# COMMENT AND ANALYSIS

## PRICE DISCRIMINATION AND PROMOTIONAL ALLOWANCES UNDER THE *COMPETITION ACT*: A SUGGESTION FOR PRAGMATIC REFORM

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> Persistent discrimination is very good evidence of monopoly because it is inconsistent with a competitive market; it implies that some consumers are paying more than the cost of serving them, a situation that would disappear with competition. (Posner, *Antitrust Law*)

### Introduction

To many, including not a few economists, there seems to be something intuitively wrong with some businesses consistently being offered better discount schemes or better non-price supply terms than those offered by the same supplier to their competitors. As long as businesses are prepared to organize themselves to qualify for the better terms or lower prices there would seem to be no economic rationale to deny them the better terms. The inability to take advantage of the better discount scheme clearly impedes a business's ability to compete effectively.

Notwithstanding such fairness considerations, the issue for competition law is: under what circumstances should such price discrimination be actionable in order to promote economic efficiency. Ideally, competition legislation should provide a clear and pragmatic definition for pricing conduct having a demonstrable negative effect on competition, coupled with a practical remedial process, while at the same time not exposing benign price innovations to regulatory intervention or to competitor litigation.

### Current Framework and Recent Developments

Competition Act *Provisions*

Section 50(1)(a) of the *Competition Act* establishes a criminal offence prohibiting suppliers from engaging in a practice of price-related concessions by selling an article[1] to one purchaser where the price concessions are not available to competing purchasers of the article in like quality and quantity.[2]

Section 51 of the *Competition Act* establishes a complementary criminal offence prohibiting a supplier from offering purchasers a promotional allowance that is not on proportionate terms when compared to the promotional allowances offered by the supplier to the purchaser's competitors.[3] Section 51 will not be separately addressed in this paper as the arguments pertaining to section 50(1)(a) are generally applicable to section 51.

*Price Discrimination Guidelines*

Admittedly, section 50(1)(a) as written appears arcane even to competition law practitioners. It has supported only three reported prosecutions since 1984, all of which resulted in guilty pleas.

In order to imbue the provision with a measure of practical value, and to recognize current economic thinking on what constitutes pro- and anti-competitive price innovation, the Competition Bureau published Price Discrimination Enforcement Guidelines in 1992 (the "Guidelines")[4]. Despite their lack of legislative status, these Guidelines have become the *de facto* price discrimination law for Canadian businesses and competition law practitioners. Therefore, the quality of Canada's price discrimination prohibition should be assessed principally by reference to these Guidelines.

Under the Guidelines, the Competition Bureau makes it clear that it will not take action against a broad range of price concession schemes including volume discounts, fidelity/loyalty discounts, functional discounts, exclusive dealing discounts, and growth bonuses as long as they are "available" to competing purchasers. The "availability" condition is considered in detail in the Guidelines. Essentially, where the seller offers the price concession scheme to one purchaser, the seller is expected to offer it as well to other customers which compete with that purchaser if they ask for it. The seller, however, is under no obligation to take steps on its own to bring the scheme to the attention of the competing purchasers, or to ensure that competing purchasers actually take advantage of some or all of the price concession scheme, as long as it is not evident that the best elements have been crafted to be accessed only by a specific purchaser.

Other important positions presented in the Guidelines include:

(i) section 50(1)(a) only captures "monetary" advantages, not technical assistance or other non-price related inducements;

(ii) price cuts to meet competitors' initiatives are unlikely to constitute a "price discrimination" practice (this is consistent with Canadian case law which establishes that matching competitors' prices cannot constitute predatory pricing);

(iii) the threshold to qualify a purchasing group as a "purchaser" to take advantage of volume discounts is low - requiring only that the purchasing group obtain nominal "title" and have the obligation to pay (deliveries can be made directly to the ultimate purchasers); and

(iv) franchisees in a franchise qualify as a single purchaser as long as the supplier is designated to be used by franchisees by the franchisor.

Canadian price discrimination law as established by the Guidelines, and industry and practitioner reliance thereon, is far more permissive than the U.S. counterpart, the *Robinson-Patman Act*.[5] Notably, Canadian price discrimination law does not require a measure of cost justification to support volume discounts, except where the scheme amounts to predatory pricing. Moreover, the Canadian approach has actively encouraged the growth

of purchasing groups which are now prevalent throughout the Canadian retail sector, particularly for grocery and pharmacy products.

Arguably, the most significant defect of section 50(1)(a) is that it contemplates meting out punishment only to suppliers where a powerful buyer may be the real cause of the price discrimination practice,[6] and making the same concessions available to competing purchasers may cause the supplier serious financial harm.

Both the Canadian and U.S. price discrimination statutes have their genesis in small business concerns that department and supermarket chains could extract price concessions from their suppliers that would put them at a distinct competitive advantage over their smaller rivals. The presence of this prohibition arguably gives suppliers a shield to deflect requests from large buyers for exclusive sustained price concessions.

A remedy under the abuse of dominance provisions is also currently available to address such an anti-competitive exercise of buyer power. Indeed, the abuse of dominance provisions are currently available to fill any gaps around section 50(1)(a) such as discriminatory non-price terms and discriminatory pricing of services. Section 50(1)(a) and the Guidelines, however, continue to provide important guidance in relation to what has historically been the source of most price discrimination complaints: differential pricing of manufactured goods.

There is probably no way to usefully quantify the overall deterrent effect of section 50(1)(a) and the Guidelines in combination. The absence of formal inquiries or damages litigation over the past 15 years since the publication of the Guidelines would suggest that there is some deterrence effect, and that, by and large, suppliers do make their price concession programs available to competing customers. Purchasers, particularly purchasing groups, are likely to become aware of, and complain about, significant price concession initiatives that are not being made available to them. The Guidelines make it quite clear when such a situation would be actionable.

Accordingly, it is certainly not evident that, with respect to the transactions it covers, section 50(1)(a), coupled with its Guidelines and the availability of the abuse of dominance provisions to address services and non-price concessions, is a competition law failure.

*Legislative Proposals*

Amendments to the *Competition Act* tabled in November 2004 by the previous Liberal government would have repealed sections 50 and 51 ("Bill C-19").[7]

This repeal would have made abuse of dominance the exclusive basis for a remedy against price discrimination and disproportionate promotional allowances in relation to sales of goods. Arguably, given its generality, different remedial procedures and different standards of proof, abuse of dominance has always been available to provide a remedy against price discrimination and disproportionate promotional allowances even with respect to the sales of goods.

However, unlike abuse of dominance, neither market power nor a substantial lessening of competition are express elements of the subsection 50(1)(a) and section 51 price discrimination and promotional allowance offences.

In this regard, the Competition Bureau's Press Release at the time of tabling Bill C-19 argued:

> This type of behaviour would continue to be dealt with under the civil abuse of dominance provisions, which would be bolstered with the addition of AMPs [administrative monetary penalties].
>
> The criminal pricing provisions have been criticized as being inadequate to deal with the types of anti-competitive practices they were designed to address. Many stakeholders recognize that price discrimination, geographic price discrimination, predatory pricing and promotional allowances are not necessarily harmful to economic welfare and can be beneficial to competition. This type of pricing behaviour would be best suited to a civil provision with a competition test.
>
> The proposal seeks the right balance between the proper level of deterrence and effective enforcement of anti-competitive pricing practices, while, at the same time, encouraging aggressive price competition that benefits consumers.[9]

On the other hand, the Legislative Summary of Bill C-19 prepared by the Parliamentary Information and Research Service observed more equivocally:

> The contents of Bill C-19 are not uniformly seen as a positive development of the law, and are not without controversy.
>
> ...
>
> It was not universally agreed that the abuse of dominance section would adequately address all issues related to price discrimination. Some submissions [in response to the Competition Bureau's consultation paper] stated the repeal of the pricing provisions should be accompanied by a new civil provision or amendments to the section on abuse of dominant position.[10]

Bill C-19 received only a First Reading before the 2006 Federal Election, and so the development of legislative options to the outright repeal of sections 50 and 51 that normally occurs in Committee hearings following Second Reading did not take place.

To date this legislation has not been reintroduced by the current Conservative government.

It is fair to say that the price discrimination and promotional allowance provisions owe their existence to small business advocacy, as did the U.S. equivalent, the *Robinson-Patman Act*, and that small business resistance has over the years rendered efforts to repeal these provisions impractical.[11] It is also fair to say that the bulk of economist commentary and much commentary from the legal community on the provision has favoured "decriminalizing" the target practices and substantial, if not complete, congruence with the general principles enshrined in the abuse of dominance provisions, namely that only "dominant firms" should face a possible remedy, and then only if their conduct substantially lessens competition (as opposed to just harming an individual competitor or a number of competitors). These critiques ignore the fact that the only way to prove lessening of competition is with the evidence of individual competitors.

By coincidence, the *Robinson-Patman Act* was a specific focus of the U.S. Anti-Trust Modernization Commission ("AMC").[12] Its April 2007 Report and Recommendations to Congress and the President, in parallel fashion to Bill C-19, proposed the outright repeal of the *Robinson-Patman Act*. Such a repeal would have had the effect of treating price discrimination matters exclusively at the Federal level under the anti-monopolization provisions of the *Sherman Act*.[13] The Chair of the AMC has concluded, however, that repeal of the *Robinson-Patman Act* has no "constituency", that it would be subject to small business lobbying, and that there were both "lots of pros and cons in recommending repeal".[14] The AMC Staff analysis of the legislation concluded that there was no systematic or quantifiable way of ensuring costs and benefits, and that at best only anecdotal information and argument were available.[15]

This paper argues that, while decriminalizing price discrimination and disproportionate promotional allowances is, in theory, a desirable objective, the simple substitution of the abuse of dominance scheme is undesirable, at least as long as the cases taken by the Commissioner of Competition all entailed monopoly or near monopoly situations[16] and the Competition Bureau's Guidelines on abuse of dominance retain complex criteria for identifying market power and relatively vague descriptions of actionable anticompetitive acts.

Rather, a practical reform, if one is really necessary (which is debatable), should be a tailored reviewable practice that draws upon the principles of the other specific reviewable practices identified in the *Competition Act*, particularly the practice of refusal to deal, and upon the elements of the Guidelines, which themselves address both the public and small business interest in fair competition and the desire of some commentators to remove "antitrust overkill tendencies" from the current legislation.

**VanDuzer Report**

The 1999 report of J. Anthony VanDuzer and Gilles Paquet on the anti-competitive pricing practices prepared for the Competition Bureau, now known as the "VanDuzer Report", presents the most thorough and objective critique of sections 50(1)(a) and 51.[17] The Report's principal criticisms of subsection 50(1)(a) can be summarized as follows, along with our comments on each point:

(a) "[I]t is essential that the approach to dealing with price discrimination in Canada focus on when it has an anticompetitive effect".[18]

Comment: The current provision does not have an express "effect on competition" element but the law would likely be applied only in serious cases. Arguably such an element would make a criminal law provision unenforceable on vagueness grounds. The requirement of a "practice" ensures that only effective and durable price discrimination schemes are actionable. It is entirely reasonable to assume that the Commissioner's discretion to refer a case to the Attorney-General for prosecution, when coupled with the Attorney-General's own prosecutorial discretion and established public prosecution criteria that support commercial prosecutions only where there is deterrent value in a conviction, would ensure that charges would be laid only in cases where the practice had significant public consequences. It is nevertheless a valid criticism of section 50(1)(a) that, as legislation, it provides no answers on how significant the price discrimination practice needs to be to attract a

sanction. Further, as the framework is criminal law, guidelines under it cannot be expected to provide precise or binding answers. As discussed, however, the Guidelines have been demonstrably useful, and there is certainly no assurance of a useful volume of case law precedent or more practical Guidelines appearing on the subject as a result of exclusive reliance on abuse of dominance.

(b) "The exclusion ... of transactions other than sales of articles is an apparent anachronism which fails to take into account...the enormous and growing importance of transactions involving services and intellectual property rights" [19]

Comment: The actual significance of this anachronism in practice is unclear. Services and intellectual property rights are generally individually negotiated and are often not comparable as between purchasers. The policy focus of price discrimination has been on the sale and resale of manufactured products.

(c) "Section 50(1)(a) focuses on protecting particular competitors...nothing in the provision requires any assessment of the effect of price discrimination on competition" [20]

Comment: As noted above, prosecutorial discretion can be relied on to weed out insignificant cases. A private right of action for damages in the civil courts is also available to competitors where the damages are substantial enough to support litigation. This surface defect, however, does not necessarily support adopting the "substantial lessening of competition" element of abuse of dominance as the only "effect" alternative, particularly as competitor-specific evidence would still have to be adduced in an abuse of dominance proceeding.

(d) "Most importantly, section 50(1)(a) does not include market power as a required element of the offence" [21]

Comment: Indirectly, the "practice" requirement and prosecutorial discretion would ensure that only effective price discrimination practices would be challenged. Arguably, an effective and sustained price discrimination practice entailing substantially different concessions among competitors is itself presumptive, if not sufficient, evidence of market power – either on the part of the purchaser obtaining the price advantage in relation to products that represent important purchases by its competitors, or on the part of the seller as part of a plan to influence downstream competition for its own strategic reasons. Absent such market power, disadvantaged purchasers would turn to an alternative supplier. It is also worth keeping in mind that the "dominance" element of section 79 has not been adopted with respect to the reviewable practices for which the *Competition Act* provides a more precise definition. For refusal to deal[22], it is not necessary that the respondent have any "market power" as the term is conventionally defined, only that the complainant be "substantially affected" by the refusal and cannot obtain adequate supplies by other means. For exclusive dealing, market restriction and tied selling, the respondent need only be a "major supplier"[23] (or the practice must be widespread in the market). Canada's resale price prohibition also does not contain market power or lessening of competition elements.[24]

(e) There is no requirement that discrimination based on quantity or quality differences be justified by reference to differences in the cost of supplying articles in different quantities or of different quality. The current provision does not permit other types of cost-justified discrimination.[25]

Comment: The cost justification defence in U.S. price discrimination law certainly has some theoretical appeal. However, it also has arguably introduced complexity into the law that can discourage price innovation that is not otherwise actionable as predatory pricing. If a price discrimination provision effectively targets sustained price discrimination practices that do materially reduce competition, the fact that the lowest price under the scheme still exceeds the supplier's costs, however calculated, should not prevent the conduct from being actionable. This consideration may be relevant to fashioning an appropriate remedy.

Moreover, cost-justification has not, to date, factored into exclusionary conduct cases arising from abuse of dominant position and has not been made a relevant factor by Parliament in relation to the specific reviewable practices (i.e., exclusive dealing, market restriction and tied selling).

**Proposal**

In supporting the repeal of the *Robinson-Patman Act*, AMC Commissioner Jacobson, in a separate statement joined by Commissioners Valentine and Warden, argues that it is pernicious to sanction a seller for price discrimination against a small purchaser when the seller can simply, under U.S. law, refuse to sell to that purchaser altogether:

> Even as to commodities, the statute is easily avoided in ways that harm its intended constituency. So while it is a violation to charge small customer S more than huge customer H for the same good, it is not a violation to refuse to sell to S altogether. The effect, then, is to cause many sellers to refuse to deal with smaller sellers outright, rather than charge them the potentially higher prices that may result from normal competitive interaction in the marketplace. Most small resellers would be better off by having *some* access to the product, albeit at a higher price, than being cut out altogether.[26]

However, unlike the parallel U.S. legislation, Canadian competition law does sanction such a refusal to supply. Commissioner Jacobson's argument could therefore be adapted to the Canadian situation to read as follows:

> Why apply a higher market power and competitive impact standard to a supplier's practice of charging a competitor higher net prices than to the more serious situation of the supplier cutting off the competitor entirely where such tests do not have to be met?

Price discrimination and refusal to deal are really part of a business discrimination conduct spectrum and arguably should operate within the *Competition Act* as complementary provisions.

The supplier significance and competition impact elements of an appropriately formulated price discrimination provision should be no more stringent than for refusal to deal. In fact, it could be argued that they should be less stringent, given that the consequences of an effective price discrimination practice are likely to be less immediate and severe relative to a refusal to supply.

Currently, the Competition Bureau's elaborate academic and somewhat vague elaboration of the definition of "dominance" in its Abuse of Dominance Enforcement Guidelines, coupled with the extremely high market

shares of respondents in abuse of dominance cases the Bureau has actually taken to the Competition Tribunal, can be expected to provide little, if any, comfort to the small business constituency, and could, in fact, encourage more anticompetitive pricing were section 50(1)(a) and section 51 to be repealed. Absent inclusion of price discrimination and disproportionate promotional allowances in the statutory list of illustrative anti-competitive acts, there is in fact no assurance that the abuse of dominance scheme will be seen as the intended substitute for sections 50(1)(a) and section 51.

