

ECONOMICS AND CANADIAN COMPETITION POLICY

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Introduction

The central role of economics in the design, interpretation and enforcement of competition laws is now recognized not only in Canada but throughout the developed world.² It was not always thus. In his study of the role of economics in U.S. antitrust policy Professor White observes that until the 1970s, the role of economists in antitrust cases was mostly to provide statistical support. It was not until the early 1980s that there was a recognition of the role microeconomics could play in developing the theory of the case itself.³

In Canada prior to 1986, almost all prosecutions under the *Combines Investigation Act* were under criminal law and a large fraction of these involved resale price maintenance which was a *per se* offence.⁴ There was little scope, if any, for economic analysis.⁵ Although economists wrote about competition matters they were on the periphery. There was a discrete increase in the role played by economists and economic analysis in competition policy when the *Competition Act* came into force in 1986 and the influence of economists has continued to increase since then. This influence has been manifest in the language of the statute and amendments to it, on enforcement decisions and guidelines and on the interpretation of the statute by the Competition Tribunal and the courts.

While it is possible to measure the influence of economists in terms of the number of economists employed in enforcement agencies or serving as expert witnesses or participating in various consultative exercises, the ultimate measure of the importance of economic learning is the extent to which statutory design, enforcement decisions and judicial reasoning are consistent with it. As Professor Winter puts it:

Are the law and economics of competition policy now aligned after years of involvement by economists, or does the law diverge from economic foundations in important ways?⁶

In broad terms, economics teaches, first, that competition policy should protect the competitive process rather than competitors and, second, that competition is a means to an end and that end is the use of society's resources to their best advantage. Competition is usually the best means of achieving efficient resource use (reducing economic waste) but it is not the only way. It

would not matter how many economists find employment in the competition policy apparatus if the application of it did not enable the Canadian economy to make better use of the resources available to it.

Professor Ross sees the focus on competitive market forces and the ultimate concern with efficiency to have been the major contribution of economists to Canadian competition policy:

Eventually, thanks in large measure to the work of economists, competition policy in Canada, the United States and many other places found a focus and purpose that found wide agreement: make the economy more efficient through the protection and enhancement of competitive market forces. That is, we came to recognize that the goal should be the protection of competition (not necessarily competitors) and that the ultimate concern was efficiency.⁷

The manner in which economic learning has influenced competition policy differs from country to country. In the United States, as Professor White has documented, the influence of economists has been on the jurisprudence under three tersely worded statutes that have been in place for many years.⁸ In Canada, with many fewer contested cases and much less jurisprudence, the influence of economists can be seen more in the language of the *Competition Act* and amendments to it and in the wording of enforcement guidelines.

While it was a major step forward, the 1986 *Competition Act* contained a number of sections that were carried over from the *Combines Investigation Act*. A number of these sections were antithetical to the teachings of economics in a variety of ways. Some made criminal offences of forms of market conduct that are potentially socially benign. Some protected competitors rather than competition. Some had nothing to do with competition. The amendments to the *Competition Act* in 2009 eliminated most of these problems and in so doing further enlarged the scope for the application of economic analysis.⁹ While the 1986 *Competition Act* owes much to an earlier generation of economists, the 2009 amendments reflect the efforts of the current generation.

The passage of the 2009 amendments occurred forty years after the publication of the Economic Council's *Interim Report on Competition Policy*.¹⁰ Pride in the extent to which the amended statute allows the application of economic learning might be accompanied by embarrassment that it took so long. There have been missteps along the way. Bureaucratic politics has intruded. Needless amendments have been proposed. There have been consultations and debates over guidelines that are often revised but seldom applied. The pace of institutional learning has been slower than might have been hoped. Some of this is to

be expected. Competition policy, like all public policy, is a product of the political process. The important question is not whether other countries make more use of economists in the formulation and application of competition policy but whether their policies are more firmly grounded in economics.

As can be seen from the numerous citations to it in this paper, the *Canadian Competition Record* has provided a valued forum through which economists have been able to contribute to the discussion of competition policy issues and to inform and be informed by the competition bar. Another productive communication channel for economists has been the annual fall conferences of the Competition Law Section of the Canadian Bar Association. In this regard, it is important to understand that the influence economists have been able to exert owes much to a receptive and thoughtful competition bar and to legal scholars such as Professor Trebilcock who have worked so hard to show lawyers and economists what they can learn from each other.

Topics Covered

It is not possible to do justice to the voluminous commentary on the issues of economics related to the *Competition Act*. This study confines itself to addressing the following issues:

- Developments in competitive effects analysis in merger cases;
- The debate over the interpretation of s.96;
- Economic evaluation of horizontal restraints;
- Economists versus s.61;
- Predatory pricing and the Air Canada case;
- Economists versus s.75;
- Exclusive dealing and the Canada Pipe case.

Some explanation of these choices is in order. Merger analysis is generally regarded as the most economics intensive part of competition policy and approaches to competitive effects analysis have been carried along by developments in techniques of merger simulation. The efficiencies exception under the merger provisions (s.96) has been by far the most intensively debated section of the *Competition Act*. The debate goes to the heart of view of economists that efficiency rather than competition for its own sake is the ultimate goal of competition law and policy.

A prohibition of collusive agreements between competitors is commonly regarded as the cornerstone of a competition statute. Economists have long regarded Canadian law and jurisprudence on horizontal restraints as permissive with respect to hard core cartels and inflexible in terms of its ability to assess agreements with both pro-competitive and anti-competitive effects.

Remediating these defects has taken forty years and economists have played a major role in the process.

While the role of economic research in changing the status of resale price maintenance under both U.S. and Canadian competition law has been documented, the path to reform differed between the two countries and there is something to be learned from the nature of these differences. Similarly, there are lessons about the role of competition policy to be learned from the *Air Canada* case as well as some unresolved questions regarding alternative theories of, and tests for predatory pricing to explore.¹¹

Analysis by economists of the refusal to deal provision under s.75 of the *Competition Act* showed that it was not about competition. This led to a partial remedy in the form of both the amendment of the section and a shift from public to private enforcement of it.

Early abuse of dominance cases under the *Competition Act* have been the subject of thorough economic analysis.¹² The more recent decisions of the Competition Tribunal and the Federal Court of Appeal in the *Canada Pipe* case are noteworthy for a variety of reasons.¹³ They involve discussions of economic theories of exclusive dealing as they relate to first dollar loyalty discounts, debates about market definition and market power and about whether conduct can reasonably be anticipated to be anti-competitive if it doesn't ultimately lessen competition.

Mergers

The merger provisions of the 1986 *Competition Act* replaced the moribund criminal merger/monopoly section of the *Combines Investigation Act*. As has been widely and ably documented, they were a long time coming but they were largely faithful to the recommendations of the Economic Council of Canada and the Skeoch-McDonald report both of which were more concerned with the rationalization and the realization of scale economies than they were with domestic producer concentration.¹⁴

The 1986 *Competition Act* provided for the rule of reason analysis of mergers under civil law by a specialized Competition Tribunal composed of lay business experts as well as federal court judges. It required the Tribunal to consider the broad market circumstances of a merger when analyzing its competitive effects rather than relying solely on market share and market concentration data. It gave the Tribunal the power to block a merger that substantially prevents or lessens competition provided this merger does not also bring about efficiencies that more than offset its anti-competitive effect.

There is general agreement that merger analysis makes the most intensive use of economics and that this has increased over time. In the view of some observers, horizontal mergers cases now turn largely on issues of economics as the legal principles involved have become well established.¹⁵ As well, with the ubiquity of computer merger simulation models using large databases, merger analysis has become much more technical and less transparent. To some, this is not an entirely good thing.¹⁶

Economics and Competitive Effects Tests

The analysis of the competitive effects of mergers has been carried along by developments in antitrust economics and the evolution of the Merger Enforcement Guidelines reflects this. There are two general mechanisms through which mergers can reduce competition. A merger can increase the market power of the merged entity itself. This is called the unilateral effects mechanism. A merger can also reduce the constraints on the ability of the firms competing in the relevant market to exercise market power jointly. This is called the interdependence (or coordinated) effects mechanism.

The coordinated effects approach was a staple of the 1982 U.S. merger guidelines.¹⁷ According to this approach, the reduction in the number of competing sellers due to a merger makes it easier for the remaining sellers to agree, tacitly or otherwise, to restrict supply and raise the market price. An inference of likely anti-competitive effects under this approach would be drawn on the basis of market concentration, the increase in market concentration due to the merger and the height of barriers to entry. Additional factors to consider were drawn from the work of George Stigler who analyzed the conditions under which a participant in a competition-restricting agreement could profitably undercut it and thus lead to its breakdown. Formal theoretical analysis of the circumstances under which competitors could successfully reach and police a competition-restricting agreement came later from the theory of repeated games. The essence of this theory is that if competitors interact repeatedly and if they place sufficient weight on future profits, collusion can be sustained.¹⁸

These developments and their implications for Canadian competition policy were described in papers by Ross and Baziliauskas and by Church.¹⁹ Ross and Baziliauskas surveyed the literature on the factors conducive to collusion. They noted that a number of these factors had been cited as causes for the Competition Bureau's concern that the proposed mergers of the Royal Bank of Canada with the Bank of Montreal and of the CIBC with the TD Bank (four of Canada's largest five banks) would increase the likelihood of interdependent behaviour among banks at both the local and national levels.²⁰ The factors listed included:

high concentration, high barriers to entry, homogeneous products, predictable demand and costs, stable market shares, good information about pricing and customers and the degree of industry cooperation.²¹

Ross and Baziliauskas concluded that interdependence theory "... judiciously applied, provides sufficient guidance to distinguish mergers that are likely to lessen competition substantially from those that are not."²²

Professor Church noted that a market may satisfy some of the conditions conducive to collusion but not others. A merger may reduce some constraints on collusion and tighten others and there is no way to weight them. He was of the view that coordinated effects analysis by itself is still insufficiently precise to identify mergers that should be prevented. He suggested, however, that the effect of a merger on the factors that constrain coordinated behaviour (such as the presence of a "maverick") be canvassed. He also suggested that coordinated effects can be determinative in cases where unilateral effects are close to the margin.

The unilateral effects approach assumes that the ability of the merged entity to raise prices post-merger comes from its increased market share rather than from more accommodating behaviour on the part of its remaining competitors. There are numerous economic models for simulating the unilateral effects of horizontal mergers. These models allow for products to be either homogeneous or differentiated and for firms to be either price setters or quantity setters. The unilateral branch includes merger to monopoly, merger to dominance and merger in a non-cooperative oligopoly. The earlier models took a dominant firm approach and focused on the reaction of the competitive fringe or assumed a homogeneous, quantity-setting (Cournot) oligopoly. The Canadian Competition Policy Page at the University of British Columbia has maintained a Cournot oligopoly merger simulation website since 1996.²³ While useful insights and rules of thumb on which to base market share safe harbours can be obtained with the Cournot model, it was another type of unilateral effects model that came to dominate competitive effects analysis.²⁴ This model, suggested by Professor Carl Shapiro allowed for products to be differentiated and assumed that firms were price-setters.²⁵

The differentiated products unilateral effects model focused on the degree of substitutability between the products of the merging firms. Its central concern was whether the merging firms were each other's closest competitor. In its simplest form, it employed a measure of substitutability called the diversion ratio where the diversion ratio between firm A and firm B is the fraction of the sales firm A loses to firm B relative to the total sales A loses when it increases its price. The higher is the diversion ratio, the closer A and B are as competitors

and the more anti-competitive is a merger between them. The predicted price increase resulting from a merger can be expressed as a function of the diversion ratio and the pre-merger price-cost margin of the merging firms.²⁶

This simple model assumed that marginal cost does not fall as a consequence of the merger and, as a consequence, it predicts a post-merger price increase as long as the diversion ratio and the price-cost margins of the merging firms are positive. Dr. Werden, an economist with the Antitrust Division of the U.S. Department of Justice, showed that the post-merger efficiency gain (percentage reduction in marginal cost) required to keep a differentiated products merger from increasing prices could also be expressed (in the simple case) as a function of the diversion ratio and the pre-merger margins of the merging firms.²⁷

The concept of the diversion ratio and its implications for predicting the price effects of mergers in differentiated products markets was explained in a 1997 presentation to the Annual Fall Conference of the Canadian Bar Association by Professor Ware.²⁸ In a paper presented to the same conference a year later, Csorgo and Sanderson provided a detailed survey of differentiated products simulation models and their use in cases that had come before the Competition Bureau.²⁹ An important implication of these models is that they do not rely on market share or market concentration measures so that they obviate the need to define the relevant market with any precision.

The methodological advances in competitive effects analysis influenced both the Merger Enforcement Guidelines and the Competition Bureau's enforcement approach. The Bureau raised concerns about interdependence effects in several merger cases.³⁰ The 2004 Revised Merger Enforcement Guidelines also contained a detailed recitation of the conditions (facilitating factors), in addition to the necessary conditions of market concentration and barriers to entry, that are required for successful collusion and of the market circumstances under which these conditions are most likely to be satisfied. The Bureau stated that its investigations would include an examination of whether the merger reduces pre-existing constraints on coordinated behaviour, for example, by reducing the number of competitors or by reducing asymmetries among competitors or by eliminating or handicapping a maverick.

The 2004 Merger Enforcement Guidelines also included a more fulsome discussion of unilateral competitive effects analysis than was the case in 1991. The 2004 Guidelines categorized unilateral effects involving either differentiated products or homogeneous products with differentiated capacities. In the case of differentiated products, unilateral market power concern is raised in cases in which the merging firms are the first and second choices of a significant number of customers. Evidence of this close substitutability includes past

buyer-switching behaviour in response to changes in relative prices is particularly useful, including information based on buyer preference surveys, own-price and cross-price elasticities, purchasing patterns and diversion ratios.

In the case of differentiated capacities, the Bureau focused on the ability of the remaining competitors to offset any attempt by the merged entity to restrict output. In this regard, the Bureau may have had either a merger to dominance or a merger among Cournot oligopolists in mind. Both of these models predict a partially offsetting response by the remaining competitors to an output restriction by the merged entity.

With respect to enforcement activity, one of the Commissioner's expert witnesses in *Superior Propane*, Professor Ward, estimated a demand system from which he was able to infer the own-price, and cross-price elasticities of demand for the products of the merging firms.³¹ He was then able to use these elasticity estimates to predict the price increases that result from the merger.

