Landmark Cinemas*[12] that activities expressly sanctioned by legislation are exempt from the operation of section 32 of the *Competition Act*.

Lilly further argued that Parliament could not have intended that conduct expressly condoned by one statute (a patent assignment under the *Patent Act*) be contrary to another Act of Parliament. Thus, as a matter of law the transfer and exercise of patent rights, without more, cannot be "undue" for the purpose of the *Competition Act*.

Shionogi's submissions were largely to the same effect as Lilly's. It also noted that if section 32 of the *Competition Act* were to apply to any exercise of patent rights then the operation of the patent regime would be wholly frustrated, and that given the existence of a patent regime there must logically be a "protected sphere" of patent activity insulated from the *Competition Act*. Shionogi argued that the existence of section 32 in the *Competition Act* was evidence that Parliament intended that the general provisions of the Act, including section 45, were to have "only a limited application to conduct involving patents."

Analysis

In commenting on this case, our fundamental submission is that it ought not to be a full answer to any and all *Competition Act* disputes which involve patents or patented products to conclude, as it would appear Mr. Justice Hugessen did, that because the *Patent Act* allows for the granting and assignment of patents, which patents confer (or, more properly, may confer) monopoly rights, no activity involving the acquisition of patent rights can ever be the subject of sanction under the general provisions of the *Competition Act*.[13] Even excluding the operation of section 32 of the Act, we believe that the Act can have application with respect to the acquisition (or at least the transfer) of patent rights, depending upon the circumstances.

It may be that Mr. Justice Hugessen conflated the concept of a patent monopoly with the concept of an economic monopoly. As noted above in *Wellcome*[14], a patent monopoly is expressly a limited one, not only temporally, but limited in its nature. In the present case, once the patent on ceflacor itself expired, neither Lilly nor Shionogi enjoyed an economic monopoly. Both had a patent monopoly over a process to produce ceflacor, but economically, since both of them had a process to create the drug, neither had an economic monopoly. That is, neither did until the Shionogi patents were assigned to Lilly.

Parliament, through the *Patent Act* and through the *Competition Act*, is simultaneously pursuing various policy objectives. The policy bargain that underpins the granting of a patent (that the innovation is shared with society in return for time-limited exclusive right) provides an incentive for the creation of valuable discoveries. The *Molnlycke* case properly stands, we submit, for the proposition that the monopoly created by the Parliamentary grant, however robust or not as an economic monopoly, ought not to be undermined by the *Competition Act*[15], whether that grant is enjoyed directly by the inventor or transferred to a party better or more efficiently able to

commercialize it. The same logic, however, does not necessarily hold true for the combination of patent rights by way of assignment. Here, Lilly had one set of patents for the process of making the drug in question and Shionogi had another. That is, they had both been granted patent protection over competing methodologies to achieve the same economic result, and appear to have had the only two viable economic methodologies. By combining the two sets of patents, assuming these were the only two methodologies available, Lilly allegedly acquired an economic monopoly, not by an Act of Parliament but by a commercially negotiated private combination. We see no reason that such an agglomeration of patent rights, if it creates market power concerns, cannot and should not be subject to review under the general provisions of the *Competition Act*. Such review would not undermine the patent grant, but it could result in a challenge to the subsequent commercial activity in combining such grants.

If ceflacor is by itself a "product" in an economic sense, and if the assignment of Shionogi's rights to Lilly gave Lilly a monopoly right to its manufacture – a monopoly which no one firm would have enjoyed but for the assignment – it would appear to us that the *Molnlycke* case is distinguishable from the present case.

It may well be that Apotex was not injured by Shionogi's assignment to Lilly. After all, whether Lilly enjoyed all of the patents in issue, or Lilly and Shionogi each enjoyed some, in neither case would Apotex obtain rights.[16] While Apotex may have no complaint respecting the combination of the Lilly and Shionogi patents, nevertheless the process of competition may have been injured. Consumers of ceflacor may have been injured. It may be that section 45 was not the ideal provision of the *Competition Act* by which this problem might be addressed – we would have thought section 92 to be more apposite. It may also be that Apotex ought not to have standing as a plaintiff – as one might argue that it has suffered no antitrust injury. Nevertheless, in our view it is likely incorrect to conclude that the *Competition Act* – or even the general provisions of the *Competition Act* (other than section 32) – could have no applicability to the combination of two competing sets of process patents.

Turning to the submissions of the parties in response to Mr. Justice Rothstein's order, we find the arguments articulated in the Apotex response to Mr. Justice Rothstein's call for submissions to be broadly persuasive, although, of course, that does not mean that it is our view that Apotex should enjoy a cause of action in this case. The situation in *Molnlycke* did not call upon the court to make a decision respecting section 32 of the *Competition Act*, and therefore it did not do so.[17] Section 32 by its very nature contemplates that the exercise of patent rights could have an undue effect on competition (whether one characterizes the exercise as the "mere" exercise of such rights or their exercise with some additional conduct, remains an open question), but we do not read *Molnlycke* as saying otherwise; rather, section 32 was not in issue in *Molnlycke* because no Information had been filed by the Attorney General, which is a necessary precondition to a section 32 application.