Moreover, there is reason to expect that reliance on the Competition Bureau's current enforcement stance in relation to abuse of dominance could result in potential anti-competitive pricing practices arising from the exercise of buyer power being found by the Bureau not to merit investigation.[27]

The current structure and application of the *Competition Act* therefore strongly favours establishing a specific reviewable practice for price discrimination and disproportionate promotional allowances having the following elements:

- the reviewable practice should apply to "products" not "articles";
- the reviewable practice should require proof of a "practice";
- the reviewable practice should be termed "supply discrimination" and should capture not just discriminatory price concessions but "all discriminatory terms relating to the supply of the product" in question (including collateral product-related services, promotional support, after sales service support, supplier technical support, discriminatory product bundling, and warranty terms);
- the products subject to the alleged discriminatory practice should be required to represent only a "significant portion" of a purchaser's total purchases;
- a remedial order should be available against the real source of the practice, such as a powerful buyer or upstream supplier, and not just against the supplier directly engaged in the practice;
- as in the case of refusal to deal, an order should be made if the practice "is having or is likely to have an adverse effect on competition in a market"; the higher standard of "substantial lessening of competition" should not be required;
- products should be deemed not to constitute a separate market based only on a trade-mark or guise unless the product is dominant in its class (as is the case for refusal to deal under subsection 75(2)); and
- the same private access right to the Competition Tribunal should be available with respect to "supply discrimination" as is currently available for the other specific reviewable practices.[28]

## Conclusion

Assuming, as is likely fair, that a practice of refusing to make available a sustained and significant price concession scheme to one purchaser when it is made available to one or more competitors of that purchaser impedes competition, the principal problem is addressing such a practice exclusively under the general abuse of dominance provision with the high market share threshold for presumptive dominance (50%), and in light of the fact that the Competition Bureau has taken dominance cases to the Competition Tribunal only in near monopoly situations.

Arguably, the ability to sustain a price discrimination practice that would be prohibited by section 50(1)(a) would itself be a strong indication of market power.

Moreover, as noted above, a strong argument can be made that the market share threshold for presumptive buyer side market power, the reason for price discrimination laws in Canada and the U.S. in the first place, should be substantially lower than for seller side market power.

Sole reliance on the current abuse of dominance law, therefore, is likely to create a situation where anti-competitive price discrimination, particularly buyer-induced price discrimination, is free from *Competition Act* scrutiny.

The combination of section 50(1)(a) and the Guidelines continues to provide a useful and contemporary framework for identifying anti-competitive price concession practices in the supply of articles. Despite imperfections, this scheme cannot reasonably be characterized as a failure. As noted, outright repeal and reliance on abuse of dominance could result in too few anti-competitive price concession schemes being actionable or effectively challenged. Rather, if section 50(1)(a) is to be repealed, a specially designed reviewable practice acting as a complement to the refusal to deal provisions, with a private Competition Tribunal access right, should preferably take its place.

### Notes

1 "article" means real and personal property of every description including:
(a) money,
(b) deeds and instruments relating to or evidencing the title or right to property or an interest, immediate, contingent or otherwise, in a corporation or in any assets of a corporation,
(c) deeds and instruments giving a right to recover or receive property,
(d) tickets or like evidence of right to be in attendance at a particular place at a particular time or times or of a right to transportation, and
(e) energy, however generated.

2 *Competition Act*, R.S. 1985, c. C-34, s.50(1)(a).

3 *Ibid.* s.51.

4 Competition Bureau, *Price Discrimination Enforcement Guidelines* (Enforcement Guidelines) (Ottawa: Competition Bureau, 1992).

5 *Robinson-Patman Act*, 15 U.S.C. §13 *et seq.*

6 It seems a stretch that the purchaser exercising buyer power could theoretically be convicted under the aiding and abetting provisions of the *Criminal Code*.

7 Since Section 50(1)(a) is a criminal offence, aggrieved purchasers including purchasing groups can sue under it to recover their economic loss.

[8] Bill C-19, *An Act to amend the Competition Act and to make consequential amendments to other Acts*, 1st Sess., 38th Parl., 2004, cl. 2.

Subsections 50(1)(b) and (c) prohibit geographical price discrimination and predatory pricing respectively, both of which have a lessening of competition element. These are not addressed in this paper as they are essentially congruent with abuse of dominant position apart from creating criminal offences. Arguably therefore, unlike subsection 50(1)(a) and section 51, their existence had been made moot by enactment of the abuse of dominance provisions to which the significantly less onerous civil standard of proof applies.

The repeal of sections 50 and 51 was recommended by a 1999 academic review of the pricing provisions of the *Competition Act* (Competition Bureau, *Anticompetitive Pricing Practices and the Competition Act - Theory, Law and Practice* [VanDuzer Report] (Ottawa: Competition Bureau, 1999, J. Anthony VanDuzer), the 2002 report of The House Standing Committee on Industry Science and Technology, "A Plan to Modernize Canada's Competition Regime", a June 2003 Competition Bureau consultation document on options for amending the *Competition Act*, and the consensus of stakeholder responses as reported by the Public Policy Forum (April 2004, prior to the introduction of C-19 the Competition Bureau held further consultations). The current Commissioner of Competition in her submission to the Competition Policy Review Commission has restated the Competition Bureau's preference for the repeal of sections 50 and 51.

[9] Competition Bureau, *Proposed changes to the Competition Act* (Press Release) (Ottawa: Competition Bureau, 2004).

[10] Parliament of Canada, *Legislative Summary of Bill C-19* (Legislative Summary) (Ottawa: Parliamentary Information and Research Service, 2004).

[11] The VanDuzer Report, *supra* note 8 at 26 citing speech to the Canadian Institute, Toronto, May 10, 1996 at 19-20 (George Addy).

[12] The Antitrust Modernization Commission was created pursuant to the *Antitrust Modernization Commission Act of 2002*, Pub. L. No. 107-273, §§ 11051-60, 116 Stat. 1856. The Commission consists of 12 members, 4 of which were appointed by the President, 4 of which were appointed by the leadership of the Senate, and 4 of which were appointed by the leadership of the House of Representatives. The Commission is charged by statute:

> (1) to examine whether the need exists to modernize the antitrust laws and to identify and study related issues;
> (2) to solicit views of all parties concerned with the operation of the antitrust laws;
> (3) to evaluate the advisability of proposals and current arrangements with respect to any issues so identified; and
> (4) to prepare and submit to Congress and the President a report.

The report is to "contain a detailed statement of the findings and conclusions of the Commission, together with recommendation for legislative or administrative action the Commission considers to be appropriate."

[13] The Antitrust Modernization Commission, *Report and Recommendations* (Connecticut: Antitrust Modernization Commission, 2007) at iii states :

> The Commission recommends that Congress finally repeal the Robinson-Patman Act (RPA). This law, enacted in 1936, appears antithetical to core antitrust principles. Its repeal or substantial overhaul has been recommended in three prior reports, in 1955, 1969, and 1977. That is because the RPA protects competitors over competition and punishes the very price discounting and innovation in distribution methods that the antitrust laws otherwise encourage. At the same time, it is not clear that the RPA actually effectively protects the small business constituents that it was meant to benefit. Continued existence of the RPA also makes it difficult for the United States to advocate against the adoption and use of similar laws against U.S. companies operating in other jurisdictions. Small business is adequately protected from truly anticompetitive behavior by application of the Sherman Act.

[14] Interview of Deborah A. Garza, Antitrust Modernization Commission Chair, by The Antitrust Source (April 23, 2007) in The Antitrust Source (Vol. 6, Issue 4).

[15] AMC Staff Discussion Memorandum to Commission, dated May 19, 2006, at www.amc.gov, Commission Documents.

[16] The lowest market share of a respondent to date in a dominance application has been approximately 85%.

[17] VanDuzer Report, *supra* note 8 at 22-41 and 74-76.

[18] *Ibid.* at 30.

[19] *Ibid.*

[20] *Ibid.*

[21] *Ibid.*

[22] *Competition Act*, R.S. 1985, c. C-34, s.75.

[23] "Major Supplier" has been defined by the Restrictive Trade Practices Commission, the predecessor to the Competition Tribunal,

in *Canada (Director of Investigation and Research) v. Bombardier Ltd.* as "one whose actions are taken to have an appreciable or significant impact on the markets where it sells" (see (1980), 53 C.P.R. (2d) 47 (R.T.P.C.), at 55.

[24] *Competition Act*, R.S. 1985, c. C-34, s.61. This criminal law provision creates a strict liability offence in any attempt to influence a resale price of a supplier or customers. The provision does not contain market share thresholds nor does it require proof of adverse effects on competition. Prosecutorial discretion may be (and is) exercised to limit prosecution of such conduct to instances where it has anti-competitive effects. Note, however, that a private right of action for damages is available based on a s.61 violation.

[25] The VanDuzer Report, *supra* note 8 at 30.

[26] The Antitrust Modernization Commission, Report and Recommendations (Connecticut: Antitrust Modernization Commission, 2007) at 417. Available at: http: www.amc.gov.

[27] It appears to now be well established that, under certain market circumstances, market power can be achieved at market shares well below even the 50% market share presumption threshold, established by the Competition Tribunal and the Abuse of Dominance Guidelines.

One such circumstance would be a concentrated retail or intermediate product wholesale/distribution market where the presence of a few major purchasers, coupled often with high consumer switching costs relative to the costs of individual products (which is particularly the case in the grocery and general merchandise sectors where individual products represent a very small portion of the total purchases in a given shopping trip to a typically multi-brand vendor), and fixed supplier/manufacturer costs have been recognized as conferring "buyer power" at purchasing market shares substantially below even the 35% "potential issue" market share threshold established by the Competition Bureau's Abuse of Dominance Guidelines. For example, in supermarket purchases, where a particular product is likely to represent a small percentage of the total bill, the presence of that product at a given store is alone unlikely to induce a significant increase in consumer visits and its absence from the shelf, particularly where substitutes are present, is unlikely to cause consumers to go elsewhere.

Significantly, and perhaps not surprisingly, it was concern over the anti-competitive exercise of chain store buyer power that was the foundation for both Canadian and U.S. price discrimination legislation.

Academic commentary and case law would suggest that buyer power could reasonably be presumed, for the purpose of further inquiry on competition effects, at around a 20-30% purchasing market share. Anticompetitive consequences would, of course, still need to be established even if market power was conclusively found to exist.

For example, in *FTC v. Morton Salt Co.*, 334 U.S. 37 (U.S. 1948), the Federal Trade Commission ("FTC") found that buyers could extract non-cost-justified discounts with shares around 20%. In *Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451 (U.S. 1992), a tied selling case, Kodak was found to have market power with a 20-30% share of the copier machine market. Most recently, the courts have upheld the FTC's finding that Toys "R" Us, with a 20% national share of toy purchasers and about a 30% share of the output of the largest toy companies, had the ability to extract significant concessions from major toy makers, and could induce toy makers to stop selling to warehouse clubs (*Toys "R" Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000)).

Commentators, who have concluded that around a 20% purchasing market share, in a concentrated market, is likely sufficient to confer buyer power, include:

(1) Philip Areeda who, in relation to market foreclosing tying arrangements, concludes:

> As usual, specifying levels of concentration and foreclosure is difficult and inevitably arbitrary. Unlike most antitrust problems, however, even the lowest arguable magnitudes will simplify planning and litigation by summarily screening out the legion of broadly defined tie-ins that have no capacity to weaken rivalry in the tied or tying markets... Of course, other cases cannot be disposed of so readily. For them, we need to set a threshold of dangerous foreclosure, at least presumptively for a "typical" market. If that threshold level is set relatively low, say 10 or 15 percent, in order to catch potentially dangerous ties without having to inquire whether other sellers in the market also practice tying, the structure of the tied market serves as a supplementary test to screen out harmless ties. Similarly, if tied sales by tying sellers are counted even though the defendant...merely purchases and resells the tied product, rather than making it, the absence of concentration among the producers of that product with ample distribution channels would continue to serve non-tied purchasers competitively. In general, I propose that foreclosure be presumed unreasonable when it reaches 20 percent for an individual seller or a total of 50 percent for five or fewer sellers. Presumptively dangerous levels of concentration would correspond roughly to those useful for testing horizontal mergers. (Philip Areeda, *Antitrust Law*, vol. IX, section 1729, at 276-277)

(2) Robert H. Lande (Venable Professor of law, University of Baltimore Law School) has observed:

> At the outset, it should be stressed that there is a fundamental reason why buyer power can have more potential to harm competition than seller power: buyer power can occur at much lower market share levels....
>
> The reason why this can happen is that a firm that purchases, e.g., 20% of all toys or salt can credibly threaten to take its business elsewhere if it does not receive lower prices (i.e., if prices are now lowered from average total cost down towards slightly more than average variable cost)... Assuming there are other significant suppliers of toys or salt, this threat can be credible. This can occur even if the sellers are perfectly competitive, so long as the buyer is larger than the fringe firms combined. [The buyer could do this by threatening to cut off all purchasers unless the seller chargers the fringe a higher price.] The seller is better off getting a small profit than none, so a firm that buys less than 20% of the product or service might be able to obtain a significant price break or other concessions. This relatively large purchase can provide the supplier crucial economies of scale and become a key part of their business strategy. The supplier may have to make this sale at only slightly above average variable cost, and cover its overhead from sales to its other customers, who end up paying more. (Robert H. Lande, "Beware Buyer Power" (July 12, 2004) The Legal Times, <http://www.antitrustinstitute.org/archives/files/331.pdf>.)

In a recent paper, Doyle and Inderst observe that similar buyer power thresholds in the 20% range have been applied in U.S. and European Merger Reviews:

> Apart from the absolute size, the fraction of a supplier's business for which a particular buyer accounts for may determine relative bargaining power. In fact, such ratios have been frequently used in recent cases. Across the Atlantic, in Aetna/Prudential it was argued that a physician's prospective loss from having to replace patients may increase more-than-proportionally with the number of patients that must be replaced; the cost to a physician of replacing 30% of his patients is likely to be more than twice that of replacing only 15% of them. [*United States, et al. v. Aetna, Inc., et al.*, No. 3-99CV1398-H. For more details see: Schwartz, M., 1999, Buyer Power Concerns and the Aetna-Prudential Merger, presented at 5th Annual Health Care Antitrust Forum, Northwestern Univ. School of Law.] In Carrefour/Promodes, the European Commission asserted that a supplier whose business with the two merging chains accounted for more than 22% of revenues was to be considered as "economically dependent" upon them, as survey evidence indicated that this was the most suppliers could afford to lose without a serious danger of them being driven bankrupt. [Apart from the possibility of scaling back operations, suppliers would clearly also have the option to bridge the temporary financial gap by raising additional funds. Ruling this out would require an explicit consideration of the "financial frictions" that are faced by these particular suppliers. (This has some analogy to the consideration of "deep pocket" or "long purse" arguments for (financial) predation or under a conglomerate merger doctrine.)] (Chris Doyle & Roman Inderst, "Some Economics on the Treatment of Buyer Power in Antitrust" (2007) 28 E.C.L.R. 210).

Using similar reasoning, the U.K. Competition Commission concluded in its 2000 Supermarket Inquiry that in that country's concentrated supermarket sector, a grocery sector customer representing at least 8% of a grocery product manufacturer sales would be in a position to exercise upstream market power against the manufacturer through the threat of cutting off purchases:

> We conclude that five multiples (the major buyers-Asda, Safeway, Sainsbury, Somerfield and Tesco), each having at least an 8 percent share of grocery purchases for resale from their stores, have sufficient buyer power that 30 of the practices identified, when carried out by any of these companies, adversely affect the competitiveness of some of their suppliers and distort competition in the supplier market-and in some cases in the retail market- for the supply of groceries. We find that these practices give rise to a second complex monopoly situation. (U.K., Competition Commission, *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom* (Inquiry Report) (London: Competition Commission, 2000), at para. 1.10; see also para. 2.458, http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#full ).

The following illustrative amending text reflects these principles:

Supply Discrimination

(1) For the purposes of this section, supply discrimination means any practice whereby a supplier of a product offers a product, or a group of products, to a customer on terms that are not available to competitors of that customer, or whereby a third party, including a customer of the supplier, has induced or required a supplier to engage in such practice.

(2) For greater certainty "terms" in subsection (1) includes, but is not limited to, price-related terms, promotional support and allowances, technical support, and warranty terms.

(3) Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that supply discrimination:

(a) is engaged in by a major supplier of a product in a market, is widespread in a market, or represents a significant portion of a purchaser's purchases which substantially affects that purchaser's business; and
(b) is likely to have an adverse effect on competition in a market

the Tribunal may make an order prohibiting the supplier from continuing to engage in that supply discrimination, and where the supplier has been required or induced to engage in that practice by a third party prohibiting that third party from requiring or inducing the supplier to engage in that supply discrimination, and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.

(4) For greater certainty, the Tribunal may not make an award of damages under this section to a person granted leave under subsection 103.1(7).

(5) The Tribunal shall not make an order under this section where, in its opinion:

(a) the supply discrimination is or will be engaged in only for a reasonable period of time to facilitate entry of a new supplier of a product into a market or of a new product into a market; or
(b) the supply discrimination is reasonable having regard to the technological relationship between or among the products to which it applies, and no order made under this section applies in respect of supply discrimination between or among companies, partnerships and sole proprietorships that are affiliated as defined in subsections 77(5) and 77(6).

(6) In considering an application by a person granted leave under subsection 103.1, the Tribunal may not draw any inference from the fact that the Commissioner has or has not taken any action in respect of the matter raised by the application.

# IDENTIFYING MARKET POWER IN NATURAL GAS STORAGE

By: David Brown, Ontario Energy Board[1]
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## Introduction

In the summer of 2006, the Ontario Energy Board ("OEB" or "Board") held a hearing, the Natural Gas Electricity Interface Review (NGEIR) Hearing, to achieve an ambitious goal: to establish whether forbearance from regulation of natural gas storage was justified.[3] This would amount to the deregulation of the storage industry, which goes well beyond what has been implemented in the United States.[4]

The OEB hearing's agenda involved determining whether the market for natural gas storage in Ontario was competitive or, more precisely, whether it would be competitive if forbearance from regulation was exercised. An equivalent way of framing the question is to ask whether the existing suppliers of natural gas storage in Ontario currently possess market power or are likely to possess market power in the event of forbearance. This paper will give an account of the NGEIR Hearing and decision but before that will develop several conceptual underpinnings that may be useful for lawyers and economists active in this area.