Unilateral effects analysis has continued to develop. Professors Farrell and Shapiro built on the earlier work of Dr. Werden and others to derive a series of general expressions that predicted the post-merger price change in a differentiated products merger as a function of diversion ratios, price cost margins and efficiency gains. This became known as upward price pressure (UPP) analysis and was viewed by Farrell and Shapiro as obviating the need for market definition.³²

Other developments included models applicable to bidding markets in which it is the offer of the bidder closest to the winning bidder that matters most for purposes of competitive effects analysis.³³ Reduced form models of the "Staples" variety which estimate the marginal effect of local market overlap on the respective prices or margins of the merging parties also continue to be used.³⁴

The influence of further developments in unilateral effects analysis is reflected in the 2011 Merger Enforcement Guidelines. The 2011 Guidelines assign a greater importance to the simulation of unilateral effects than do the 2004 Guidelines and there is a corresponding diminution of the importance attached to market definition and market concentration:

Market definition is not necessarily the initial step, or a required step, but generally is undertaken. The same evidence may be relevant and contribute to both the definition of relevant markets and the assessment of competitive effects. Merger review is often an iterative process in which evidence respecting the relevant market and market shares is considered alongside other evidence

of competitive effects, with the analysis of each informing and complementing the other.³⁵

The 2011 Guidelines also explain the diversion ratio and appear to recognize its role in upward price pressure analysis.³⁶ There is also a recognition that upward price pressure analysis involves both a direct effect (the profit-maximizing price increase of the merged given the prices of rivals) and an indirect effect which takes account of the price (or non-price) responses of competitors.³⁷

The 2011 Guidelines also include a section on the analysis of the anti-competitive effect of mergers in bidding markets. The Bureau recognizes that what matters in a bidding market is how close the merging firms are as bidders and whether there are other bidders that are equally close.³⁸ While the treatment of coordinated effects remains largely unchanged, the question arises as to whether it use extends beyond strengthening a unilateral effects case. In this regard, there is evidence that the coordinated effects approach has retained currency at the Federal Trade Commission in the U.S.³⁹

Merger simulation is attractive to economists both because it yields a quantitative prediction of the anti-competitive effect of a merger and because it focuses discussion on the match between assumptions of the model and the particulars of the case concerned. This is a considerable advance on attempting to infer the likelihood of a substantial lessening simply by canvassing s.93 factors and market shares. Professor Slade provides an example that resonates with most of us:

... a merger between two firms that produce lagers can have very different consequences than one between a producer of lager and a producer of stout even though the HHI changes by the same amount after the two mergers.⁴⁰

That said, simulation models can produce widely divergent results depending on the assumptions used and accurate models require a great deal of experience to construct.⁴¹ They have a black box quality to them and it could be that in some instances the choice between them will turn on the testimony of competing expert econometricians rather than antitrust economists. It does not appear that this has been a problem in Canada to date. While merger cases are increasingly turning on matters of economics rather than law, the issues of economics have been more conceptual than technical. Market definition and structural analysis can speak to these issues. For example, the Tribunal's findings regarding market definition in *Canadian Waste Services* may have turned on its lack of understanding of the distinction between Ricardian rents and supra-normal profits.⁴²

Economists and Section 96

Section 96 of the 1986 *Competition Act* reflects the longstanding and fairly widely held view that competition policy in a small open economy should give precedence to the efficiency of domestic producers over concerns about domestic producer concentration. The Macdonald Royal Commission expressed this view as follows:

... if our producers are taking advantage of large scale production we should expect them to be large relative to the Canadian market. Moreover, as the rationalization of production proceeds, a number of Canadian industries may become even more concentrated, which would not be an undesirable development.⁴³

Section 96 prohibits the Tribunal from issuing a remedial order against a merger that it has found to prevent or lessen competition substantially if the merger would bring about gains in efficiency that are greater than and offset its anti-competitive effect. This willingness to examine the net effect of a merger or acquisition on national economic productivity was thought to be a considerable advance over competition legislation in place elsewhere at the time:

Commentators have often claimed that Canada's competition legislation is among the most economically sophisticated in the world. In large part, this claim is based on the explicit recognition given to efficiency as an overall criterion in the Competition Act (the "Act") (section 1.1) and as a specific criterion in the treatment of mergers.⁴⁴

The wording of section 96 (hereafter s.96) left it open to a variety of interpretations in a number of respects.⁴⁵ It ultimately became clear that what economists had in mind was a benefit: cost analysis where the benefit would be the dollar value of the cost savings realized by the merged entity as a consequence of the merger and the cost would be the dollar value of the anti-competitive effect. It was then a matter of defining eligible cost savings and the anti-competitive effect.

The Bureau's views in this regard appeared in the 1991 Merger Enforcement Guidelines. The definition of eligible cost savings was relatively uncontroversial. In the early years the typical cost savings involved economies of rationalization and specialization in production and logistics rather than economies of larger scale. The anti-competitive effect was defined to be the allocative efficiency (deadweight) loss resulting from supra-competitive pricing by the merged entity:

Where a merger results in a price increase, it brings about both a neutral redistribution effect and a negative resource allocation effect on the sum of producer and consumer surplus (total surplus) within Canada. The efficiency gains described above are balanced against the latter effect, i.e., the deadweight loss to the Canadian economy. ...

In estimating the extent of negative resource allocation effects of mergers, the Bureau includes the additional losses in total surplus that arise when market power is being exercised in the relevant market prior to the merger. Similar losses that arise as a result of foregone contribution to fixed costs (due to restricting levels of output) are also recognized.⁴⁶

It is clear that the Competition Bureau and others recognized that in the presence of pre-merger market power, the deadweight loss would include an element of foregone producer surplus as well as foregone consumer surplus and would therefore be greater in magnitude than the area of the “Harberger triangle.”⁴⁷

The assumption that transfers among Canadians wash out and it is the net effect of a merger on economic surplus that matters came to be known as the total surplus standard. The essence of this thinking was that what matters most is whether economic surplus (the size of the pie) has increased and that it is costly and sometimes impossible to know the respective characteristics or even the identity of the winners and losers from this economic change. Determination of who among them is the more deserving is beyond the scope of economics. It was thought that a reasonable default option is to treat them the same. During the subsequent debate over the application of s.96, however, it was pointed out that if nothing is known about the winners and losers, treating them the same is neither better nor worse than treating them differently.⁴⁸ The assumption that a dollar is worth a dollar to winners and losers alike also implies a value judgement.

While the total surplus standard found favour with economists, judicial scepticism soon surfaced in the Tribunal’s *Hillsdown* decision and further signs of discontent were to come.⁴⁹ There were indications from speeches by the Commissioner of Competition and other Bureau personnel that the efficiencies defence would not apply in cases of merger to monopoly. Trebilcock and Winter were the first of many to argue that, as a matter of economics, this made no sense.⁵⁰ Among other things, they noted that since the Bureau’s Hypothetical Monopolist Test defines a relevant market as one in which a hypothetical monopolist could profitably raise the market price by 5 percent or more above

the competitive level, any merger that would raise prices by 5 percent would be a merger to monopoly regardless of the number of competitors in the market. They also noted if costs fall sufficiently, even a merger to monopoly can result in price decreases making all parties better off.

Matters soon came to a head in the *Superior Propane* case which was heard by the Competition Tribunal beginning in September 1999.⁵¹ The case involved a merger of two propane distributors whose combined market share exceeded 70 percent nationally and exceeded 80% in 32 of 74 local markets.

The Tribunal issued its decision in August 2000. Among the Tribunal's findings with respect to the s.93 factors were that barriers to entry or expansion were significant, the merger removed a vigorous and effective competitor and that remaining competition would be ineffective. On the basis of the econometric evidence of one of the Commissioner's expert economists, the Tribunal found that the merger would lead to price increases of 8 percent or more. The Tribunal concluded that the merger would likely lessen or prevent competition substantially in all but a few local markets.

Having found a substantial lessening, the Tribunal turned to the efficiencies exception under s.96. The Tribunal found that eligible efficiencies were \$29.2 million (annually). With respect to the anti-competitive effect, Commissioner abandoned the total surplus standard in the in the 1991 Merger Enforcement Guidelines arguing instead that consumer losses be weighted more heavily than producer gains. The specific approach advocated by the Commissioner's expert in this area, Professor Townley, was for the Tribunal to find the extra weight that would have to be given to consumer losses to make them equal to producers gains and then to reach a judgement as to whether this weight is reasonable. This came to be known as the balancing weights standard.

The Tribunal rejected the balancing weights standard for a variety of reasons, one of which was that it was neither equipped nor mandated to make socio-political distributional judgements, applying the total surplus standard instead. The Commissioner's evidence was that the deadweight loss in surplus (which turned out to be only the deadweight loss in consumer surplus) was approximately \$3 million annually. Adding a further \$3 million for qualitative anti-competitive effects, the Tribunal concluded that the \$29.2 million annual gain in efficiencies realized by the merged entity were greater than and offset the \$6 million annual anti-competitive effect and, in a split decision, declined to issue the divestiture order sought by the Commissioner.

The Tribunal's decision evoked immediate comment from both the competition bar and from economists.⁵² Professor Ware expressed surprise that the

Commissioner's expert, Professor Ward, had apparently employed what is known as the naïve trade-off model⁵³ which assumes no pre-merger market power in estimating the anti-competitive effect of the merger:

... I am surprised that the Bureau did not file evidence on this issue given that they appeared to believe that many of the relevant markets pre-merger took the form of a duopoly with some small fringe players. It has been recognized by Williamson and others that pre-existing market power will increase the size of the deadweight loss considerably ...⁵⁴

Professors Mathewson and Winter estimated what the magnitude of the anti-competitive effect (deadweight loss) would have been if pre-merger market power had been taken into account. They find that it would be approximately 8.5 times as large as the deadweight loss estimate employed by one of the Commissioner's expert witnesses, Professor Ward.⁵⁵ This would make it approximately \$25.5 million. With the \$3 million in qualitative anti-competitive effects added, it would have come very close to the \$29.2 million efficiency gain. Mathewson and Winter observed that the difference between the eligible efficiencies and the deadweight loss (properly calculated) is well within the margin of error likely given the nature of the evidence involved. The clear implication was that had the Commissioner's estimate of the anti-competitive effect of the merger been correct, he would have prevailed under the total surplus standard, that is, without resorting to differential distributive weights.

Professor Ware also corrected some of the errors of economics made by Ms. Lloyd, a lay member of the Tribunal, in her dissent. He explained that the deadweight loss resulting from a merger is not lower in markets with inelastic demand and that section 96 is not biased in favour of mergers in markets with inelastic demand. It is true that the deadweight loss resulting from a given price increase is lower the less elastic is demand but the post-merger price increase itself must be greater the less elastic is demand. The net effect is that the deadweight loss resulting from a given merger is greater, the less elastic is market demand and s.96 is not biased one way or the other. Indeed, this inverse relationship between the deadweight loss and the elasticity of demand was apparent from the evidence of Professor Ward and this was highlighted by another lay member of the Tribunal, Dr. Schwartz, in his concurring opinion.⁵⁶

The Commissioner appealed the Tribunal's decision in *Superior Propane* to the Federal Court of Appeal. In his appeal, the Commissioner abandoned the balancing weights approach to s.96 that had been advocated by his expert economist, Professor Townley, in favour of an approach that had been suggested by the Tribunal in its *Hillsdown* decision and, has been labelled variously

as the consumer surplus standard or the *Hillsdown* standard. It required that the efficiency gain exceed the sum of the deadweight loss in consumer surplus plus the transfer from consumers to producers in order to qualify for the efficiency exception. This approach came under withering fire from economists for its inconsistency and for its lack of any foundation in welfare economics.⁵⁷

In April, 2001, the Court issued its decision upholding the Commissioner's appeal and sending the case back to the Tribunal for redetermination. The Court found that the Tribunal had erred in law by failing to consider objectives of the *Competition Act* (as stated in s.1.1) other than economic efficiency, for purposes of the application of s.96. The Court declined to specify a test but stated that whatever standard the Tribunal chose must be better able to reflect the objectives of the Act than is the total surplus standard. The Court did state, however, that the balancing weights approach would meet that requirement.

The April 2001 decision of the Federal Court of Appeal made a number of errors of economic analysis although it was not the only participant in this process to do so. Professor Ware addressed some of these errors.⁵⁸ He explained that, contrary to the Court's assertion, the total surplus standard makes it *more* difficult to justify mergers between suppliers of products for which the demand is relatively inelastic. He also explained that, again contrary to the Court's assertion, it is standard practice in merger analysis throughout the world to consider the elasticity of demand in the relevant market as a factor bearing on the magnitude of any anti-competitive effect.

Professor Ware noted that the Court appeared to be under the impression that the balancing weights approach it recommended would somehow balance all the objectives listed in s.1.1 of the *Act* rather than consumer losses and producer gains. He applied the balancing weights approach as suggested by Professor Townley to the facts of the case and found that consumer losses would equal producer gains if consumer losses were weighted 50 percent more heavily than producer gains.⁵⁹ It would then have been up to the Tribunal to determine whether a weight differential of this magnitude is warranted.

The Tribunal released its redetermination decision in April, 2002. The Tribunal reiterated its view that efficiency rather than consumer protection is the paramount objective of the *Act*. In compliance with the decision of the Federal Court of Appeal, however, it applied the balancing weights approach to the comparison of consumer losses with producer gains. The Tribunal discerned from the public finance literature that the net effect of taxes and various government expenditure programs is to redistribute wealth in favour of the poor rather than more generally from the more wealthy to the less wealthy. The Tribunal then found that propane consumption by households takes the form of

bottled propane and that, given the lack of good alternatives, price increases could be burdensome for low income customers. The Tribunal estimated the value of bottled propane consumption by low income customers (which it defined to be customers in the lowest 20 percent of the income distribution) to be \$2.6 million which it then added to the \$6 million anti-competitive effect (deadweight loss plus qualitative effects) that it had found in its initial decision, yielding a combined deadweight loss, qualitative effect and adverse wealth transfer of \$8.6 million. This continued to be dwarfed by the \$29 million in efficiencies leaving the Tribunal to conclude that even after taking the adverse redistributive consequences of the merger into account, the efficiency gains it brought about were sufficient to offset its anti-competitive effects under any reasonable set of weights.

The Commissioner immediately appealed the Tribunal's redetermination decision on the grounds that the Tribunal had not taken sufficient account of the redistributive effects of the merger but in January 2003 that appeal was dismissed. There followed a series of attempts to amend s.96 beginning in the spring of 2003 with a private member's bill (C-249) that would have made efficiencies a factor that the Tribunal may consider only to the extent benefits are passed on to consumers.