We read the *Molnlycke* case to say that, absent a section 32 application, then activity in enforcing a single patent is not capable of offending section 45 of the *Competition Act*. We think that is a correct interpretation of the law, and is consistent with the approach taken in the Competition Bureau's *Intellectual Property Enforcement Guidelines*. However, as we argue above, we do not believe it is necessary to reach the same conclusion with respect to the combination of separate patent rights, which combination may create an anticompetitive result.

That is, in our view, *Molnlycke* need not be found to be wrongly decided (although some of its language might be argued to be extravagant) in order to reach a different conclusion (or perhaps the same conclusion, but for different reasons) than that reached by the Federal Court Trial Division in the *Lilly* v. *Apotex* case.

In seeking to define the boundary between patent law and competition law it would be simple and neat, but in our view incorrect, to conclude that either doctrine absolutely ousts the other. The appropriate analysis, we submit, requires an analysis of what the intended scope of the patent grant protection was. That grant should be free from challenge under the general provisions of the *Competition Act*. Conduct which was not intended to be protected by the patent grant, however, such as, we submit, the combination of two or more patents as in the *Lilly* v. *Apotex* case, ought not to be immunized from antitrust scrutiny just because the assets in issue are patents rather than some other form of property. In that regard we think the argument advanced by Lilly and Shionogi, that since the *Patent Act* allows assignment of patents such assignment cannot be challenged under the *Competition Act*, is no more persuasive an argument than the argument that since various laws allow and establish mechanisms for the transfer of real and personal property, such transfers cannot be challenged under the *Competition Act*. If that were so there could be no merger control regime. Ultimately, therefore, we do not think that the narrow issue raised in the *Apotex* v. *Lilly* case is particularly challenging, although with the case under reserve we may be running some prognostication risks.

We think, however, that the much more difficult issue turns on the proper scope of section 32 of the *Competition Act*. In neither the *Apotex* v. *Lilly* case, nor the earlier *Molnlycke* case, was section 32 properly engaged. However, the question of the proper scope for application of section 32 is very difficult. As noted in the *Society of Composers* v. *Landmark Cinemas*[18] case, if conduct is expressly sanctioned by legislation – in the language of that case if the actions are within an explicit legislative mandate – then section 32 ought not to apply. But how far does that rule extend? The regulated conduct jurisprudence is far from clear on such points. Lilly and Shionogi argued in the present case that in order to engage section 32, more than the simple exercise of IP rights is required. The Competition Bureau's *Intellectual Property Enforcement Guidelines* suggest the same, or at least indicate that the Bureau would not recommend a proceeding to the Attorney General unless the conduct had implications beyond the particular patented product alone. Nevertheless, the questions of what more than the "simple" exercise of the IP right is required, or how to draw the line between the simple exercise of the IP right and something more, are very difficult indeed. For the present case those are questions which need not be answered, but in our view section 32 will ultimately prove to be the most theoretically and intellectually challenging issue in the ongoing exercise to properly define the IP law/competition law frontier.

AUTHORS' POSTSCRIPT I

After the above article was prepared, but before it was published*, the Federal Court of Appeal released its decision in the *Apotex* case**. Fortunately for us, the Federal Court of Appeal agreed in substance with our view of the decision of the Federal Court. The reasoning of the Federal Court of Appeal – drawing a distinction between the mere transfer of a patent, as in the *Molnlycke* case, and the combination of patents, as in the

Apotex case – is consistent with our commentary on the motion decision, and is in our view sound. In particular, the Federal Court of Appeal stated:

> In the case of *Molnlycke*, there was a single supplier lawfully entitled to sell the subject of the patent prior to the patent being assigned. The assignment merely transferred the patent to another company. The only effect of the assignment was that a different company could sue the defendant for infringement. There was no change in the number of patent-holders before and after the assignment...
>
> *Molnlycke* held that, in order to provide scope for the statutory monopolies granted by the *Patent Act* to operate, Parliament must have intended that "undue impairment of competition cannot be inferred from evidence of the exercise of [patent] rights alone" [emphasis added]. Where, however, there is evidence of something more than the mere exercise of patent rights that may affect competition in the relevant market, *Molnlycke* does not purport to completely preclude application of the *Competition Act*.

And later:

> In the present case, Apotex does not allege that it is the mere assignment of patent rights or the enforcement of those patent rights by Lilly that gave it a cause of action. Rather, Apotex says that the assignment in this case resulted in one company, Lilly, acquiring patent rights that allow it to control all of the commercially viable processes for making ceflacor where, before the agreement, those processes were controlled by two companies, Shionogi and Lilly. Apotex argues that this consolidation was something more than the mere exercise of patent rights....
>
> The learned motions judge foreclosed a consideration of this argument because, in his view, *Molnlycke* precluded a cause of action under the *Competition Act* in respect of "the simple assignment of patent rights". However, in my opinion, *Molnlycke* did not preclude the motions judge from considering whether the evidence presented by Apotex of other facts and circumstances beyond the simple assignment from Shionogi to Lilly resulted in an undue lessening of competition which could engage subsection 45(1).