Market power is defined in a typical economics text as the ability to increase price above marginal cost for a sustained period.[5] Sometimes we add the rider that firms with market power will earn supernormal profits over a sustained period. The definition of marginal cost can also be elaborated at considerable length. Do we mean short run or long run marginal cost? In the long run marginal cost can, in some industries, be difficult to define. For example, what is the long run marginal cost of producing a new drug? Or, in the software industry, what is the long run marginal cost of a new software application? Moreover, *ex ante* and *ex post* are important distinctions as well. *Ex ante*, a firm may have to explore many avenues through research and development in order to discover a single new drug with a particular set of therapeutic properties. *Ex post*, some of the false trails which did not lead to the new drug may be missed in any attempt to quantify long run incremental cost.

A second issue which confuses many practical attempts to identify market power is the presence of rents. A firm with a superior cost structure, or lower transportation costs, may earn economic rents while some or all of its rivals earn only competitive returns. These rents are not supernormal profits and they provide no necessary indication of the presence of market power.

In practical cases facing competition and regulatory authorities, it can be difficult to tell when market power is likely being exercised and when it is likely not. Of course, in the case of competition law, the mere exercise of market power is not illegal, and some further abusive practices would likely be required for a competition agency to mount a legal challenge. In the case of regulatory agencies, many perceive a crucial part of their mandate as the prevention of the exercise of market power, and so it is of fundamental importance for this goal to "get the diagnosis right".

In this paper we explore the issues of identifying market power through one such example drawn from the energy industry: the supply of natural gas storage facilities.

**An Economic Theory Parable: Oligopoly with Capacity Constraints**

In this section we set the stage for the discussion of competition in gas storage by presenting a simple, stylized economic model. Suppose two firms produce a homogeneous product, and compete over price for the same group of consumers as Bertrand competitors. Suppose also firm 1 has a cost advantage, so that its unit costs are $c_1$ which are lower than the unit costs of firm 2, $c_2$. The well known Bertrand duopoly solution in this case has $P = c_2$, the unit costs of the high cost firm. Firm 1 will have 100% market share, and firm 2, the high cost firm, will be excluded completely from the market. Moreover, firm 1 will earn profits (or are they rents?) equal to $(c_2 - c_1)$ x $Q(c_2)$.

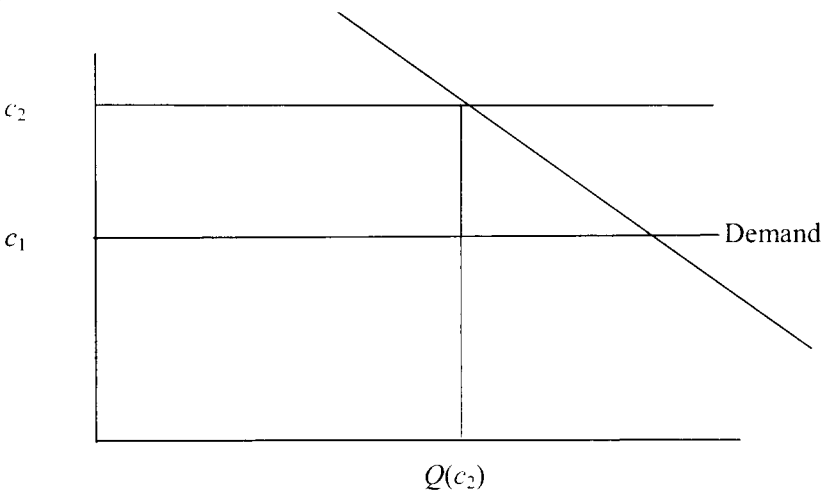


***Figure 1: Bertrand competition with different costs***

But less well known is the answer to the question: is firm 1 exercising market power? If there are no capacity constraints, then firm 1 is indeed exercising market power, as the competitive price would be lower, namely $P = c_1$ and it is effectively because firm 1 is increasing price and restricting supply that the duopoly equilibrium price lies above that competitive price. Firm 1's profit of $(c_2 - c_1)$ x $Q(c_2)$ is not rent, because it is created through the artificial restriction of output, not through the return to a scarce input in a competitive market.

The interpretation changes completely, however, if firm 1 has a strict capacity constraint equal to $Q(c_2)$, the Bertrand equilibrium output. The equilibrium price is unchanged, but now firm 1 is not exercising market power, and is earning rents, not profits. Although firm 1 is the low cost producer, it has no influence over the market price. To check this, note that if firm 1 reduced its own output by a small amount, its supply would be replaced by an equal supply from firm 2, and the price would not change. Moreover, firm 1 has no ability to lower the price, as it is unable to supply more to the market because of the capacity constraint. So the necessary condition for market power, the ability to influence price, is not met in this case. The amount $(c_2 - c_1)$ x $Q(c_2)$ measures a rent to firm 1's low cost production asset, and not an economic profit. In fact, if we label this capacity $K$, any capacity less than $K$ would lead to the same conclusion: firm 1 has no market power but does receive economic rents.

Assuming the capacity constraint case, what kind of rents does firm 1 receive? The pioneering analysis of Sanderson and Winter (2002a and b) addressed the effect of economic rents on the analysis of market power in the context of a Canadian merger involving waste landfills. We believe that similar issues arise in the context of competition between gas storage facilities.

An exhaustible or depletable resource earns scarcity rents which capture the property that the opportunity cost of using the resource today is not having it available tomorrow. The use of an exhaustible resource can thus attract two sources of rent, that accruing to a low cost producer (which may derive from locational advantage) known as Ricardian rents, and a scarcity rent.

Gas storage is a case where rents are likely to be important[6], but unlike waste landfills, it is not a depletable resource. In fact, the essence of gas storage is repeated injection and withdrawal cycles. Hence, no scarcity rent accrues to the case of gas storage. The rents that do accrue, similar to the case of landfills, are Ricardian rents, mostly deriving from the advantages of location as one storage facility closer to an area of consumption would have relatively lower costs of use. Gas storage facilities likely exhibit intrinsic cost differences also, which imply that rents will accrue to the low cost facility. For example, those based on salt caverns have different cost characteristics than facilities using depleted gas reservoirs.

Returning to our Bertrand competition parable, if we consider firm 2 as a competitive supplier of gas storage available from a distant source, and firm 1 as a local gas storage facility close to a consumption area, the usefulness of this analogy becomes clear. As we shall see, whether or not the local gas storage facility is in a position to exercise market power depends on a careful and detailed analysis of the circumstances, and in particular the ability of the local storage facility to expand production in both the short and long term.

**An Optimal Pipeline Network with Storage**

In a conventional manufacturing industry little can be said about what an optimal firm and plant configuration would look like, other than what could be found in an intermediate microeconomics textbook. Costs are minimized at the firm and plant level, and therefore for the industry as a whole. Perfect competition will ensure that this occurs. Demand for the product in equilibrium will equal the value of demand at long run marginal cost.

The demand for natural gas storage under long run competitive conditions is a derived demand, arising from the demand for gas at different points in time. In a pipeline network, the seasonality of demand creates the need for storage located close to the consuming area in order to smooth the flow of gas through the pipeline coming from the producing region, and thus economize on the size of pipeline required to meet both summer and winter demand.

Suppose that we divide a year into two equal seasons, summer and winter, and that demand in each six month season is known with certainty and is completely price inelastic. The two seasonal demands are $D_W$ and $D_S$, with the units being billions of cubic feet (bcf ) per six month cycle.

Assuming that the volume of production is flexible, which is sometimes but not always the case, the demand for storage is created by the cost of building a pipeline from the consuming area to the producing area. Pipeline capacity is measured in units of gas transported per six month cycle. As an upper bound, the pipeline could be built with a capacity equal to the winter demand, $D_W$. The pipeline would have unused capacity in the summer (equal to $D_W - D_S$) and given the availability of some storage at a cost less than the cost of building marginal pipeline capacity this strategy would generally not be optimal.

Once again starting with the simplest possible assumption, we assume that construction of storage capacity is costless. In this case both optimal storage and optimal pipeline capacity will be positive. To determine these optimal levels of pipeline and storage capacities, smoothing equations can be analyzed. Figure 2 illustrates a simple pipeline network with one source of natural gas, an upstream pipeline with capacity $k_A$, a storage facility and a downstream pipeline with capacity $k_B$.

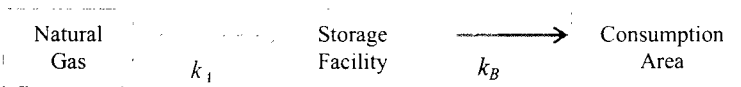


***Figure 2: A Simple Pipeline Network***

The downstream pipeline must be large enough to handle winter demand ($k_B = D_W$). Winter demand can be wholly satisfied using upstream pipeline capacity ($k_A$) plus storage capacity ($T$):

$$D_W = k_A + T$$

Likewise, summer demand can be satisfied using gas that is transported along pipeline $A$ minus what is injected into storage:

$$D_S = k_A - T$$

These two equations can be solved for $k_A$ and $T$:

$$k_A^* = \frac{1}{2}(D_W + D_S) \qquad (1a)$$

$$T^* = \frac{1}{2}(D_W - D_S) \qquad (1b)$$

Figure 3 below illustrates the operation of this simple smoothing function of storage.

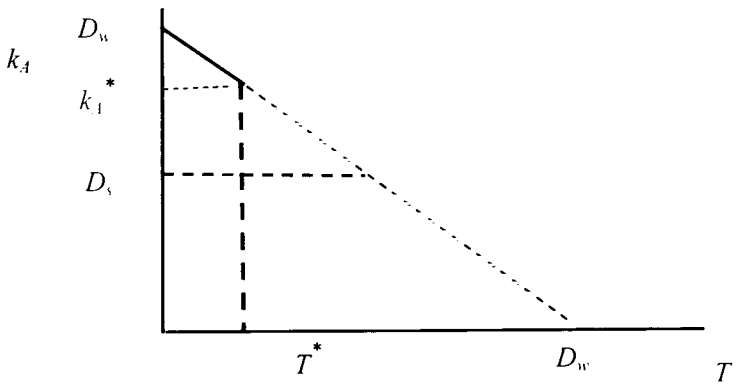


***Figure 3: The Storage – Pipeline Tradeoff***

*Notes for Figure 3:*

- $k_A$ is pipeline $A$ capacity; $T$ is storage capacity
- $k_A$ and $T$ trade off on a 45° line. All of winter demand $D_W$ could be met with pipeline capacity only where the 45° line intersects the vertical axis.
- As we increase the amount of storage, capacity trades off one-for-one with storage capacity until the point $k_A^*$ is reached.
- Any further increase in storage capacity at the expense of pipeline capacity will result in a pipeline too small to both meet summer demand $D_S$ and re-fill the storage area sufficiently to meet winter demand $D_W$ which requires an injection of $D_W$ minus $k_A$.

These equations illustrate nicely the basic role of storage in the simplest possible environment. Storage allows a pipeline to be built with a capacity equal to average demand over the annual cycle. In the summer, production of gas goes partly to fill consumption needs, and partly to be injected into storage. In the winter, demand is met partly by production, which remains constant throughout the year and ensures full capacity in the pipeline at all times, and partly by the extraction of gas from the storage facility.

Suppose, more realistically, that the construction and utilization of gas storage entails some cost, and that the long run cost function can be written $C_S(T)$ with the cost function for pipeline capacity given by $C_P(k)$. In order to preserve comparability, the units for both cost functions are "billions of cubic feet per half-year" Assume further that the variable costs of transporting gas through a pipeline are zero. Simple cost minimization requires that we minimize $2C_P(k) + 2C_S(T)$ with respect to $k$ and $T$.

We know that $k = D_W - T$ because it will never be optimal to have excess pipeline capacity in the winter. Making this substitution yields the first order condition

$C'_P(k) = C'_S(T)$

In words, storage should be built until the marginal cost of another unit of storage capacity is equal to the marginal cost of a unit of pipeline capacity.

Moreover, it is easy to see that although the pipeline will be full in the winter season, in the summer there will be excess capacity. Thus the equation for $T^*$, derived for the artificial case of zero costs of storage, no longer holds. Provided that the marginal cost of a unit of storage exceeds the marginal cost of a unit of pipeline capacity at $T^*$, then pipeline capacity will be expanded to allow more direct supply from the production area in the winter peak period, less storage will be required, and in the summer some excess capacity will appear in the pipeline.

**Implications for Gas Prices**

The model of a pipeline network with storage has implications for seasonal gas prices. If storage were costless, so that equations (1a) and (1b) always held, then there is no reason for seasonal gas price differentials to ever be observed. Any price differential would be met by arbitrage, with arbitrageurs storing more gas in the summer and selling it for winter consumption at a higher price and a profit.[7] If storage is costly, then in a long run sense the price of incremental storage puts an upper bound on the seasonal price differential. If the price of gas for winter delivery exceeds the summer price of gas by more than the incremental cost of storage, additional storage will be created and this profit opportunity will be exploited. We will return to this issue in the next section when we discuss the empirical evidence for market power.

**How Does the Network Structure Influence the Ability to Exercise Market Power?**

Now that we have an idea what an optimal configuration of an integrated storage and pipeline network might look like, consider the effect of the exercise of market power. Market power over the storage facilities in Ontario would be exercised by restricting their supply and raising the price, as it always is. Such an exercise of market power over storage has the effect of raising the price above the marginal cost of storage leading to the need for a larger (and costlier) pipeline, a greater volume of gas shipped directly from the production area to meet winter demand, and more excess capacity in the summer season.

The second point relates to the configuration of the pipeline network between producing and consuming areas. We illustrate the role of the pipeline network with three polar case examples, two in which, perhaps surprisingly, market power cannot be exercised, and one in which market power could be exercised.

*I. Competitive storage available from a single source, but all gas flows down the same pipeline from production area to consumption area.*

The first network market structure consists of a competitive storage market located some distance from the local consumer concentration, together with a single storage facility located much closer to the consumer region (see Figure 4).

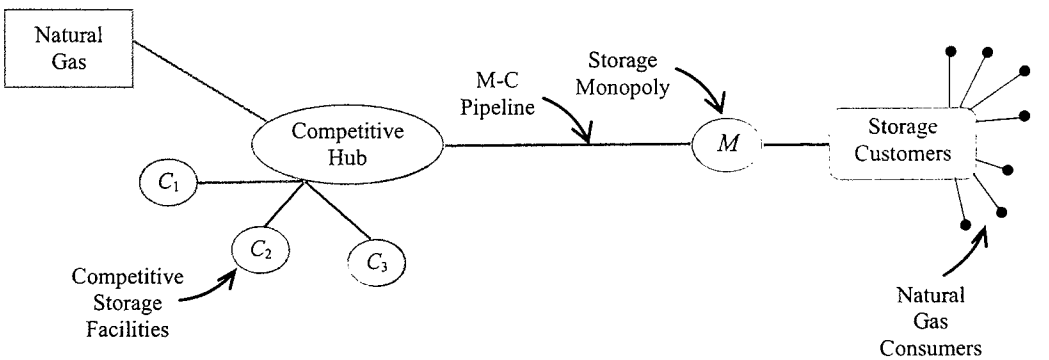


***Figure 4: Local Storage Monopoly with No Transmission Cost Advantage***

What we have in mind here is the abundant supply of storage facilities in US states neighbouring Ontario, such as Michigan and New York. The consumer concentration is analogous to the Southern Ontario area, consisting of the GTA and western shore of Lake Ontario. The two key assumptions are that a perfectly elastic supply of "storage services" is available from the U.S. industry, and that all gas from the producing region must pass through a single pipeline past the competitive storage area on its way to the consumers in Southern Ontario.

With this structure, all gas reaching the consuming region incurs the same costs of transportation, whether it is stored in a competitive storage facility ($C_1$) or the monopoly storage facility ($M$). Thus, although it may appear counter-intuitive, the local storage "monopoly" has no competitive advantage over the more distant storage industry, and in fact possesses no market power. In effect, the local storage facility is just another competitive supplier in the perfectly competitive storage market, even if all of its rival suppliers are located some distance away across an international border. Thus, the facility $M$ has no ability to increase the price of storage above the incremental cost of providing it, or any incentive to restrict the supply of storage in order to bring about a price increase. If it attempted to do so, storage consumers would simply switch their purchases, at no cost to themselves, to one of the international storage providers, and the price of storage would remain unchanged.[8]

*II. Competitive storage available from an international source, but an additional source of gas supply is available for consumers and local storage owners. Because of limited local capacity, the local storage monopolist cannot exercise market power.*

In this configuration the local consumers have access to gas via a more direct pipeline than the one feeding the U.S. storage facilities (see Figure 5).