C-249 had the support of the Commissioner of Competition and passed in the House of Commons. The bill came in for serious criticism from members of the competition bar before the Senate Standing Committee on Banking, Trade and Commerce and ultimately died on the order paper. The manner in which the House of Commons Standing Committee on Industry, Science and Technology dealt with C-249 was also criticized by both economists and the competition bar. Dr. Duhamel and Professor Townley observe:

Had these Members of Parliament been made thoroughly aware of the deficiencies of the Commissioner's prosecution of Section 96 – which have been the subject of several published articles – perhaps they would have concluded that no legislative action was required. ... We note that supporters of Bill C-249 were not able to produce a single academic economist willing to voice support for it. As the *Competition Act* is economic framework legislation, we find this telling.⁶⁰

Economists saw no need to amend s.96. Professors Ross and Winter argued that as a result of the Tribunal's redetermination decision in *Superior*, s.96 jurisprudence was not only "surprisingly precise" but also consistent with economic theory.⁶¹ Most importantly, these authors argued that the respective weights the Tribunal would likely apply to losses in consumer surplus and gains in

producer surplus given the *Superior* precedent would, in most cases, differ by a miniscule amount from the equal weights it would have applied under the total surplus standard.⁶²

Ross and Winter reasoned that the Tribunal had found a case for taking the redistributive effects of a merger into account only insofar as they involved the “poor and needy” which it had defined arbitrarily as the consumers in the lowest 20 percent of the income distribution.⁶³ Since consumption of most products is usually higher in households with higher incomes, the bottom 20 percent of consumers normally account for much less than 20 percent of the spending on it. As a consequence, even if the value of a dollar in the hands of a poor (lowest 20 percent) person were valued much more highly than the value of a dollar in the hands of producers and all other consumers, the fraction of spending involved is small enough that respective weights attached to producer gains and consumers losses under the balancing weights approach would not differ much from the equal weights implied by the total surplus standard.

To take an example, Ross and Winter’s analysis implies that if the value of a dollar in the hands of a poor person is valued at 50 percent more than the value of a dollar in the hands of producers and all other consumers and if the lowest 20 percent of the income distribution (the poor) accounted for, say, 10 percent of the spending on the product concerned, the benchmark weights applied to consumer losses and producer gains respectively would be .512 and .488 instead of the weights of .5 and .5 that would be applied under the total surplus standard.⁶⁴ Ross and Winter go on to argue that the benchmark distributional weights they calculate would come even closer to equality if account is taken of the avoided excess burden on the taxes the government would otherwise have been obliged to levy were it not for the additional tax revenue it receives on the profits of the merged entity.⁶⁵

Dr. Duhamel and Professor Townley also saw no need to amend s.96. They welcomed the recognition by Ross and Winter of the grounding of distributional weighting in welfare economics although they regarded the approach used by Ross and Winter to derive default distributional weights “may suggest a step backward.”⁶⁶ In their view, the use of distributional weights should not be confined to cases in which the distributional impacts of a merger are egregious and the weights themselves should be based on case-specific information on the winners and the losers rather than on general assumptions about the portion of sales in the relevant market likely to be accounted for by poor customers.⁶⁷

As Ross and Winter observe, however, their method gives the Tribunal the flexibility to take case-specific information into account. To take an example of

a product much beloved of intermediate microeconomics instructors, suppose there is an anti-competitive merger in the potato market and the poor account for 50 percent of potato sales. If the value of a dollar in the hands of a poor person is valued at 50 percent more than the value of a dollar in the hands of producers and all other consumers, the weights Ross and Winter would attach to producer gains and consumer losses would be .44 and .56 respectively. If the value of a dollar in the hands of a poor person is valued at twice the value of a dollar in the hands of producers and all other consumers, the weights would be .40 and .60 respectively.

With respect to the relative circumstances of those who gain and those who lose from a merger, it may be that shareholders of the merged entity are much more wealthy than *all* consumers of the product concerned and that there is something the Tribunal can observe in the stance of public policy that implies that their gains should be given less weight. Then again, Warren Buffet's secretary apparently faces a higher tax rate than he does.

Others continued to regard the interpretation of s.96 as uncertain and to suggest alternatives. An advisory panel convened by the Competition Bureau concluded in 2005 that it was not satisfied with balancing weights as it is cumbersome, unpredictable and highly complex. The panel agreed that a merger that substantially lessens or prevents competition should be permitted where it will produce sufficient offsetting efficiency gains but also stated that the efficiency exception should not be available in the case of a merger to monopoly.

The numerous suggestions for amending s.96 were reviewed by Margaret Sanderson in a paper published in 2006.⁶⁸ She concluded that in the light of the evidence that the balancing weights approach would generally lead to the same conclusion as the total surplus standard and that the balancing weights approach would allow the Tribunal the flexibility to deal with the rare cases in which a merger has large detrimental impacts on the distribution of wealth, none of the proposed amendments of s.96 represented an improvement on the *status quo*.

The view taken by the Competition Bureau following this sequence of attempted amendments, suggested amendments, consultations and reports came in its 2009 Bulletin on Efficiencies in Merger Review and in the 2011 Merger Enforcement Guidelines which superceded the Bulletin. The 2009 Bulletin states that the Bureau will be guided by the Tribunal's decision in *Superior Propane*.⁶⁹ In so doing, it appears to perpetuate an error the Tribunal's approach detected by Duhamel and Townley in that it applies balancing weights to the transfer component of consumer surplus losses and producer surplus gains as opposed to all losses in consumer surplus and all gains in producer surplus.⁷⁰

The Bulletin also contemplates applying the balancing weights approach to situations in which shareholders are very wealthy and in which business customers of the merged entity can pass on price increases to poor customers. The latter has the potential to complicate application of s.96 greatly.

The 2011 Merger Enforcement Guidelines confine the discussion of redistributive effects to a very short paragraph as one of the possible anti-competitive price effects of a merger:

Price increases resulting from an anti-competitive merger cause a redistributive effect (“wealth transfer”) from buyers to sellers. Providing buyers with competitive prices and product choices is an objective of the Act.⁷¹

Instead, the Guidelines consider, at much greater length, the types of efficiency losses that a merger may cause. This includes losses in production and dynamic efficiency due to increased insulation from competitive forces post-merger. In this, the Guidelines might be taking heed of the observation of the Competition Policy Review Panel that mergers evaluation should focus more on efficiencies.⁷²

As to where this leaves s.96, it is true that it does not come into play very often. If it does come into play it is difficult to believe that the Commissioner would be satisfied with default weights calculated using the Ross and Winter methodology. The balancing weights test as Ross and Winter or indeed, Professor Townley would apply it may not be what the Federal Court of Appeal had in mind. The Tribunal’s assessment of the fiscal stance of public policy as implying concern only about redistribution as it involves the poor and needy would likely be contested. Enterprising counsel may argue that shareholders are members of “the 1%” or worse, some of them could be “foreigners.”

The essence of the problem is that once the full methodology of benefit: cost analysis is brought to bear, many of the assumptions underlying not only trade-off analysis, but also the efficiency benchmark as it applies to the evaluation of various forms of market conduct could be questioned. Competition policy assumes that market prices reflect opportunity costs. What if they don’t? What if workers laid off as a result of a merger face a long stretch of unemployment? What if firms excluded from the market by a tying arrangement have to lay off workers in a region of high unemployment? The question is how many objectives can competition policy pursue before it loses its focus and its analytical clarity?

It was not that long ago that competition policy was bedevilled by multiple goals as Professor Ross has noted.⁷³ The evolution of competition policy to the point at which it has a predictable and logical focus on making the best use of

society's resources is, as Professor Trebilcock has stated, "...[t]he single greatest advance in thinking in the competition policy field over the past 30 years ..."⁷⁴ There are reasonable approaches to balancing weights approach but there are also approaches that could sacrifice the hard-won focus, clarity and consistency of competition policy at least as it applies to mergers.

Economic Evaluation of Horizontal Restraints

As had been the case with the *Combines Investigation Act*, agreements that limit production or other facilities unduly or prevent, limit or lessen production unduly or enhance the price of a product unreasonably or otherwise restrain or injure competition unduly were criminal offences under s.45 of the 1986 *Competition Act*. S.45 and its predecessors also provided for limited defences for certain types of agreements, for example, for cooperation in research and development or in the definition of product standards or common package sizes. These defences did not apply, however, if these agreements were also likely either to lessen competition unduly with respect to prices, quantity or quality supplied, markets or customers, distribution channels or to restrict entry.

There were longstanding concerns about the effectiveness of s.45 and its predecessors in dealing with naked restraints. Naked restraints are agreements among competitors to fix prices, restrict output or allocate markets or customers. They are regarded by economists as serving no purpose other than to suppress competition. Given that there is, by definition, little to be lost by simply prohibiting agreements of this nature, a strong case could be made for their *per se* illegality.

The Economic Council's *Interim Report on Competition Policy* stated that a practice is a candidate for *per se* illegality:

... if the practice in question appears upon analysis to be inimical to the public interest and rarely if ever productive of any substantial public benefit. Where such conditions exist, the cost of striking down those few instances of the practice capable of producing some net benefit to the public may be judged to be outweighed by the greater and certainty of a *per se* ban.⁷⁵

As it had evolved, the jurisprudence under s.45 and its predecessors came to require, among other things, that an agreement to prevent or lessen competition embrace a considerable fraction of the relevant market in order for the prevention or lessening contemplated to be deemed to be undue. Thus, whether a price-fixing agreement was an offence or not depended on the market circumstances. For this reason, offences under s.45 were termed "partial rule of reason" offences rather than *per se* offences.

While the undueness requirement was helpful in screening out agreements among firms with no market power, it also had a considerable downside. Judicial opinion on the threshold market share at which the prevention or lessening of competition agreed upon would become undue varied widely and this led to uncertainty regarding the market circumstances under which s.45 would apply. The vagueness of the undueness requirement also led the courts occasionally to accept exculpatory justifications for price-fixing that were of dubious economic relevance. Perhaps most importantly, the burden of defining the relevant market and proving beyond a reasonable doubt that competitive circumstances were such that the accused had sufficient market power to satisfy the undueness requirement was thought to be too heavy. As a consequence, some anti-competitive agreements might have escaped sanction. The poor record of the Crown in litigated cartel cases was cited in support of this argument.⁷⁶

Economists took a dim view of this situation. Professor Stanbury observed:

The toleration of “garden variety” price fixing and market sharing agreements undermines the most fundamental tenets of a market economy, namely that sellers will act independently in seeking competitive advantage.⁷⁷

The Economic Council of Canada’s *Interim Report on Competition Policy* had recommended in 1969 that the predecessor of s.45 (s.32 of the *Combines Investigation Act*) “... be rewritten so as to become as much as possible a *per se* ban...” of collusive arrangements to fix prices, allocate markets or to prevent entry.⁷⁸

The Council went on to consider whether a *per se* ban on collusive horizontal arrangements could dispense with the “unduly” qualifier. This anticipated a policy discussion that was to continue for the next 35 years. The argument against retaining the unduly qualifier was that it would require the courts to continue to measure markets with a consequent loss of clarity and deterrence. The argument in favour of retention of the unduly qualifier was that, in addition to screening out minor cases, it would exempt the then emerging voluntary retail chains which the Council saw as being pro-competitive, from prosecution.⁷⁹ It was thought that, in the absence of the unduly qualifier, other qualifying language would have to be inserted to exempt horizontal agreements of this nature. The Council also recommended that the unduly qualifier or any other qualifying language not apply to bid rigging.

Other economists were of the view that the unduly qualifier had to go. Professor Green argued in his industrial organization textbook that:

“... it is hard to see how either private interest or public interest are

served by continued use of the term “unduly.” That term has played havoc with the jurisprudence, leading to a virtual breakdown in the law in recent years. A new perspective is needed. There is little dispute that price fixing is usually undesirable. There is even less dispute that Canada’s small domestic markets are relatively concentrated. Add to this the protection provided by tariff barriers and one can only conclude that a more explicit prohibition of collusion is justified to ensure competitive behavior in Canada. It makes more sense to thwart all collective attempts to lessen competition, not just those which are “undue.”⁸⁰

In his industrial organization textbook, Professor Perrakis observed that the undue requirement “... seems to imply that there is a permissible degree of lessening of price competition.”⁸¹ He went on to argue that “... no economic case can be made that the public interest will be advanced by price fixing.”⁸² He recommended that all price fixing agreements be made illegal *per se*.

There were three abortive attempts between 1971 and 1986 to eliminate the unduly qualifier from the predecessors of s.45.⁸³ However, the Economic Council’s recommendation that bid-rigging be made a *per se* offence was implemented in the 1976 amendments to the *Combines Investigation Act*.

With the passage of the *Competition Act*, concern over s.45 opened up on a second front. It was argued that in addition to being overly permissive of naked restraints, s.45 might also discourage potentially pro-competitive agreements among competitors. The *Competition Act* provided for rule of reason assessment and balancing of the likely pro-competitive and anti-competitive effects of horizontal mergers and specialization agreements under civil law. Consistency required that horizontal agreements that had both pro-competitive and anti-competitive effects receive the same consideration.

The Supreme Court’s 1992 *PANS* decision reinforced concerns that s.45 could be over-inclusive as well as under-inclusive.⁸⁴ The *PANS* decision provided welcome clarification of the jurisprudence under s.45, entrenching the status of agreements among competitors to prevent or lessen competition as partial rule of reason offences. Under the *PANS* jurisprudence, an inference that an agreement would prevent or lessen competition unduly depended on both the market power of the accused and the nature of the prevention or lessening flowing from the agreement. Inferences of market power were based principally on the portion of the relevant market accounted for by the alleged agreement although other structural factors such as barriers to entry and the availability of substitutes were advanced for consideration. The *PANS* reasoning raised the possibility that agreements involving less serious forms of restriction on

competition could nevertheless be vulnerable to prosecution under s.45 if the parties to the agreement had sufficient market power.

The *PANS* framework was regarded as being consistent with economic principles as far as it went.⁸⁵ However, it did not allow for consideration of whether the impugned restraints on competition were a necessary component of a broader pro-competitive agreement. This raised a concern that the prospect of facing criminal sanctions under s.45 could deter pro-competitive horizontal arrangements among competing firms with market power.

As statute law and jurisprudence were evolving, so to were business organization and the economic analysis of it. It was turning out that in the “new economy” the range of potentially pro-competitive horizontal arrangements went well beyond the voluntary retail chains cited in the Economic Council’s 1969 report.

Studies of the economics of innovation emphasized that the innovative process is continuous, cumulative and interactive and that it extends beyond formal research and development programs to production, logistical and distribution activity. It often involves swaps of various forms of business information including production experience and knowhow and feedback from customers and distributors. It can involve ongoing collaboration with suppliers, customers, competitors and potential competitors and may take the form of a series of small, unremarkable product, process or organizational improvements.

An important implication of the economics of innovation is that the exchanges of information involved are not confined to specified, pre-competitive formal R&D activities and transfers of intellectual property rights.⁸⁶ Impacts on competition are unavoidable and the limited defence that was available under s.45 for cooperative R&D was too narrow. Moreover, proper assessment of these agreements would have regard for the benefits derived from the innovative activity involved and s.45 jurisprudence simply did not allow for this.

In an effort to reassure the business community that most forms of cooperative innovation or, more broadly, strategic alliances, would not raise concerns under s.45, the Competition Bureau published its Information Bulletin, “Strategic Alliances under the *Competition Act*” in 1995.⁸⁷ The Bulletin was intended to reduce the risk that alliances beneficial to the economy might not be pursued due to uncertainty about their legality but it also emphasized that some common features of cooperative innovation arrangements such as information exchanges could violate s.45 if the participating firms possessed market power and the information exchanged were deemed by the Competition Bureau to be competitively sensitive. In reminding businesses that it was

open to the Commissioner to use s.45 where competitively sensitive information is exchanged between firms with market power, the Bulletin might have heightened concern about the chilling effect of s.45 on pro-competitive agreements among competitors.

