COMMENT AND ANALYSIS

REVOKING IMMUNITY: COULD THE *STOLT-NIELSEN* SCENARIO OCCUR IN CANADA?

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Introduction

By now, the U.S. Department of Justice Antitrust Division's pending appeal from the District Court's injunction[2] barring prosecution of Stolt-Nielsen for the alleged breach of its immunity deal is well known. The government's appeal[3] centres around whether Stolt-Nielsen had taken "prompt and effective action" to terminate its participation in illegal antitrust activity in the parcel tanker industry and whether, by allegedly failing to take such steps and misrepresenting same to the Division, it thereby disqualified itself from immunity and was thus subject to indictment.

Briefly, Stolt-Nielsen was provided with a formal immunity letter in January 2003 in which, under its standard terms, the Division promised that it would not prosecute the company or any of its employees or executives for anticompetitive activities occurring prior to the date of the letter.[4] The Division maintains that the company falsely asserted that it had ceased its illegal activities in March or April, 2002 while in fact continuing them into the second half of the year. The Division indicated its intention to indict the company and one of its executives and, in response, Stolt-Nielsen and the executive filed civil proceedings in District Court seeking injunctive relief against the prosecution.

In its analysis, the District Court focused on the terms of the Division's standard form letter[5] which, in the Court's view, set out a binding contract to the effect that no prosecution would occur for activities prior to the date of the letter, observing that no other date was set out in the text. As the letter contained the standard clause indicating that it superseded all prior arrangements, the Court determined that the Division could not subsequently rely on an underlying understanding of what the parties had meant when entering into the agreement. The injunction was issued because the corporation and its executive would suffer irreparable harm from an indictment, even if they were eventually acquitted.

The Court also declared that the Division had received the benefit of co-operation from the company (obtaining guilty pleas and a total of $62,000,000 in fines against two other companies as well as jail time for several executives) and that it had, by co-operating, incriminated itself in the process.

In its appeal brief[6], the Division strongly contests the imposition of injunctive relief, arguing separation of powers grounds, the absence of irreparable harm, and legal error attaching to the District Court's finding that no breach of the agreement had occurred.[7]

Global enforcement of international antitrust law now incorporates numerous immunity and leniency[8] programs. Canada's Competition Bureau has now had five years' experience with its own immunity programme. Regulators threaten the prospect of revocation in the event of non-compliance with immunity deals. Reflecting on *Stolt-Nielsen v. U.S.*, one could therefore ask whether the same scenario could arise in Canada.

Immunity and Discretion

The Bureau's immunity program[9] outlines practices and procedures jointly employed by the Bureau and the Attorney General of Canada (the "AG") on issues of immunity for criminal antitrust behaviour. The policy is similar in content and scope to the Antitrust Division's corporate leniency policy, enabling immunity if the applicant is the first to report illegal conduct, takes "effective steps to terminate its participation", is not the instigator nor the sole beneficiary of the conduct in Canada, reveals all competition-related offences relative to the product, makes truthful and continuing co-operation and disclosure of evidence and information, and (where possible) makes restitution.[10]

Unlike the Antitrust Division, however, the process for an immunity grant in Canada is a bifurcated one, with formal immunity granted only by the AG on the positive recommendation of the Bureau. The Antitrust Division's leniency policy formally suppresses discretion on the part of the Attorney General of the United States[11] as a component of the necessary guarantee that prosecution will not lie for a successful applicant.

The situation in Canada is different. The AG makes a discretionary grant of immunity in exchange for evidence, information, co-operation or assistance provided by an applicant. The Bureau has no such power but may "recommend" to the AG that immunity be granted.[12] The AG's immunity policy[13] indicates that consultation with the Bureau in the ultimate decision will occur but the AG retains sole discretion to determine whether immunity will be granted and continued.

There is no statutory or administrative law guarantee that immunity will be granted in Canada. This flows from the nature of the plenary discretionary power available to the AG in the exercise of his or her functions, which has been held to be constitutionally valid in Canada.[14]

Revocation in Canada

This discretionary power on the part of the AG flows through to potential revocation of immunity. The Bureau's policy notes that failure to comply with requirements of an immunity agreement may result in the AG revoking immunity.[15]

As noted above, the Bureau's policy requires an applicant to "take effective steps to terminate its participation" in the activity and that it must make no misrepresentation of any material facts.

The typical provisional grant of immunity ("PGI") or final immunity agreement with the AG contains a corporate co-operation clause that will:

(a) require the corporation to provide full, frank, and truthful disclosure of evidence and production of all non-privileged relevant information known to it, in its possession or under its control; and

(b) require the corporation to "use all lawful measures" to secure the ongoing, complete, and truthful co-operation of directors, officers and employees of the corporation.

In the case of individuals, similar co-operation is required, with the additional requirement of ensuring their availability for interview and potential testimony in contested proceedings.

The Bureau's policy states that it will recommend that the AG revoke immunity in any of the following circumstances:

- where the party agrees to co-operate but does not fulfil its obligation under the agreement;
- where a corporation does not fully promote the complete and timely co-operation of its employees;
- where the party fails to disclose any and all offences; or
- where the party does not provide full, frank and truthful disclosure of all evidence and information known or available to it under its control.[16]

The AG's sample immunity letters contain revocation clauses for failing to fulfil the continuing co-operation conditions set out in the immunity agreement and provide that:

> ... on seven days' prior written notice to that person and to counsel for [the company] of its intention to do so, may revoke the immunity granted to the person concerned and may, therefore, take such action against that person, including prosecution under the *Competition Act* or otherwise, as the Attorney General considers appropriate.[17]

To date, the AG has not revoked a grant of immunity in the five year history of the Bureau's formal immunity program, although public statements by various Bureau officials have indicated that revocation was contemplated in a recent case "due to an apparent lack of co-operation and information" In order to ensure compliance (and maintain the integrity of its immunity program), the Bureau will point to potential revocation as a genuine sanction.

Remedies

Prosecutorial Discretion: The Context

In Canada, prosecutorial discretion constitutes a bulwark of the administration of justice and reviewing Courts tread carefully in this area, lest they be seen as co-opting the prosecution process and compromising judicial independence.[18] In its decision in *T. (V.)*[19], the Supreme Court of Canada commented on the rationale for non-interference as follows:

> It is important to understand the rationale for this judicial deference to the prosecutor's discretion. In this regard, the reasons of Viscount Dilhorne in Director of Public Prosecutions v. Humphrys, [1976] 2 All E.R. 497 (H.L.), at p. 511, are instructive:
>
> > A judge must keep out of the arena. He should not have or appear to have any responsibility for the institution of a prosecution. The functions of prosecutors and of judges must not be blurred. If a judge has power to decline to hear a case because he does not think it should be brought, then it soon may be thought that the cases he allows to proceed are cases brought with his consent or approval.

In the case of *Power*[20], the Supreme Court further noted that "... the Crown cannot function as a prosecutor before the Court while also serving under its general supervision. The Court, in turn, cannot both supervise the exercise of prosecutorial discretion and act as an impartial arbitrator of the case presented to it. Judicial review of prosecutorial discretion, which would enable Courts to evaluate whether or not a prosecutor's discretion was correctly exercised, would destroy the very system of justice it was intended to protect".[21] Thus, it would seem that there is very little scope in Canada for judicial review of the prosecutor's decision to indict.