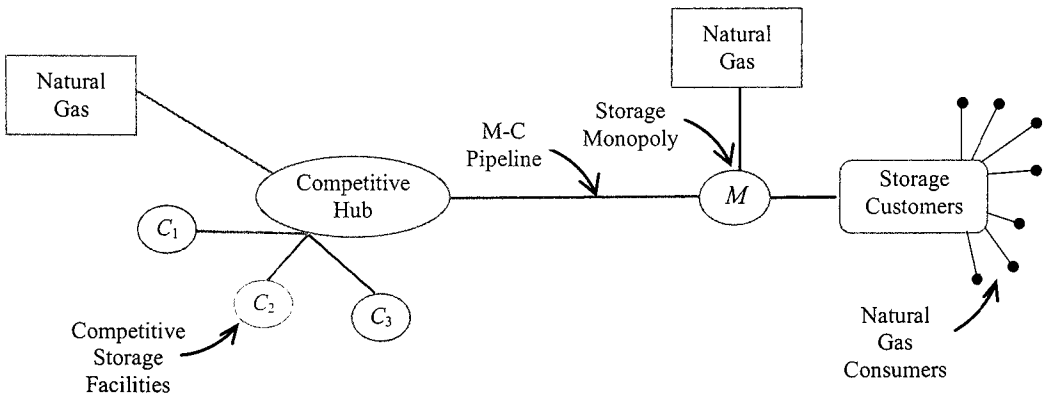


***Figure 5: Local Storage Monopoly with Transmission Cost Advantage***

In this case, local storage is low cost. In fact, the case exactly fits the "economic theory parable" set out in the introduction, and is illustrated in Figure 6 below. If capacity of the local storage field ($K$ in Figure 6) is not sufficient to lower the price of storage below the foreign supply price, then the local storage monopoly will earn economic rents but will not be able to exercise market power because it has no influence over the price.[9]

*III. Local storage owner has ample capacity but chooses to restrict supply of storage and to exercise market power.*

The final possibility is that the local storage monopolist possesses enough capacity that, by supplying sufficient capacity to the market, it can lower the local price of storage (Figure 7). By keeping the price high, just below the price at which storage can be supplied by the competitive international market, the local monopolist is now exercising market power in keeping the price at the international level $P_m$ instead of increasing supply and bringing price down to the competitive level $P_c$. In the case illustrated in Figure 7, the local storage monopolist supplies 100% of the storage used by local gas consumers.

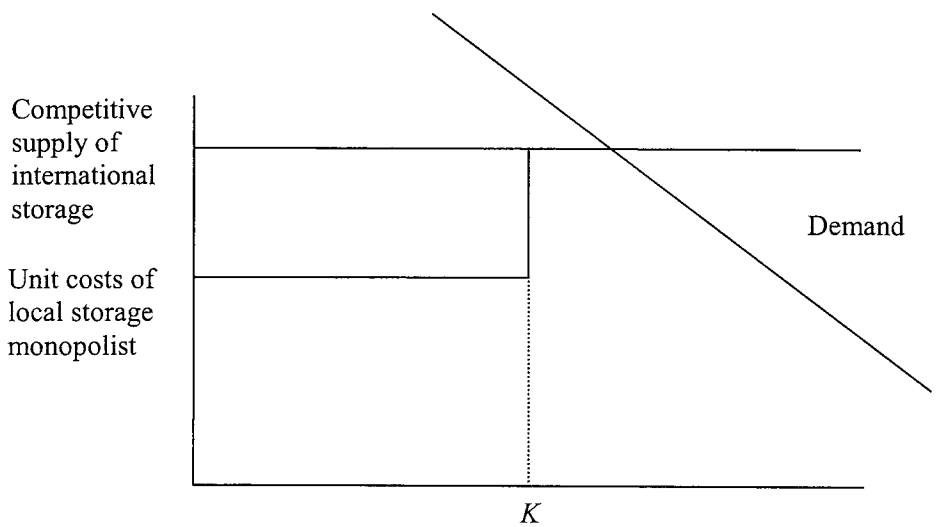


***Figure 6: Local Storage Monopolist earns rents in a competitive market***

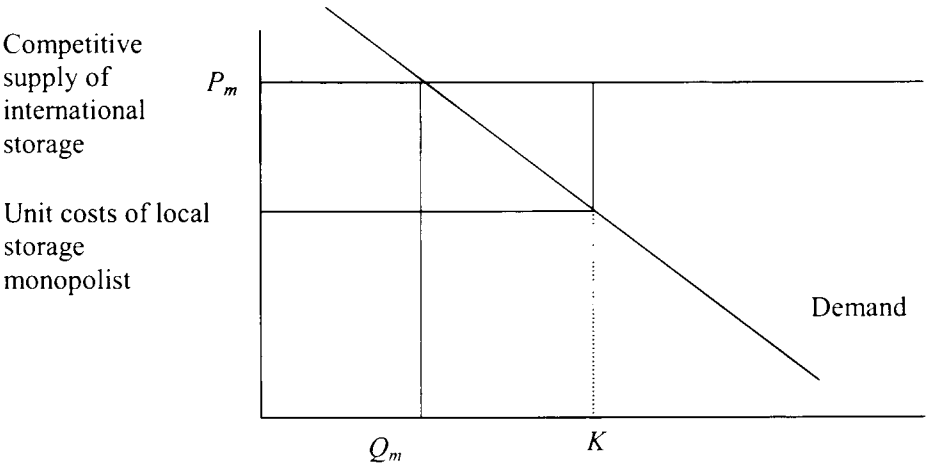


***Figure 7: Local Storage Monopolist exercises market power at $P_m$ and earns monopoly profits***

If we take a step back and consider the storage investment decision by the monopolist, where capacity may be variable (depending on geological and other factors), then the analysis can be extended, except that now the relevant marginal cost is long run, rather than short run. If a builder of a new storage facility chooses capacity below the competitive level, then they are exercising market power in making an investment decision that restricts the supply of storage capacity to the market.

**Identifying Market Power**

As is usually the case, there are two possible avenues available for identifying possible market power. Direct observation of the prices or quantities, compared to the competitive price or quantity, or indirect observation of other indicators, such as concentration statistics, price cost margins or correlation coefficients.

Data on prices charged for storage are hard to come by, partly because storage is often supplied as a bundled commodity together with gas service. Data on gas prices, however, are abundantly available. We begin with these data, and review the degree of correlation between gas commodity prices across the major North American trading hubs. Table 1 below reports correlation coefficients for the price of gas at the Dawn trading hub with nine other major North American trading hubs.

***Table 1: Natural Gas Price Correlation with Dawn***
(reproduced from EEA Schwindt, 2006, Table 4, page 37)

| | 1999-2005 | 2001-2005 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005/b |
|---|---|---|---|---|---|---|---|---|---|
| Henry Hub | 0.991 | 0.987 | 0.990 | 0.998 | 0.997 | 0.992 | 0.963 | 0.966 | 0.990 |
| Niagara | 0.993 | 0.989 | 0.998 | 0.999 | 0.999 | 0.996 | 0.977 | 0.816 | 0.989 |
| Consumers Energy, Citigate | 0.998 | 0.997 | 0.993 | 0.999 | 0.999 | 0.998 | 0.994 | 0.989 | 0.997 |
| Mich Con, Citigate | 0.996 | 0.997 | 0.992 | 0.988 | 0.999 | 0.998 | 0.993 | 0.992 | 0.998 |
| Chicago, citigates | 0.991 | 0.995 | 0.982 | 0.978 | 0.999 | 0.996 | 0.986 | 0.979 | 0.991 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Alliance, into Interstates | 0.996 | 0.996 | | | 0.999 | 0.997 | 0.989 | 0.980 | 0.992 |
| Columbia Appalachia | 0.991 | .0986 | 0.990 | 0.998 | 0.97 | 0.983 | 0.962 | 0.968 | 0.991 |
| Dominion South Point | 0.988 | 0.987 | | 0.997 | 0.996 | 0.993 | 0.966 | 0.944 | 0.988 |
| NOVA, AECO-C | 0.975 | 0.965 | 0.966 | 0.987 | 0.996 | 0.885 | 0.887 | 0.952 | 0.988 |

They indicate that correlations are very high, generally over .99. It is difficult to determine what conclusions can be drawn from these statistics. At the very least they show the North American market is connected – that is, prices at all the major hubs rise and fall together, and that gas flows through the pipeline network in search of higher prices. It is less clear that these high correlations prove a lack of market power in Ontario. A simple counter example illustrates the point. Suppose that storage in Ontario were completely monopolized, but storage was available from distant fields at a constant competitive delivered price. Then the Ontario storage monopolist would simply price to the "delivered price of imports" Any shocks to the North American market, such as supply disruptions or continent wide increases in production costs, would be reflected in increases in this delivered price of imports, and hence increases in the price charged by the domestic supplier. A correlation analysis would reveal perfect correlation between Ontario storage prices and prices charged by foreign suppliers, and yet there would be considerable market power being exercised by the Ontario storage supplier, with a conventional allocative distortion of resources.

Table 2 below (reproduced from Table 5 in EEA/Schwindt) attempts to provide more direct evidence in support of integration of the market for gas storage. The bottom section of this table shows averages of the difference between the winter withdrawal season price average and the summer injection season price average. The average winter-summer price differential can be viewed as an upper bound for a local storage customers' marginal valuation of storage. If market power in storage was being successfully exercised at a given trading hub but not at other hubs then a larger seasonal variation in gas prices would be possible at that hub within the limits imposed by geographic arbitrage of gas prices up to transportation cost differentials. Although looking at the seasonal variation themselves is probably confusing dependent and independent variables, some insight can be gained from it. While there is some dispersion in these average seasonal differences across trading hubs, there is no indication that the Dawn Hub stands out as having a higher average difference than the other hubs.

*Table 2: Natural Gas Prices at Various Trading Hubs: Annual and Seasonal Averages and Seasonal Differences*

| | Dawn | Henry Hub | Niagara | Consumers Energy Citigate | MichCon Citigate |
|---|---|---|---|---|---|
| **AVERAGE PRICE** | | | | | |
| **Overall Average** | | | | | |
| 1999-2005 | 4.65 | 4.49 | 4.75 | 4.60 | 4.59 |
| Jan 2001-Aug 2005 | 5.20 | 5.01 | 5.31 | 5.14 | 5.14 |
| **Winter** | | | | | |
| Nov 1999-Mar 2000 | 2.62 | 2.51 | 2.68 | 2.57 | 2.55 |
| Nov 2000-Mar 2001 | 6.95 | 6.73 | 7.05 | 6.88 | 6.64 |
| Nov 2001-Mar 2002 | 2.60 | 2.47 | 2.67 | 2.53 | 2.54 |
| Nov 2002-Mar 2003 | 5.90 | 5.52 | 6.29 | 5.73 | 5.69 |
| Nov 2003-Mar 2004 | 5.70 | 5.49 | 5.98 | 5.61 | 5.58 |
| Nov 2004-Mar 2005 | 6.67 | 6.41 | 6.82 | 6.55 | 6.56 |
| **Summer** | | | | | |
| Apr 1999-Oct 1999 | 2.51 | 2.43 | 2.54 | 2.50 | 2.51 |
| Apr 2000-Oct 2000 | 4.35 | 4.20 | 4.37 | 4.31 | 4.35 |
| Apr 2001-Oct 2001 | 3.58 | 3.41 | 3.59 | 3.55 | 3.57 |
| Apr 2002-Oct 2002 | 3.41 | 3.41 | 3.48 | 3.44 | 3.42 |
| Apr 2003-Oct 2003 | 5.42 | 5.17 | 5.46 | 5.36 | 5.41 |
| Apr 2004-Oct 2004 | 6.08 | 5.86 | 6.12 | 6.01 | 6.04 |
| Apr 2005-Aug 2005 | 7.57 | 7.47 | 7.65 | 7.56 | 7.57 |
| **Annual** | | | | | |
| Nov 1999-Oct 2000 | 3.62 | 3.49 | 3.66 | 3.58 | 3.59 |
| Nov 2000-Oct 2001 | 4.97 | 4.78 | 5.02 | 4.93 | 4.84 |
| Nov 2001-Oct 2002 | 3.08 | 3.02 | 3.15 | 3.07 | 3.06 |
| Nov 2002-Oct 2003 | 5.62 | 5.31 | 5.80 | 5.51 | 5.52 |
| Nov 2003-Oct 2004 | 5.92 | 5.71 | 6.06 | 5.85 | 5.85 |
| Nov 2004-Aug 2005 | 7.12 | 6.94 | 7.23 | 7.06 | 7.06 |
| | **(Winter-Summer)** | **(Summer)** | **Gas** | **Price** | **Difference** |
| **Seasonal Average** | 0.85 | 0.77 | 0.99 | 0.78 | 0.71 |
| Apr 1999-Mar 2000 | 0.11 | 0.07 | 0.15 | 0.07 | 0.04 |
| Apr 2000-Mar 2001 | 2.60 | 2.52 | 2.68 | 2.57 | 2.29 |
| Apr 2001-Mar 2002 | (0.98) | (0.94) | (0.92) | (1.02) | (1.03) |
| Apr 2002-Mar 2003 | 2.49 | 2.11 | 2.81 | 2.29 | 2.27 |
| Apr 2003-Mar 2004 | 0.27 | 0.32 | 0.52 | 0.25 | 0.17 |
| Apr 2004-Mar 2005 | 0.59 | 0.55 | 0.70 | 0.54 | 0.52 |

# CANADIAN COMPETITION RECORD

*Table 2 (Cont.)*

| | Chicago Citigate | Alliance into Interstate | Columbia Gas Appalachia | Dominion Southpoint | NOVA/AECO-C |
|---|---|---|---|---|---|
| **AVERAGE PRICE** | | | | | |
| **Overall Average** | | | | | |
| 1999-2005 | 4.53 | 5.02 | 4.70 | 5.22 | 3.85 |
| Jan 2001-Aug 2005 | 5.03 | 5.02 | 5.25 | 5.37 | 4.28 |
| **Winter** | | | | | |
| Nov 1999-Mar 2000 | 2.55 | | 2.63 | | 2.19 |
| Nov 2000-Mar 2001 | 7.04 | 6.43 | 7.01 | 7.17 | 6.22 |
| Nov 2001-Mar 2002 | 2.47 | 2.48 | 2.57 | 2.63 | 2.20 |
| Nov 2002-Mar 2003 | 5.62 | 5.62 | 5.73 | 6.50 | 4.72 |
| Nov 2003-Mar 2004 | 5.54 | 5.54 | 5.70 | 5.88 | 4.75 |
| Nov 2004-Mar 2005 | 6.44 | 6.45 | 6.71 | 6.77 | 5.61 |
| **Summer** | | | | | |
| Apr 1999-Oct 1999 | 2.48 | | 2.57 | | 2.11 |
| Apr 2000-Oct 2000 | 4.29 | | 4.40 | 4.43 | 3.55 |
| Apr 2001-Oct 2001 | 3.45 | 3.44 | 3.61 | 3.63 | 2.94 |
| Apr 2002-Oct 2002 | 3.39 | 3.38 | 3.62 | 3.59 | 2.46 |
| Apr 2003-Oct 2003 | 5.22 | 5.22 | 5.42 | 5.53 | 4.49 |
| Apr 2004-Oct 2004 | 5.83 | 5.83 | 6.14 | 6.18 | 5.01 |
| Apr 2005-Aug 2005 | 7.36 | 7.37 | 7.79 | 7.83 | 6.27 |
| **Annual** | | | | | |
| Nov 1999-Oct 2000 | 3.56 | | 3.65 | 3.95 | 2.98 |
| Nov 2000-Oct 2001 | 4.94 | 4.30 | 5.02 | 5.09 | 4.30 |
| Nov 2001-Oct 2002 | 3.02 | 3.01 | 3.19 | 3.19 | 2.36 |
| Nov 2002-Oct 2003 | 5.39 | 5.38 | 5.54 | 5.93 | 4.59 |
| Nov 2003-Oct 2004 | 5.71 | 5.71 | 5.96 | 6.06 | 4.90 |
| Nov 2004-Aug 2005 | 6.90 | 6.91 | 7.25 | 7.30 | 5.94 |
| **Seasonal Average** | 0.83 | 0.55 | 0.76 | 1.12 | 0.85 |
| Apr 1999-Mar 2000 | 0.06 | | 0.06 | | 0.08 |
| Apr 2000-Mar 2001 | 2.76 | | 2.61 | 2.74 | 2.67 |
| Apr 2001-Mar 2002 | (0.97) | (0.96) | (1.04) | (1.00) | (0.74) |
| Apr 2002-Mar 2003 | 2.22 | 2.23 | 2.11 | 2.91 | 2.26 |
| Apr 2003-Mar 2004 | 0.32 | 0.32 | 0.29 | 0.35 | 0.25 |
| Apr 2004-Mar 2005 | 0.60 | 0.62 | 0.57 | 0.59 | 0.60 |

**The NGEIR Hearing**[10]

The NGEIR Hearing was the outcome of a substantial and lengthy two-phased consultative process whereby the OEB, as the regulator of natural gas and electricity in the Province of Ontario, sought to understand and facilitate the present and future needs of both natural gas and electricity consumers. In addition to rates issues, which the Natural Gas Forum and NGEIR policy processes revealed to be of primary importance, it also became apparent that the Board should consider whether it should forbear from regulating natural gas storage. The analysis for such an inquiry begins with section 29 of the Board's empowering statute, the *Ontario Energy Board Act, 1998* which section reads as follows:

> On an application or in a proceeding, the Board shall make a determination to refrain, in whole or part, from exercising any power or performing any duty under this Act if it finds as a question of fact that a licensee, person, product, class or products, service or class of services is or will be subject to competition sufficient to protect the public interest.

In this case, the Board would consider whether the natural gas storage market is or will be sufficiently competitive to warrant that the Board should refrain from exercising its power to set regulated rates for the provision of natural gas storage services.

The legal and administrative processes associated with making such a determination were extensive. While a creature of statute and governed by the words in that statute as the provincial energy regulator and as an administrative tribunal, the Board is subject to significant administrative law processes. Further, the Board has a long history in the regulation of natural gas in Ontario and this was the first time it would invoke section 29 of its legislation. In fact, to the Board's knowledge, this is the first wholesale review of the state of competition of natural gas storage that has occurred in North America. While the U.S. Federal Energy Regulatory Commission (FERC) has certainly conducted a number of proceedings which looked at the competitive impacts of individual proposed natural gas projects, a wholesale review by a regulator of the scope of the NGEIR proceeding has never been conducted. For that reason, great caution was taken to involve all possible interested parties in the process and to proceed in a highly deliberate manner to ensure that both the procedural and substantive aspects of the proceeding were respected.