In sum, there were two sources of pressure to amend s.45. The proponents of reform had long regarded s.45 as excessively permissive towards hard core cartels and, more recently, had also come to regard it as hostile towards horizontal restraints that are ancillary to the achievement of a broader, pro-competitive objective. In essence, s.45 was thought to be both under and over-inclusive:

It is under-inclusive because it can allow manifestly anti-competitive arrangements to escape condemnation. Since the current prohibition requires the Crown to prove on a criminal burden of proof that an arrangement has lessened competition “unduly,” specious arguments about the collateral benefits of price-fixing may allow price-fixers to escape conviction. ...

At the same time, the current prohibition is over-inclusive because it subjects all horizontal arrangements to criminal prohibitions and casts a shadow over many arrangements that may increase welfare. Apart from the obvious price-fixing case, many horizontal arrangements have ambiguous welfare effects and do not justify the deterrent of criminal sanctions.⁸⁸

There were also sceptics who argued that the Crown’s poor record in obtaining convictions in litigated cartel cases was due to factors other than the burden of proving market power beyond a reasonable doubt.⁸⁹ It was also argued that the Crown’s record looked considerably better when guilty pleas were included and it is the overall record that matters.⁹⁰

A number of remedial proposals were advanced. Professor Ross suggested naked restraints be dealt with separately from horizontal restraints that are ancillary to a broader potentially pro-competitive agreement:

... agreements that had no redeeming qualities (i.e. “naked” restraints) would be *per se* illegal and subject to criminal penalties. This would involve removing the word “unduly” from section 45 and adding a clause that clarifies the fact that the section applies to naked restraints.

Any agreements that had (nontrivial) beneficial features (i.e. where the anticompetitive restraint is ancillary) would be made subject to review by the Competition Tribunal with procedures and authority similar to those applying in merger review.⁹¹

Trebilcock and Warner proposed that price-fixing agreements among competitors be treated as a *per se* criminal offence but that criminal liability could be avoided by notifying the Competition Bureau of the agreement in advance. Agreements so notified would then be subject to civil review by the Competition Tribunal using the criteria applied to mergers under s.92 of the *Competition Act*.⁹²

Kennish and Ross proposed a two track regime that would give the Competition Bureau the option prosecuting agreements that simply suppressed competition as criminal offences with no undue-ness requirement or seeking a remedial order from the Competition Tribunal in instances in which anti-competitive effects of a horizontal agreement outweigh its pro-competitive effects:

Under this proposal, a second civil branch would be added to conspiracy law. Agreements that involve nothing more than agreements not to compete (i.e., “naked” restraints) would be *per se* illegal and punishable under criminal law, with heavy fines and jail terms. This could be achieved by deleting the word “unduly” from s. 45 and adding a clause that made it clear that the section applied only to naked restraints.

Any “non-naked” agreement (i.e., those which do not have, as their sole or predominant purpose, an agreement not to compete or those which include a restraint on competition which is merely ancillary and reasonably necessary to a larger agreement), would be made subject to review by the Tribunal with authority and procedures analogous to those for merger review.⁹³

The 2002 report of the House of Commons Committee on Industry, Science and Technology, citing the testimony of several economists, recommended that the two track approach to horizontal restraints referred to above be adopted. In particular, it recommended the removal of the unduly qualifier from s.45 and the addition of an exception for restraints that are necessary to achieve a broader pro-competitive purpose. With respect to the second, civil track, the Committee recommended:

That the Government of Canada amend the civilly reviewable section of the *Competition Act* to add a new strategic alliance section for the review of a horizontal agreement between competitors. Such a section should, as much as possible, afford the same treatment as the merger review provisions (sections 92 through 96), and should authorize the Commissioner of Competition to apply to the Competition Tribunal with respect to such agreements that have or are likely to have the effect of “preventing or lessening competition substantially” in a market.⁹⁴

There followed a lengthy debate much of which concerned statutory wording that would keep the criminal prohibition of naked restraints from being either over or under-inclusive.⁹⁵ This was a classic case of balancing the respective costs of over and under-enforcement. There was a considerable body of opinion to the effect that naked restraints could not be precisely defined and that if undueness was to go, a market power screen of some sort should replace it.⁹⁶ Market share thresholds were proposed but these seemed to be undueness by another name. Another alternative was to confine the application of s.45 to covert agreements. A third alternative was to define the naked restraints to which s.45 would apply precisely in the statute. The solution that was ultimately adopted was to follow the House of Commons Committee's recommendation, in part, and provide for an ancillary restraints defence (on the balance of probabilities) in s.45 itself.

There was less debate over the proposal to treat horizontal agreements with both pro-competitive and anti-competitive aspects as practices reviewable by the Competition Tribunal using the existing merger evaluation criteria. One dissenting observer argued that strategic alliances differed from mergers in important ways and there was reason to question whether a typical strategic alliance could bear the burden, in terms of formalization, documentation, disclosure and delay, of the type of rule of reason analysis that had been applied in merger cases.⁹⁷ The general concern in this regard is that, as Richard Posner put it, there is "... a mismatch between law time and new economy real time."⁹⁸

Amendments to s.45 were further considered by the Competition Policy Review Panel. In its 2008 report the Panel recommended that the *Competition Act* be amended:

[to] repeal the existing conspiracy provisions and replace them with a *per se* criminal offence to address hardcore cartels and a civil provision to deal with other types of agreements between competitors that have anti-competitive effects;⁹⁹

Amendments to the *Competition Act* to eliminate the unduly qualifier from s.45 and to provide for review by the Competition Tribunal of horizontal agreements with both pro-competitive and anti-competitive aspects under a new section 90.1 were passed in 2009 and took effect in 2010.

The Competition Bureau's Competitor Collaboration Guidelines explain how the Bureau would enforce both the amended s.45 and the new s.90.1 and how it would choose between them. With respect to this choice, the Guidelines state:

... the amended criminal prohibition is reserved for agreements between competitors to fix prices, allocate markets or restrict

output that constitute “naked restraints” on competition (restraints that are not implemented in furtherance of a legitimate collaboration, strategic alliance or joint venture).¹⁰⁰

It remains to be seen whether the choice of enforcement tracks is as obvious as the Guidelines suggest. The Bureau has given itself the flexibility of shifting to the civil track if its initial application of the ancillary restraints test under s.45(4) warrants it. With respect to the civil track, the evaluative criteria are very similar to the merger evaluation criteria (including s.96). Concerns about the potential over-inclusiveness of civil review are somewhat allayed by the existence of safe harbours for agreements between firms with modest market shares. Whether other merger evaluation criteria and the merger assessment process itself will transfer readily to strategic alliances remains to be seen.

Pricing Practices

Pricing practices include price discrimination, predatory pricing and price maintenance (or resale price maintenance). The 1986 *Competition Act* included criminal prohibitions of these three pricing practices that carried over from the *Combines Investigation Act*. Predatory pricing can also be addressed as a reviewable practice by the Competition Tribunal under civil law.

The criminal price discrimination (s.50(1)(a)) and predatory pricing (s.50(1)(b) and s.50(1)(c)) sections of the Act were poorly drafted, inconsistent with the teaching of economics and, in any event, were not much used.¹⁰¹ They were repealed as part of the 2009 amendments and not replaced. They are discussed only briefly here.

The criminal price maintenance section (s.61) accounted for a significant fraction of the Competition Bureau’s prosecutions for a considerable period of time.¹⁰² The work of economists showed that to the extent that it was applied unilaterally by an upstream firm (manufacturer) on downstream resellers of its brand, it was likely socially benign. After a long struggle in which economists played a major role, s.(61) was repealed in 2009 and price maintenance became a reviewable practice under civil law (s.76). The influence of economists is also apparent in the decision of the U.S. Supreme Court to overturn prior decisions which had treated resale price maintenance as a *per se* offence.

Professor Winter whose research is central to the change in the way resale price maintenance is viewed has discussed the issues of economics and the interface between economics and law in his 2009 Presidential Address to the Canadian Economics Association.¹⁰³ Further discussion here focuses on the institutional response to this new learning and how it differed between the United States and Canada.

While predatory pricing is no longer a criminal offence, it is reviewable under the abuse of dominance provisions of the Act and the criteria the Competition Bureau uses to distinguish predatory pricing from aggressive (and desirable) price competition appear in its Abuse of Dominance Guidelines. The *Air Canada* case is the only predatory pricing case contested under the abuse of dominance provisions of the Act.¹⁰⁴ It is instructive both with respect to the way the Competition Tribunal chose to interpret its price-cost test and with respect to the broader question of the role of competition policy in compensating for regulatory policy failures.

Economists and Resale Price Maintenance

Resale price maintenance (RPM) is traditionally seen as occurring when an upstream firm, often a manufacturer, sets a specific price or price floor or price ceiling at which downstream firms, often retailers, are permitted to sell its product. In Canada, beginning in 1976, the term price maintenance also covered situations in which a firm induces a competitor to raise its price. This is sometimes called horizontal price maintenance.

The manner in which resale price maintenance has been dealt with in competition law is an interesting case study of the role that economic analysis and economists themselves can play in the evolution of statute law, jurisprudence and enforcement. Judicial hostility to RPM (“vertical price fixing”) has been based, in part, on the observation that it restricts price competition among downstream distributors or dealers. In a literature that dates back to 1960, however, economists showed that, while RPM may facilitate a cartel among distributors or manufacturers, it is also the case that higher downstream distributor margins can increase the attractiveness of a manufacturer’s distribution network in a variety of ways and therefore be output-increasing rather than output-restricting.¹⁰⁵ For economists, price competition among distributors is not an end in itself and the suppression of it can be efficiency-enhancing (which is the ultimate goal) in a variety of circumstances.

The likelihood that RPM is often socially beneficial militates against a *per se* criminal prohibition of it. Despite the longstanding consensus among economists in this regard, the law has been slow to change in both Canada and the United States. The reasons for the slow pace of change differ between the two countries. In the United States, there is no specific RPM legislation so that change took the form of an evolutionary narrowing by the courts, with the support of the Department of Justice, of the scope of the *per se* prohibition of RPM embodied in earlier interpretations of section 2 of the Sherman Act. In Canada, the Competition Bureau responded to the new learning by reducing

the effort it devoted to enforcement of the RPM provisions of the *Competition Act* in the courts but opposed their repeal or modification.

In Canada, RPM was made a *per se* criminal offence under the Combines Investigation Act in 1951. The 1976 amendments to the *Combines Investigation Act* broadened the offence to “price maintenance” allowing it to be applied to horizontal as well as vertical inducements to increase prices. The 1986 *Competition Act* left the 1976 criminal price maintenance offence intact (as s.61) and it remained that way until 2009.

The long survival of s.61 is explained in part by the fact that neither it nor its predecessors required that an undue or substantial or, indeed, any kind of a lessening of competition for a conviction. For this reason, the Competition Bureau found it a convenient vehicle to use against horizontal price fixing agreements in place of s.45 which required that the agreement lessen competition unduly.

In a 1985 study of vertical restraints commissioned by the Macdonald Royal Commission, Professors Mathewson and Winter conclude that the vast majority of Canadian RPM cases were consistent with the single manufacturer “efficiency” hypothesis rather than the manufacturer or dealer cartel hypothesis. They conclude that RPM should be legal unless conclusive evidence is presented that it supports a manufacturer cartel or protects a cartel of established retailers against entry by more efficient discount retailers.¹⁰⁶ The Macdonald Royal Commission subsequently recommended that RPM might better be treated as a reviewable practice subject to rule of reason analysis than to continue the *per se* criminal prohibition.¹⁰⁷

In the 1985 edition of his textbook, Christopher Green cited the early work of Mathewson and Winter but noted the efficiencies arguments that had been made by economists had “cut no legal ice” in Canada:

... it is argued by some economists that RPM, when initiated by producers rather than a dealer cartel, should be viewed as part of an overall efficient system of distribution and should be presumed legal. This kind of argument has contributed to an attempt by the U.S. Justice department to relax the application of the RPM law in the U.S.A. In Canada, however persuasive this argument might be in economic terms, it cuts no legal ice, for here we have for all intents and purposes a *per se* rule against RPM.¹⁰⁸

In their 1998 review paper on further developments in the economics of RPM and on the enforcement of the RPM provisions of the *Competition Act* during its first ten years of existence, Mathewson & Winter explain that there is much more to the efficiency rationale for RPM than the elimination of the classic “Lee

Jeans” retailer free-riding problem in which discounters free-ride on the point of sale information and amenities provided by full service retailers. While it is understood by the courts, free riding is not needed to provide an efficiency rationale for RPM. All that is required for a manufacturer to have an incentive to impose RPM is for customers who are careful shoppers (sensitive to price differences across retailers) to be less influenced, on average, by product promotional services.¹⁰⁹

While RPM is profitable and output-increasing for the manufacturer under readily satisfied conditions, the price-services/characteristics bundle induced by RPM may benefit less well-informed customers at the expense of the more well-informed. Depending on the respective characteristics of the average and marginal customers of the brand concerned, it may increase or decrease total surplus.¹¹⁰ However, determination whether the various value propositions that might be chosen by competing firms are surplus-increasing or decreasing is generally considered to be too complex for rule of reason analysis. It is also beside the point. The objectives of RPM might also be achieved by means of exclusive territories or by means of vertical integration. The first is subject to a rule of reason test (under s.77) and is subject to a remedial order only if it prevents or lessens competition substantially. The second is entirely beyond the purview of the *Competition Act*.

The Competition Bureau acknowledged the debate over the merits of the *per se* criminal prohibition of RPM and reduced its prosecutions after 1990. It also appears that it changed the composition of its enforcement away from strictly vertical (and likely benign) cases toward cases with a horizontal element:

There is some evidence that suggests that the Bureau throughout the 1990s took more price maintenance cases that contained a horizontal, and thus anti-competitive, element relative to those cases that were strictly vertical in nature. This is in keeping with the Bureau’s stated policy with respect to case prioritization that ranks price-fixing and bid-rigging cases highly as these cases are more likely to cause the greatest economic harm. Moreover, between 1990 and 1999, no cases that were strictly vertical were subject to formal enforcement proceedings.¹¹¹

There appears to have been some backsliding during the period 2000 – 2003 during which only one of the six cases brought clearly contained a horizontal element. This period also saw the first strictly vertical RPM case since 1989 (Stroh Brewery) which resulted in the largest fine in the history of price maintenance enforcement.¹¹² Over the period 2004 – 2007 there were two further

convictions and one consent order. There were no further prosecutions under s.61 after that.¹¹³

Further discussion of the proper legal treatment of RPM was provided when the Bureau commissioned Professors VanDuzer and Paquet to report on enforcement activities and options for the price discrimination, predatory pricing and price maintenance sections of the *Competition Act*. With respect to price maintenance, their report recommended that RPM should be dealt with under s.79 which would involve a market power (dominance) screen and require a substantial prevention or lessening of competition. It also recommended that the retailer service defences for RPM be broadened.¹¹⁴ It recommended as well that s.61 continue to be used to pursue horizontal price maintenance.