The "Abuse of Process" Doctrine

However, another line of cases, some constitutionally-based, has developed a remedy in the form of a stay of proceedings where the defence is able to establish that there has been an "abuse of process". Under this doctrine, the AG may be enjoined from proceeding with a prosecution where "compelling an accused to stand trial would violate those fundamental principles of justice which underlie the community's sense of fair play and decency" or where the proceedings are "oppressive or vexatious".[22] Prosecutorial misconduct is not a prerequisite for invoking the doctrine[23] but the sanction should be employed only in the "clearest of cases".[24] A summary of this doctrine was set out in the Supreme Court's decision in *Regan*[25] as follows:

> A stay of proceedings is only one remedy to an abuse of process, but the most drastic one: "that ultimate remedy", as this Court in Tobiass, (citation omitted) called it. It is ultimate in the sense that it is final. Charges that are stayed may never be prosecuted; an alleged victim will never get his or her day in court; society will never have the matter resolved by a trier of fact. For these reasons, a stay is reserved for only those cases of abuse where a very high threshold is met: "the threshold for obtaining a stay of proceedings remains, under the Charter as under the common law doctrine of abuse of process, the 'clearest of cases'" (*R. v. O'Connor* (1996) 103 C.C.C. (3d) 1, at para. 68).
>
> Regardless of whether the abuse causes prejudice to the accused, because of an unfair trial, or to the integrity of the justice system, a stay of proceedings will only be appropriate when two criteria are met:

(i) the prejudice caused by the abuse in question will be manifested, perpetuated or aggravated through the conduct of the trial, or by its outcome; and

(ii) no other remedy is reasonably capable of removing the prejudice.[26]

Review of Canadian Revocation Cases

Although there are as yet no antitrust applications of this doctrine, a review of cases decided under the general criminal law discloses that the most common method of challenge to an AG's indictment following alleged breach of an immunity or non-prosecution agreement has been through a post-indictment pre-trial abuse of process application which is brought by the accused to the trial court.[27] In such an application, the immunity recipient complains that his or her agreement has foreclosed prosecution for the acts set out in the indictment. While the form of application is consistent, the results in the decided cases, however, are mixed.

In the case of *Crneck, Bradley and Shelley*[28], the Crown reneged on an agreement not to prosecute an accused after she had provided a formal statement to police implicating other persons in a manslaughter case. The accused agreed to testify against one of the other accused at trial. Subsequent prosecuting counsel determined that this arrangement was not appropriate, and decided that the accused should be charged. The Ontario High Court determined that the Crown had reneged upon its agreement to extend immunity from prosecution in return for co-operation and that this act "... undermines the administration of justice and brings the entire system of the administration of justice into disrepute". The Court also held that the applicant would be seriously prejudiced in her defence to the charge, having provided a formal statement to police upon which she could be cross-examined. The proceedings were stayed.

In *MacDonald*[29], the accused's application for a stay of proceedings on the basis of the Crown's breach of its agreement not to prosecute was refused. The accused was tried and convicted of the offence of first degree murder. The accused had provided a statement to police concerning his knowledge of the murder and the Crown thereafter agreed that he would be charged only with an offence of being an accessory after the fact to murder upon his providing a "truthful statement". However, subsequent investigation established that the accused had been untruthful and had, in fact, perpetrated the crime. The Court held that the Crown did not get the "complete and truthful statement" from the accused that it had bargained for and was therefore under no obligation to meet the final requirement of the agreement to charge the accused only with the lesser offence, rather than the offence of first degree murder.

The Court stated that to permit the agreement to stand would permit the accused to benefit from his incomplete and untruthful statements and from the deal he had struck with the Crown before all the facts were known. The Court also observed that the accused had suffered no prejudice because none of the statements that he provided to the police were used at his trial. This was not a case in which there had been an affront to fair play and decency that outweighed society's interest in the effective prosecution of criminal cases. The stay application was refused and the conviction affirmed.

In *Pritchard*, the B.C. Supreme Court dealt with an application to stay proceedings and, alternatively, for exclusion of evidence on allegations that the Crown had not honoured its "limited immunity agreement" Pritchard was charged with first degree murder arising from a homicide committed in the course of a drug rip-off robbery and after his indictment (and on the eve of trial), offered to provide information to the police implicating another in the robbery and homicide. The trial was adjourned and the parties entered into an agreement which would have limited Pritchard's prosecution to a second degree murder charge (or a lesser offence) provided that he made full and truthful disclosure of the circumstances. Interestingly, the agreement fashioned by the parties included a term that the agreement could be "litigated" in the event that a first degree murder charge was continued against Pritchard and a waiver of use and derivative use immunity clause that enabled the prosecution to utilize all evidence obtained from Pritchard before and after the agreement (with limited exceptions) in the event of Pritchard's failure to comply with the terms of the agreement.

Pritchard provided an extensive statement to police which, after analysis by the prosecution, was determined to be untrue and fabricated long after the events in question in order to provide him with a defence to the murder charge. The prosecution then proceeded with the first degree murder charge and the defence brought an application to stay the case.

In approaching the issue, the Court rejected a purely contractual analysis of the circumstances which was derived from U.S. jurisprudence such as *Santobello*[31] and instead adopted a more nuanced view as set out in later cases such as *Alegria*[32] and *Weaver*[33]. In the former case, the 1st Circuit observed:

> Courts customarily treat plea agreements, for purposes of construction, more or less in the same [citation omitted] manner as they do contracts. See United States v. Atwood, 963 F.2d 476, 479 (1st Cir. 1992); United States v. Anderson, 921 F.2d 335, 337-38 (1st Cir. 1990). We say "more or less" because this analogy has its limitations. See United States v. Hogan, 862 F.2d 386, 388 (1st Cir. 1988) (observing that plea agreements are similar to commercial contracts, but only "in certain respects"). Thus, although contract law supplies a useful reference point for construing plea agreements in federal criminal cases, such agreements are not governed by the law of contracts. See United States v. Kelly, 18 F.3d 612, 616 (8th Cir. 1994).[34]

The Court declined to apply principles of contract law to the facts "except in the very broadest sense" and, after a review of the case law, set out the following principles of analysis for application of the stay remedy for abuse of process:

1. Applications for stays of proceedings are fact specific. The facts upon which an application is based should be carefully canvassed.

2. The onus rests upon the applicant to prove the facts upon which he relies for a stay of proceedings.

3. The standard of proof is proof on a balance of probabilities.

4. A stay of proceedings may be granted to ensure trial fairness or to prevent a violation of those principles of justice which underlie the community's sense of decency and fair play.

5. A stay of proceedings is a prospective rather than a retrospective remedy.

6. A stay of proceedings should be granted only in the clearest of cases where no lesser remedy will serve to avoid manifesting, perpetuating, or aggravating the prejudice caused by the abuse.[35]

As in the *MacDonald* case discussed above, the Court found that the version of events given by Pritchard was "substantially false", that he failed to establish on a balance of probabilities that his statements were true in order to claim the benefit of the agreement, and that there was no abuse of process by the prosecution. The Court also rejected submissions that the prosecution should be banned from taking advantage of the waiver of evidence clause in the agreement, and found that Pritchard had forfeited his right to silence by providing a statement; there was accordingly no violation of his fair trial rights under section 7 of the *Charter* and the resulting evidence was not excluded.