What follows is a summary discussion of the evidence presented at the hearing by certain stakeholders and the Board's findings with particular relevance to the forbearance question. This does not constitute a comprehensive review of the evidentiary filings at the hearing, nor the Board's decision. The proceeding was lengthy, involved many procedural steps and the evidence, both written and oral, was voluminous.

**Product Market**

Certain parties at the NGEIR hearing argued for a broad definition of the product market. They implicitly based their analysis on the notion that storage is not demanded for its own sake, but rather as one means among several to ensure the timely and cost-effective delivery of gas supplies.

Parties who held to this broader view of the storage market argued that the relevant product market would include physical storage, local production from the regions in the relevant geographic market, pipeline capacity in the relevant geographic market contracted by marketers either directly or as agent for industrial customers, and Liquefied Natural Gas ("LNG") peakshaving facilities. The rationale for including marketer-contracted pipeline capacity is that this capacity could be reasonably expected to be active in the secondary market for transportation services, and thus provide readily available deliverability in direct competition to storage services. Local production and peakshaving would also provide deliverability in competition with storage.

Those parties holding to a narrow view of the product market argued that the relevant product market should be limited to storage only. While in their view LNG and uncontracted pipeline capacity could be substitutes for storage, in Ontario neither of these potential substitutes exist. They did not agree that contracted pipeline capacity – even if held by active participants in the secondary market for pipeline services – could be correctly considered to be a close substitute to physical storage.

The Board found that storage competes with several other products that are substitutes to storage. These include various ways of selling the gas commodity itself. The Board found that there was insufficient evidence to conclude that pipeline capacity should be included in the same product market as storage. The Board chose to define the product market as storage services alone. In addition, the Board's reason was based on the difficulty of quantifying the other services that compete directly with storage. The Board noted "...that this approach has the benefit of providing a conservative assessment of the level of competition."[11]

**Geographic Market**

To determine the geographic market, one holds the group of buyers constant and asks: from what location do suppliers compete for the business of those buyers? In the case of gas storage, this amounts to examining whether the market is restricted to Ontario or whether it should be more broadly drawn.

During the NGEIR hearing, the utilities and their affiliates argued for a larger geographic market which includes storage in Michigan, Indiana, New York, Pennsylvania and parts of Illinois. Consumer intervenors argued for a geographic market limited to Ontario. The issue centered on whether transportation constraints close off access to storage outside Ontario and included discussion of the secondary market for pipeline capacity.

Those arguing for a narrow geographic market concluded that the storage market was limited to Ontario because there is no firm uncontracted pipeline capacity joining Ontario to other markets and that therefore storage in other areas (such as Michigan) are not substitutes and not part of the same market.

Experts on the utility side presented a seasonal price analysis and a price correlation analysis in support of a broader geographic market. The heart of the price correlation evidence showed correlation coefficients of daily gas commodity prices at nine different North American trading hubs with the daily commodity price at the Dawn trading hub. Several different time periods over which these correlations are calculated were provided. The

full sample covered the period from 1999 to August 2005. In only two cases did the correlation coefficients dip below 0.99, the lowest being 0.975 for NOVA-AECO-C.

This evidence was advanced to show that gas commodity prices move very closely together over several trading hubs. The argument was that the gas commodity market is highly integrated geographically.

For the seasonal price analysis, the utility experts examined differentials in the marginal value of storage approximated by the differential between the peak (winter) and off-peak (summer) prices. The argument was that if storage providers at a particular market hub are exercising market power this differential should be greater than at other pricing hubs. The utility evidence on these seasonal differentials revealed little or no systematic variation between different pricing locations and in their view supported a conclusion of a broader geographic market.

The consumer representatives acknowledged that the commodity market is highly integrated but argued that does not lead to the conclusion that the storage market is integrated. They argued that the price correlation analysis has never been accepted by the FERC. The utilities responded that the FERC rejected use of the price correlation analysis as a means of demonstrating a lack of market power but that in this case it is being used as a means of defining the scope of the market.

One of the utilities pointed out that it is clear that the Dawn Hub is physically connected to storage in Michigan and elsewhere through the extensive pipeline interconnections. In the utilities' view the secondary market for transportation of natural gas provides adequate access to substitute natural gas storage facilities. They pointed to the evidence of an important natural gas distributor in Quebec and a large Canadian natural gas marketer as being actual market participants who consider and, at times, use these alternative means.

The Board concluded that the geographic market for natural gas storage extends beyond Ontario, even though there is a lack of uncontracted firm pipeline capacity. The Board was satisfied that there are reasonable alternative means for storage customers in Ontario to access a broad market area by contracting in secondary markets or by participating in open seasons for new firm pipeline capacity. The Board was also satisfied that there is access to suitable substitutes for Ontario storage available in the broader market because there was direct evidence presented at the hearing that the alternatives are considered and are being used.

The Board also found that the price correlation analysis presented by the utilities, while not in and of itself determinative of the existence of a broader geographic market, did support the conclusion. The Board stated that the very high level of these correlations, combined with the other evidence about the advanced state of inter-hub trading and the absence of occurrences of "basis blow-outs"[12] at individual hubs, supported the conclusion that the market is highly integrated.

Finally, the Board found that the seasonal price analysis supported the conclusion that storage facilities outside Ontario are part of the same market.

### Market Share and Market Concentration

With the product and geographic markets established, the Board went on to review evidence on the market structure. The Board selected working gas capacity and maximum daily deliverability as volumetric measures of the product market. Using these measures the Board found that neither of the two incumbent utilities in Ontario that operate significant storage assets had market shares high enough to justify concerns about market power. In addition, the Herfindahl-Hirschmann Index (HHI) was found to be at levels well below thresholds for concern in standard American antitrust analysis (see Table 3, below).[13]

***Table 3: Market Shares and Market Concentration***

| | Working Gas Capacity | Max. Daily Deliverability |
|---|---|---|
| **Union Market Share** | 13.1% | 9.1% |
| **Enbridge Market Share** | 7.9% | 7.1% |
| **4 Firm Concentration** | 61.7% | 56.9% |
| **HHI** | 1,270 | 1,220 |

### The Hearing Decision

Having reviewed the evidence relevant to determining the product and geographic markets for natural gas storage and the evidence related to the relative market shares and calculations of market concentration, the Board determined that the natural gas storage market in Ontario is subject to workable competition. This was not, however, the end of the analysis. In accordance with its statutory mandate under section 29 of the *Ontario Energy Board Act, 1998* the Board then went on to consider whether the level of competition is or will be sufficient to protect the public interest. The Board determined that it was appropriate to consider its legislative objectives, because they are a clear expression of the factors the Board should take into account. In particular, the Board looked at the following of its objectives in detail:

- to facilitate competition in the sale of gas to users;
- to protect the interests of consumers with respect to prices and the reliability and quality of gas service; and
- to facilitate rational development and safe operation of gas storage.

The Board also addressed whether it should refrain from setting storage prices and approving storage contracts "in whole or in part" in accordance with its discretion under section 29 of the *Ontario Energy Board Act, 1998*. In other words, the Board considered who is entitled to cost-based rates (regulated rates set by the Board) and who will pay market-based rates (in those areas where the Board would forbear from regulating rates). In particular, the Board considered the following segments of the storage market:

- storage provided by third-party or independent storage providers; and

- storage provided by utilities (this segment was considered in its current framework which includes a fairly complex demarcation between the provision of services at cost-based rates to "in-franchise" customers and services at market-based or regulated "range-rates" to "ex-franchise" customers).

Ultimately, the Board decided to forbear from price regulation of storage services for all new (independent) storage providers and for all Ontario storage providers as far as their services to customers outside of their own distribution franchises are concerned.

The Board determined that it would continue to regulate storage rates for the "in-franchise" customers of the two main storage providers in the province.

**The Subsequent Legal Process**

The Board's November 7, 2006 Decision in the main hearing was the subject of three separate motions to review. The Board determined that some of the issues raised by the moving parties met the Board's review threshold and those issues were sent back to the original panel for re-consideration. None of the issues that were sent for reconsideration were directly related to the Board's forbearance decision. The Board recently released its review decision on these issues, wherein it decided not to vary any aspect of its November 7, 2006 decision.

Finally, three parties have filed petitions with Ontario's Lieutenant Governor in Council to require and direct the OEB to review and correct either its original November 7, 2006 decision or the orders stemming from that decision or to review and correct its subsequent review decision dated July 30, 2007.

These multiple stages of review are demonstrative of both the legal complexity associated with a wholesale forbearance proceeding and of the impacts that the issues considered in such a proceeding have on various interested parties.

**Conclusions**

The OEB's Decision in the NGEIR proceeding is the first that we are aware of that provides a general forbearance from regulation for the natural gas storage industry. While this Decision allows the storage segment of the natural gas infrastructure network to operate as a competitive industry it does not require unbundling or structural separation of storage services from the naturally monopolistic gas transmission and distribution services.

An alternative to structural separation is the development of a code of conduct for storage operations that would mandate non-discriminatory access to the utilities' networks by third-party storage providers, and discourage the exercise of market power by utility storage providers. Indeed some intervenors in the NGEIR proceeding raised the possibility of such a development.

The development of the new storage market in Ontario promises to be an interesting case study in deregulation and regulatory forbearance in energy infrastructure industries. Already third-party out-of-province storage developers have expressed intent to invest in Ontario. We expect observers in other jurisdictions will follow Ontario's developments with interest as they assess the applicability of Ontario's forbearance decision to their own jurisdictions.

## Notes

[1] The views expressed herein are solely those of the authors and are not necessarily those of the Ontario Energy Board, the Commissioner of Competition or the Competition Bureau.

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[3] In Canada, certain energy resource issues are handled by Provincial Energy Boards.

[4] Gas storage facilities are regulated in the United States by the Federal Energy Regulatory Commission (FERC), generally on a cost of service basis. However, on occasion, the FERC has elected to allow a gas storage facility to charge "market based rates" where it was satisfied that sufficient competition existed to ensure protection for the consumer.

The process by which the FERC has attempted to determine whether market based rates were justified by the extent of competition is essentially a fairly mechanistic application of the U.S. Department of Justice's *Merger Enforcement Guidelines*. Given a proposed expansion of storage capacity, the boundaries of the product and geographic markets are first identified. Standard measures of concentration, such as Herfindahl indices, are then computed, and, if found to be below a "safe harbour" type of threshold, the transition of regulation to market based rates is permitted.

[5] Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* (Irwin McGraw-Hill: 2000), 10.

[6] Key features of production are inelasticity in long run supply and the importance of transportation costs.

[7] There is an extensive economic literature on commodity markets, storage and arbitrage, both geographic and across time. Key contributions in this literature include Samuelson (1951), Wiliams and Wright (1991). A recent application to natural gas under competitive conditions is Chaton, Creti, and Villeneuve (2006). In future work we plan to investigate the implications of storage and commodity arbitrage for the identification of market power in natural gas storage.

[8] Note that this conclusion could change if we were considering short term, unexpected demands for storage. For example, if a consumer with contracted delivery for gas at the consuming area faces an unexpected demand downtown and needs to store the gas for some period. Then the relevant transportation costs would be those from the consuming area to the storage facility, and the local provider would possess a locational advantage (see Case II).

[9] A similar case is possible in which local storage is supplied at increasing marginal cost. In this case the local storage monopolist has no market power because the price is again determined by the supply of imported storage, and no attempt to restrict (or for that amount increase) the capacity of local storage available would change the market price.

[10] Parts of this section draw heavily on Ontario Energy Board Decision EB-2005-0551.

[11] Ontario Energy Board Decision EB-2005-0551 page 33.

[12] "Basis blow-out" refers to a situation where the natural gas commodity price at one trading hub has risen considerably above the general price pattern prevailing at other trading hubs. This can happen only when pipeline transportation to that hub has become congested and arbitrage transactions are not possible.

[13] Reproduced from Table 2 in the Board's November 7, 2006 Decision, at page 39.

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# RESALE PRICE MAINTENANCE – LESSONS FROM *LEEGIN*

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This article discusses prohibitions on vertical resale price maintenance ("RPM") in light of the United States Supreme Court decision in *Leegin Creative Leather Products Inc. v. PSKS, Inc.* ("Leegin").[2]

In Canada, it is illegal *per se* for a supplier of a product to attempt to influence upward (or to discourage the reduction of) the price at which its products are resold.[3] For example, it is illegal for an upstream firm to require a downstream firm to charge a certain price, to set a floor price, or to maintain a fixed margin.[4]

Historically, outright prohibitions on RPM were justified by the negative welfare impact of higher prices and RPM's use as a monitoring mechanism in cartels. More recently, the economics literature has recognized the potentially pro-competitive effects of RPM. For example, while RPM may reduce intrabrand price competition, it may encourage (or require) retailers to differentiate themselves (and to compete) across non-price demand factors, such as service. In some cases, the value to consumers of this non-price competition may be greater than the welfare loss attributable to higher prices. Non-price intrabrand competition may also increase interbrand competition.

In a decision that reflects current economic thinking, the U.S. Supreme Court in *Leegin* rejected the *per se* treatment of RPM and mandated a rule-of-reason analysis in RPM cases. The Court's analysis is compelling and, by implication, suggests that section 61 of the *Competition Act* is inappropriately restrictive.

## Resale Price Maintenance in Canada

RPM has been prohibited in Canada since 1889.[5] Early prosecutions focused on RPM in horizontal arrangements because the original prohibition did not apply to a supplier who acted unilaterally.[6] Following the recommendations of the MacQuarrie Report,[7] unilateral RPM became an offence under the *Combines Investigation Act* in 1951. The current prohibition is set out in paragraph 61(1)(a) of the *Competition Act*, as follows:

> 61. (1) No person who is engaged in the business of producing or supplying a product ... shall, directly or indirectly,
>
> (a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada; [...]

In creating a *per se* offence, section 61 does not allow the court to take into account any pro-competitive effects that RPM may have on consumers or producers.

**Economic Rationales**

Traditional economic support for the *per se* treatment of RPM focused on its negative economic effects and its use as a monitoring mechanism in cartels.[8] More recently, commentators have argued that RPM may increase both interbrand competition and consumer welfare.

*Efficiency Explanations: The Services Hypothesis and the Free-Rider Problem*

The economic rationale for prohibiting RPM is that it results in higher prices to consumers and can sustain artificially high retailer margins while protecting inefficient retailers.[9] But, while RPM may increase the price of a particular product in the market, it does not necessarily end competition – in the right circumstances it will focus competition on non-price demand factors.[10] Where enough consumers place sufficient value on non-price demand factors, such as service,[11] competition between retailers who differentiate themselves on the basis of service can drive an increase in overall demand[12] that is greater than any demand reduction associated with higher uniform prices. According to Elzinga and Mills, "[i]n some instances, an increase in demand caused by increased retail service can increase unit sales and make consumers better off, even if accompanied by a price increase."[13] This is described as the "services hypothesis."

Traditionally, the services hypothesis reflected free-rider concerns.[14] Free riders "are competing retailers that take advantage of the fact that a prospective customer is under no obligation to purchase the product from the retailer that invests in retail-level services."[15] This can result in consumers obtaining services (such as product education) from a retailer that maintains a knowledgeable sales staff (trained at the retailer's expense) and making their actual purchase from another retailer that does not offer this service but offers the product at a lower price. The existence of free riders may mean that a retailer is effectively forced to compete on price and to stop incurring the cost of providing better services. While this outcome will result in lower prices, it can be at the expense of more highly valued non-price product features.

However, free-rider concerns do not explain RPM use in all cases. As Winter notes, RPM has been used in a greater number of markets to influence a more diverse set of services than free riding might suggest.[16] Another concern flows from the fact that vertically integrated manufacturers have different incentives to invest in the provision of better service than non-integrated retailers. Retailers that incur costs or invest capital to provide better service may undervalue the true benefit of providing this service because the benefits partially accrue to the manufacturer.[17] It is also the case that in some markets, retailers overemphasize price competition, resulting in lower price and service levels than those that can maximize collective (i.e. manufacturer and retailer) profit.[18]

Price floors and other forms of RPM may be used to provide retailers with margin protection that can offset the costs of providing services, thereby creating a revenue (and profit) model that a retailer might not otherwise consider. Mathewson and Winter note:

> An increase in the retail price through the imposition of a price floor will in general have the effect of increasing the demand determinants other than price. Protecting a higher retail margin increases the marginal benefit that each retailer gains from attracting an additional customer by providing service, and therefore increases the amount of service that each retailer will provide.[19]

The alternative – namely, specifying service levels in the distribution contract – can be difficult to monitor and enforce. RPM provides a manufacturer with a mechanism that is easily monitored through observed prices and that can achieve the same service results without having to exhaustively define service standards through a detailed contractual exercise.