As we argued in the body of this commentary, we believe that the Federal Court of Appeal has correctly articulated the difference between *Molnlycke* and *Lilly*, and as a result has properly identified the differing competition law implications of the two fact patterns. However, the fact that there may be a competition law remedy, even without resort to section 32 of the *Competition Act*, with respect to the fact pattern in the *Lilly* case does not, in our view, necessarily suggest that Apotex has suffered antitrust injury or it should enjoy cause of action.

Turning from the facts of the *Lilly* case to the issue of section 32 of the *Competition Act*, the Court of Appeal offered some limited commentary respecting the implication of section 32:

> However, the express statement in section 32 [of the *Competition Act*] that the use of patent rights could lessen competition unduly giving rise to a remedy under section 32 indicates that *Molnlycke* cannot reasonably be interpreted as completely precluding application of the *Competition Act* whenever patent rights are involved.

We also agree with that statement. However, as we argued in the body of the paper, and as we continue to believe, the genuinely difficult issues at the intersection of intellectual property rights and competition law are likely to revolve around the appropriate scope of section 32. Neither the *Molnlycke* nor the *Lilly* case address these issues in a meaningful way, nor were they required to do so. We believe that, ultimately, that will prove to be the most challenging issue. But that is a case for another day.

AUTHORS' POSTSCRIPT II

On October 20, 2004, the case having been referred by the Court of Appeal back to Mr. Justice Hugessen for further consideration, he released his reasons in respect of that further consideration. At the heart of his decision was the following statement:

> It appears to me to be undoubted that the *Patent Act* does not have the effect of insulating from liability under the *Competition Act* any and every agreement which may also have to do with the exercise of patent rights. However, where an agreement deals only with patent rights and is itself specifically authorized by the *Patent Act*, any lessening of competition resulting therefrom, being authorized by Parliament, is not "undue" and is not an offence under section 45. The two statutes must be read together harmoniously and that can only be done if the meaning of the key word "undue" in section 45 is limited to restrictions on competition which are not specifically authorized by the *Patent Act*.

Mr. Justice Hugessen then went on to note that the only act of agreement was the assignment of patent rights, and that section 50 of the *Patent Act* provides that:

> Every patent issued for an invention is assignable in law either as to the whole invention or as to any part thereof, by an instrument in writing.

Mr. Justice Hugessen did not accept that this was merely confirmation of the normal right to assign property, because:

> [W]hat Parliament is dealing with here is a patent, a monopoly. The monopolist is given specific legal warrant to deal in his monopoly by transferring it to another. The provision would not be necessary if it did not go beyond the right of every proprietor to deal with his own as he or she sees fit.

It is an interesting decision, but it seems to us that it may well continue to confuse the difference between a patent monopoly and an economic one. Our view in this regard is confirmed by the following statement in the reasons:

> Assuming that the patent is for an invention that is useful and marketable, which in the present case it manifestly was, that agreement has for a necessary consequence the increase in the assignee's market power.

That statement, it seems to us, may or may not be true (as to the increase in market power), but it is certainly meaningless. Firstly, if the invention is useful and marketable, but only one of fifty equally useful competitive products, any increase in market power (recalling that a patent does not provide a right to make something – just a right to block others from doing so) to the assignee is non-existent or trivial. Secondly, the assignee who has no previous business or patents in the relevant field may experience an increase in market power – but of no more than the assignor lost. The assignment only increases the assignee's market power above that which the assignor enjoyed if the assignee already has relevant patents in the field – then his or her blocking power is increased. If the assignment is from the patent holder to a person who doesn't hold patents in relation to the relevant process or product, there is no increase in market power in the economy, merely a transfer of it. If, by contrast, the assignment is to the only other possible producer – say the holder of patents over the only other commercially viable process, for instance, the result may be the creation of an economic monopoly. Very different outcomes indeed.

Mr. Justice Hugessen also noted that it is possible that a patent assignment agreement could be reviewable under provisions of the *Competition Act* other than section 45, but that was not what the present case was about. Insofar as, by that, Mr. Justice Hugessen suggested that section 45 is not the appropriate provision of the *Competition Act* under which patent transfers should be attacked, we agree. Indeed, we said so in our original article. However, to go as far as Mr. Justice Hugessen does, and suggest that dealing in patents may never offend section 45, <u>for the reason that Parliament provided for the transfer of patents</u>, is, it seems to us, peculiar.

To take a simple example, Parliament has also provided for the transfer of ships pursuant to the *Canada Shipping Act*. Does that mean that the transfer by one of two owners of all Great Lakes transport ships to the other owner of Great Lake transport ships would be insulated from challenge? We cannot think that that would be the right answer. Maybe, as we note, such a transfer ought not to be attacked as a conspiracy, but we do not think that that conclusion has to do particularly with the fact that it is patent rights, or rights in steamships, which is the subject of the agreement. Rather, we think that is because the nature of the transaction in issue is more akin to a merger than something which would be appropriately deemed a conspiracy pursuant to section 45 of the *Competition Act*. It has not to do with the type of property, but rather the type of conduct.