The B.C. Supreme Court stayed proceedings in the case of *D.A.H.*[36] where the prosecution brought long-delayed charges against the accused after he had entered a plea of guilty to sexual assault offences and had been promised immunity on the very charges brought several years later. The Court determined that the prosecution's conduct constituted an abuse of process.

In *Betesh*[37], an undertaking given by the federal Crown not to prosecute postal workers for criminal offences committed during a strike was held to be binding on the provincial Crown and the Court determined that it had an inherent jurisdiction to stay proceedings where the provincial Crown's reneging on such an agreement would constitute an abuse of the Court's process. In its judgement, the Court noted other cases where the prosecutor had been bound by a pre-trial agreement relative to a position to be taken upon sentencing of an accused, noting that such position could not be repudiated by the Crown on a subsequent appeal to the Court of Appeal.[38] The Court observed that the Crown, as any other litigant "... ought not to be heard to repudiate before an Appellate Court the position taken by its counsel in the Trial Court, except for the gravest possible reasons".

In the case of *Demers*[39], the accused alleged that the Crown had breached an agreement not to prosecute in circumstances where the accused had been apprehended for robbery but had provided assistance in a murder investigation. As in *McDonald, supra*, further investigation determined his involvement in the murder (for which he was later charged, tried and acquitted). He was then charged with the robbery. The accused alleged that the prosecution had reneged on an earlier agreement not to charge him with robbery in return for co-operation on the homicide charge. The Court stayed proceedings against the accused upon the basis that he was entitled to know, at the time of entering into his agreement with the Crown, all the charges he would have to meet.[40]

An interesting sidelight to this area occurred in the sentencing case of *Atkinson*[41] where the New Brunswick Court of Appeal criticized a suggestion by a trial Judge that the prosecution enable prosecutions of other involved

persons through a grant of immunity from further prosecution to the accused, a lawyer who had made no financial gain from commission of the offences. While agreeing that the police were unable to obtain co-operation of the accused in supplying further information, the prosecutor refused to extend immunity and the trial Judge imposed the lenient sentence of an absolute discharge on an offence of paying secret commissions. The Court of Appeal reversed the decision and imposed a fine, holding that the Trial Court's reasoning in suggesting that immunity be granted upon the basis of further co-operation was unprecedented and could not be sustained. The suggestion that an accused obtain a more lenient sentence by co-operating and implicating others was seen as inappropriate.[42]

In *R. v. E.D.*[43], Arbour J.A. (as she then was) summarized the rationale of these cases in the following fashion:

> Typically though, these cases involved "deals" in which the accused had genuinely compromised his or her position and made a real concession in anticipation of some reward, such as the abandonment of a prosecution. Moreover, and largely because of that, they were all cases where the accused had been prejudiced by the Crown reneging on the deal.[44]

Other Forms of Relief

Obtaining a pre-indictment injunction or other relief against the AG, as was the case in *Stolt-Nielsen v. U.S.*, has virtually no chance of success for an accused in Canada. First, the Crown is not subject to injunctive relief in Canada.[45] There is also a general reluctance by Courts to permit free-standing applications where there is a trial court in view[46] and as well because of the overriding judicial deference, noted *supra*, to the discretionary power of the AG.[47] In general terms, the AG's decision to prosecute, absent dishonesty, bad faith or exceptional circumstances, is not subject to Canadian judicial review, unlike some other jurisdictions.[48]

So what is the "bottom line" in Canada? While the AG has full discretionary power to issue grants of immunity and commence proceedings, the immunity policy[49] incorporates substantial advance consultation with investigative agencies such as the Bureau. Even where a corporation may have made the alleged misrepresentations as to cessation of illegal activities as in *Stolt-Nielsen v. U.S.*, it is unlikely that immunity would be revoked directly by the AG in the absence of a recommendation from the Bureau. In such a case, though, the regulator is likely to assert that the applicant has not met the terms of its bargain, or, as in the *MacDonald* case cited above, that the applicant wrongfully took advantage of its arrangement before all the (true) facts were known. By adhering to a more clinical breach of contract analysis, the prosecution would attempt to avoid the supervisory overlay of procedural unfairness and prejudice referred to in Arbour J.A.'s analysis of the immunity cases referred to above. The defence would counter that mounting a prosecution, in the face of detrimental reliance and substantial prejudice to the accused, would constitute an "abuse of process" and demand a stay.

Pitfalls in the Immunity Process

There are other "grey areas" with revocation risks. What, for example, is the ambit of the Bureau's policy that an immunity applicant provide "full, frank and truthful disclosure of all the evidence and information known or

available to it or under its control, wherever located, relating to the offences under investigations".[50] What if the applicant negligently, but not intentionally, misrepresents certain facts in its leniency application? Who decides whether those facts are "material"? Further, what is the scope of the requirement that a corporation bring about co-operation of its employees and officers? Current Bureau policy requires corporations to take "all lawful measures" to promote such co-operation; would such measures entail dismissal of an employee where such dismissal may be unlawful under domestic labour legislation?

Although the AG's model immunity letter and typical immunity agreement provide for a notice period in order for the potential accused to make submissions regarding potential prosecution, these provisions are not likely to have constitutional significance and the AG is not likely to be required to adhere to any particular due process requirements in entertaining such submissions.[51]

There are further problems arising from a decision to revoke immunity and prosecute. Standard form Antitrust Division immunity agreements expressly provide for the extinction of any use or derivative use immunity on the products of a leniency applicant's co-operation where immunity is revoked[52]; thus all documentary or other information provided by the applicant may be used against it in a subsequent prosecution for the substantive offence.

Canadian PGI or immunity agreements contain clauses enabling prosecution for perjury or obstruction of justice (and similar offences) if an immunity applicant lies or provides misleading or deceptive information during the co-operation process, but do not normally have an evidence waiver so as to enable use or derivative use of evidence obtained during the co-operation process in a subsequent prosecution for the substantive offence. Significant and troubling issues may arise where the prosecution attempts to mount a subsequent prosecution upon evidence derived from the co-operation process in the absence of a fully informed waiver.[53] At the very least, an individual accused (even as representative of the corporation) would be able to argue that his or her co-operation was extended to the AG in an involuntary process with the applicant hoping and expecting favourable treatment by authorities. On this analysis, any real evidence derived from an involuntary statement made to regulators which is not independently discoverable would attract derivative testimonial privilege.[54] In these circumstances, the admissibility of any evidence thereby derived would be seriously in doubt.[55] Even more serious issues would arise if material has been shared with foreign regulators and action initiated by them.