It is also worth noting that RPM does not always result in retail prices that exceed what otherwise would be the "market price." Intense interbrand competition may effectively require a manufacturer to set retail prices at the prevailing market price and to reduce its wholesale price, thereby increasing retailer margins and encouraging service investments.[20]

*Empirical Results*

In order to test the various RPM rationales, Ippolito studied RPM cases brought by the government and private parties under U.S. antitrust law between 1975 and 1982.[21] She found that horizontal price-fixing allegations accompanied only 13.1% of contested RPM cases suggesting that "non-collusive uses of RPM are far more common than collusive uses."[22]

In testing the services hypothesis, Ippolito characterized complex articles as products to which quality and use information were non-trivial pre-purchase issues and the information was not specific to the individual retailer's product. In privately litigated cases, complex articles were involved in 50% to 65% of all cases and in government litigated cases, the range was 42% to 68%; Ippolito thus concluded that the services hypothesis "has the potential to be a major explanation for RPM-type practices, but it does not have the capacity to explain the entire sample."[23] Ippolito also found that 43% of the litigated cases involved products categorized as having their quality directly affected by the efforts of the retailer.[24]

**_Leegin_: A Breakthrough?**

RPM has been subject to the *per se* rule[25] in the United States since 1911. In *Dr. Miles Medical Co. v. John D. Park & Sons Co.* ("*Dr. Miles*"),[26] the Court held that RPM is tantamount to a horizontal agreement between resellers since the benefits derived from greater margins accrue to the resellers. In the Court's opinion, such an agreement provided no exception to the common law rule against restraint on alienation as it "in effect, creates a combination for the prohibited purposes."[27] RPM remained judged on a *per se* basis until the decision in *Leegin* in 2007.

In *Leegin*, a retailer brought suit against a manufacturer, Leegin Creative Leather Products, Inc., on the basis that the manufacturer, by requiring retailers to abide by its suggested retail prices, was *per se* in violation of section 1 of the *Sherman Act*. During the trial, expert testimony regarding the pro-competitive effects of RPM was excluded on the basis that the *per se* illegality of RPM rendered such testimony irrelevant. On appeal to the Supreme Court, the manufacturer argued that, in light of current economic thinking, RPM should be subject to a rule-of-reason analysis similar to the analysis of other non-price vertical restraints.[28] The Court agreed and, in doing so, overturned *Dr. Miles*. The Court viewed the common law rule against restraint on alienation as a rule that was developed in a bygone era with little application or relevance to the antitrust issues of today. In addition,

the Court noted earlier decisions that rejected the treatment of vertical restraints on the same basis as horizontal restraints. The Court held that "[t]he reasons upon which *Dr. Miles* relied do not justify a *per se* rule."[29]

In considering whether there were other bases on which to justify a *per se* prohibition,[30] the Court noted that, although RPM may produce anticompetitive effects, the "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[31] The Court accepted that "[a]bsent vertical price restraints, the retail services that enhance interbrand competition may be underprovided."[32] To this end, the Court held:

> Notwithstanding the risks of unlawful conduct, it cannot be stated with any degree of confidence that resale price maintenance "always or almost always tend[s] to restrict competition and decrease output" ... Vertical agreements establishing minimum resale prices can either have procompetitive or anticompetitive effects, depending upon the circumstances in which they are formed ... As the rule would proscribe a significant amount of procompetitive conduct, these agreements appear ill suited for *per se* condemnation.[33] [citations omitted]

**Canada: A Time for Change**

Two government reports in the past nine years have recommended moving to an effects-based test for RPM in Canada. The VanDuzer Report, commissioned by the Competition Bureau, recommended that RPM should be reviewed under the abuse of dominance provision because the provision has a built-in economic effects test. Similarly, the House of Commons Standing Committee on Industry, Science and Technology concluded that, to the extent that efficiency rationales may justify imposing RPM, a *per se* prohibition is over-inclusive and agreed that such conduct ought to be reviewed under the abuse of dominance provision.[34]

Outright prohibitions on RPM are also inconsistent with the effects-based test applied to non-price vertical restraints, such as market restrictions and exclusive dealing. These practices achieve many of the same ends as RPM and it is curious that they are accorded different treatment under the *Competition Act*.

*Per se* prohibition of RPM on the basis of manufacturer cartel use is a dubious justification given that a more direct prohibition to combat cartels – the conspiracy offence – exists under the *Competition Act*. As Marvel and McCafferty note:

> If the manufacturer cartel case were the only threat to competition posed by RPM, the case against permitting the practice would be weak, since other means of protecting competition are available.[35]

For the past 40 years, a guiding principle of Canadian competition policy has been that competition is not the ultimate goal of our competition laws but a means by which efficiency in Canada is to be achieved.[36] Since RPM can increase efficiency and consumer welfare, a *per se* prohibition can limit efficiency gains and is inconsistent with a fundamental tenet of Canadian competition policy.

It is noteworthy that the U.S. Department of Justice and the Federal Trade Commission filed an *amicus curiae* brief in *Leegin* in which they argued that "the per se rule is clearly inappropriate."[37] It is hoped that the decision

in *Leegin* will act as a catalyst for a reconsideration of section 61 of the *Competition Act*. Although Canada's economy is more concentrated than that of the United States – and therefore may be more susceptible to anticompetitive RPM use – the very real possibility that RPM will produce pro-competitive effects cannot and should not be ignored.

**Notes**

[1] My thanks to Jay Holsten for his assistance in the preparation of this article.

[2] 127 S.Ct. 2705 (2007).

[3] *Competition Act*, R.S. 1985, c. C-34, s. 61 [*Competition Act*].

[4] Throughout this paper, upstream firms are referred to as "manufacturers" and downstream firms "retailers"

[5] *An Act for the Prevention and Suppression of Combinations formed in Restraint of Trade*, S.C. 1889, c. 41.

[6] See, for example, *The King v. Central Supply Association, Limited* (1907), 12 C.C.C. 371 (Ont. C.A.) and *The King v. Clarke* (1907) 14 C.C.C. 46 (Alta. S.C.). Each case involved RPM use by horizontal arrangements.

[7] Joint Committee of the Senate and the House of Commons on Combines Legislation, *Resale Price Maintenance: An Interim Report of the Committee to Study Combines Legislation* (Ottawa: Queens Printer, 1951) (the "MacQuarrie Report").

[8] By observing downstream prices, RPM allows a manufacturer cartel to monitor the pricing behaviour of its members and detect cheating if a member lowers its price. Retailer cartels may insist manufacturers use RPM so that the retailers can deter entry of discount retailers or hide their own price-fixing by setting prices indirectly through manufacturers. As several authors have observed, however, use of RPM by retailer cartels is unlikely because retailers generally lack the market power required to influence manufacturers, discounters already exist in most relevant markets and, because of the ease of entry in most retail markets, increasing competition from inflated margins will erode any rents available to the cartel from imposing RPM.

[9] See, for example, Competition Bureau, Canada, *Anticompetitive Pricing Practices and the Competition Act: Theory, Law and Practice* by J.A. VanDuzer & G. Paquet (Ottawa: Competition Bureau, 1999) (the "VanDuzer Report") at 13.

[10] See Frank Mathewson & Ralph Winter, "The Law and Economics of Resale Price Maintenance" (1998) 13 Review of Industrial Organization 57. Demand may be influenced by such factors as information provided at the point of sale, the sales effort and talent of the sales people, the number of outlets, the convenience of the outlet's location and the reputation of the product for quality.

[11] See Pauline M. Ippolito, "Resale Price Maintenance: Empirical Evidence from Litigation" (1991) 2 Journal of Law and Economics 263 at 282-83. "Services" may include showrooms, knowledgeable sales staff providing quality and use information as well as "... the fashion or quality certification implicit in high-reputation outlets carrying the product."

[12] Better service is desirable because it can attract consumers to the manufacturer's brand and into the market generally. Better service can increase overall perceptions of product quality that, in turn, can increase the competitiveness of the manufacturer's good vis-à-vis rival brands (interbrand competition). It can also reduce the opportunity cost of shopping time and draw more customers into the market, thereby further increasing manufacturers' sales. See Ralph A. Winter, "Vertical Control and Price versus Nonprice Competition" (1993) 108 Quarterly Journal of Economics 61. One of the assumptions in Winter's model is that services reduce a consumer's searching time.

[13] Kenneth G. Elzinga & David E. Mills, "The Economics of Resale Price Maintenance" in Wayne D. Collins, ed., *Issues in Competition Law* (Chicago: ABA Publications, 2007) *forthcoming* online: University of Virginia <http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf> at 2.

[14] See, for example, Lester Telser, "Why Should Manufacturers Want Free Trade" (1960) 3 Journal of Law and Economics 86.

[15] *Leegin*, Amicus Brief of Economists in support of the Petitioner at 3, 2006 *U.S. Briefs* 480.

[16] Winter, *supra* note 12.

[17] See Jeffrey Church & Roger Ware, *Industrial Organization: A Strategic Approach* (San Francisco: Irwin/McGraw-Hill, 1999) at 691. This is sometimes referred to as a vertical service externality.

[18] See Winter, *supra* note 12. Generally, if the ratio of firm price elasticity to market price elasticity is greater than the ratio of firm service elasticity to market service elasticity, retailers will focus more on price competition since the proportionate effect of a price reduction on sales is greater than the proportionate effect of an increase in service levels. In such circumstances, a price floor is optimal in achieving the collective profit-maximizing level of price and services.

[19] Mathewson & Winter, *supra* note 10 at 64.

[20] See Elzinga & Mills, *supra* note 13. RPM also does not serve to protect an inflated retailer margin. Overcompensating retailers only reduces the manufacturer's profit and makes its products less competitive.

[21] Ippolito, *supra* note 11.
[22] *Ibid.* at 282.
[23] *Ibid.* at 285.
[24] See also United States Federal Trade Commission, *Resale Price Maintenance: Economic Theories and Empirical Evidence* by Thomas R. Overstreet, Jr. (Washington: Federal Trade Commission, 1983) at 163. Overstreet concluded, on the basis of his empirical study of RPM, that "... it appears that the empirical evidence on the effects of RPM validates the implications of current economic theory. Theory suggests that RPM can have diverse effects, and the empirical evidence suggests that, in fact, RPM has been used in the U.S. and elsewhere in both socially desirable and undesirable ways"
[25] The *per se* rule means that finding a practice is a restraint of trade is sufficient to support a violation of section 1 of the *Sherman Act*, 15 U.S.C. §1 without consideration of harm.
[26] 220 U.S. 373 (1911).
[27] *Ibid.* at 385.
[28] See *Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36. (1977).
[29] *Leegin*, *supra* note 2 at 2714.
[30] See *ibid.* at 2713. To maintain the *per se* rule, the Court would need to find: ... [conduct] "that would always or almost always tend to restrict competition and decrease output." ... a restraint must have "manifestly anticompetitive effects", ... and "lack ... any redeeming virtue" [citations and notations omitted]
[31] *Ibid.* at 2714.
[32] *Ibid.* at 2715.
[33] *Ibid.* at 2717-8.
[34] House of Commons, Standing Committee on Industry, Science and Technology, *A Plan to Modernize Canada's Competition Regime*, 37th Parl. 1st Sess., April 2002.
[35] Howard P. Marvel & Stephen McCafferty, "The Welfare Effects of Resale Price Maintenance" (1985) 28 Journal of Law & Economics 363 at 369.
[36] Economic Council of Canada, *Interim Report on Competition Policy* (Ottawa: Queens Printer, 1969).
[37] *Leegin*, Amicus Brief of the United States in support of the Petitioner at 3-4.

CANADIAN COMPETITION RECORD

# JUSTICE MUST BE SEEN TO BE DONE: A LOOK AT CANADA'S COMPETITION BUREAU PROCEDURES

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## Introduction

Amendments culminating in the promulgation of Canada's *Competition Act*[2] in 1986 sought to replace the criminal justice system with speedier and more economically-reasoned judgments by a new, specialized and relatively informal "competition court": the Competition Tribunal. The Competition Bureau would continue to investigate alleged anti-competitive behaviour and transactions, but would itself prosecute civil (non-criminal) cases against anti-competitive mergers, as well as against reviewable marketing practices such as abuse of dominance and refusal to supply. The traditional separation of the Bureau "police" from the Attorney General's criminal prosecutors was maintained with respect to what were thought to be the most socially-harmful behaviours, including cartels, bid-rigging, price maintenance, price discrimination and predatory pricing.

Much energy has been expended in trying to find the right balance between fairness and expediency in Tribunal proceedings. Most observers agree that Tribunal proceedings, which are rare, are likely to remain relatively formal and extremely costly, both in terms of money and time. *De facto* decision-making authority has, as a result, devolved to the Commissioner of Competition and other senior Bureau officials. This is particularly true of civil cases, but the trend towards further de-criminalization of all but "hard-core" anti-competitive behaviour such as cartels and bid-rigging means that the *de facto* decision of cases by the Commissioner and the Bureau is only becoming further entrenched as a feature of Canadian competition law practice.

There is no explicit recognition in the Act of the Commissioner's role in actually deciding cases. Rather, it is the internal decisions leading to settlement or abandonment of contentious cases to which we refer as the "adjudicatory" function of the Commissioner. In the majority of contentious cases, such internal decisions are the final word.

Of course, not all cases can or should be decided in contested, adjudicated proceedings, nor was it thought that they would be in competition law cases.[3] In a sophisticated legal system, pre-trial settlements are thought to occur in the shadow of a growing body of jurisprudence, which lends predictability and facilitates fair settlements. Given the paucity of competition law jurisprudence in Canada, however, the presumption that settlement occurs in the "shadow of the law" must come under serious question, and consequently the predictability and fairness of those settlements must inevitably be questioned as well. Indeed, it would be important in any event to examine Bureau practices and procedures with a view to ensuring they are as fair as possible (without sacrificing "too much" in the way of functionality). This becomes all the more important when one takes into account the lack of direction coming from the Tribunal and courts.

In this paper, we have sought to measure Bureau decision-making procedures against the purpose of the Act[4] and the Bureau's own operating principles:

(1) confidentiality;

(2) fairness;

(3) predictability;

(4) timeliness; and

(5) transparency.[5]

We consider some alternative models and examine whether features thereof should be applied at the Bureau. We conclude with suggestions for changes that may improve the quality of decision-making at the Bureau – both in terms of justice being done, and in terms of justice being seen to be done. We also conclude that statutory time limits for Tribunal proceedings are necessary to provide for a realistically accessible avenue for redress where settlement is not possible.

This paper is not intended to criticize either the Commissioner or the Bureau; however, we hope to stimulate discussion on whether the work done by the Commissioner and the Bureau could be made even better if their *de facto* decision-making power was recognized and if minimum features of due process and transparency were introduced. In our view, measures that could improve fairness, transparency and predictability without doing "too much" damage to confidentiality and timeliness should be taken.

**Canada's Competition Law Institutions**

*Competition Tribunal*

Established in 1986, the Tribunal is a specialized quasi-judicial adjudicative tribunal that hears applications and issues orders related to the civil reviewable matters set out in the Act. Areas such as mergers and abuse of dominance are within the exclusive jurisdiction of the Tribunal.[6]

While the rationale behind the creation of the Tribunal was the search for a more efficient process with expert appreciation of economics,[7] the Tribunal has adopted many court-like practices and time-consuming formalized procedures.[8] By our count, litigated Tribunal proceedings between 1996 and 2007 lasted an average of 15 months,[9] in addition to the months devoted to the Commissioner's investigation prior to filing an application with the Tribunal. Lengthy hearings, especially in the context of mergers, are often not practicable for businesses and place large financial burdens on the parties. Accordingly, contested proceedings before the Tribunal have been few and far between. Since 1986, the Tribunal has issued decisions on the merits in only four contested merger cases[10] and six abuse of dominance cases.[11]

*Superior Propane*[12] is an example of the potential scale of a contested merger case. Superior Propane notified the Bureau of the proposed merger in the summer of 1998. Following a lengthy hearing, which saw the Commissioner call 74 lay witnesses and 17 expert witnesses, the Tribunal released its decision more than two years later, on August 30, 2000, and appeals stretched the matter out until January 31, 2003.[13] There is also *Southam*[14], where

the Tribunal heard from 46 witnesses and received 520 documents into evidence. The Tribunal's divesture order came twenty-two months after the transaction closed and the appeals lasted until 1997 (nearly six years after the case was first filed at the Tribunal). While such cases may simply reflect the "growing pains" of a young law, it is clear that the Tribunal has been used more as an avenue of appeal from Bureau enforcement decisions than as a "court of first instance."

One of the Tribunal's most active roles was originally as the issuer of orders on consent ("consent orders"). Consent orders were issued after fairly minimal scrutiny, however the Commissioner still had to file an application expounding a coherent theory of the case, and the parties had to file an agreed statement of facts. Therefore, cases resulting in a negotiated settlement had some public disclosure and ensured that the Bureau went through the exercise of preparing a credible case. However, in June 2002, section 105 of the Act was amended to remove this minimal oversight. Consent agreements are now simply filed with the Tribunal for "immediate registration" without supporting documentation.[15]

This amendment was welcomed by those who believed the former procedure was too cumbersome and time-consuming, particularly with respect to curbing the potential for intervenors. However, given the fact that most contentious cases are settled privately at the Bureau investigation stage, the Commissioner is now allowed to operate largely independently of Tribunal oversight and public accountability. The Tribunal was "relegate[d] ... to the very rubber stamp that it rejected in earlier cases"[16], and the transparency and accountability inherent in the old consent order process were lost.

Given the nature of competition cases, it may be time to recognize that – regardless of procedural improvements – the Tribunal will always be reserved for those relatively few cases where the stakes are high enough on both sides. With the Bureau effectively deciding most cases, adherence to, and optimization of, its practices in light of its operating principles is required.

In this context, we question whether the role of the Commissioner and Bureau process should be modified to introduce greater fairness, transparency and predictability into their decisions and thereby improve the predictability of outcomes (thus encouraging settlement), and the perceived justice of competition law enforcement in Canada.

*Competition Bureau*

The Competition Bureau is part of the federal department of Industry Canada. It is headed by the Commissioner of Competition, currently Sheridan Scott, who has the primary responsibility for enforcing the Act.