With respect to the recommendation that the service defence be broadened, one commentator noted that a lesson of the work of Mathewson and Winter on RPM is that it is an attempt to contractually align the incentives of the retailers of a product with those of its manufacturer with respect to a wide variety of possible retailer conduct and characteristics.¹¹⁵ This is not amenable to a statutory listing of specific “retailer services” that might qualify as defences in the many differentiated products market and value chain circumstances in which price maintenance might be alleged.

In the context of its advocacy role, the Competition Bureau refused to endorse the recommendation of the 1999 VanDuzer report and of the 2002 Report of the House of Commons Standing Committee on Industry, Science and Technology, that vertical price maintenance be treated as a reviewable practice under s.79.¹¹⁶ The Standing Committee noted in its report that with the exception of the Bureau, all the witnesses before it were in agreement with the Committee’s recommendation. The Bureau’s reason for dissenting from expert opinion was apparently that it had a higher success rate when prosecuting under a *per se* offence. The Committee rightly observed that competition policy is not about winning and losing cases.¹¹⁷

The Bureau’s 2003 discussion paper on options for amending the *Competition Act* contained no references to RPM.¹¹⁸ Nor did the amendments to the *Act* proposed in 2004.¹¹⁹

The final straw for s.61 may have come with the 2007 *Leegin* decision by the U.S. Supreme Court. The Court overturned both the decision of a lower court to exclude expert testimony regarding the pro-competitive effects of RPM and the *per se* illegality of minimum-price RPM itself, finding that “the economics literature is replete with pro-competitive justifications for a manufacturer’s use

of resale price maintenance.¹²⁰ This case is notable in that the Court cited an *amici curiae* brief by 22 distinguished economists, nine of whom had served as either the Director of the Bureau of Economics of the Federal Trade Commission (FTC) or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (DOJ).¹²¹ In marked contrast to the situation in Canada, the FTC and the DOJ also filed an amicus brief in support of according rule of reason treatment to RPM.¹²² Professor Winter has observed, however, that despite the progress that has been made, the treatment of RPM by U.S. enforcement agencies remains inconsistent with economic theory.¹²³

In its 2008 report, the Competition Policy Review Panel, noting that (after *Leegin*) Canadian law with respect to RPM was more restrictive than U.S. law, recommended moving RPM from criminal to civil law but not into to the abuse of dominance section of the Act.¹²⁴ It suggested instead that the existing resale price maintenance provisions be replaced “with a new civil provision to address this practice when it has an anti-competitive effect.” It also recommended that this new provision should be subject to the private access rights before the Competition Tribunal.¹²⁵

With the passage of Bill C-10 in March, 2009, s.61 was finally repealed and, effective March, 2010, it was replaced by s.76 which provides for the review of alleged vertical price maintenance by the Competition Tribunal. The Tribunal may issue a remedial order only if the conduct in question has an adverse effect on competition. There is a private right of access but private parties need to obtain leave from the Tribunal to bring an application, class actions are not allowed and the Tribunal is not authorized to award damages. Although, price maintenance continues to be treated differently than non-price vertical restrictions for which a remedial order can be issued only if they prevent or lessen competition substantially, the treatment of RPM may finally have become consistent with the learning of economists.

Economists and Predatory Pricing

Consistent with a broad stream of economic analysis stretching back to John McGee’s paper in 1958, economists stress that the difficulty of distinguishing predatory pricing from aggressive price competition and the adverse consequences of deterring the latter militate in favour of a cautious approach.¹²⁶ The more recent strategic predation theories imply that predatory pricing is not so rare that it can be ignored completely.¹²⁷ The cautious approach has usually taken the form of subjecting allegations of predatory pricing to a series of tests or screens. There is widespread agreement about the first screen, the

requirement that the alleged predator have substantial market power. There is less agreement about the remaining screens.

Price-cost screens are common. One approach is to regard a price below average avoidable cost as presumptively predatory in that it makes sense only if the losses involved can be recovered by supra-competitive pricing later on. All versions of the Competition Bureau's Abuse of Dominance Guidelines have included an avoidable cost screen. Price-cost screens have their critics.¹²⁸ They can be complex to apply.¹²⁹ Different cost concepts may be appropriate when the alleged predator expands output. They should not necessarily be interpreted as providing a safe harbour for a price above avoidable cost.¹³⁰

Another common screen requires evidence that the alleged predator be able to recoup losses incurred during a predatory episode. The possibility of recoupment is a necessary condition for profitable below cost pricing.¹³¹ For years, recoupment was "... a bedrock element of Canadian predatory pricing law ..."¹³² While a theory of the case must surely include a plausible narrative about the nature of the return on the alleged predatory investment, recoupment can occur in a variety of ways. Predatory losses may not themselves be fully recovered but predation may have forestalled even further losses in the future. Structural indicators of the ability to recoup predatory losses (high market share, barriers to entry and re-entry) may understate the ability to recoup predatory losses if predation itself deters future entry.

In the 2001 Abuse of Dominance Guidelines, the ability to recoup predatory losses is inferred from the dominance of the alleged predator.¹³³ The 2009 Draft Abuse of Dominance Guidelines refer to a recoupment screen but again state that a finding of dominance is sufficient to establish that a firm will likely be able to recoup its losses following a period of predatory pricing. An additional consideration in 2009 Draft Guidelines is the extent to which the act of predation will deter entry or re-entry through establishing a reputation for predation.¹³⁴ The 2012 Revised Abuse of Dominance Guidelines do not mention recoupment.¹³⁵ This is unfortunate given that recoupment of some sort is central to any economic theory of predation. While there are differing views on this, it is also arguable that recoupment cannot be presumed on the basis of pre-existing market power and the assertion of reputation effects.

Another possible screen considers whether the alleged predator initiated price cuts or merely responded to competition and whether the alleged predator undercut the victim's prices or merely matched them. A price matching screen has been suggested by Professors Ross and Stanbury. Writing in response to the publication of the Competition Bureau's Draft Enforcement Guidelines on the Abuse of Dominance in the Airline Industry, they suggested that, having

established that market conditions are conducive to successful predation, the Bureau should turn to the avoidable cost test only after it had been established that the alleged predator had gone beyond simply responding to and matching a rival's competitive initiatives.¹³⁶

The 2012 Guidelines state that the Bureau will examine whether the alleged predatory price is in fact merely "meeting competition" by reacting to match a competitor's price.¹³⁷ This is not mentioned in either the 2001 or the 2009 guidelines.

There appears to be agreement that any price-cost test for predation be preceded either by an independent recoupment test or a meeting-the-competition test. In its latest guidelines, the Competition Bureau appears to have opted for a meeting-the-competition screen. With respect to the influence of economists' strategic theories of predation, all versions of the guidelines take the possibility of a reputation effect into account while both the 2009 and 2012 guidelines include either the effect of the alleged predation on the victim's profits or the ability of the victim to profitably match the alleged predator's prices.

Air Canada

The acquisition of a failing Canadian Airlines by Air Canada in January 2000 left the latter with roughly 90 percent of domestic passenger traffic. This outcome might have been avoided if regulatory restrictions on foreign ownership of domestic air carriers had been less severe. As it was, there were legitimate concerns about a lack of competition post-merger. These concerns could have been allayed in large measure if the federal government had adopted some of the various possible forms of cabotage ("freedoms") listed by Ross and Stanbury.¹³⁸ The Competition Bureau also suggested a number of policy measures that would have allowed for increased foreign competition.¹³⁹

It was not to be. Protectionism and restrictions on foreign investment held the day and the federal government enacted legislation to give the Canadian Transportation Agency the power to control air fares that it deemed to be too high and to give the Competition Bureau the power to hold a price umbrella over new entrants. This harkened back to an era when competition policy was used to provide political cover for protectionist trade and regulatory policies:

The fundamental problem with current Canadian airline regulation is the following. Rather than taking the natural step of remedying competition concerns (to the extent that they exist) by lowering barriers to foreign competition, the government has instead chosen to address competition issues through a crude combination of anti-gouging and anti-predatory pricing statutory measures.¹⁴⁰

The price umbrella took the form of Bill C-26 which amended the abuse of dominance section of the Competition Act (s.78) to include two new anti-competitive acts (s.78(1)(j) and s.78(1)(k)) specific to the airline industry. The amendments gave the government the power to make regulations specifying the types of conduct on the part of the dominant carrier that that would be considered an anti-competitive act under s.78(1)(j). First on the list of seven anti-competitive acts listed was “operating capacity on a route or routes at fares that do not cover the avoidable cost of providing the service.” The regulations also specified what constituted the denial of an essential service by the dominant carrier to a competing carrier under s.78(1)(k).

The Competition Bureau published an explanation of how it would enforce s.78(1)(j) and 78(1)(k) in its Draft Enforcement Guidelines on the Abuse of Dominance in the Airline Industry in February 2001.¹⁴¹ The Guidelines stated that the Bureau considered labour and aircraft costs to be avoidable in the sense that upon cancellation of a flight, the personnel and aircraft involved would likely be redeployed to an alternative route.

In their paper discussing some of the issues raised in the Guidelines, Professors Ross and Stanbury appeared to caution against drawing the inference that the dominant carrier had committed anti-competitive acts on the basis of a price-cost test alone. They suggested that, having established that market conditions are conducive to successful predation, the Bureau should turn to the avoidable cost test *only* when: (1) the incumbent cuts fares below those of the entrant; (2) the incumbent matches the entrant but adds capacity or; (3) the incumbent matches fares but changes its schedule so as to bracket the entrant’s flights.¹⁴² The authors did not venture an opinion as to the appropriate definition of avoidable cost although they did note that the concept of long-run average incremental cost had been suggested for revenue/cost comparisons when the alleged predator increases output in response to new entry.

In order to nip potential predation in the bud, the amendments to s.78 also gave the Competition Bureau the power to act as both a prosecutor and an adjudicator in seeking interim relief for predatory conduct likely to cause irreparable harm either to a competitor or to competition. Some commentators called this “bad policy and bad law.”¹⁴³

In March, 2001, the Commissioner filed a notice of application with the Competition Tribunal alleging abuse of dominance by Air Canada on seven city-pair routes in eastern Canada. According to the application, Air Canada had responded to new entry by increasing its capacity and decreasing its fares in a manner that did not cover the avoidable cost of operating the flights on these routes.

The Tribunal decided to hear the application in two phases. The first phase would address the application of the avoidable cost test on two routes. The second phase was to cover the remaining five routes and also to determine whether the other requirements for abuse of dominance under s.79 were satisfied.

The Tribunal issued its Phase 1 decision in July, 2003 after a process that involved 40 hearing days, 499 exhibits and 17 witnesses, including 5 economists.¹⁴⁴ Professor Baumol who originally suggested the average avoidable cost test was one of the witnesses.¹⁴⁵ The Tribunal ruled that the appropriate application of the avoidable cost test was to compare revenues and avoidable costs on individual, unidirectional scheduled flights over a period of a month. With respect to the quantification of avoidable cost, Dr. Csorgo offers the following summary:

... the parties disagreed on 26 cost items and agreed on 17. The 17 agreed to items accounted for 38% of Air Canada's fully allocated costs on the two routes subject to the hearing. Of the 26 disputed costs, the point of contention was largely whether they could be avoided by means of passenger recapture, resource redeployment, and asset disposal. Seven of the disputed costs were found by the Tribunal to be unavoidable and 19 to be avoidable. This included, for example, finding that airport security costs were avoidable.

In regard to aircraft costs, a main area of dispute, the Tribunal found that the costs were avoidable by disposal, sublease, return to lessor and profitable redeployment, where opportunities for redeployment needed only to be shown as generally and reasonably available, rather than specifically available for the routes in question.

The determination whether a cost was avoidable (which led to the conclusion that 762 out of a possible 978 flights on one route were operating below avoidable cost, and 1187 out of a possible 1466 on another were) relied heavily on the assumption that revenues from cancelled flights would be recaptured by having passengers switch to other Air Canada flights on the route. The Tribunal accepted this assumption for "a very significant portion of the passengers" on the basis of the load factors on the remaining Air Canada flights, and because the other two carriers providing service on the routes in question "offered very few flights."¹⁴⁶

The cost categories deemed to be avoidable by recapture of the traffic on cancelled flights and by redeployment of the resources involved within Air Canada

are not avoided in the sense that they are no longer incurred by Air Canada. They are avoided only in the sense that these resources could, hypothetically, have made a bigger contribution to Air Canada's revenue if they had been used on other flights. The Tribunal conceded that the opportunities for recapture and redeployment are a matter of speculation as they involve a hypothetical flight cancellation. The Tribunal ruled that given their speculative nature, the Commissioner need only show that these opportunities are generally and reasonably available. This evidentiary standard troubled one commentator, as did the Tribunal's apparent failure to recognize that what it was dealing with was opportunity costs rather than out-of-pocket costs.¹⁴⁷ Perhaps equally troublesome was the lack of discussion of the link between the assumed ability of Air Canada to recapture traffic on cancelled flights and its incentive to predate.¹⁴⁸

Other commentators questioned the wisdom of abandoning the recoupment screen.¹⁴⁹ Still others predicted that very few of Air Canada's flights would have passed the standard promulgated by the Tribunal and noted the extent to which it diverged from U.S. jurisprudence (which requires "a dangerous probability" of recoupment and does not accept foregone profits as costs).¹⁵⁰ They predicted that predatory pricing allegations would be much more likely to succeed in Canada in the future:

Given the Canadian law set out in the airline regulations, and the Tribunal's decision in the Air Canada case, and in particular, the Tribunal's willingness to find most costs avoidable via redeployment, and its classification of foregone profit or opportunity costs as true costs, it appears to us that predatory pricing allegations, at least involving airlines, will be much more likely to succeed in this country. The Tribunal found that most of Air Canada's costs were avoidable over a relatively short period of time, which will militate in favour of finding predation.¹⁵¹

As it turned out, Air Canada subsequently declared bankruptcy and the Phase 2 hearings were never held. In 2004, in a letter to the airline industry, the Commissioner set out the Bureau's views on when the expansive avoidable cost test that had become part of the jurisprudence under s.78(1)(j) would be triggered insofar as its own investigation of allegations of predatory pricing were concerned.¹⁵² It stated that the Bureau would only take action if a dominant carrier were to respond to new entry in a significant way that went beyond price matching. When the dominant carrier goes beyond fare matching, the Bureau would consider all the elements of s.79 in addition to the avoidable cost test in deciding to take action. This approach bears considerable resemblance to the approach suggested by Ross and Stanbury in 2001.