Conclusion

Given the above-noted principles arising from the jurisprudence, one would expect that the Bureau and AG would be scrupulous in invoking revocation and pursuing an indictment. An immunity applicant who faces such a prosecution will have an uncertain outcome in any remedial proceedings. As outlined above, obtaining success on a "stay for abuse of process" post-indictment motion in Canada may ultimately depend upon a trial court's view of whether enabling the prosecution to continue would violate principles of fair play and community decency. In opposition, the Crown may assert misrepresentation by the applicant in a breach of contract analysis akin to that advanced in the *MacDonald* case, *supra*. An applicant's position is more tenable it if approaches such an application with "clean hands" (i.e. has not intentionally or recklessly misled or deceived authorities, and has

taken all reasonable steps in attempting to provide full and truthful information) and has documented its detrimental reliance upon the grant of immunity in providing its co-operation. At last measure, an individual accused in such a situation may be able to bar prosecution upon arguing that the prosecution's case is based upon inadmissible derivative evidence. The situation for corporations is less clear, given the more restricted "personal" fair trial and associated rights available to them under the *Charter*.[56]

Whatever its result, the outcome in *Stolt-Nielsen v. U.S.* will be closely watched by both competition authorities and the Bar. Undoubtedly, the spectre of revocation places a close focus on elements of most immunity processes and it is expected that the judgement in appeal will provide guidance for parties in this developing area.

Notes

[1] Partner, Competition & Antitrust Law Group, Osler, Hoskin & Harcourt LLP, Toronto; I am grateful to Tim Kennish, Counsel to the Firm and to my Partner, Laura Fric for their helpful suggestions on this paper.

[2] *U.S. v. Stolt-Nielsen S.A., Stolt-Nielsen Transportation Group Ltd. and Richard B. Wingfield*, United States District Court for the Eastern District of Pennsylvania, Action No. 04-CV-537, Findings of Fact of Timothy J. Savage, J., January 14, 2005, [2005] 352 F. Supp. 553 [*Stolt-Nielsen v. U.S.*].

[3] Heard September 30th, 2005.

[4] *Stolt-Nielsen v. U.S.*, *supra* note 2 at para. 62.

[5] See Gary R. Spratling, then Deputy Assistant Attorney General, Antitrust Division, "Making Companies an Offer they Shouldn't Refuse – the Antitrust Division's Corporate Leniency Policy – An Update", February 16, 1999, Model Corporate Amnesty Letter (attached).

[6] *Stolt-Nielsen v. U.S.*: Brief for Appellant United States of America (05/17/2005) "Issues Presented".

[7] Full analysis of the Division's legal position in a Canadian context is outside the scope of this paper.

[8] In this paper, the terms "immunity" and "leniency" are used interchangeably and denote, as reflected in both Canadian and U.S. policies, a complete amnesty from prosecution.

[9] *Immunity Program Under the Competition Act*, Competition Bureau Information Bulletin, September 2000.

[10] *Ibid* at paras. 13-17.

[11] Scott D. Hammond [then] Director of Criminal Enforcement, Antitrust Division, U.S. Department of Justice, "Fighting Cartels – Why and How – Lessons Common to Detecting and Deterring Cartel Activity" (Paper delivered to the 3rd Nordic Competition Policy Conference, Stockholm, Sweden, September 12, 2000).

[12] *Immunity Program Under the Competition Act, supra* note 9 at paras. 11, 24.

[13] Federal Prosecution Service Desk Book, Part VII, Chapter 35 ("Immunity Agreements").

[14] *R. v Lyons* (1987), 37 C.C.C. (3d) 1 (S.C.C.).

[15] *Immunity Program Under the Competition Act*, *supra* note 9 at para. 25.

[16] *Ibid.* at para. 26 & 27.

[17] Federal Prosecution Service Desk Book, *supra* note 13: "Sample Immunity Agreement – Individual" at 35-15.

[18] *R. v. Balderstone* (1983) 8 C.C.C. (3d) 532 at 539 (Man. C.A.); leave to appeal refused: [1983] 2 S.C.R. vi.

[19] *R. v. T. (V.)* [1992] 1 S.C.R. 749.

[20] *R. v Power* (1994) 89 C.C.C. (3d) (1) (S.C.C.).

[21] *Ibid.* at para. 40.

[22] *R. v. Jewitt* (1985) 21 C.C.C. (3d) 7 (S.C.C.); *R. v. Keyowski* (1988), 40 C.C.C. (3d) 481 (S.C.C.).

[23] *R. v Keyowski, ibid.*

[24] *R. v Jewitt, supra* note 22 at 14; see also *Re Abitibi Paper Company Ltd. and The Queen* [1979] 47 C.C.C. (2d) 487 (Ont. C.A.) where it was observed that "the power is to be very sparingly exercised and only in very exceptional cases".

[25] *R. v Regan* [2002] 1 S.C.R. 297.

[26] *Ibid. per* LeBel, J. at para. 53.

[27] See *R. v. Power, supra* note 20.

[28] *R. v. Crneck, Bradley and Shelley* (1980), 55 C.C.C. (2d) 1 (Ont. H.C.).

[29] *R. v MacDonald* (1990), 54 C.C.C. (3d) 97 (Ont. C.A.); leave to appeal to S.C.C. refused: 61 C.C.C. (3d) (vi).

[30] *R. v. Pritchard* [2002] B.C.J. No. 3174.

[31] *Santobello v. New York*, 404 U.S. 257 (1971).

[32] *United States v. Alegria*, 192 F.3d 179 (1st Cir. 1999).

[33] *United States v. Weaver*, 905 F.2d 1466 (11th Cir. 1990).

[34] *Supra* note 31 at para. 11.

[35] *Ibid* at para. 32.

[36] *R. v. D.A.H.*, unreported decision of B.C.S.C., K. Smith, J., May 25, 2000, Vancouver Registry X052691.

[37] *R. v. Betesh* (1975) 30 C.C.C. (2d) 233 (Ont. Co.Ct.).

[38] *R. v. Agozzino* [1970] 1 C.C.C. 380 (Ont. C.A.).

[39] *R. v. Demers* (1989) 49 C.C.C. (3d) 52 (Que. C.A.).

[40] The decision is somewhat unclear; although the Court commented critically on the Crown's non-disclosure of the potential future charges against the accused, it appears that proceedings were stayed largely on the basis of trial delay (although *Charter* considerations were not argued in the case).

[41] *Regina v. Atkinson* (1981) 57 C.C.C. (2d) 513 (N.B.C.A.).

[42] This decision is at odds with more recent authority in which courts have positively acknowledged assistance provided to authorities – both pre- and post-indictment – as a mitigating sentencing factor (see e.g. *R. v. John Doe* (1999), 142 C.C.C. (3d) 330 (Ont. Sup. Ct.)) and with US practice on "substantial assistance to authorities: (see s. 5K1.1 of the *Federal Sentencing Guidelines* – now somewhat in doubt arising from the case of *United States v Booker* 125 S. Ct. 738); the appeal court in this case was more likely distressed by the trial Judge's excursion into the prosecutorial arena.

[43] *R. v E.D* (1990), 57 C.C.C. (3d) 151 (Ont. C.A.).

[44] *Ibid.* at 164.

[45] See the Federal *Crown Liability and Proceedings Act*, R.S. 1985, c. C-50, ss. 22(1) and, e.g. *C.I.A.C. v. H.M.T.Q.* [1984] 2 F.C. 866 (F.C.A.); injunctive relief, however, may lie against a particular Minister or public servant to restrain him/her from acting outside the scope of his/her authority at law or in the constitution: *Zenon Environmental Inc. v Canada* [2005] F.C.J. No. 254 (F.C.).