Notes

[1] *Eli Lilly and Co.* v. *Apotex Inc.* (2003), 28 C.P.R. (4th) 37 (F.C.T.D.) [hereinafter *Lilly* v. *Apotex*]. While the *Lilly* v. *Apotex* decision was formally a motion for summary judgment, in substance it involved striking a pleading without the introduction of any evidence.

[2] *Lilly* v. *Apotex*, *ibid.* at 45.
[3] *Molnlycke AB* v. *Kimberly-Clark of Canada Ltd.* (1991), 36 CPR (3d) 493 (F.C.A.).
[4] *Lilly* v. *Apotex*, *supra* note 1 at 43.
[5] *Ibid.*
[6] *Ibid.* at 44-45
[7] *Ibid.* at 46
[8] *Ibid* at 47
[9] In particular the statement: "In my opinion, as a matter of law, it is not arguable that the impairment of competition inherent in the exercise of rights expressly provided by that [Patent] *Act*...can be undue".
[10] *Intellectual Property Enforcement Guidelines*, online: Competition Bureau, http://cb-bc.gc.ca/epic/internet/incb-bc.nsf/ en/ ct01992e.html. (Last modified: 23 December 2003).
[11] *Apotex* v. *Wellcome Foundation Ltd.* [2002] 4 S.C.R. 153 ¶37.
[12] *Society of Composers, Authors and Music Publishers of Canada* v. *Landmark Cinemas of Canada Ltd. et al*, (1992), 45 C.P.R. (3d) 346 at 353 (F.C.T.D.).
[13] If Mr. Justice Huggesen's comments are taken simply as a conclusion that there was no evidence or precise allegation that the combination of the Lilly and Shionogi process patents had economic effect because there may have been other methodologies available to manufacture ceflacor not protected by these patents, then of course the decision is unobjectable. However, Mr. Justice Hugessen's characterization of Lilly's patents as "the other" (than Shionogi's) patents to manufacture ceflacor, as well as the logic of the case, suggest that the patents in issue were the only economic methods by which ceflacor may be manufactured. The language of the decision suggests that in the view of the Federal Court, regardless of the availability or unavailability of other processes to produce ceflacor, that the assignment could not be challenged under the *Competition Act.*
[14] *Supra* note 11.
[15] We submit that, in fact, *Molnlycke* stands for the proposition that the general provisions of the *Competition Act* cannot be used to challenge the patent monopoly itself. *Molnlycke* did not, however, consider section 32 of the *Competition Act*. We do not believe that *Molnlycke* can be properly read to have indicated that the court may not make orders under section 32 – rather the court in *Molnlycke* simply did not address section 32.
[16] In that respect, the case of *Eli Lilly Co.* v. *Novopharm Ltd.* (1996), 68 CPR (3d) 254 (FCTD) may be instructive. In that case Novopharm's complaint was that Lilly would not license one of its trade marks to Novopharm, but would license it to a third party. The court noted that it was not the license to the third party which "injured" Novopharm, but rather Lilly's ownership of the mark. Lilly was free to decide not to license that mark to Novopharm if it chose not to do so.
[17] As noted in the case of *Volkswagen* v. *Access International Automotive Ltd.* (unreported decision of Giles, ASP, FCTD, April 1999), such a determination can only be made upon the application of the Attorney General, by filing an Information.
[18] *Supra* note 12.
* Those whose faith is tested by this assertion are invited to review "Antitrust and Misuse Restraints: The Impact of Competition Law on Intellectual Property Rights in Canada", Federated Press, June 7-8, where the same thesis was advanced before the decision of the Federal Court of Appeal was released.
** *Apotex Inc.* v. *Eli Lilly and Company.* Unreported Decision F.C.A. June 14, 2004.

ARE CANADIAN BANKS FIT TO BE TIED?

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Introduction

In both Canada and the United States it is common for banks[3] to provide customers with incentives to purchase multiple products. This practice is referred to, in business terms, as "bundling" or "relationship pricing." But there is a fine line between permissible relationship pricing and prohibited tied selling. Tied selling involves making the purchase of one product conditional on the purchase of another.

In the United States, allegations of tied selling by banks have led to investigations by Congress and banking and securities regulators.[4] In Canada, recent legislative initiatives have strengthened prohibitions against tied selling by banks.

In today's increasingly competitive financial services markets, there are strong incentives to bundle product offerings. Economically, this makes sense. However, banks must comply with three relatively unharmonized legislative regimes that regulate bundling activities. This article discusses the rules prohibiting tied selling by banks and argues (i) that although the *Competition Act* rightly recognizes that tied selling is not anti-competitive in all cases, it does not explicitly recognize that tied selling can be efficiency-enhancing; and (ii) that the *Bank Act* and securities laws – as consumer-protection legislation – overreach, capturing not only individual consumers but also large sophisticated corporations that do not require such protection.

In this article, the term "bank," apart from the section relating to the *Bank Act* specifically, should be read to include other financial services providers who are "non-bank" financial institutions. The prohibitions against tied selling under the *Competition Act* and the securities laws described below apply broadly to all businesses in Canada.