Repeal of the airline-specific sections of the *Competition Act* was first proposed, in Bill C-19 which was introduced in 2004. The reason given was that circumstances in the airline industry had changed. Another factor may have been the recognition of the straightjacket placed on the dominant carrier by s.78(1) (j) and the Tribunal's interpretation of it as well as opposition (including some from economists) to both industry-specific provisions in competition legislation and industry-specific enforcement guidelines. The decision that the airline-specific predation provisions of the *Competition Act* were no longer needed a year after the Tribunal found that the dominant carrier had committed anti-competitive acts gave new meaning to the old adage that "a week is a long time in politics." It is seen by some as an implicit admission that the case should never have been brought in the first place:

The first phase of the case, which concluded that Air Canada had committed anti-competitive acts, was decided in July 2003. If market conditions could change sufficiently that the Competition Bureau would decide not to pursue its claim of abuse against Air Canada, and that the minister would propose changing the act, only one year after a finding of a dominant airline committing an anti-competitive act, there is a powerful suggestion that the case should never have been brought in the first place.¹⁵³

Bill C-19 died on the order paper and it was not until Parliament passed a broad set of amendments to the *Act* in March, 2009 that the airline-specific sections of the abuse of dominance provisions of the *Competition Act* were finally repealed.

There are several lessons to draw from *Air Canada*. Unfortunately these are not new lessons. Use of competition policy to offset the effects of protectionist or restrictive public policies can be detrimental to its focus, clarity and longer term effectiveness. Historic evidentiary requirements for inferring a lessening of competition are there for a reason and should not be abandoned without discussion. There is an ongoing debate about the criteria for inferring a failure by a dominant firm to compete on the merits in abuse of dominance cases.¹⁵⁴ Profit sacrifice is one of a number of possible criteria and failure to maximize is an extreme version of that. Under the market circumstances that prevailed at the time, the standard advocated by the Commissioner and accepted by the Tribunal may have been even more demanding.

Distribution Strategies

Distribution strategies include refusal to deal, exclusive dealing, tied selling and market restriction. Refusal to deal is covered under s.75 of the *Competition*

Act and also under s.79 as an abuse of dominance. Exclusive dealing, tied selling and market restriction are covered under s.77 of the *Competition Act* and also under s. 79 as an abuse of dominance.

As it stood in 1986, s.75 was a poor fit with the *Act* because it addressed disputes between buyers and sellers rather than conduct that affected competition. Economists pointed this out and their concerns were remedied in part. A number of s.75 cases involved after-market tying and economic analysis addressed the conditions under which this is a competition problem. If Appendix III of the 2009 Draft Abuse of Dominance Guidelines is any indication, the Competition Bureau's views on after-market tying are consistent with the research findings of economists.¹⁵⁵

Canada Pipe was an abuse of dominance case involving the use of loyalty rebates to induce exclusive dealing. The Tribunal's decision in the case was appealed, the appeal was upheld and the case was sent back to the Tribunal for redetermination. The parties settled and this ended the matter. The decisions of both the Tribunal and the Federal Court of Appeal have raised issues ranging from the circumstances under which a loyalty rebate becomes anti-competitive to whether business conduct can be deemed to be anti-competitive without preventing or lessening competition.

Refusal to Deal Under Section 75

A refusal by a supplier to sell a product to a customer is a reviewable practice under s.75 of the *Competition Act*. A similar provision had been added to the *Combines Investigation Act* in 1975 apparently in response to concerns that a refusal to supply on the part of one or more major suppliers could cause business difficulties for a wholesaler or retailer.¹⁵⁶

Under the 1986 *Act*, s.75 empowered the Tribunal to order a supplier to supply a customer if: (1) the customer is substantially affected in his business because of the refusal; (2) if the customer's inability to obtain supply is the result of insufficient competition among suppliers in the market; (3) the customer is willing and able to meet the usual trade terms and; (4) the product is in ample supply. S.75 required only that the customer's business be adversely affected. Unlike most of the civil and criminal provisions of the *Act*, it did not require that competition be lessened or prevented. Nor did it require the Tribunal to consider the implications of the refusal to supply for economic efficiency. Its apparent objective of protecting an individual business was markedly out of step with most of the rest of the *Act* and with the economic thinking behind it.

In their 1998 paper Chen, Ross and Stanbury canvassed the prevailing

economic theories of refusal to supply with special reference to aftermarket theories which attempted to explain refusals by original equipment manufacturers (OEM's) to sell parts to independent service organizations (ISO's). They find that under some circumstances refusals to supply are efficiency-improving and under some circumstances ("installed base opportunism") they are not. In the instances in which refusals to supply are efficiency-reducing, questions remain about the size of the efficiency loss involved and about whether there are better remedies than an order to supply or, indeed, better remedies outside the ambit of the *Competition Act*. They also note that in the two cases heard by the Tribunal, expert economists, concerned as they are about the efficiency consequences of business conduct, were deemed by the Tribunal to have been unhelpful to it.¹⁵⁷

The authors concluded that, having nothing to do with competition, s.75 has no place in a competition statute. While they observed that in its case selection the Competition Bureau may have been filtering out cases in which there was an apparent efficiency motive for a refusal to supply, they recommended further action to repeal s.75. Failing this, the authors suggested that a requirement that competition be lessened as a consequence of a refusal to supply be added to s.75. Failing this, they suggested that in order to avoid wasting public enforcement resources, private access to the Competition Tribunal could be granted in s.75 cases.¹⁵⁸

In 2002, s.75 was amended to add a requirement that a refusal to supply have an adverse effect on competition as a condition for the issue of a remedial order to supply. The amendments also provided for a private right of access to the Tribunal in s.75 cases.¹⁵⁹ S.75 remained an outlier from a competition perspective in that it did not require an undue or substantial prevention or lessening of competition as a condition for issuing a remedial order.

Canada Pipe

In October 2002 the Commissioner of Competition applied to the Competition Tribunal for an order under the exclusive dealing (s.77) and abuse of dominance (s.79) sections of the *Competition Act* alleging that Canada Pipe's loyalty discount program created, enhanced and preserved its market power. The Respondent, Canada Pipe, manufactured cast iron drain waste and vent (DWV) pipe and fittings through its Bibby St. Croix division (Bibby). Bibby accounted for 80 to 90 percent of Canadian sales of DWV with the balance being accounted for by a recent entrant and by imports. Bibby was the only company in Canada to manufacture a full product line.¹⁶⁰ Cast iron DWV products were sold through three large national distributors as well as some smaller ones.

Cast iron pipe was gradually being replaced by plastic pipe and, given that Bibby's share of a market defined to include plastic DWV products would have been approximately 11 percent, this raised a classic product market definition issue.¹⁶¹ As well, market conditions varied across the country, in part because imports from the Far East had penetrated western Canada, and this led the Tribunal to define six geographic markets within Canada.

At the heart of the case was Bibby's Stocking Distributor Program (SDP). Under the SDP, distributors who agreed to purchase all their cast iron DWV requirements from Bibby (100 percent loyalty) were eligible for a discount off list as well as two rebates. The discount which amounted to as much as 45 percent off-list was given at the time of purchase and was not recoverable by Bibby in the event that the distributor left the plan. The first rebate (7 percent on pipe purchases, for example) was paid at the end of each quarter for 100 percent loyalty during that quarter. The second rebate (4 percent) was paid at the end of the year for 100 percent loyalty during the year. Distributors who did not join the plan received a 6 percent discount off list and no rebate. Distributors were free to join or leave the SDP at any time with departure at the end of a calendar year involving no loss of rebates.

The Tribunal found that although the SDP was an inducement to exclusivity, it had none of the characteristics the Tribunal had found offensive in earlier exclusive dealing cases (*NutraSweet*, *Laidlaw* and *Nielsen*).¹⁶² Distributors were free to terminate the agreement without loss or penalty at the beginning of each calendar year. Distributors could opt out at the end of a quarter at the cost of the accumulated annual rebate and could reinstate the program in a subsequent quarter. There were no long-term contracts, no staggered termination dates, no liquidated damages or other penalty clauses and no logos to remove. These facts did not square with the assumptions underlying the economic theories of anti-competitive exclusive dealing that had been relevant in the earlier abuse cases.¹⁶³ In the light of this evidence the Tribunal found that switching costs were not high.

While it was apparently open to a competing full-line supplier simply to match the SDP at the beginning of a calendar year, the Commissioner's argument was that since Bibby was the only full-line supplier in Canada, a distributor who wished to leave the SDP would still have to rely on Bibby for a significant portion of the cast iron DWV products it needed to carry. If a smaller competitor simply matched the SDP on the products it could supply, the distributor would incur a mixing cost in the form of the foregone SDP discount and rebates on the products it continued to purchase from Bibby. This left small suppliers with the option of either trying to cooperate in order to provide a full line of

products or to offer their products individually at prices well below the SDP. Either way, in the Commissioner's view, this discouraged toe-hold entry and the expansion by small competitors.

The Tribunal agreed that there could be significant mixing costs if a distributor were to leave the SDP and still continue to be supplied by Bibby for a large portion of its needs but was of the view that a distributor could switch to other sources of supply and would need to rely on Bibby for only the "exotic" components and this would not entail significant mixing costs.

The evidence was that distributors leaving the SDP would likely rely on Bibby for between 10 and 20 percent of their requirements.¹⁶⁴ Whether this constituted reliance on Bibby only for exotic components and implied that mixing costs were low might have been questionable. On the Tribunal's findings of fact, a distributor would be indifferent between the SDP and a competitor able to supply 80 percent of the distributor's requirements if the competitor's price was 62 percent off Bibby's list price or 33 percent below Bibby's SDP price.¹⁶⁵ If the competitor merely matched Bibby's SDP price on the 80 percent of the distributor's requirements it supplied, the distributor would incur a mixing cost (premium) of 18 percent over the SDP price.

A number of efficiency or business justifications for the SDP were raised and were considered by the Tribunal. Bibby had apparently made a significant investment in promoting cast iron DWV products (relative to plastic, copper etc.) and the SDP might have been seen as preventing other cast iron DWV suppliers from free-riding on this investment. It would have done so, however, only to the extent that it excluded other cast iron DWV suppliers from the market which the Respondent maintained it is not intended to do. Moreover, the free-riding argument is usually made in connection with the promotion of inter-brand competition in differentiated products markets. A distributor that carried only cast iron DWV products would have a strong incentive to promote them rather than plastic. But the SDP did not restrict (induce) distributors to stock only cast iron DWV products. Distributors were free to carry and did carry all types of DWV products. The SDP did not prevent a distributor from persuading a customer to switch from cast iron to plastic if the distributor's margin is higher on plastic.

The Tribunal found a business justification for the SDP was that it enabled Bibby to produce a full product line domestically. It is not entirely clear why the Tribunal might regard this as pro-competitive. One interpretation of the Respondent's argument is that it would be uneconomic to produce low volume products in the absence of a significant contribution to plant overhead from high volume products. This comes precariously close to asserting that a

full-line plant can survive in Canada only if it is assured of market dominance. This would appear to cast the motivation for the SDP into question. It also begs the question, given the Respondent's emphasis on the reliability of imports as an alternative source of supply, of what the consequences for competition and consumers would have been had Bibby imported part of its product line from its affiliates in the U.S. or from overseas.

A pro-competitive business justification for the SDP might have been that, by basing discounts on loyalty rather than volume, it treated all distributors the same and this resulted in more distributors carrying cast iron DWV products. This may have resulted in more intense downstream competition among distributors than would have been the case if Bibby had relied on volume discounts which would have favoured the largest of the national distributors. Any increase in downstream competition could have reduced distributor margins and alleviated the double mark-up problem that exists when competition is imperfect at successive stages of production.

The Tribunal released its decision in February, 2005. It found that the SDP did not constitute an anti-competitive act under s.79(1)(b) of the Act for the following reasons: (1) it did not have the punitive design features of exclusive dealing arrangements in *Nutrasweet*, *Laidlaw* and *Nielsen*; (2) it did not increase the costs to customers of mixing Bibby's products with those of competitors; (3) it had a valid business justification in that it allowed Bibby to continue to produce a full product line in Canada and; (4) it did not in fact prevent competition.

With respect to the effect of the SDP on competition (under s.79(1)(c) of the Act), the Tribunal found that while entry was difficult due to declining demand and Bibby's established reputation as a reliable supplier, the SDP had not prevented an increase in imports, nor had it prevented the emergence, for the first time in thirty years, of a new manufacturer of cast iron DWV products.

The Commissioner appealed the Tribunal's decision to the Federal Court of Appeal and the Court released its decision upholding the Commissioner's appeal in June, 2006.¹⁶⁶ The Court found that the Tribunal erred in law in requiring proof of a causal link between the SDP and a decrease in competition or an adverse effect on consumers. The FCA opined that it is necessary only to prove under s.79(1)(b) is that the impugned act has a negative effect on a competitor that is predatory, exclusionary or disciplinary. With respect to the Tribunal's finding that the SDP had not prevented competition, the Court found that the Tribunal had erred in basing its finding on the amount of competition that existed rather than asking how much competition there would have been absent the SDP (the "but for") test.

The Court sent the case back to the Tribunal for redetermination. The parties settled in December 2007 and the matter ended with a consent order under which Canada pipe committed to offer conventional volume-based discounts as well as its SDP. This ending raised several sorts of concerns.

First, questions about the status of loyalty discount relative to other forms of discounts from a competition perspective were left unresolved as were the market circumstances under which an exclusivity-inducing discount might become anti-competitive. Many different types of discounts had been employed in the industry prior to Bibby's implementation of the SDP. These included customer-specific first dollar discounts with volume-based thresholds, loyalty discounts similar to the SDP but with lower loyalty thresholds and conventional volume discounts. Each has potential exclusionary effects and this might have been addressed in a but-for analysis.

With respect to the market circumstances under which a program such as the SDP might be deemed to be anti-competitive, the Commissioner's expert accepted that he might not regard the SDP as anti-competitive in the context of a market with three or more vigorously competing full-line producers. The Tribunal set the threshold at which no inference of anti-competitive conduct would be drawn much lower, finding that it was sufficient that reasonable competitive alternatives existed for most of Bibby's products. This threshold might have been re-examined in connection with a determination of whether an anti-competitive effect was reasonably foreseeable.