The foremost function of the Commissioner is investigative. The Commissioner, supported by the Bureau, investigates criminal offences and civil reviewable matters under the Act. Transactions meeting certain thresholds must be notified to the Bureau, and a waiting period respected, before closing. The waiting period is either 14 days or 42 days, depending on the type of filing chosen, but the Commissioner can request more detailed information, thus imposing the longer waiting period if the parties try the shorter procedure in a difficult case. Significantly, investigations often continue beyond the end of the waiting period. The Bureau classifies mergers

as "non-complex", "complex" or "very complex" and endeavours to conclude its investigation within a maximum of 2, 10 or 20 weeks accordingly. There are, however, no statutory time limits on Bureau reviews of mergers, or any other type of case.

The Commissioner's role in civil, so-called reviewable matters[17] – including mergers – extends beyond the investigation stage. If the Commissioner determines that there are, or are likely to be, grounds for a remedial order, she may bring an application to the Tribunal, where the Commissioner acts as a prosecutor. Moreover, she is explicitly empowered to enter into binding consent agreements in settlement of alleged violations of the civil provisions of the Act, which have the force of Tribunal orders once registered with the Tribunal.[18] The Commissioner has also settled many cases on the strength of unregistered, contractual "undertakings" In respect of negotiated settlements, the Commissioner and her officials are, in essence, police, prosecutor and judge. Such settlements terminate the vast majority of contentious civil cases.

For example, in 2005-2006, the Bureau completed 283 merger investigations; serious competition concerns were raised in only six cases, and none went to the Tribunal. Consent agreements were filed in three cases; remedies required by foreign agencies satisfied the Commissioner's concerns in two; and the remaining merger proposal was withdrawn due to the Commissioner's position.[19]

In terms of process at the Bureau, there are no formal due process requirements prior to commencing litigation at the Tribunal. The Act does not require the Commissioner, as ultimate decision-maker, to remain aloof from the investigation. Parties are asked for information and are given a brief summary of the conclusions reached in the case against them (in fairly summary detail), but are seldom given an opportunity to challenge the underlying evidence. Decisions, whether to discontinue an inquiry or request a remedy, require no published or private reasons to be issued.

If real decision-making power lay with the Tribunal, rather than with the Bureau, none of this would be surprising. When considered as the decision-maker, however, recent Bureau initiatives to improve internal decision-making processes (e.g. peer review of cases headed to litigation) and transparency (e.g. technical bulletins on merger cases) could be built upon, we suspect, without slowing things down significantly, and with real benefits in terms of the actual and perceived quality of outcomes.

*Decision-Making at the Bureau: How Does it Measure Up to the Operating Principles?*

Confidentiality

Inquiries must be conducted in private; information gathered pursuant to the Act can only be disclosed to Canadian law enforcement agencies or for the administration or enforcement of the Act.[20] Similar confidentiality protection applies to the provision of information to foreign competition law enforcers.

The importance of protecting the innermost business secrets of those under investigation cannot be overstated. That said, the Bureau's track-record in this area is quite good. The Commissioner and Bureau officers understand

and take very seriously their obligations to preserve confidentiality – not only of those under investigation, but also their informants.[21]

Indeed, a preoccupation with confidentiality and the lack of reasons for decisions has meant that the Bureau rarely provides meaningful disclosure unless and until required to do so during Tribunal proceedings. The recent reintroduction of the practice of releasing non-confidential details of interesting merger cases in the form of "technical backgrounders" is designed to enhance transparency, somewhat, but is too late and too summary in nature to assist the parties in that case.

Fairness

Given that the Bureau views itself as an investigative and not an adjudicative body, it is perhaps not surprising that there is little formal "due process" in Bureau procedures. However, Bureau officers solicit and carefully review information from the parties under investigation and parties are free to submit information on their own. Moreover, most Bureau officers are willing to discuss with counsel, in at least a general way, concerns they are developing on a file as they arise.

When viewed as a decision-making process, however, Bureau procedures could be improved in order to permit more opportunity for parties under inquiry to examine the evidence, and not just the conclusions drawn therefrom. As is discussed below, detailed disclosure of the evidence in the file is a routine part of phase II merger investigations in Europe. On a less formal basis, our experience has been that agencies in the United States, while not inclined to reveal specific sources, are nonetheless more open to discussing concerns, and the supporting economic evidence, in greater detail than their Canadian counterparts.

Another key feature of fairness is the independence of the decision-maker from the investigation. When viewed as an adjudicative process, the lack of separation of Bureau decision-makers from case officers is again problematic. The recent introduction of peer review for major cases goes some way to alleviating the problem. "Independent" case assessments by a Bureau economist should also lend some measure of detachment to the process.[22] Ultimately, however, all significant enforcement decisions are made, first by the Deputy Commissioner in charge of the branch, and ultimately by the Commissioner, and the flow of information to those people is controlled by those closest to the investigation. A critical oversight or misapprehension by those closest to the case would not likely be uncovered.

Predictability

Given the relative paucity of jurisprudence, recent Commissioners have focused on issuing bulletins and guidelines in an effort to make Bureau enforcement decisions more predictable. The *Merger Enforcement Guidelines*, in particular, have been very useful. However, as competition law is very fact-dependent and case-specific, generic guidelines and bulletins can only go so far. As is discussed further below, the issuance of written decisions would significantly improve the predictability of Bureau decisions. The recently resumed issuance of technical backgrounders in some merger cases is a start, but does not, in our view, substitute for reasoned decisions in all cases.

Timeliness

Despite the lack of statutory time limits on investigations, merger investigations are generally conducted in a reasonably expeditious manner. The inability of the Bureau to extend waiting periods, as well as the sometimes high profile and time-sensitive nature of merger work and the refusal by the Tribunal to rubber-stamp Bureau requests for more time to complete reviews[23], tends to speed merger cases through the Bureau faster than other types of cases. While we believe Bureau officers should begin meaningful dialogue with the parties sooner (see "Fairness"), the overall time taken by the Bureau to review mergers is generally acceptable. That said, time spent at the Bureau decreases the time available at the Tribunal before a merger is effectively killed – thus reinforcing the Commissioner's decision-making role. Indeed, it appears that most businesses would sooner abandon a merger than go up against the Commissioner at the Tribunal.[24]

Inquiries related to abuse of dominance and other civil reviewable behaviour and criminal investigations are a different story, however, as the subject of the investigation is typically in no hurry for them to conclude. In an abuse case, it is the complainant who wants the Bureau to devote resources to speed up the investigation. There are service standards for providing written opinions in relation to requests under section 79 of the Act, but in our experience, investigations take much longer than six to ten weeks.

Transparency

In our view, transparency could be improved with relatively few costs. Guidelines and bulletins can only go so far in illustrating how particular cases will be analyzed. With the 2002 amendments to the consent order process, there is no official requirement for public disclosure of the facts and reasoning underlying a Bureau request for a remedy. The technical backgrounders issued in merger cases go some way toward alleviating the problem,[25] but too few are issued and it takes too long.

Moreover, transparency after-the-fact is one thing, but transparency during the decision-making process by sharing evidence with parties would help ensure that those under investigation have full opportunity to answer the case against them as it is being developed.

Viewed as a decision-making process, we feel that the Commissioner and Bureau's processes could be improved with respect to fairness and transparency in particular – and as a result, predictability as well. Accordingly, we have cast our eyes to other models, to see what measures might be taken to improve the investigation and adjudication processes in these areas.

**Alternative Designs for Competition Law Enforcement**

The following discusses the institutional structures of competition law enforcement in Australia, the European Union, the United Kingdom and the United States, with a view to identifying features thereof that could promote transparency, fairness and predictability within the Canadian system. This is followed by a brief discussion of certain features of the process of another specialized economic tribunal, the Canadian International Trade Tribunal ("CITT"), which could potentially apply to competition law enforcement.

*Australia*

Australian competition law is governed by the *Trade Practices Act 1974* ("*TPA*"), which, substantively, is quite similar to the *Competition Act*.[26] The Australian Competition & Consumer Commission ("ACCC") is a multi-member commission responsible for investigation and enforcement. Qualified commissioners have relevant "knowledge of, or experience in, industry, commerce, economics, law, public administration or consumer protection."[27]

Functioning more like a corporate board of directors than a formal adjudicative body, the commissioners meet weekly to discuss and decide on matters such as commencing a court action, approving/rejecting a major merger proposal, or authorizing anti-competitive behaviour shown to be in the public interest. In order to facilitate efficient decision-making, the ACCC has five subject matter committees which address adjudication, enforcement, mergers, communications, and transport and prices oversight.

Actions regarding anti-competitive practices are heard in the Federal Court, where the ACCC may seek a variety of remedies.[28] The ACCC may commence representative actions on behalf of persons who have suffered loss or damage. The *TPA* also allows for private rights of action.

Merging parties commonly approach the ACCC for clearance in order to avoid inquiry and potential injunctive action. Merging parties may seek "informal clearance" that the ACCC does not intend to oppose the acquisition. Parties may also seek formal (and binding) clearance pursuant to a new voluntary process, or they may seek "authorization" for a merger in circumstances where a "substantial lessening of competition" may occur in a relevant market, but there exists sufficient "benefit to the public ... [so as to] outweigh the detriment ... constituted by any lessening of competition".

Decisions on whether to grant a formal clearance must be made within 40 business days (extendable by 20 days) or the application is taken to have been refused. The ACCC must give reasons for any decision. While the formal clearance process is binding and gives the parties certainty, such certainty comes at the cost of confidentiality, as this process is very public.[29]

The ACCC seeks to resolve matters less formally where appropriate and may accept formal settlements or undertakings from businesses.[30] Undertakings may be enforced in court if they are not honoured.[31] Significantly, if the Commission goes to Court to have an undertaking enforced, it only has to prove a breach of the undertaking, rather than a breach of a substantive provision of the *TPA*.

In order to promote transparency and consistency, the ACCC publishes its merger and conduct decisions on its website. Like the Canadian Bureau, the ACCC has begun issuing public competition assessments outlining how it reached its final conclusions. In contrast to the Bureau, however, which issued seven "technical backgrounders" in 2006 and two in 2007, the ACCC released 13 assessments in 2006 and 29 in 2007.[32]

The ACCC reportedly operates in a very informal manner, which, as shown below, is in contrast to the American model and for the most part the EU. Commission members participate in day-to-day operations, and

rather than sitting as a formal adjudicative body in particular cases, make decisions at weekly meetings. The atmosphere among the Commissioners and with the staff is said to be very collegial, facilitating the efficient and cooperative resolution of cases.[33] Nonetheless, even in this informal setting, major decisions are taken by a panel of Commissioners somewhat removed from the investigation, and reasons for all important decisions are published.

Formal decisions made by the ACCC may be appealed to the Australian Competition Tribunal, which consists of judges (presidential members) and members appointed based on their knowledge of, or experience in, industry, commerce, economics, law or public administration. Panels consist of a judge, an economist and one other member. Questions of law are determined in accordance with the opinion of a presidential member.[34]

When applications for merger "authorizations" are brought directly to the tribunal, the ACCC participates by reporting on the authorization and making submissions, as well as examining and cross-examining witnesses. The tribunal has three months to decide (extendable up to six months for complex transactions) or the application is taken to be refused.[35]

*European Union*

The European Union has a unitary structure responsible for the investigation, prosecution and adjudication of competition law.[36] The investigation and decision-making process is more formal than in Australia and mergers are subject to strict time limits. While merger decisions are formally taken by the European Commission, in practice, review is undertaken by a case team of officials from the Directorate-General for Competition and remedies, where required, are negotiated with that team.[37] Commission decisions may be appealed to the courts. If the Commission plans to reject a complaint, it must notify the complainant in writing of its intentions and reasons for not proceeding and give the complainant an opportunity to respond.[38]

The Commission must be notified before mergers with a "Community dimension" and exceeding certain thresholds are completed. Parties may offer to restructure a proposed merger in order to satisfy the Commission's concerns. Undertakings ("commitments") negotiated with case handlers must be approved by the Commission.[39] The Commission may revoke its clearance when an obligation is not fulfilled.[40]

Merger review begins with a 25-working-day investigation into whether or not the merger will have anti-competitive effects ("phase I"). This can be extended to 35 working days if commitments are offered by day 20. At the end of phase I, the Commission either authorizes the merger (with or without remedies) or initiates an in-depth investigation ("phase II").[41] The deadline for a decision in phase II is 90 working days from the beginning of the second phase, extended to 105 working days if commitments are offered by day 65 (or to 125 working days in certain circumstances).[42]

While the Commission is not required to publish reasons for its decisions at the close of phase I, it has adopted the practice of announcing them in the Official Journal, as well as explaining them in press releases and publishing the full text of decisions on its website.[43] Parties are given written reasons for a decision to enter phase II, as well as an opportunity to reply to the Commission staff at a meeting prior to the decision.

The Commission issues a statement of objections during phase II containing its preliminary findings, which must refer to everything that the Commission will be relying on for its final decision.[44] Parties may access the Commission's file before responding to the Commission's objections, and have the right to reply at an oral hearing.[45]

Phase II investigations have a "quality-control" mechanism whereby panels review the case team's conclusions. Peer review panels hear the case team's findings in a presentation, which may last a full day. Scrutiny panels have reportedly recommended changes in more than half of the cases reviewed, most often regarding remedies. Reviews are normally conducted after the parties have responded to the statement of objections so that the panel may consider both sides of the case.[46]

EU procedures have been received favourably by many commentators and participants.[47] The Commission has successfully implemented procedures that allow for merger decisions within the five-month statutory window. The European model is not without its flaws, however. There are concerns that vesting investigative, prosecutorial and adjudicative powers in one body may compromise objectivity. Furthermore, the closed nature of hearings means reduced transparency,[48] although the Commission does provide reasons for its decisions at the ends of both phases of investigation.

A concern in Canada and elsewhere is the possibility that parties may be unfairly pressured into accepting remedies to avoid costly and lengthy Tribunal proceedings. Despite oversight efforts, the Commission is not immune to this problem and has been accused of encouraging parties to offer undertakings in order to avoid phase II proceedings that may have resulted in unconditional clearance. There is also some concern that the timelines are too short to permit the parties to properly address all of the issues. It is noteworthy that almost all phase II investigations take the full time permitted.[49]

*United Kingdom*

The principal legislation in the United Kingdom is the *Competition Act 1998*[50] and the *Enterprise Act 2002*.[51] The Office of Fair Trading ("OFT") is the front-line competition enforcement agency. The Competition Commission ("CC") decides on cases referred to it by the OFT as well as sectoral regulators.

The CC consists of 50 members, appointed for their relevant knowledge, experience and expertise in competition, economics, law, finance and industry. Decisions are made by panels of at least three members.

The OFT refers mergers to the CC that are likely to result in substantial lessening of competition, unless binding undertakings are negotiated. Between April 1, 2006 and March 31, 2007, the OFT investigated 131 public mergers, 30 of which required a closer look at a Case Review Meeting. Case Review Meetings are an internal forum for testing findings in more complex cases prior to a decision, to "ensure that internal OFT views are rigorously and carefully tested before decisions are taken."[52] Ultimately, the OFT accepted undertakings in six cases and made 13 references to the CC.[53]

Whether it decides to refer a matter to the CC or not, the OFT must issue reasons for its decisions. The OFT website contains information on all merger investigations.[54] Affected third-parties may challenge OFT decisions.

The CC conducts its own investigation. This could lead to duplication of efforts with the OFT and extend the length of investigations; however, proponents of this model feel that it ensures the separation and independence that allows for a "genuine second look at a case." CC investigators are not put in the position of European peer reviewers, who may feel "pressure[d] to confirm the decision of close colleagues who undertook the first stage examination."[55]

The OFT has 20 working days following a merger notification to complete its review, which may be extended by 10 or 20 working days. The OFT attempts to issue decisions on informal submissions within 40 working days, however, there are no statutory time limits. The CC must complete its report within 24 weeks of referral (this may be extended by eight weeks).[56]

The CC may accept undertakings or impose remedial orders. During the 2006 07 reporting year, the CC found a substantial lessening of competition in five of nine merger investigations. No mergers were completely blocked; however some transactions were abandoned following reference. The average merger investigation at the CC took 16.4 weeks; three required eight-week extensions.

OFT and CC decisions may be appealed to the Competition Appeal Tribunal ("CAT"). Decisions are made by panels of three, consisting of two "ordinary members" and either the President or a member of the panel of chairmen (comprised of judges and senior lawyers). The panel of ordinary members consists of experts in law and related fields.

CAT proceedings are subject to "active case management". The CAT does not adhere to strict rules of evidence, but is "guided by overall considerations of fairness."[57] Hearings are generally quite short: in 2006-2007 the CAT sat for 35 days to hold 29 hearings.[58]

*United States*

Responsibility for enforcement of competition law in the United States is shared by the U.S. Department of Justice Antitrust Division ("U.S. DOJ"), the Federal Trade Commission ("FTC") and state attorneys-general. There is also much greater emphasis on private enforcement than in Canada.

The U.S. DOJ can bring civil or criminal cases, seek civil injunctions, or sue to recover damages suffered by the federal government. Civil and criminal actions brought by the U.S. DOJ are heard by the federal district courts. The U.S. DOJ process is similar to that of the Canadian Competition Bureau, with little formal requirements for disclosure or reasons. That said, many more cases are litigated by the U.S. DOJ, and investigation officers are, in our experience, more open to discussing the economic evidence than are their Bureau counterparts. Accordingly, settlement negotiations can be said to take place "in the shadow of the law."