Relationship Pricing and Tied Selling by Banks

Banks may offer bundled products for economic reasons, taking advantage of reduced transaction costs and economies of scope in production and distribution. For example, once a bank has incurred the cost of assessing a customer's credit for one product, it need not repeat the process for other products and can therefore offer additional credit products at a lower overall cost than if each product were purchased separately.[5]

The Canadian government only becomes concerned about bundling when it can be characterized as tied selling. The prohibitions against tied selling by banks apply when competition is threatened or when tied selling forces customers to purchase products they may not want.

Competition law prohibits tied selling only when it is anti-competitive.

Banking and securities laws reflect a different set of concerns – consumer-protection concerns – and aim to protect small customers by prohibiting forced tying outright. Without consumer-oriented prohibitions, regulators (or legislators) are concerned that banks could take advantage of individual retail customers – for example, by making approval of a mortgage conditional on the purchase of investments. However, these banking and securities laws also prohibit tied selling to large, sophisticated corporate customers – for example, tying a corporate loan to investment banking services, a business practice that has recently received attention on both sides of the border.[6]

An Overview of Tied Selling Laws in Canada

What follows is an overview of the tied selling rules applicable to banks in Canada, under the *Competition Act*,[7] the *Bank Act*,[8] and securities laws.

Competition Act

Tied selling is addressed in section 77 of the *Competition Act*.[9] This section applies to all suppliers of "products," which include both articles and services.[10] Under section 77, tied selling occurs when a supplier conditions the sale of one product – say, film – referred to as the "tied product," on the purchase of another product – say, a camera – referred to as the "tying product," or when the supplier requires a customer to refrain from using another company's product with the tying product. Tied selling also occurs when a supplier does the same thing by inducement – that is, offering the two products on such attractive terms that they are essentially always purchased together. However, tied selling, under the *Competition Act*, is problematic only where the practice is engaged in by a "major supplier" or is "widespread in a market" and is likely to have an anti-competitive effect.

Tied selling is not prohibited where it "is reasonable having regard to the technological relationship between or among the products to which it applies." Another exception, specific to the financial services sector, applies if the practice is engaged in by a person in the business of lending money for the purpose of better securing loans and is reasonably necessary for that purpose.[11]

Section 77 of the *Competition Act* requires three elements to prove that tied selling has taken place: (i) the existence of "two separate products" – the "tied" and the "tying" product; (ii) a "practice" of tying; and (iii) "anti-competitive effects" of the practice, which lead to a substantial lessening of competition. Although no cases under the *Competition Act* have dealt with tied selling by banks, one case, *Tele-Direct*,[12] has addressed tied selling in detail.

Separate Products

The first element to be addressed under the *Competition Act* is whether the tied and the tying products are actually separate products. As interpreted in *Tele-Direct*, the separate products test has two parts: first, there must be "sufficient demand" for the products to be sold separately; and second, such products must be able to be supplied separately in an efficient manner.[13]

In *Tele-Direct*, the Tribunal concluded that tied selling will not be found to exist if offering the products separately would result in "higher costs that outweigh the benefits to those who seek to purchase them separately."[14] In doing so, the Tribunal acknowledged that efficiency considerations are relevant in considering the separate products requirement for tied selling.[15]

"Practice" Requirement

The second element to be addressed under the *Competition Act* is whether the supplier is engaged in the "practice" of tying. The term "practice" is not defined in the *Competition Act*. In *NutraSweet*,[16] a case involving abuse of dominance and exclusive dealing, the Tribunal defined a "practice" as more than "an isolated act or acts." This reflects the *Competition Act*'s focus on encouraging competitive market conditions generally, as opposed to protecting individual consumers, regardless of market conditions.

Anti-Competitive Effect

Finally, for a practice of tied selling to contravene the *Competition Act*, it must have an anti-competitive effect. To meet this condition, the tied selling must be engaged in by a major supplier or be widespread in the market, and have an exclusionary effect that will actually or is likely to result in a substantial lessening of competition. The *Competition Act* does not define the terms "major supplier" or "widespread in a market"; however, the definitions seem unimportant, in practice, since the *Competition Act* also requires the presence of exclusionary effects that lead to a substantial lessening of competition. If a substantial lessening of competition exists, it seems likely that the tied selling would be engaged in by a "major supplier" with market power.

The Tribunal has not considered the meaning of a "substantial lessening of competition" in detail in a tied selling case. In *Tele-Direct*, the Tribunal's discussion of a "substantial lessening of competition" is very brief. The "substantial lessening of competition" test, as articulated in *NutraSweet*, the case referred to above, elaborates more fully on the meaning of a substantial lessening of competition by asking whether the anti-competitive act creates, preserves or enhances market power.[17]

Market power is the ability to sustain prices materially above competitive levels or to sustain quality, output or variety materially below competitive levels. The Tribunal uses a similar test under the *Competition Act*'s merger and abuse of dominance provisions. In considering whether particular actions (such as tying) by a firm are likely to substantially lessen competition, market share and barriers to entry will be considered along with other factors. All else being equal, the higher the market share of a supplier and the greater the barriers to entry to the market, the more likely the supplier will be found to have market power.

Competition Act Remedies

If the above conditions are met, the Tribunal may issue a remedial or prohibitive order. Until recently, only the Commissioner of Competition[18] could seek orders from the Tribunal to prohibit tied selling, although few applications have been brought to date.