From a broader perspective, economists were perplexed by the Federal Court's decision that business conduct could be found to be anti-competitive independent of its effect on competition:

To economists, whose sole interest is competitive effects, the implication that an act can be anti-competitive without anti-competitive effect is puzzling. If not effect, then what?¹⁶⁷

The Federal Court's decision also raises the spectre of protecting competitors rather than competition. It also appears to advocate increased reliance on intent evidence, something with which economists are generally uncomfortable:

... It is unfortunate to have on the record the statement that an act taken with the purpose of having a "negative effect on a competitor" is by definition anticompetitive. Such an interpretation reinforces the idea that the purpose of competition policy is to protect competitors. All sorts of acts hurt competitors, primarily offering lower prices and offering better service. On that account, firms

would and should be acting anti-competitively all the time. There is perhaps a qualification which is that the point is not just to harm competitors, but the intent to exclude, predate or discipline them. But as noted above, this relies on psychology rather than economics and presupposes an ability to separate good intent to beat out competitors from bad without looking at effects ...¹⁶⁸

It has been suggested that the Federal Court's test can be interpreted as distinguishing between reasonably predictable effects for purposes of s.79(1)(b) and actual effects for purposes of s.79(1)(c).¹⁶⁹ Reasonably predictable effects might be inferred from the existence of market power, the nature of the conduct concerned, the absence of an overriding pro-competitive purpose and, possibly, intent evidence. The 2012 Revised Abuse of Dominance Guidelines take an approach of this nature.¹⁷⁰ Nevertheless, it remains difficult to imagine how conduct that doesn't ultimately lessen competition could reasonably have been expected to do so.

Conclusions

Economists have long advocated that competition policy focus on protecting the competitive process with the ultimate objective of avoiding economic waste. The Economic Council of Canada's statement of this objective in 1969 has often been often quoted:

Essentially we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view of enhancing the wellbeing of Canadians.¹⁷¹

The *Competition Act* was a major step forward and with the passage of Bill C-10 in March 2009, Canadian competition law has become further aligned with economics. The convergence of jurisprudence with economics is less complete and is less well established. There have been aspects of high-profile decisions by the Federal Court of Appeal in *Superior* and *Canada Pipe* with which economists have taken issue. Although not covered in detail here, economists have questioned the economic reasoning (or lack thereof) of the Competition Tribunal in its decisions in *Tele-Direct*, *NutraSweet*, *Canada Pipe* and *Canadian Waste Services* among others while the Tribunal's decision in *Nielsen* has come in for considerable praise.¹⁷²

The Competition Bureau's enforcement guidelines appear to be responsive, at least in some of their incarnations, to developments in economic analysis. Given the paucity of litigated cases and a high profile instance in which the

Commissioner ignored his guidelines, however, it is hard to know how much significance to attach to their content.

With respect to enforcement decisions, hard core cartels are pleading guilty and being fined and the Competition Bureau's immunity policy has come in for praise.¹⁷³ With respect to mergers, Margaret Sanderson has observed that, confusion about the interpretation of s.96 notwithstanding, mergers have continued to be evaluated by the Competition Bureau "without mishap."¹⁷⁴ Given the lack of transparency of the process, however, it is difficult to know whether economic analysis played the appropriate role in these evaluations. There has been criticism of the Commissioner's decision to appeal both of the Tribunal's decisions in *Superior*, given the role that the Commissioner's presentation of his own evidence played in the Tribunal's initial decision.¹⁷⁵

The question has also been raised as to whether the *Air Canada* case should ever have been brought. This raises a broader issue. Given its proper focus on the competitive process and efficiency, competition policy cannot or at least should not always be available to help solve every microeconomic public policy problem. This may mean that occasionally other government agencies or departments will be asked to address policy matters that have implications for competition and they may do so in a matter that is detrimental to both competition and efficiency. The institutions of competition policy might well have achieved the multiple goals of public policy with less detriment to competition and efficiency but this would come at the potentially serious cost of a loss of focus.

In situations where competition is but one of several public policy goals, the Competition Bureau can always serve an advocacy role and there are numerous instances in which it has done so. There are also some high profile instances in which it has arguably not played the appropriate advocacy role. One would be its support of an ill-conceived private member's bill to amend s.96 of the *Competition Act*. Another would be its apparent unwillingness to support the decriminalization of price maintenance. On the other hand, the Bureau played a positive role in connection with the amendments to s.45.

Looking forward, the question for this paper is whether the institutions of competition policy in Canada are equipped to cope with the increasing importance of economics in both enforcement and adjudication.¹⁷⁶ In his 2004 survey paper, Professor Ross expressed concern that economics was not being given sufficient resources or prominence within the Competition Bureau.¹⁷⁷ This may be so but a lesson of the last twenty years is that the tone set by the Commissioner can be at least as important as resources and titles for economists. With respect to the Tribunal, its outgoing Chair, Judge Simpson, has pointed out that

future lay members of the Tribunal will likely need stronger backgrounds in economics than has been required in the past.¹⁷⁸

ENDNOTES

¹The author is a Professor Emeritus in the Department of Economics at Carleton University.

²Timothy Brennan and Alan Gunderson, "2006 in Competition Policy and Enforcement: An Economic Perspective" *Canadian Competition Record* 22 (Summer, 2007) p. 67.

³Lawrence White, "Economics, Economists and Antitrust: A Tale of Growing Influence" (Paper presented to the American Economics Association Meetings, New Orleans, January 5, 2008) pp.10-13. http://www.aeaweb.org/annual_mtg_papers/2008/2008_180.pdf.

⁴The Stage 1 amendments to the *Combines Investigation Act* in 1976 made tied selling, exclusive dealing, market restriction and consignment selling reviewable by the Restrictive Trade Practices Commission under civil law. The Director of Investigation and Research successfully sought a prohibition order in one tied selling case and was unsuccessful in one exclusive dealing case. For a discussion these two cases and all four practices see Bruce Dunlop, David McQueen and Michael Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis* (Toronto, Canada Law Book, 1987) pp.271-9. For an economic analysis of the tied selling case see Frank Mathewson and Ralph Winter, *Competition Policy and Vertical Exchange* (Toronto, University of Toronto Press, 1985) pp.74-83 and the references therein.

⁵Between 1965 and 1983 there were 26 Restrictive Trade Practices Commission reports published. See Paul Gorecki and W. T. Stanbury, *The Objectives of Canadian Competition Policy 1888 – 1983* (Montreal, Institute for Research on Public Policy, 1984), Tables 1A and 1B. Professor Green called these reports "an excellent source of information on Canadian industrial behaviour." See Christopher Green, *Canadian Industrial Organization and Policy*, Second Edition (Toronto, McGraw Hill Ryerson, 1985) p.252.

⁶Ralph Winter, "Presidential Address: Antitrust Restrictions on Single-Firm Strategies" *Canadian Journal of Economics* 42 (November, 2009) p.1208.

⁷Thomas Ross, "Viewpoint: Canadian Competition Policy: Progress and Prospects" *Canadian Journal of Economics* 37 (May, 2004) p.252.

⁸The Sherman Act (1890); the Clayton Act (1914) and; the Federal Trade Commission Act (1914). See White, *op.cit.*, p.1.

⁹For a critique of the 2009 amendments see Neil Campbell and Sorcha O'Carroll, "The Americanization of Canada's Competition Act" *Canadian Business Law Journal* 48, 2010, pp.446-61.

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¹¹Canada (Commissioner of Competition) v. Air Canada, 26 C.P.R. (4th) 476 (Competition Tribunal, 2003).

¹²Jeffrey Church and Roger Ware "Abuse of Dominance under the 1986 Competition Act" *Review of Industrial Organization* 13 (April, 1998) pp.85-129; Michael Trebilcock, Ralph Winter, Paul Collins and Edward Iacobucci, *The Law and Economics of Canadian Competition Policy* (Toronto, University Press, 2002) pp.476-572; Winter, Presidential Address., *op.cit.*, pp.1223-1236.

¹³ (Canada (Commissioner of Competition) v. Canada Pipe Co. Ltd., [2005] C.C.T.D. No. 3 (Comp. Trib.)); *Commissioner of Competition v. Canada Pipe Company Ltd.* (2006), 268 D.L.R. (4th) 193 (F.C.A.).

¹⁴ Economic Council of Canada, *op.cit.* pp.113-8; Lawrence Skeoch and Bruce McDonald, *Dynamic Change and Accountability in a Canadian Market Economy* (Ottawa, Consumer and Corporate Affairs, 1976) pp.47-124. For discussions of the development of the merger provisions of the *Competition Act* see: Paul Crampton, *Mergers and the Competition Act* (Toronto, Carswell, 1990) Ch.1 and Neil Campbell, *Merger Law and Practice: The Regulation of Mergers under the Competition Act* (Toronto, Carswell, 1997) pp.2-33.

¹⁵ Anne Carty and Peter Glossop, "Outcome of Waste Industry Case Turns on Economics" *Canadian Competition Record* 20 (Summer, 2001) pp.20-24.

¹⁶ Neil Campbell, "The Economic Theory of 'Unilateral Effects' and the Practical Reality of Differentiated Products Mergers" in Bruce Graham ed., *Canadian Bar Association Competition Law Section Annual Fall Conference on Competition Law 1998*, pp.177-84.

¹⁷ Lawrence White, *op.cit.* pp.15-16.

¹⁸ Ross, 2004, *op.cit.*, pp.256-7.

¹⁹ Thomas Ross and Andy Baziliauskas, "Lessening of Competition in Mergers under the Competition Act: Unilateral and Interdependence Effects" *Canadian Business Law Journal* 33, 2000, pp.373-426; Jeffrey Church, "The Economics of Coordinated Effects and Merger Analysis" in Donald Houston ed., *Canadian Bar Association Annual Fall Conference on Competition Law - 2000* pp.561-78.

²⁰ "Competition Bureau's Letter to the Royal Bank and the Bank of Montreal," (December 11, 1998), <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01612.html>; "Competition Bureau's Letter to the CIBC and the TD Bank," (December 11, 1998), <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01601.html>.

²¹ Ross and Baziliauskas, *ibid.*, p.421.

²² *ibid.*, p.426.

²³ <http://csgb.ubc.ca/ccpp/simulation/#about>.

²⁴ For the fundamentals of the application of the Cournot model to merger policy see Joseph Farrell and Carl Shapiro, "Horizontal Mergers: An Equilibrium Analysis" *American Economic Review* 80 (March, 1990) pp.107-26.

²⁵ Carl Shapiro, "Mergers with Differentiated Products" *Antitrust* 10, 1996 pp.23-30.

²⁶ For purposes of illustration, the two merging firms are assumed to have the same price-cost margins (Lerner Indexes).

²⁷ Gregory Werden, "A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Differentiated Products" *The Journal of Industrial Economics* 44 (December, 1996) pp.409-13.

²⁸ Roger Ware, "Leading Edge Issues in the Economics of Competition Policy" in James Musgrove ed. *Competition Law for the 21st Century* (Canadian Bar Association Competition Law Section, Annual Conference 1997) pp.65-68.

²⁹ Lilla Csorgo and Margaret Sanderson, "Differentiated Products Mergers: Recent Experience in Canada and the U.S." in Bruce Graham ed., *Canadian Bar Association Competition Law Section Annual Fall Conference on Competition Law 1998*, pp.133-62.

³⁰ George Lerner, "The Competition Bureau Dusts Off the Interdependence

(Collusion) Doctrine" *International Antitrust Bulletin* (Spring, 1999) pp.13-22.

³¹ Competition Tribunal, Commissioner of Competition v. Superior Propane, Affidavit of Michael R. Ward, http://www.ct-tc.gc.ca/CMFiles/CT-1998-002_0125_38JWG-7162007-1414.pdf.

³² Joseph Farrell and Carl Shapiro, "Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition" *The B.E. Journal of Theoretical Economics* v.10, n.1, 2010, Article 9. Farrell and Shapiro first posted their analysis in 2008.

³³ Presentation of Frederick Warren-Boulton to the 2010 Canadian Bar Association 2010 Annual Fall Competition Law Conference, http://www.cba.org/cba/cle/PDF/COMP10_WarrenBoulton_paper.pdf.

³⁴ The Staples case involved the merger of two big box business supplies retailers, Staples and Business Depot. An important question was whether the relevant product market was confined to big box retailers. Econometricians on each side estimated the sensitivity of the respective prices and margins of the merging retailers to the proximity of big box competitors. See Orley Ashenfelter, David Ashmore, Johnathan Baker, Susan Gleason and Daniel Hoskin, "Empirical Methods in Merger Analysis: Econometric Analysis of Pricing in *FTC v. Staples*" *International Journal of the Economics of Business* 13 (July 2006) pp. 265–279. For a different perspective see Jerry Hausman and Gregory Leonard, "Documents versus Econometrics in Staples" (NERA Consulting, September 1, 1997) http://www.nera.com/nera-files/PUB_Staples_963.pdf. These authors are of the view that the econometric studies cancelled each other out leaving the court to rely on the raw documents.

³⁵ Competition Bureau, Merger Enforcement Guidelines, October 6, 2011, para.3.1 http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html#s4_1.

³⁶ *ibid.* para.6.15.

³⁷ *ibid.*, para.6.17.

³⁸ *ibid.* §.6.

³⁹ Malcolm Coate, "Alive and Kicking: Collusion Theories in Merger Analysis at the Federal Trade Commission" *Competition Policy International* 4 (Autumn, 2008) pp.145-174.

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⁴¹ Slade, *ibid.*, pp.21-2.

⁴² *Canada, Commissioner of Competition v. Canadian Waste Services Holdings Inc.* (2001), 11 C.P.R. (4d) 425 (Comp.Trib.). For an explanation of the distinction between Ricardian rents and supra-normal profits see: Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* (Boston, McGraw Hill, 2000) p.435. For a discussion of this distinction in the context of *Canadian Waste Services* see: Margaret Sanderson and Ralph Winter, "Geographic Market Definition in *Canadian Waste Services*" *Canadian Competition Record* 21 (Spring/Summer, 2002) pp.112-125; Margaret Sanderson and Ralph Winter, "Profits versus Rents in Antitrust Analysis: An Application to the *Canadian Waste Services Merger*" *Antitrust Law Journal* 70, (November, 2002), pp.485-513.

⁴³ Royal Commission on the Economic Union and Development Prospects for

Canada, *Report Volume Two* (Ottawa, Supply and Services Canada, 1985) p.218. See also R.S. Khemani, "Merger Policy in Small versus Large Economies" in R.S. Khemani and W.T. Stanbury eds. *Canadian Competition Law and Policy at the Centenary* (Halifax, Institute for Research on Public Policy, 1991) pp.205-24.

⁴⁴ Michael Trebilcock and Ralph Winter, "The State of Efficiencies in Canadian Merger Policy" *Canadian Competition Record*, 19 (Winter 1999-2000) p.106.

⁴⁵ Paul Crampton, *Mergers and the Competition Act op.cit.*, ch.7.

⁴⁶ Competition Bureau, *Merger Enforcement Guidelines* (March, 1991) s.5.5. <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01682.html>.

⁴⁷ See also Crampton, *op.cit.*, pp.529-32.

⁴⁸ Peter Townley, "Efficiency Standards: They Also Serve Who Only Sit and Weight" *Canadian Competition Record* 21 (Winter 2002-2003) pp.115-132.

⁴⁹ *Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289.

⁵⁰ Trebilcock and Winter, "The State of Efficiencies in Canadian Merger Policy" *op.cit.*, pp.108-9.