[46] *R. v. Zevallos* (1987), 37 C.C.C. (3d) 79 (Ont. C.A.).

[47] *R. v. T. (V)*, *supra* note 19.

[48] In the U.K., failure to follow policies may make the D.P.P. subject to administrative law remedies: See *R. v. D.P.P. Ex. Manning and Others* [2003] (3 W.L.R.) (463) (Q.B.) and *Exparte Kebilene and Others* [1999] 4 All E.R. 827 (H of L.).

[49] *Supra* note 13.

[50] *Immunity Program Under the Competition Act*, *supra* note 9 at para. 16(b).

[51] However, see *R. v Brown [Production of Information]* 1997 O.J. 6164 (Ont. Ct. Gen. Div., Trafford, J. February 17, 1997) wherein AG counsel indicated that, in the case of preferred indictments, "...in an attempt to ensure that the Attorney General exercises his discretion in an informed and fair manner, this office solicits written submissions from defence counsel in most cases."[emphasis added]

[52] See Model Corporate Amnesty Letter, *supra* note 5.

[53] See, e.g. *R. v. Goldman* (1979), 51 C.C.C. (2d) 1 (S.C.C.).

[54] But see the "Limited Immunity Agreement" in *Pritchard*, *supra* note 30, which contained a clause explicitly waiving any reliance upon involuntariness arising from the confession rule in the following terms: "Pritchard acknowledges that nothing in this agreement shall be construed as providing any hope of advantage or fear of prejudice or other breach of the Canadian Common Law Confession Rulings"; this wording served to protect the Crown against allegations that it had breached the confessions rule in obtaining the evidence.

[55] See in this regard *R. v. Stillman* [1997] 1 S.C.R. 607; *Thomson Newspapers Inc. v Canada (Director of Investigation)* [1990] 1 S.C.R. 425; *R.J.S.* (1995) 96 C.C.C. (3d) 1 (S.C.C.).

[56] See e.g. *R v Wholesale Travel Group* (1991), 67 C.C.C. (3d) 193 (S.C.C.).

THE HYPOTHETICAL MONOPOLIST APPROACH RECONSIDERED – PART I

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LECG

The 2004 changes to the Competition Bureau's *Merger Enforcement Guidelines* (the "2004 Canadian MEGs")[2] include a restatement and clarification of the hypothetical monopolist approach to market definition in merger review. In so doing, the Bureau has confirmed its commitment to certain basic principles and has clearly aligned its approach with the U.S. *Horizontal Merger Guidelines*.

However, these changes will likely make little impression on competition counsel because the hypothetical monopolist approach appears to be nothing more than an abstract statement with no practical implications for them.[3] This is unfortunate because the hypothetical monopolist is increasingly accepted by the enforcement agencies in the leading jurisdictions and is based on a relatively small number of economic concepts that are readily understood.[4] Moreover, the approach carries very significant implications for merging parties and has been criticized for delineating narrow product markets.[5]

Accordingly, this first of two articles discusses the changes in the Canadian Guidelines, presents an overview of the hypothetical monopolist approach, considers the principal alternate approach, critical loss theory, and illustrates the concern about narrow product markets. Part II, to be published in a subsequent issue of the *Record*, will analyze further issues relating to this concern.

Changes in the MEGs

The changes introduced in the 2004 Canadian MEGs conform the Competition Bureau's view of the hypothetical monopolist approach to the statement in the U.S. Guidelines first published in 1982 and subsequently clarified.[6]

Definition of a Market

The 2004 Canadian MEGs define the "relevant market" as:

> The smallest group of products, including at least one product of the merging parties, and the smallest geographic area in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a significant and non-transitory price increase above levels that would likely exist in the absence of the merger. In most cases, the Bureau considers a five per cent price increase to be significant and a one-year period to be non-transitory. (¶3.1)

This definition is quite similar to the one in the previous Canadian Guidelines (the "1991 Canadian MEGs"), but in a crucial clarification it emphasizes the conventional economic theory of the profit-maximizing firm.[7] The key issue in delineating markets is what a monopolist would do in regard to price so as to maximize profits following a hypothetical merger, and this is described by conventional theory as discussed below.

By referring to the price increase that a hypothetical monopolist "could profitably impose", the 1991 Canadian MEGs seemed to suggest that monopoly pricing followed something other than this conventional approach. Note, however, that the 1991 Canadian MEGs were influenced by the 1984 U.S. Guidelines then in force. As Baumann & Godek note, those guidelines, which were undoubtedly based on conventional economic analysis, used the phrase "could profitably" six times and "would profitably" once. As they also point out, the 1992 U.S. Guidelines eliminated the confusion by using "would profitably" consistently.[8] If the 1991 Canadian MEGs sought to follow the intent of the 1984 U.S. Guidelines, then the "would" approach should have been adopted then, and the clarification now is welcome.[9]

Sole Seller

Whereas the 1992 U.S. Guidelines explicitly refer to a hypothetical monopolist that is "the one and only current and future seller", the 1991 Canadian MEGs spoke of a hypothetical monopolist that was the "only seller".[10] Thus, whereas the U.S. approach delineated markets on the assumption that the hypothetical monopolist retained its position indefinitely, the Canadian approach suggested that potential competition should be assessed at the market definition stage.

This divergence highlighted a fundamental distinction. In the U.S. Guidelines, the purpose of delineating markets is the identification of products to be included in the market, and this identification of products is entirely driven by consumer demand in response to a price increase by the hypothetical monopolist that was the only current and future seller of the identified products. After the relevant market is found, competitors and potential competitors are identified and their market shares assigned.

In the 1991 Canadian MEGs, the hypothetical monopolist is the only current seller. There could be other sellers in the future, and if those sellers could adapt their existing facilities to produce "future substitutes" in significant quantities and in a short enough amount of time, then these potential competitors are considered during market definition, at least in principle. As Crampton explains,

> Given that the future substitutes that would be sold as a result of the above-described production substitution are added to the relevant market under the Canadian Guidelines, no distinction needs to be made between market definition (which involves the identification of the products and sales locations that comprise the relevant market) and the firms that sell or would likely commence to sell the relevant product in the relevant geographic area. It is taken for granted that each actual or future substitute and each sales location or future sales location that has been added to the market has a corresponding seller.[11]

Thus, market delineation under the 1991 Canadian MEGs identifies not only products but also the competitors and potential competitors and their production capabilities. The 1991 Canadian MEGs acknowledged the difficulties, in practice, associated with establishing the future sales of substitutes by potential competitors.[12]

In effect, the 1991 Canadian MEGs called for the examination of supply substitutability conditions at the market delineation stage. In so doing, they differed from the 1992 U.S. Guidelines, which postpone the examination of "uncommitted entry" until after the relevant markets have been delineated.[13]

In the 2004 Canadian MEGs, this divergence has been eliminated. Relevant markets are to be determined solely on the basis of substitutability in demand[14], and supply responses are examined in the following stage in which competitors are identified.[15] Although the revised guidelines refer to the "sole seller", the emphasis on substitutability makes it clear that the hypothetical monopolist is the only current and future seller and that market definition is only the first step in the structural analysis of mergers.