Amendments to the *Competition Act*, in June 2002, now permit private parties to seek leave from the Tribunal to bring a tied selling application. The Tribunal may grant leave to a private party when it believes that the applicant is directly and substantially affected by the tied selling and is able to meet the substantive test outlined above.[19]

To date, no private parties have sought leave to bring a tied selling application since there is currently little incentive to do so.[20] The costs to the party may exceed the losses suffered from the tied selling. Currently, the Tribunal has the discretion only to prohibit or remedy the tied selling; it cannot award damages. However, this could soon change. In 2003, the Canadian government released for comment a discussion paper that includes draft legislation that would allow for administrative monetary penalties and <u>awards of damages</u> [emphasis added] to private parties in certain civil matters, including tied selling cases, where an order has been made by the Tribunal prohibiting the conduct or restoring competition in the market.[21]

If the *Competition Act* is amended to include awards of damages, private parties will have a real incentive to bring applications. A parliamentary committee report acknowledged as much, stating that "in the longer term ... we believe <u>damages</u> [emphasis added] and fines will be necessary to realize effective enforcement."[22] If ultimately enacted, these reforms would expose businesses to possible monetary penalties and civil damages, a dramatic change from the current situation in which breaches of the *Competition Act*'s civil provisions (which include tied selling) carry no monetary risk.

Bank Act

In addition to the *Competition Act*, banks and their affiliates are subject to the tied selling provisions of section 459.1 of the *Bank Act*. This section provides that a bank shall not impose undue pressure on or coerce a person to obtain a product or service as a condition of obtaining another product or service from the bank. The bank may, however, offer a product with better pricing or on more favourable terms on the condition that another product is purchased.

The *Bank Act* provision is consumer-protection – not competition – legislation. The rationale behind it is that consumers of banking products have a "special relationship" with banks and have unequal bargaining power.[23]

Unlike the *Competition Act*, the *Bank Act* prohibits coercive tied selling under all circumstances. However, the *Bank Act* is also less strict than the *Competition Act* in that it allows a bank to offer inducements to customers to buy other products – prohibited tied selling occurs only where a bank <u>requires</u> or <u>coerces</u> a customer to buy tied products. Any contravention of section 459.1 is subject to a fine of up to five million dollars.[24] To date, there has been no judicial consideration of the *Bank Act*'s tied selling provisions.

Securities Laws

The final source of anti-tying law that applies to banks is securities laws. These laws apply to any person or company selling securities. National Instrument 33-102 ("NI 33-102") provides that:

> no person or company shall require another person or company (a) to invest in particular securities, either as a condition or on terms that would appear to a reasonable person to be a condition, of supplying or continuing to supply products or services; or (b) to purchase or use any products or services, either as a condition or on terms that would appear to a reasonable person to be a condition, of selling particular securities.

Like the *Bank Act*, NI 33-102 is a prohibition with a consumer-protection focus.

Companion Policy 33-102 makes clear that NI 33-102 is designed to prevent "abusive sales practices" but not to prohibit "relationship pricing" or similar selling arrangements. Accordingly, it would not apply if a bank offered a better rate of interest on a loan to a customer who also agreed to buy a mutual fund sponsored by the bank. But it would prohibit such an arrangement if a customer was coerced or forced to purchase the two products together. These securities laws are similar to the *Bank Act* in substance. Contravention of NI 33-102 is an offence under the *Securities Act* (Ontario) and, under the general provisions, subject to penalties of up to five million dollars or a term of imprisonment of up to five years, or both. There are also other possible remedies available to securities regulators. To date, there has been no consideration of this provision.

Summary of Canadian Anti-Tying laws

The *Competition Act* protects consumers against both anti-competitive tied selling and relationship pricing while permitting pro-competitive or competitively neutral tied selling and relationship pricing. In contrast, the *Bank Act* and securities laws prohibit all forced tying arrangements, but permit any relationship pricing.

Canadian banks face costs in complying with the different statutory anti-tying rules. Are the costs of compliance justified? The answer to this question requires an examination of the economics of tying.

An Economic Look at Tying

Economics literature recognizes that tying, in its broadest sense, is efficient. For example, tying can enable suppliers to take advantage of economies of scope in production and distribution, and many products sold in competitive markets are sold on a tied basis. It is therefore appropriate that the *Competition Act* focuses only on situations in which tying is engaged in by a supplier with market power. But the economics literature also suggests that tying arrangements can enhance efficiency even when they are engaged in by a monopolist.

Efficiency Explanations for Tying

Economists have suggested several non-sinister, efficiency-enhancing reasons why a firm – even a dominant one or a monopolist – may choose to tie products. One of the most commonly accepted is to engage in price discrimination. Price discrimination allows a seller to charge different prices to different buyers of the same product. In these circumstances, tying could act as a metering device, allowing a seller to identify heavy users of a product – who presumably value the product most. Although it allows the seller to extract a greater degree of surplus from consumers, from an efficiency standpoint, price discrimination is generally thought to be an

improvement on a "single price" monopoly, since it allows the seller to charge a lower price for its product to those specific consumers who otherwise would have been shut out of the market. This, in turn, results in increased economic output.[25]

Some economists have also suggested that tying may be used for quality control. For example, the reputation of a camera supplier could be damaged if consumers used low-grade film that resulted in inferior pictures or caused the camera to break down. The camera manufacturer might therefore wish to regulate the sale of its after-market products and services.