The FTC is an independent administrative body with a unitary enforcement model, composed of five Commissioners. Decisions are made by a majority vote of at least three Commissioners. Anti-trust enforcement cases can be brought in the FTC administrative tribunal or in a federal court. Administrative hearings are held before an Administrative Law Judge, "a Commission employee with partially protected tenure and status", with a right to appeal to the full Commission.[59]

Under the *Hart-Scott-Rodino Antitrust Improvements Act of 1976*, certain mergers must be reported to both the FTC and DOJ. Companies must then wait for a specified period (normally 30 days) while FTC, or DOJ, staff members investigate the proposed merger. The reviewing agency may send a "second request" for additional information, which extends the initial waiting period (normally stretching the investigation to at least several months).

The majority of mergers are cleared at the first stage. Two-thirds of transactions receive "early termination", with the transaction being cleared in less than 30 days. In 2006, the FTC issued second requests in 1.5% of mergers, and took action in 13 of the 22 second request merger investigations it concluded.

Before a merger case is brought to the Commissioners or sent to the Assistant Attorney-General's office for enforcement decisions, negotiations typically take place between the parties and FTC or DOJ staff to find acceptable remedies. FTC consent orders must be approved by the Commission and are published on the FTC website.[60] When DOJ cases are settled, a consent decree is issued by a court, with full supporting documentation.

Terry Calvani, a former FTC Commissioner, warns against adoption of the U.S. model. He describes the FTC as "a strange animal with three different bodies." As an adjudicative body, proceedings are characterized by "[a]n elaborate courtroom, bailiffs, briefs, oral arguments, and written decisions ... On other occasions, the Commission sits as a quasi-legislative body. ... The Commission also acts as a prosecutorial agency in determining which cases it will file ..."[61] As decisions made in administrative hearings can be appealed to the full Commission, the FTC is also vested with an appellate review function. While this process has been upheld in U.S. courts, according to Calvani, "litigants almost universally find it objectionable."

The American experience serves as evidence that a unitary model is not a panacea. Despite housing investigative, prosecutorial and adjudicative functions in one organization, FTC hearings feature protracted delays and court-like procedures.[62] There are no statutorily imposed timelines for adjudication, and while there are some internal guidelines, there are no penalties for failing to adhere to them.[63]

In practice, many merger cases are either settled at the agencies, or determined at the preliminary injunction stage – a ground for the issuance of which is showing a substantial likelihood that the government will succeed on the merits. Injunction hearings therefore serve as short-form hearings on the merits, and effectively decide the cases. Similar to Canada, given the time and costs involved, we understand that merging parties in the U.S. often prefer to settle a case rather than fight an injunction. The greater frequency of litigation in the U.S. than in Canada may perhaps be explained, however, by its greater market size and the greater financial resources available to both sides.

*Canadian International Trade Tribunal*

Canada's trade remedies system has a streamlined adjudicative process, with tight statutory time limits. Once an investigation into dumping or subsidizing has been commenced, the Canadian Border Services Agency ("CBSA") President must make a preliminary determination within 90 days (or 135 days in extraordinarily complex cases) and a final determination within a further 90 days.[64] The CITT also makes a preliminary determination as to whether the complaint discloses a reasonable indication of injury.[65] The CITT begins its official inquiry after receiving the CBSA President's preliminary determination, and must issue a final ruling in no more than 120 days.[66]

From initial filing of a properly documented complaint to Tribunal ruling, dumping and subsidy cases are normally completed in less than 210 days, and in exceptional circumstances, 255 days. The statutory maximum time permitted for an investigation into the existence of dumping or subsidizing (by the CBSA) and an inquiry into the economic effects thereof and whether such dumping and/or subsidizing has been or will likely be a cause of material injury to the domestic industry is between seven and eight-and-half months. For the responding parties, however, the emphasis is on the four-month period following a preliminary determination, as substantially all evidence regarding the key economic questions of injury and causation is prepared and presented during this time.

Of necessity, with the time limits as a framework, the CITT has developed its procedures in order to deal with matters efficiently, and as fairly as time permits. Confidentiality is respected, as well as the need for fair disclosure of the opposing parties' case, by permitting opposing external counsel – but not their clients – to review the highly sensitive business information filed in such cases. Counsel who breach confidentiality obligations are subject to severe penalties.

It could be argued that the strict timelines imposed on the CITT are unreasonable. For example, in many cases all evidence in chief (which is permitted in written form only) and all argument of parties opposing the complaint are due a mere 20 days after the complainant's evidence and arguments are filed. The complainant's reply submission, if necessary, is generally due 10 days after that, and the hearing begins 10 days later.[67] Hearings longer than five days are very rare. Cross-examination by parties opposed and questions by Tribunal members only are permitted at the hearings, as well as final argument by both sides.

There is a price to be paid for such efficiency, to be sure. The tight timelines put enormous pressure on parties and counsel. Further, it often means that econometric evidence cannot be rigorously tested, and therefore plays a backseat role to more anecdotal evidence. Nonetheless, this system certainly pays heed to William Gladstone's warning that "justice delayed is justice denied."

Like the Competition Tribunal, the CITT is charged with examining how markets function and determining the economic impact of market events. Unlike the Tribunal, however, it is protected by a strong privative clause and is rarely overturned. In this context, with the CITT completing an average of 110 cases annually over the last 10 years (including dumping and subsidization inquiries and reviews, appeals of decisions made under the *Customs*

*Act* and the *Excise Tax Act*, procurement reviews, safeguard inquiries and tariff references), to the Tribunal's 11 (including "cases" where Consent Orders were simply registered), setting time limits for Competition Tribunal proceedings is well worth considering.

**Proposed Changes to Canadian Competition Law**

Michael Trebilcock and Edward Iacobucci frame the issue as a choice between improving the Tribunal process and shifting to a unitary agency structure, which they have labelled the "integrated agency model."[68] However, the authors of this paper advocate choosing both Tribunal and Bureau reform – albeit the latter incrementally, as radical surgery may not be required, and may have unintended side-effects.

The Commissioner makes almost all decisions and the Tribunal is underused. We propose formalizing the Bureau's decision-making process to some extent to provide more transparency, fairness and predictability, while subjecting the Tribunal to a maximum six-month time limit and making it more relevant as, effectively, an appellate body. This single change to the Tribunal would, in our view, go a long way to making it more relevant – and busier.

With respect to the Bureau, we recommend that:

- Economic case assessments and peer review should be required in all abuse cases and all complex and very complex mergers. Someone not involved in the investigation should fully review the evidence before decisions are made.

- Disclosure meetings, potentially involving disclosure of confidential evidence to outside counsel only (like in CITT hearings), should precede peer review. Such disclosure should provide, to the fullest extent possible, access to the arguments and evidence in support of the case. Despite confidentiality obligations, the EC permits access to large portions of the file.

- Backgrounders should be routinely issued in all "complex" and "very complex" merger cases within 30 days of resolution and all decisions should be made public.

- The Act should be amended to ensure that consent agreements are registrable only if accompanied by an agreed statement of facts and detailed case summary.

- All enforcement decisions requesting a remedy should be taken by a panel of the Commissioner, the Senior Economist, a senior Justice lawyer and the relevant Deputy Commissioner, none of whom would be involved in day-to-day investigations. The role of the Bureau's new Litigation Committee could be expanded.

- Alternatively, consideration should be given to amending the Act to have not one, but three Commissioners – like the ACCC – who would make key enforcement decisions together.

Continuing recent moves toward transparency and fairness in this way, and implementing statutory time limits for Tribunal appeals, should go a long way to ensuring that justice is done – and seen to be done – in Canadian

competition law enforcement. If, however, such reforms are not sufficient, we would support further reforms, including time limits on Bureau merger reviews, and perhaps moving explicitly to a unitary, EC-style model.

## Notes

[1] The views expressed herein are those of the authors alone, as are any errors and omissions. This paper has been adapted from an earlier version entitled "Justice Must be Seen to be Done", presented to the CBA 2007 Annual Fall Conference on Competition Law, October 12, 2007, Gatineau, Quebec, online: <http://cba.org>.

[2] R.S.C. 1985, c. C-34.

[3] See Dunlop, McQueen & Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis* (Toronto: Canada Law Book, 1987) at 289.

[4] The purpose of the Act, as set out in section 1.1, is:

> [T]o maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

[5] Competition Bureau, "Operating Principles," online: <http://www.competitionbureau.gc.ca>

[6] Private parties have very limited rights. Section 36(1) provides that any person who has suffered damages as a result of criminal conduct contrary to the Act or a violation of a Tribunal or court order may sue for damages incurred as a result of such behaviour. Private parties may also seek leave from the Tribunal to bring an application under sections 75 or 77 of the Act (covering refusals to supply, exclusive dealing, tied selling, and market restriction). Significantly, however, private parties have no enforcement rights with respect to mergers or abuse of dominance, and no damages may be awarded in respect of such applications as they are permitted to bring in respect of civil reviewable practices before the Tribunal.

[7] See Economic Council of Canada, *Interim Report on Competition Policy* (Ottawa: Queen's Printer, 1969); and L.A. Skeoch & B.C. McDonald, *Dynamic Change and Accountability in a Canadian Market Economy* (Ottawa: Queen's Printer, 1976).

[8] Calvin S. Goldman & John D. Bodrug, "The Hillsdown and Southam Decisions: The First Round of Contested Mergers Under the Competition Act" (1993) 38 McGill L.J. 724 at 751.

[9] This includes cases that were settled or withdrawn after 100 or more days before the Tribunal.

[10] *Canada (Commissioner of Competition) v. Canadian Waste Holdings* (2001), 11 C.P.R. (4d) 425 (Initial Decision), (2002), 15 C.P.R. (4d) 5 (Remedy), aff'd (2003), 24 C.P.R. (4th) 178 (F.C.A.), leave to appeal refused, [2003] S.C.C.A. No. 222; *Canada (Commissioner of Competition) v. Superior Propane* (2002), 18 C.P.R. (4th) 417, aff'd (2003), 23 C.P.R. (4th) 316 (F.C.A.); *Canada (Director of Investigation and Research) v. Southam* (1992), 43 C.P.R. (3d) 161; and (1993), 47 C.P.R. (3d) 240 (Remedy); *Canada (Director of Investigation and Research) v. Hillsdown Holdings Ltd.* (1992), 41 C.P.R. (3d) 289.

[11] *Canada (Commissioner of Competition) v. Canada Pipe*, 2005 Comp. Trib. 3; *Canada (Commissioner of Competition) v. Air Canada* (2003), 26 C.P.R. (4th) 476; *Canada (Director of Investigation and Research) v. D&B Companies of Canada Ltd.*, [1995] C.C.T.D. No. 20 ["*Nielsen*"]; *Canada (Director of Investigation and Research) v. Tele-Direct (Publications) Inc.* (1995), 64 C.P.R. (3d) 216; *Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd.* (1991), 40 C.P.R. (3d) 289, [1992] C.C.T.D. No. 1; *Canada (Director of Investigation and Research) v. NutraSweet* (1990), 32 C.P.R. (3d) 1; [1990] C.C.T.D. No. 17. The Air Canada case eventually settled; however the Tribunal issued a decision on the avoidable costs issue.

[12] *Canada (Commissioner of Competition) v. Superior Propane*, [2000] C.C.T.D. No. 15, rev'd [2001] 3 F.C. 185.

[13] *Canada (Commissioner of Competition) v. Superior Propane*, [2003] 3 F.C. 529, aff'g (2000), Comp. Trib. 16.

[14] *Canada (Director of Investigation and Research) v. Southam*, [1997] 1 S.C.R. 748.

[15] *An Act to Amend the Competition Act and the Competition Tribunal Act*, S.C. 2002, c. 16, s. 14.

[16] Donald B. Houston & Jeanne L. Pratt, "The Marginalization of the Competition Tribunal" (Paper presented to the CBA National Competition Law Conference, November 2005) at 4.

[17] The civil provisions of the Act are often referred to as "reviewable", as the behaviours covered are not illegal unless and until they have been reviewed and prohibited by the Competition Tribunal.

[18] Section 105 of the Act.

[19] Competition Bureau, *Annual Report of the Commissioner of Competition for the Year Ending March 31, 2006*, at 45-46, online: <http://www.competitionbureau.gc.ca>.

[20] Sections 10 and 29 of the Act.

[21] See the Bureau's *Information Bulletin on the Communication of Confidential Information under the Competition Act* (October 10, 2007), online: <http://www.competitionbureau.gc.ca>.

[22] We understand that case assessment teams now include economists from the Economic Policy and Enforcement Division of the Bureau, who prepare a case assessment for the Commissioner to review before proposing a remedy or initiating proceedings.

[23] *Commissioner of Competition v. Labatt Brewing Co. Ltd.*, 2007 Comp. Trib. 9 (March 28, 2007).

[24] See A. Neil Campbell, Hudson N. Janisch & Michael J. Trebilcock, "Rethinking the Role of the Tribunal" (1997) 76 Canadian Bar Review 297 at 299. Between 1986 and 1995, where a settlement was not reached with the Commissioner, the parties were six times more likely to abandon the merger than proceed to the Tribunal.

[25] See the Bureau's "Policy Statement for the Publication of Technical Backgrounders", online: <http://www.competitionbureau.gc.ca>.

[26] See Allan Fels, "Competition Policy: Governance Issues - What are the Alternative Structures? Australia's Experience" (Paper presented to the CBA National Competition Law Conference, June 2001).

[27] *TPA*, s. 7(3)(a).

[28] ACCC, *Summary of the Trade Practices Act 1974: and additional responsibilities of the ACCC under other legislation* (Commonwealth of Australia, 2007) at 5 and 19, online: <http://www.accc.gov.au>.

[29] This is likely why merging parties prefer the informal system. See Geoff Carter, "A formal merger clearance regime: practical alternative or procedural quagmire?" (March 19, 2007), online: <http://www.minterellison.com>

[30] Of 272 mergers examined from 2005 to 2006, six were resolved with undertakings, two were initially opposed but subsequently resolved with undertakings, and only three were blocked outright: ACCC, *2005-06 Annual Report* (ACCC Publishing Unit, September 2006), online: <http://www.accc.gov.au>.

[31] *TPA*, s. 87B.

[32] ACCC, "Public Competition Assessments", online: <http://www.accc.gov.au>.

[33] Fels, *supra* note 26 at 17.

[34] *TPA*, ss. 31, 37 and 42.

[35] *TPA*, s. 95AA.

[36] The rules governing EU competition law are found in Articles 81 and 82 of the EC Treaty and the EC Merger Regulation, Council Regulation (EC) No 139/2004 of 20 January 2004 [ECMR].

[37] Peter R. Willis, *Introduction to EU Competition Law* (London: Informa Professional, 2005) at 191.

[38] Howard I. Wetston, Q.C. & Edward M. Iacobucci, "Is it Time to Give the Commissioner of Competition a Competition Commission?" (June 5, 2001) at 3, online: <http://strategis.ic.gc.ca>.

[39] *Ibid.* at 7.

[40] Willis, *supra* note 37 at 193-196.

[41] If the Commission does not decide within the time limits, the transaction is "deemed to have been declared compatible with the common market": ECMR, Article 10(6).

[42] European Commission, "EU competition policy and the consumer", at 11, online: EUROPA <http://ec.europa.eu/comm/competition/publications>.

[43] Nicholas Levy, *European Merger Control Law*, looseleaf (LexisNexis, 2007) at 17-57.

[44] *Ibid.* at 17-65.

[45] Willis, *supra* note 37 at 197. See also Michael J. Trebilcock & Edward M. Iacobucci, "Designing Competition Law Institutions" (2002) 25(3) World Competition 361 at 381-382 (oral hearings normally last less than two days, with limited documentary evidence and few witnesses).

[46] Michael Wise, *Competition Law and Policy in the European Union* (Paris: OECD, 2005) at 32 and 37.

[47] Michael J. Trebilcock & Lisa Austin, "The Limits of the Full Court Press: of Blood and Mergers" (Winter 1998) 48 Univ. of Toronto L.J. 1 at 25-26.

[48] Trebilcock & Iacobucci, *supra* note 45.

[49] Levy, *supra* note 43 at 17-50, 56 & 58.

[50] (U.K.), 1998, c. 41.

[51] (U.K.), 2002, c. 40.

[52] OFT, *Annual Report and Resource Accounts 2003-04*, at 61, online: <http://www.oft.gov.uk>.

[53] OFT, *Annual Report and Resource Accounts 2006-07*, at 48, online: <http://www.oft.gov.uk>.

[54] OFT, online: <http://oft.gov.uk>.

55 *Memorandum by the Competition Commission* (9 February 2007), online: <http://www.parliament.uk>.
56 *Enterprise Act 2002*, ss. 97 and 39.
57 CAT, *Guide to Proceedings* (October 2005) at 32 & 45, online: <http://www.catribunal.org.uk>.
58 CAT, *Annual Review and Accounts 2006/2007*, online: <http://www.catribunal.org.uk>.
59 OECD, Directorate for Financial and Enterprise Affairs – Competition Committee, "United States – Report on Competition Law and Institutions (2004)" (January 20, 2005).
60 See FTC Bureau of Competition, "Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies", online: <http://www.ftc.gov>.
61 Terry Calvani, "Lessons to be Avoided: the Experience South of the Border" (Paper presented to the CBA National Competition Law Conference, June 2001) at 4.
62 Trebilcock & Iacobucci, *supra* note 45 at 382.
63 See Calvani, *supra* note 61 at 11 where he writes: "Historically the agency's adjudicative calendar has been an embarrassment."
64 *Special Import Measures Act*, R.S.C. 1985, c. S-15 [*SIMA*], ss. 38, 39 and 41.
65 *SIMA*, s. 37.1.
66 *SIMA*, s. 43(1).
67 CITT, "SIMA Injury Inquiry Timeline" (22 November 1996), online: <http://www.citt-tcce.gc.ca>.
68 *Supra* note 45 at 393.

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