For all practical purposes, the 2004 Canadian MEGs' treatment of the hypothetical monopolist approach conforms to that in the U.S. *Horizontal Merger Guidelines*. One consequence is that the conventional economic analysis that underlies the latter now also applies to the former.

The Need for Principles of Market Definition

Two examples illustrate the need for an objective test for delineating markets in traditional antitrust merger cases. In the 1986 acquisition of the Dr. Pepper Company by the Coca-Cola Company[16], Coca-Cola proposed that market shares were low when calculated on a base of all potable liquids including carbonated soft drinks, alcoholic beverages, coffee, tea and water, these being substitutes for the products of the merging parties. In the recent *Superior Propane* merger, the merging parties proposed an all-energy market including home heating oil, natural gas, hydroelectric and wood in addition to propane.[17]

In each case, the broadest proposed market or any subset thereof could be the relevant product market. To avoid a result-oriented analysis, some principle or set of principles is needed that identifies the correct one for the purpose of merger review.

The hypothetical monopolist approach to market definition appeared first in the 1982 U.S. Guidelines. Although earlier judicial decisions required the determination of relevant markets for merger review, the courts offered little guidance on determining relevance and there was considerable dissatisfaction with the lack of a systematic approach.

At that time, the principal concern of the American antitrust laws was post-merger collusion, whether explicit or tacit. The possibility that a merger would facilitate collusion among the remaining firms in the industry gives rise to the familiar "structural" concern with the number of firms in the industry and their respective shares. To the extent that a large number of sellers remains, each with a relatively small share of industry-wide sales, collusion among sellers in the industry will be unsuccessful and the merger will not create market power in the industry or increase any such existing market power. The difficulties in delineating markets for the purpose of market share calculation were accordingly emphasized.

It suffices to point out that the first presentation of the approach in the legal and economics literatures emphasizes that it grew out of traditional antitrust concerns.[18]

Overview and Restatement of the Approach

Note that markets that are relevant to competition law need not correspond to markets as defined by business managers, or even by economic theory in which the term is taken as an abstraction referring to the meeting of buyers and sellers. The hypothetical monopolist approach adapts conventional economic concepts to an avowedly non-economic task that most economists have never had to perform or even considered how to do.

A Thought Experiment

The approach calls for a thought experiment beginning with the provisional adoption of a narrowly defined product market, such as a product of parties to an actual merger.[19] The product itself is homogeneous; all of its producers make the same well-defined good or service. Then, the approach envisages a merger to monopoly over that "candidate" product market and, accordingly, the demand curve faced by that hypothetical merged firm will be the market demand curve for the product itself.[20] According to conventional theory, the monopolist will increase the price to that level that maximizes its profit, so the question for market definition under the 2004 Canadian MEGs becomes: "Would that price increase be significant and non-transitory, i.e. a SNIP?"[21] If not, then the relevant market has not been identified.

Of course, the optimal monopoly price is not known and so the price increase that would be imposed is not determinable unless more information about demand is provided. The question can be posed differently: "Do the conditions of demand faced by the monopolist allow it to increase the price by at least a SNIP?" Stated differently, would such a monopolist have market power?[22]

To answer this question, all non-price determinants of demand (e.g. income growth, macroeconomic activity, employment levels, etc.) must be held constant. Under this *ceteris paribus* assumption, since the price increase will cause at least some customers to switch to other products or reduce consumption, the answer is: yes, if the resulting loss of profit due to those lost sales is less than the increase in profit due to the higher price on the sales to customers who maintain their purchases. Thus, we need to know (i) customer price sensitivity (the price-elasticity of demand[23]) that the monopolist faces and (ii) the monopolist's costs and how they change with output.

When the demand curve facing the monopoly is price-inelastic (i.e. relatively insensitive to price increases) at the prevailing price, we have all the information we need. The conventional economic theory of the monopoly demonstrates that as long as the price-elasticity of demand for the monopoly's product is less than 1.0 in absolute value, the monopoly will certainly raise the price. In this inelastic range of demand, an increase in price raises total revenue, for in this range the increase in revenue from the customers who do not switch or cut back exceeds the loss in revenue from those customers who do. Since the monopoly's output falls (however modestly) as it raises the price, its total costs are either constant or falling. With higher revenues and constant or lower

costs, the monopoly's profit increases as a result of the price increase and, accordingly, a monopolist will continue to increase the price as long as it operates in the inelastic region of demand.[24]

The Critical Demand Elasticity

When demand is price-sensitive at the prevailing price (i.e. as indicated by a price-elasticity greater than 1.0 in absolute value), a price increase may or may not increase profit for a monopolist. Total revenue declines as the price is raised, but if costs in that region of demand fall faster than revenue, the monopoly profit will increase as a result of the higher price. However, if revenue declines faster than costs, the monopolist's profit declines as the price is raised. Thus, for a given set of cost conditions, demand may be so price-sensitive (or elastic) that even a monopolist would not increase the price.

Hence, if the price-elasticity of demand is greater than 1.0, it is uncertain whether the monopolist would impose a significant price increase, and the question above can be expressed somewhat differently: "For a given set of cost conditions, how large can the price-elasticity of demand be at the pre-merger price before a hypothetical monopolist chooses not to raise the price by at least a SNIP?"

Although the guidelines of the enforcement agencies do not mention it, this criterion, referred to in the antitrust literature as the "critical demand elasticity" at the pre-merger price, is the key datum with which the hypothetical monopolist approach is implemented.

Absent very detailed information on the shape of the demand curve and the monopolist's costs, economists will make assumptions about these data. In applied work, the assumption of linear demand and constant marginal cost is common, and the corresponding critical demand elasticity may be derived:

$$e^* = \frac{1}{m + 2SNIP}$$

where m is the pre-merger price-cost margin in the industry.[25]

To illustrate, consider a hypothetical merger-to-monopoly from a perfectly competitive industry (i.e. m=0) in which the demand elasticity for the product is 3.0 at the pre-merger price. From the formula above, the critical elasticity is $1/(m+2SNIP) = 10$ for a 5% SNIP. Since the demand elasticity of the product is less than the critical level, the market would not be expanded; the hypothetical monopolist would increase the price by at least the 5% SNIP.[26]

Suppose, however, that the pre-merger demand elasticity in the candidate product market was 12.0. Then, given the cost conditions, a hypothetical monopolist would not raise its price by even 5%. Hence, the hypothetical monopolist approach would support the conclusion that the candidate market that contains only that product must be expanded to include another product. According to the 1992 U.S. Guidelines, this expansion is accomplished by adding the "next-best substitute" [27]

Conceptually, the elasticity of demand for the resulting set of products in this expanded market is measured and compared with the critical demand elasticity, and the candidate market is repeatedly enlarged until a set of products is reached over which the hypothetical monopolist would impose a price increase of 5% or more.[28] Hence, it is open to the merging parties to argue that the product demand elasticity is high enough to warrant a broadening of the market.[29]

Creating, as it does, the only current and future seller, this hypothetical merger-to-monopoly is clearly the most extreme type of transaction that could attract the attention of competition policy. If such a merger would not create or increase market power in the candidate market under consideration, then no other merger in that industry would do so.