Other rationales for tying include the reduction in costs by creating economies of scope, technological interdependence between two products and evasion of a regulatory price ceiling on the primary product.

Should Tying Be Illegal?

The original rationale for prohibiting tied selling, adopted by U.S. courts in the early 20th century, has been discredited. The "leverage" theory, which was an early motivation for the prohibition, asserted that a company with a monopoly in one product that ties a second product in a competitive market to the monopoly product can "leverage" its monopoly into the second market that was previously competitive. For example, a monopolist in the camera market could consequently end up with a monopoly in the film market as well.

Critics of the leverage theory have pointed out that no additional monopoly profits are earned. The profit-maximizing strategy for the monopolist is to charge monopoly prices in the market in which it has market power only, since it is possible to earn monopoly rents only once.[26] Under the example described above, a monopolist charging the full monopoly price for a product, such as a camera, has already extracted the maximum that consumers are willing to pay for the product. An increase in the price of a tied product, such as film, means the consumer must pay a higher price for the final bundle. But this just leads to prices being higher than the profit-maximizing monopoly price, which leads to lower profits to the monopolist than if it only charged monopoly prices on the one product. In the camera and film example, the price increase on film bundled with cameras will simply reduce the total purchases of cameras and film below levels that would be achieved by charging monopoly prices for cameras and competitive prices for film, which is not in the monopolist's best interest.

The leverage theory has made a minor comeback with some commentators arguing that leveraging a monopoly in one market into market power in a second market may be profitable in limited circumstances – such as where the second market is not perfectly competitive and is characterized by economies of scale.[27] In this situation, a monopolist might be able to leverage monopoly power from the first market to the second market by foreclosing the second market to competitors. A monopolist could do this by driving down prices in the second market, thereby lowering competitors' revenues below the level that would justify any continued operation. But even if such leveraging were possible, its effect on both consumer welfare and total surplus is ambiguous. If leveraging would not create negative wealth effects, why should it be prohibited?

Conclusion

Economic theory suggests we should be careful about prohibiting tying outright. Since anti-tying laws under Canada's banking and securities regimes do precisely this (with respect to forced tying arrangements), they are suspect from an economic efficiency perspective. Still, since the purpose of the banking and securities laws is ostensibly to protect consumers, it would be wrong to criticize them solely from an efficiency perspective. These laws may, however, be criticized on their own terms.

The *Bank Act* prohibition was designed to protect retail consumers in a competitive retail environment in which banks increasingly try to sell their customers different products, and vie for a greater share of the retail customer's wallet.[28] When the banking law was enacted, benefits were promised to individuals and small businesses.[29] But it is arguable that the current provisions go too far, since they capture the sale of tied products, such as corporate lending and investment banking products, to large sophisticated corporate customers.

Consolidation of lending and investment banking activities by big banks in the past 20 years in Canada and the United States is increasing incentives to bundle products.[30] The question has been raised as to whether there are remedies for retail consumer-related concerns that fall short of the current outright prohibition on forced tying, which also affects large sophisticated corporate entities that do not require such protection.[31]

While anti-tying laws under the *Competition Act* are not as strict, they are easier to criticise from an efficiency standpoint since one of the explicit goals of the *Competition Act* is to increase efficiency. Canadian competition laws rightly recognize that tying is not anti-competitive in all cases, and in many cases should be allowed. What the *Competition Act* should also explicitly recognize is that even if tying is anti-competitive, it may still be beneficial because it is efficiency-enhancing. The Tribunal, in *Tele-Direct*, acknowledged that it has discretion to consider any efficiency-enhancing aspects of a tied selling argument, and that a supplier with market power may sell items in combination for efficiency-related reasons.[32]

The role of efficiencies under the *Competition Act* is the subject of a national consultation process launched in September 2004 by the Competition Bureau.[33] Canadian competition policy ought to have a single, main objective – that of obtaining the most efficient performance possible from the Canadian economy. Such a policy would maximize productivity (and thereby, real income) for the benefit of all Canadians. It is also likely to be applied more consistently and effectively than a policy focused on other less clear objectives such as consumer protection. A realignment of the *Competition Act* to more explicitly acknowledge an efficiency-related focus would be a welcome development. To this realignment, an amendment relating to the significance of economic efficiency in assessing tied selling arrangements could, fittingly, be tied.