⁵¹ My discussion follows Jason Gudolsky and Patrick Gay, "Long Live the *Merger Enforcement Guidelines*? A Review of the *Superior Propane* Decision" *Canadian Competition Record* 20 (Fall, 2000), pp.47-79.

⁵² For a commentary on the series of events following the Tribunal's Superior decision see: Andrew Roman, Michael Piaskoski and Michelle Wong, "Legal Principles versus Economic Principles: The Battle over Efficiencies in Canadian Merger Review" *Canadian Business Law Journal* 44 (December 2006) pp. 173-210.

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⁵⁴ Roger Ware, "Efficiencies and the Propane Case" in Donald Houston ed. *Canadian Bar Association Annual Fall Conference on Competition Law 2000* (Juris Publishing, 2001), p.147.

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⁵⁷ Thomas Ross and Ralph Winter, "Canadian Merger Policy Following Superior Propane" *Canadian Competition Record* (Summer, 2003) pp.7-23; Marc Duhamel and Peter Townley, "An Effective and Enforceable Alternative to the Consumer Surplus Standard" *World Competition Law and Economics Review* 26, n.1, 2003 pp.3-24; D.G. McFetridge, "Efficiencies Standards: Take Your Pick" *Canadian Competition Record* (Summer, 2002) pp.45-58.

⁵⁸ Roger Ware, "Is Competition Economics 'Beyond the Ken of Judges'? The Federal Court of Appeal Ruling in Superior Propane" *Canadian Competition Record* 20 (Summer, 2003) pp.1-7.

⁵⁹ Ware, *ibid.*, p.5.

⁶⁰ Marc Duhamel and Peter Townley, "From Superior Propane to Bill C-249: The Consequences of Informed Ignorance?" *Canadian Competition Record* 21 (Spring, 2004) p.117.

⁶¹To reach this conclusion they appeal to John Rawls' "veil of ignorance" argument which is that if a person does not know where he will end up in the income distribution and is risk averse, he will support income redistribution as a form of insurance against an adverse drawing even though this would reduce his income in the event of a favourable drawing. See Thomas Ross and Ralph Winter, "Canadian Merger Policy Following Superior Propane" *Canadian Competition Record* (Summer, 2003) pp.7-23 and the references therein.

⁶²Ross and Winter, *ibid.*, pp.14-5.

⁶³Thomas Ross and Ralph Winter, "The Efficiency Defense in Merger Law: Economic Foundations and Recent Canadian Developments" *Antitrust Law Journal* 72, n.2, 2005 pp.471-504.

⁶⁴These weights are calculated using the expression in Ross and Winter, "The Efficiency Defense in Merger Law," *ibid.*, n.57.

⁶⁵Ross and Winter, *ibid.* Appendix Table 2, p.503. These authors appear to push this too far when they argue (n.61, p.492) that propane consumption by the poor should be confined to direct sales to households because it is not known whether price increases to business customers are ultimately passed on to the poor. If one is behind the Rawlsian veil of ignorance, it is reasonable to assume that the fraction of indirect consumption accounted for by the poor is the same as the fraction of direct consumption. Moreover, if issues of pass-on have to be considered, the jurisprudence under s.96 is not nearly as precise as the authors suggest.

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⁶⁷*ibid.*, pp.115-6.

⁶⁸Margaret Sanderson, "Efficiencies Analysis in Canadian Merger Review: A Case for Leaving Things Be" *Canadian Competition Record* 22 (Fall, 2006) pp.86-101.

⁶⁹Competition Bureau, Efficiencies in Merger Review, March 2, 2009 <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02982.html#a5>.

⁷⁰Duhamel and Townley, "From *Superior Propane* to Bill C-249" *op.cit.*, pp.114-5.

⁷¹Competition Bureau, Merger Enforcement Guidelines, October 6, 2011, para.12.28. http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html#para_12_13.

⁷²Competition Policy Review Panel *op.cit.*, p.56.

⁷³Ross, "Viewpoint" *op.cit.*, pp.252-3.

⁷⁴Michael Trebilcock, "Abuse of Dominance: A Critique of *Canada Pipe*" *Canadian Competition Record* 22 (Summer, 2007) p.7.

⁷⁵Economic Council of Canada, *op.cit.*, p.101.

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⁷⁷W.T. Stanbury, "A Review of Conspiracy Cases in Canada, 1965/66 to 1987/88" *Canadian Competition Policy Record* 10 (March, 1989) pp.33-49.

⁷⁸Economic Council of Canada, *op.cit.*, p.102.

⁷⁹*ibid.*, p.103.

⁸⁰Green, *op.cit.*, p.265.

⁸¹Stylianos Perrakis, *Canadian Industrial Organization* (Scarborough, Prentice Hall, 1990) p.272.

⁸² *ibid*, p.272.

⁸³ Stanbury, *op.cit.*, p.37.

⁸⁴ *R. v. Nova Scotia Pharmaceutical Society* (1992), S.C.R. 606, 139 N.R., 43 C.P.R. (3d) 1, 10 C.R.R. 34.

⁸⁵ Patrick Hughes and Margaret Sanderson, "Conspiracy Law and Jurisprudence in Canada: Towards an Economic Approach" *Review of Industrial Organization* 13 (April, 1998) pp.153-76.

⁸⁶ Donald McFetridge, "Competition Policy and Cooperative Innovation" in Richard Braudo and Jeffrey MacIntosh eds., *Competitive Industrial Development in the Age of Innovation* (London, Routledge, 1999) pp.179-98.

⁸⁷ Competition Bureau, "Strategic Alliances under the Competition Act" November, 1995, <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01671.html>

⁸⁸ Michael Trebilcock and Presley Warner, "Fixing Price-Fixing Laws" *Canadian Competition Record* 17 (Spring, 1996) pp.49-50.

⁸⁹ Stanbury, *op.cit.*, p.37. With respect to the post-PANS era, see: Shawn Neylan and Michael Mahoney, "It's Not Too Tough for the Crown to Win: The Prosecutorial Track Record is not a Basis for Amending Section 45 of the *Competition Act*" *Canadian Competition Record* 21 (Spring, 2004) pp.99-108.

⁹⁰ Brian Facey and Dany Assaf, "Innovation, Growth and Prosperity: A Framework for Amending Canada's Conspiracy Laws" *Canadian Competition Record* 20 (Winter 2001-2) pp.62-4.

⁹¹ Thomas Ross, "Proposals for a new Canadian competition law on conspiracy" *The Antitrust Bulletin* 36 (Winter, 1991) pp. 851-82. p.872.

⁹² Trebilcock and Warner, *op.cit.*, pp.51-7.

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⁹⁷ Donald McFetridge, "Horizontal Agreements as Reviewable Practices" CBA Annual Fall Conference on Competition Law, October, 2002.

⁹⁸ Richard Posner, "Antitrust and the New Economy" *Antitrust Law Journal* 68, 2001, p.939.

⁹⁹ Competition Policy Review Panel, *op.cit.*, p.61.

¹⁰⁰ Canada, Competition Bureau, *Competitor Collaboration Guidelines*, May 2009, p.3.

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¹²¹ Professor Mathewson of the University of Toronto was a member of this group.

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¹²⁴ Competition Policy Review Panel, *Compete to Win Final Report*, June 2008, p.58. [http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/\\$FILE/Compete_to_Win.pdf](http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/$FILE/Compete_to_Win.pdf).

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¹²⁸ Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach op.cit.*, pp.647-62.

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¹³¹ Winter, 2009, *op.cit.*, pp.1220-1221.

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¹³³ Competition Bureau, "Enforcement Guidelines on the Abuse of Dominance Provisions, July 2001" §.4.3. <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01251.html>.

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¹⁴³ Margaret Sanderson and Michael Trebilcock, "Bad Policy, Bad Law: Bill C-26 Amendments to the Competition Act on Airline Predation" *Canadian Competition Record* (Spring/Summer, 2000) pp.32-37.

¹⁴⁴ Lilla Csorgo, "Canada's Draft Abuse of Dominance Guidelines: A Comparative Look" pp.21-22. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1416171 At the time she wrote this paper, Dr. Csorgo was T.D. MacDonald Chair at the Competition Bureau. Her discussion of the Air Canada case is part of a larger discussion of the role of price-cost screens in abuse of dominance or monopolization cases.

¹⁴⁵ William Baumol, "Predation and the Logic of the Average Variable Cost Test" *Journal of Law and Economics* 39 (April, 1996) pp.49-72.

¹⁴⁶ Csorgo, "Canada's Draft Abuse of Dominance Guidelines: A Comparative Look," *op.cit.*, pp.24-25.

¹⁴⁷ Donald McFetridge, "The Commissioner of Competition v. Air Canada: Phase 1" *Canadian Competition Record* (Spring, 2004) pp.81-98. Professor McFetridge was retained by Air Canada on this case.

¹⁴⁸ Csorgo, *op.cit.* pp.22-23.

¹⁴⁹ Iacobucci, Trebilcock and Winter, *op.cit.*, p.54.

¹⁵⁰ James Musgrove and Dan Edmonstone, "Stalled on Take-off: Commissioner of Competition v. Air Canada – A Comment" *Canadian Competition Record* (Spring, 2004) pp.76-79.

¹⁵¹ Musgrove and Edmonstone, *ibid.* p.77.

¹⁵² Jeffrey Brown, Paul Collins and Kevin Rushton, "The Aspen Skiing Case from a Canadian Competition Law Perspective" *Antitrust Law Journal* 73, n.1 pp.259-60

¹⁵³ Iacobucci, Trebilcock and Winter, *op.cit.*, p.57.

¹⁵⁴ Paul Crampton, "Abuse' of 'Dominance' in Canada: Building on the International Experience" *Antitrust Law Journal* 73, n.3, 2006, pp.803-67.

¹⁵⁵ Competition Bureau, "Updated Enforcement Guidelines on the Abuse of Dominance Provisions, January 2009" *op.cit.*, Appendix III.

¹⁵⁶ The discussion in this section draws heavily on Zhiqi Chen, Thomas Ross and W.T. Stanbury, "Refusals to Deal and Aftermarkets" *Review of Industrial Organization* 13 (April, 1998) pp.131-51.

¹⁵⁷ Experts must now sign an agreement that their obligation to inform the Tribunal supercedes their obligation to their client.

¹⁵⁸ Chen, Ross and Stanbury, *op.cit.* p.150.

¹⁵⁹ To date, leave to bring an application before the Tribunal under s.75 has been granted to seven private parties.

¹⁶⁰ My discussion of the Tribunal's decision follows Peter Franklyn and Steve Sansom, "Tribunal Finds Exclusivity Rebate by Dominant Firm not Anti-Competitive" *Canadian Competition Record* 22 (Fall, 2005) pp.49-64.

¹⁶¹ The Tribunal defined the product market on the basis that cast iron was required by building codes for some applications, implying that all cast iron DWV customers were essentially captive. In the alternative, there may have been many potential buyers who were not captive to cast iron and if Bibby could not distinguish among buyers it would not have had any market power. See Andy Baziliauskas and Roger Ware, "Does Canada Pipe Really Have Market Power?" *Canadian Competition Record*

22 (Fall, 2005) pp.65-77.

¹⁶² *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.); *Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.); *Canada (Director of Investigation and Research) v. D&B Companies of Canada Ltd.* (1995), 64 C.P.R. (3d) 216 (Comp. Trib.).

¹⁶³ Franklyn and Sansom, *op.cit.*, pp.52-3 and the references therein.

¹⁶⁴ *ibid.*, p.52.

¹⁶⁵ This calculation assumes the following: (1) the multiplier under the SDP is .55 (the customer pays 55% of list); (2) the multiplier for non-SDP customers is .94; (3) SDP customers also receive a 7% quarterly rebate and a 4% annual rebate on their purchases and; (4) the distributor must continue to purchase 20% of its requirements from Bibby. For purposes of this calculation the rebates are treated as if they are paid at time of purchase. If C is the competitor's price, L is Bibby's list price, S is Bibby's SDP price and M is the distributor's mixing cost, then the distributor is indifferent between the SDP and the competitor if $(.94)(.2)L + .8C = .55(1 - (.07 + .04))L = S$. The left hand equality solves for $C/L = .38$ and $1 - C/L = .62$. From the right hand equality, $S/L = .55(1 - (.07 + .04)) = .49$ so that $C/S = .77$ and $1 - C/S = .33$. If a competitor matched the SDP on the 80% of the distributor's requirements, it would set its price $C = .55(1 - (.07 + .04))L$. The distributor's mixing cost, M, would be $(.94)(.2)L + .55(1 - (.07 + .04))(.8)L$ and $M/S = 1.18$. All results are rounded to two decimal places.

¹⁶⁶ *Canada (Commissioner of Competition) v. Canada Pipe Co.* (F.C.A.), 2006 FCA 233, [2007] 2 F.C.R. 3.

¹⁶⁷ Brennan and Gunderson, *op.cit.*, p.76.

¹⁶⁸ Brennan and Gunderson, *op.cit.*, p.77. See also Trebilcock, *op.cit.*, pp.5-9. Professor Trebilcock raises a number of other concerns about the Federal Court's decision.

¹⁶⁹ *ibid.*, p.77.

¹⁷⁰ Competition Bureau, "The Abuse of Dominance Provisions (Sections 78 and 79 of the Competition Act)" *op.cit.*, §.3.2.

¹⁷¹ *op.cit.*, p.19.

¹⁷² On *Tele-Direct*, *NutraSweet* and *Nielsen*, see Church and Ware, 1998, *op.cit.* pp.85-129 and Winter, 2009, *op.cit.*, pp.1223-34 and the references therein. On *Canada Pipe* see Baziliaskas and Ware, *op.cit.*, pp.65-77 and on *Waste Management* see Sanderson and Winter, "Geographic Market Definition," *op.cit.*, pp.112-25 and Sanderson and Winter, "Profits versus Rents," *op.cit.*, pp.485-513.

¹⁷³ Ross, "Viewpoint," *op.cit.*, Table 1, p.248. See also Peter Glossop, "Canada's 2007 Amendments to its Immunity Policy: A Brief Review" *Canadian Competition Record* 23, (Spring, 2008) pp.8-14.

¹⁷⁴ Sanderson, "Efficiencies Analysis in Canadian Merger Review," *op.cit.* p.86.

¹⁷⁵ R.Jay Holsten, "The Commissioner of Competition v. Superior Propane: The Tribunal Strikes Back" *Canadian Competition Record* 21 (Spring/Summer, 2002) pp.29-30.

¹⁷⁶ For a broader institutional critique see: Edward Iacobucci and Michael Trebilcock, "Critical Reflections on The Institutional Design of Canadian Competition Policy" *Canadian Competition Law Review* 24, n.1 (2011) pp.39-48.

¹⁷⁷ Ross, "Viewpoint," *op.cit.*, pp.262-6.

¹⁷⁸ Justice Sandra J. Simpson, "The Competition Tribunal 2003-2011 and Beyond" *Canadian Competition Law Review* v.24, n.1, 2011, pp.49-50.