A Subtle Distinction

A frequently cited alternative to the hypothetical monopolist approach illustrates the approach's reliance on conventional microeconomic theory. The "breakeven critical sales loss" approach of Harris & Simons asks whether a cartel could profitably raise the price by a SNIP and experience no reduction in profit.[30] The research by Harris & Simons is a response to the 1984 U.S. Guidelines that, in their view, turns on the question whether a SNIP would be profitable for a hypothetical monopolist or cartel.[31]

The hypothetical monopolist approach calls for a subtle distinction. Its criterion is not whether a SNIP would be profitable for a hypothetical monopolist. Rather, the question is whether the profit-maximizing price for that monopolist is at least a SNIP above the price that prevailed at the time of the hypothetical merger to monopoly.

To illustrate, assume that any positive price increase up to and including 8% would be profitable to the monopolist in the sense that any increase in that range would lead to an increase in the monopoly profit. It is tempting to conclude that the monopolist would raise the price by 8%. With a SNIP set at 5%, a relevant market would be identified.

However, the prediction of a price increase of 8% in this circumstance may be incorrect. As noted above, economic theory predicts that an unregulated monopolist would raise the pre-merger price to the level that maximizes its profit. Suppose that the price that yielded the maximum monopoly profit is reached by an increase of only 3%. Thus, even if an 8% increase were profitable, the monopolist would impose only a 3% increase. With the SNIP set at 5%, a relevant market would not be identified.

Differences between the "would" and "could" interpretations of the hypothetical monopolist approach have spawned a small literature.[32] Baumann & Godek conclude that while the "would" approach is the correct one to use for market definition, the alternative is not clearly incorrect.[33]

Note that, like the critical demand elasticity, the breakeven critical sales loss is lower when the pre-merger price is above marginal cost (i.e. $m>0$). When applying the latter approach in this circumstance, a relatively small price increase may cause the firm to fail to break even[34] and hence support an expanded market. However, the

optimal price increase for a hypothetical monopolist, i.e. the price increase that it would impose, could be much larger and hence support a narrower market. Werden points out that where *m* is substantial and the SNIP is small, there may be little difference in the market delineated by these approaches.[35]

Narrow Product Markets?

Merger review typically delineates markets on the assumption that the pre-merger situation is competitive, hence m=0. For linear demand, constant costs and a 5% SNIP, the hypothetical monopolist approach requires that the demand elasticity in the candidate market be at least 10 in order to support expansion of the product market. There are few general rules, one of which is that the demand elasticity for goods considered as necessities tends to be less than 1.0.

Figure 1 presents estimates from various sources of the demand elasticities for several conventional goods, services and categories thereof from which it can be seen that elasticities of 2 or more must be seen as high. Category-wide estimates should be viewed as only indicative because elasticities for individual items in a category may differ. For example, the price-elasticity of demand for men's shoes, women's shoes, dress shoes, running shoes and work boots are not all likely to be 0.9.[36]

It is possible that the pre-merger market demand is highly elastic. Nevertheless, for most conventional commodities, a demand elasticity as high as 10 would not generally be expected. Accordingly, merging parties will claim that the hypothetical monopolist approach supports the general conclusion that product markets are narrow rather than broad and hence favors the plaintiff.

Concluding Remarks

The hypothetical monopolist approach delineates relevant markets on the basis of market power, not competitor identification. It is not surprising, therefore, that business managers, who doubtless know who their competitors are, find the approach unrealistic.

Moreover, from a legal perspective, it is not unusual for merger counsel to say, in regard to the hypothetical monopolist approach in the agency guidelines, that they do not "use it". This position can be taken because the guidelines are not law and do not bind the merging parties or the agency.

Indeed, practitioners are inclined to blame the agencies' merger guidelines for the apparent lack of specific direction in the market delineation process. This criticism of the guidelines is misplaced. One can only agree with Werden, a key contributor to the U.S. *Horizontal Merger Guidelines*, that it is not the purpose of those guidelines to present practitioners with a cookbook on how to define markets. At best, they give some guidance as to the agency's view of the important conceptual issues involved in market delineation.[37] How the merging parties advance particular markets within the principles of this approach is a matter for them and their advisors.

Nonetheless, the clarification of the hypothetical monopolist approach in the 2004 Canadian MEGs will lead to better understanding of both what the approach is, and what it is not.

Figure 1: Estimated Price-Elasticities of Demand

Category of Good	Price Elasticity
Fuel & Light	0.47
Food	0.52
Alcohol	0.83
Durables	0.89
Services	1.02
Dairy Produce	0.05
Bread & Cereals	0.22
Entertainment	1.40
Expenditure abroad	1.63
Catering	2.61

Source: B. Beachill, Leeds Metropolitan University
http://www.lmu.ac.uk/lbs/epia/people/beachill/micro1/mic1top3.doc

Airline travel (long run)	2.4
Fresh fish	2.2
New cars (short run)	1.2-1.5
Private education	1.1
Radios and television	1.2
Shoes	0.9
Cigarettes	0.4
Coffee	0.3
Gasoline (short run)	0.2

Source: M. Javanmard, Riverside Community College
http://faculty.rcc.edu/javanmard/powerpointseco4/Chapter04.ppt#43

Coffee	0.25
Electricity	0.13
Tobacco	0.51
Alcohol	0.92
Restaurant meals	1.63
Automobiles	1.35

Source: R. Fisher, State and Local Public Finance, Chicago, Irwin, 1996, Table 4-1

Notes

[1] Lawrence P. Schwartz, Ph.D., Director in the Toronto office of LECG, was formerly Lay Member, Competition Tribunal, Government of Canada. He thanks Gregory Werden, the principal contributor to the literature surveyed in this article, and Michael Baumann, Melvyn Fuss, Thomas Ross, Michael Trebilcock, Ralph Winter, and Lourdes DaCosta, Alan Gunderson and Patrick Hughes and the other participants in the Competition Bureau seminar on September 18, 2003 for their comments on earlier drafts. All errors remain those of the author (lschwartz@lecg.com).

[2] Competition Bureau, September, 2004.

[3] Antitrust lawyers are not alone. The late Nobel-prize winning economist, George Stigler, called the 1984 U.S. Guidelines' approach to market delineation "non-operational". He was wrong, but his views anticipated similar criticisms of lawyers and economists as well. Finkelstein and Cohen are not alone when, in reference to the hypothetical monopolist approach, they state: "Though endorsed by a number of commentators, our principal objection is not with the methodology but with the difficulties associated with its implementation." See N. Finkelstein & R. Cohen, "The Evolving Concept of Market Definition: Southam, Neilsen and Consolidated Fastfrate" (Paper presented at the Canadian Institute Conference on Competition Law and Competitive Business Practices, Toronto, 1996) at 35. They are also wrong; the hypothetical monopolist is not a methodology to be implemented but rather a conceptual approach that establishes the focus of market definition and guides the inquiry.

[4] Two recent papers call attention to the adoption of the significant and non-transitory price increase, SNIP, test by the European Commission as an example of convergence by European authorities toward the American approach to market definition. See Merit E. Janow, "Transatlantic Cooperation on Competition Policy" and James S. Venit & William J. Kolasky, "Substantial Convergence and Procedural Dissonance" in Evenett, S. et al., eds., *Antitrust Goes Global: What Future for Transatlantic Cooperation?* (Washington: The Brookings Institution, 2000) at 50 and 84, respectively.