Notes

1 Carolyn Naiman is a partner in the Antitrust and Competition Law Group at Torys LLP.
2 Jason Brooks is an associate at Torys LLP.
3 See the explanation of the term "bank," below.
4 The Federal Reserve and Office of the Comptroller General have reviewed the practice and the General Accounting Office, the investigative arm of Congress, issued a report in October 2003 that found little evidence of tied selling but noted this could be because

there is no good system for monitoring the practice and recommended stronger enforcement. See U.S., House of Representatives, General Accounting Office, *Bank Tying: Additional Steps Needed to Ensure Effective Enforcement of Tying Prohibitions*, Committee on Energy and Commerce Report to the Ranking Minority Member, (October 2003). The chairman of the SEC said in his Senate confirmation hearings last year that he would look into the practice. The National Association of Securities Dealers passed a rule in June 2003 to require adequate supervision policies and procedures regarding tying at investment banks. See D. Anason & R. Julavits, "Early Look at One Possible Industry Stand in Tying Fight" *The American Banker* (13 June 2003) 1; R.D. Atlas, "Corporations in Survey Say Banks Tie Loans to Other Business" *New York Times* (19 March 2003) C4; and M. Heller, "GAO Sets Tying Probe Report Due Out Oct. 6" *The American Banker* (12 March 2003) 20.

[5] Competition Bureau, "Appendix I - Tied Selling: Background Information for the Task Force on the Future of the Canadian Financial Services Sector Tied Selling Defined" (Submission to the Task Force on the Future of the Canadian Financial Services Sector, http://cb-bc.gc.ca/epic/internet/incb-bc.nsf./vwGeneratedInterE/ct01164e.html).

[6] For examples of Canadian coverage of this issue, see D. DeCloet, "A Loan Without Strings" *National Post* (10 March 2001) C3; D. Francis, "The Banks' Cozy Brokerage Cartel" *National Post* (16 June 2001) C3; and A. Willis, "Winning Financing Deals is a Lot Like Selling Big Macs" *The Globe and Mail* (2 August 2001) B12.

[7] *Competition Act*, R.S.C. 1985, c. C-34.

[8] *Bank Act*, R.S.C. 1991, c. C-46.

[9] While not discussed in this article, tied selling may in certain cases be caught under the *Competition Act* provisions dealing with abuse of dominant position, misleading advertising and predatory pricing.

[10] *Competition Act, supra* note 7, s. 2(1).

[11] *Ibid.*, s. 77(4)(b) and (c).

[12] *Canada (Director of Investigation and Research) v. Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1. For a thorough review of this case, see S. Wong, "The First Tied Selling Case" in J.B. Musgrove, ed., *Competition Law for the 21st Century: Papers of the Canadian Bar Association, Competition Law Section, 1997 Annual Conference* (Ottawa: Canadian Bar Association, 1998) 16.

[13] *Tele-Direct*, *ibid.* at 119.

[14] *Ibid.*

[15] As a practical matter, when it is more efficient to sell products bundled, it is unlikely there will be high demand for the products to be sold separately – the other half of the two-products test – though it is conceivable that this could happen if efficiencies from tying were not passed along to customers.

[16] *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 at 35.

[17] *Ibid.* at 55.

[18] *Competition Act*, *supra* note 7, s. 2(1).

[19] *Ibid.*, s. 103.1.

[20] It is noteworthy that the Commissioner of Competition has not brought many cases under this provision either.

[21] Views on various matters relating to the proposed amendments to the civil provisions have been widely divergent. See Public Policy Forum, *National Consultation on the Competition Act:* Final Report (Ottawa, 8 April 2004).

[22] Canada, Report of the Standing Committee on Industry, Science and Technology, *A Plan to Modernize Canada's Competition Regime* (April 2002).

[23] Canada, Department of Finance, *1997 Review of Financial Sector Legislation: Proposals for Changes* (June 1996) 17.

[24] Canada, Task Force on the Future of the Canadian Financial Services Sector, *The Report of the Task Force on the Future of the Canadian Financial Services Sector* (September 1998) 133.

[25] Of course, this kind of price discrimination could run afoul of the *Competition Act*, despite having a positive effect on efficiency. As a practical matter, this is not risky activity as there have been very few price discrimination cases to date.

[26] See A. Director & E. Levi, "Law and the Future: Trade Regulation" (1956) 51 Nw. U.L. Rev. 281; and R. Posner, *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976).

[27] For instance, see M.D. Whinston, "Tying, Foreclosure and Exclusion" (1990) 80 American Economic Review 837.

[28] Canada, House of Commons, Standing Committee on Finance, "1997 Review of Financial Services Sector Legislation: Proposals for Changes 4th Report" (October 1996) at 5.

[29] For example, see *House of Commons Debates* (17 March 1997) at 1535; and Canada, House of Commons, Standing Committee on Finance, "1997 Review of Financial Services Sector Legislation: Proposals for Changes, 4th Report" (October 1996).

[30] In the United States, the consolidation of banking and investment banking services has increased considerably following the 1999 passage of the *Gramm-Leach-Bliley (Financial Services Modernization Act 1999)* P.L. 106-102. This Act lifted restrictions on

the amount of investment banking that traditional banks can engage in. In Canada, amendments to the *Bank Act* in 1987 loosened ownership rules and as a result a number of big banks have purchased brokerage houses.

[31] Competition Bureau, "Appendix I - Tied Selling: Background Information for the Task Force on the Future of the Canadian Financial Services Sector Tied Selling Defined," *supra* note 5.

[32] *Tele-Direct*, *supra* note 12 at 118.

[33] Canada, Competition Bureau, *Treatment of Efficiencies in the Competition Act; Consultation Paper* (Ottawa, September 2004).

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