[5] The focus of this article is clearly on product market definition. As the various guidelines point out, the approach is also applicable to delineation of geographic markets. Interestingly, the hypothetical monopolist approach suggests broad (i.e. at least national) geographic markets for U.S. manufacturing. See Gregory J. Werden's example in "Market Delineation and the Justice Department's Merger Guidelines" (1983) Duke Law Journal 514 at 556, footnote 124.

[6] See United States Department of Justice, Merger Guidelines: (June 14, 1982) §II.B reprinted in 2 Trade Reg. Rep. (CCH) ¶4501-4505 (the "1982 U.S. Guidelines"); (June 14, 1984), § 2.0, reprinted in 4 Trade Reg. Rep. (CCH) ¶13,103 (the "1984 U.S. Guidelines"); United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992), §1, reprinted in 4 Trade Reg. Rep. (CCH) ¶13,104 (the "1992 U.S. Guidelines").

[7] Competition Bureau, *Merger Enforcement Guidelines* (Information Bulletin No. 5) Ottawa, 1991. The 1991 Canadian MEGs had provided:

> Conceptually, a relevant market for merger analysis under the Act is defined in terms of the smallest group of products and smallest geographic area in relation to which sellers, if acting as a single firm (a "hypothetical monopolist") that was the only seller of those products in that area, could profitably impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger. (¶3.1)

[8] See Michael G. Baumann & Paul E. Godek, "Could and Would Understood: Critical Elasticities and the Merger Guidelines" (1995) 40 The Antitrust Bulletin 885 at 887.

[9] A drafter of the 1991 Canadian MEGs states that the intent was to be consistent with the intent of the 1984 U.S. Guidelines. See Paul S. Crampton, "The DOJ/FTC 1992 Horizontal Merger Guidelines: a Canadian Perspective" (1993) Fall The Antitrust Bulletin 665 at 682.

[10] *Supra* note 7 at ¶3.1.

[11] Crampton, *supra* note 9 at 680.

[12] *Supra* note 7 at ¶3.2.2.7, footnote 22, which states "a market share cannot reasonably be attributed to this future production" Crampton, *supra* note 9 at 680, states "the future products of likely supply substitutors that are added to the relevant market are given a zero market share."

[13] i.e. during the following stage in which firms that participate in the relevant market are identified. See 1992 U.S Guidelines ¶1.32. Such firms incur no significant fixed costs of entry or exit and their entry must be likely within one year in response to a SNIP.

[14] *Supra* note 2 at ¶3.3.

[15] *Ibid.* Note that the analysis of entry is a separate matter that follows market definition, competitor identification and the assignment of market shares.

[16] *F.T.C. v. Coca-Cola Co.*, 641 F. Supp. 1128 (1986).

[17] See *The Commissioner of Competition v. Superior Propane Inc.*, 2000 Comp. Trib. 15 at ¶39.

[18] That the 1982 U.S. Guidelines describing the hypothetical monopolist approach focus directly on the traditional antitrust concern for collusion under section 7 of the Clayton Act is emphasized by Werden, *supra* note 5 at 517-518, footnote 14.

[19] If the merging parties have more than one common product, then separate markets would be delineated for each product.

[20] The market demand curve will be much less elastic than the demand curve as perceived by individual competitive sellers prior to the hypothetical monopolization. Demand appears horizontal (infinitely elastic) to each of them as none have the ability to influence the price. To the monopolist facing the entire market, however, demand appears downward sloping, possibly with elastic and inelastic segments; by withholding output from the market, the monopolist's action will raise the price.

[21] See *supra* note 4. Note further that the hypothetical monopolist is assumed to impose the same percentage increase in price to all customers "across-the-board". The approach delineates a market on the assumption that the hypothetical monopolist does not price-discriminate.

[22] The more natural view perhaps is that the unregulated monopolist has the ability to raise the price and hence increase its profits indefinitely, limited only by public relations and the threat of government intervention. Suffice it to say that this is not the view of conventional theory, in which even a monopolist is constrained by demand and cost conditions.

[23] i.e., the "own-price" elasticity of demand. The cross-price demand elasticity, which defines substitutes in the economic sense, is a different, but related, concept.

[24] In its decision in August 2000 in the *Superior Propane* case, the Competition Tribunal took note of the uncontroverted expert statistical evidence of inelastic demand and concluded that the relevant product market consisted solely of retail propane, thus excluding all other fuels used by consumers. See *The Commissioner of Competition v. Superior Propane Inc.*, 2000 Comp. Trib. 15 at ¶63.

[25] See Gregory J. Werden, "Demand Elasticities in Antitrust Analysis" (1998) 66 Antitrust Law Journal 363 at 410, Appendix A. Werden's derivation of this formula is succinct but not easy to follow; a longer but more intuitive derivation is available from the author.

[26] Note that linear demand is not always a good description of conditions in a market. For constant-elasticity demand and constant costs, the critical demand elasticity is 21 for a 5% SNIP. Demand curves with kinks or horizontal sections can arise.

[27] Hence, the order in which substitutes are added to the market is important. The 1992 U.S. Guidelines define the next-best-substitute as "the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a 'small but significant and nontransitory' price increase." *Supra* note 6.

[28] In the 1984 and 1992 U.S. Guidelines, an "antitrust market" is a product or set of products over which market power could be exercised; the relevant antitrust market is usually the smallest such market. In *Superior Propane*, the Competition Tribunal referred to a "competition market" and stated that the relevant competition market was the one with the fewest products. The Canadian Guidelines refer only to the "relevant market"

[29] In differentiated-products mergers this may be hard to establish. See C. Shapiro, "Mergers with Differentiated Products" (1996) Spring Antitrust 23 at 28-29.

[30] See B.C. Harris & J.J. Simons, "Focusing Market Definition: How Much Substitution is Necessary?" (1989) 12 Research in Law and Economics 207. Recent articles evaluate the break-even critical loss. See J. Langenfeld & W. Li, "Critical Loss Analysis in Evaluating Mergers" (2001) Summer The Antitrust Bulletin 299; K. Danger & H. Frech III, "Critical Thinking About "Critical Loss" in Antitrust" (2001) Summer The Antitrust Bulletin 339; D.P. O'Brien & A.L. Wickelgren, "A Critical Analysis of Critical Loss Analysis" (2003) 71:1 Antitrust Law Journal 161.

[31] Harris & Simons, *ibid.* at 211.

[32] See, for example, Baumann & Godek, *supra* note 8.

[33] *Ibid.* at 893.

[34] Perhaps through the loss of a single, large customer.

[35] Werden points out the advantage of not having to assume a functional form for the demand curve under the breakeven critical loss approach. See Werden, *supra* note 25 at 389-390.

[36] Hence, "shoes" would probably not qualify as a relevant market for merger review. See *supra* note 19.

[37] See Gregory J. Werden, "Market Delineation under the Merger Guidelines: A Tenth Anniversary Retrospective" (1993) 38 The Antitrust Bulletin at 534.

CANADIAN COMPETITION RECORD

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