CANADIAN COMPETITION RECORD

COMMENT & ANALYSIS

WHAT'S ESSENTIAL, WHAT'S PRUDENTIAL, WHAT CAN COMPETITION PROVIDE?

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Abstract: Electronic networks associated with bank machines, credit cards, and point-of-sale direct-debit facilities increasingly dominate the delivery of retail financial services. The efficiency of these networks is based on convenience for both consumers and merchants and the ability of these networks to transmit payments directly into clearing and settlement systems. The Canadian Payments Association Act and the rules developed by this Association prohibit direct participation in these networks by non-deposit-taking institutions. The rapid convergence of banking, insurance, and funds management into a single financial service marketplace suggests that this prohibition is an increasing impediment to competition. We argue that it is access to the payments systems, rather than access to any individual electronic network, that is essential for competition.

Introduction

The trend towards a single financial services marketplace in Canada has the potential to intensify competition among the major institutions in banking, insurance, and funds management. One feature of this market is that the delivery of financial services is increasingly dominated by networks, such as those associated with the shared use of bank machine ("ATM"), credit card, and point-of-sale ("POS") direct-debit facilities. To compete, financial firms must be able to deliver services through a network. Networks lower transactions costs associated with payment instructions and are characterized by externalities which ensure that the larger the coverage, the greater the value to all participants. The lower costs of electronic payment networks also reflect the advantages of electronic data interchange ("EDI") over paper-based transfers of value.

The growing importance and cost advantages of participation in these electronic networks have resulted in recent claims that they represent essential facilities for competition in the modern financial services marketplace. Here we use the term 'essential facility' to indicate a privately owned asset that has two features: (i) it is a necessary input into the provision of a good or service, and (ii) it cannot be duplicated on a cost-effective basis. Correspondingly, an essential facility market is the market for a service or collection of services requiring the essential facility as an input. Where an essential facility is privately owned, it is commonly argued that competition will be inhibited, and active regulatory intervention through access pricing rules may be necessary. Decisions by courts or competition authorities to require that access be provided are invariably controversial.

With respect to participation in modern financial services networks by insurance companies and fund managers, the access issue is more problematic. In so far as these networks provide demand access to funds held at financial institutions, whether for cash withdrawal or the transfer of value to third parties, they constitute part of the retail end of the payments system. In Canada, the *Canadian Payments Association Act* (the "CPA Act") and the regulations developed by the Canadian Payments Association (the "CPA") currently prohibit insurance companies and fund managers from any direct participation in the payments system.

In this paper we argue that these networks are not in themselves essential facilities. The essential facility is the payments system, and the competition problem is the regulatory framework within which it operates. In the absence of this regulatory barrier, we believe that competition will provide for the efficient operation of the Canadian payments system.

The Canadian Payments System

Definition of the Payments System and Payments Services

The payments system is made up of four components:

- payment instruments that provide instructions for the transfer of value;
- clearing systems for the receipt, processing and netting of these instructions for the transfer of value;
- settlement systems through which are sent instructions for the transfer of value between the settlement accounts held by the individual institutions at the central bank; and
- settlement accounts at the central bank in which individual clearing institutions hold the funds used to make the ultimate settlement.

The settlement and clearing functions are conceptually distinctive, but many payment system architectures combine both functions.

Risks in the Payments System

The operation of the payments system requires both the smooth functioning of the interconnected messaging, clearing and settlement systems described above and the solvency of the individuals and institutions on whom payment items are drawn. This level of interconnectedness achieves particular significance because of the delays in timing that are associated with the operation of the payments system, and the daily accumulation of counterparty obligations that result. These features of the payments system create four types of risk, the management of which is central to the regulatory regime associated with the payments system:

(i) the risk that the payer or the payer's financial institution will fail to meet their obligations to provide value through the settlement process may be termed liquidity and solvency risk;

(ii) systemic risk occurs when the failure of one party to meet its settlement obligations precludes other parties from meeting their obligations. In the extreme, all direct settling institutions may be unable to meet their obligations, and the whole payments system may collapse. Systemic risk is unlikely to be significant in small value payment systems (such as ATM withdrawals) because the net amounts owing at the end of each day will be small and the failure of one institution to provide this amount will not affect the solvency of the other institutions;

(iii) operational risk arises from the need for payments instructions to be transmitted from the different institutions clearing and settling on behalf of the payee and payer; and

(iv) risks associated with the incompleteness of contracts. Uncertainty arises because the legal framework does not cover every contingency gaps and uncertainty in the law associated with payments instruments and the operation of the payments system result in risk that a transfer of value may not be completed. Particular risk is associated with the uncertainty that arises from new payments instruments and services, about which there may be few legal precedents, and from the elements of the system such as netting.

The Role of the Canadian Payments Association

The CPA Act provides the CPA with a mandate to "establish and operate a national clearings and settlements system and to plan the evolution of the national payments system".[1] The justification for this mandate lay in the presumption that an efficient electronic payments system would require a "common user communication network .... defined as a shared service which would be openly accessible to all qualified users on a fee-for-use basis"[2] and that development of that common electronic payment network would be "an evolutionary process best accomplished through the participation of all categories of deposit-taking institutions."[3]

CPA membership is restricted to deposit-taking institutions: chartered banks, credit unions, and trust and mortgage loan companies. A monopoly over the provision of all payment instruments is ensured by the fact that the CPA operates the only mechanism by which settlement instructions may be sent to the Bank of Canada, and by the fact that only payment items drawn on institutions eligible for CPA membership may be presented for clearing and settlement.[4] The latter provision has provided the CPA with effective control over all retail payment mechanisms. The issue of payment instruments, clearing and settlement are separable functions, but so long as the current *Act* remains in force, the CPA has the authority to restrict to its members participation in the whole payments system.

The Payment, Clearing and Settlement Act, 1996

The *Payment Clearing and Settlement Act* gives the Bank of Canada an explicit role in the oversight of settlement and clearing systems, in ensuring that appropriate arrangements are in place to minimize systemic risk, and in guaranteeing the ultimate stability of the settlement system. The Act establishes the Bank of Canada as the supervisor of clearing and settlement systems in Canada, but provides particularly important powers for the Bank in relation to those systems that it designates as providing systemic risk for the Canadian financial system as a whole. The Act defines the phrase "clearing and settlement system" in a way that is capable of including not only the proposed large value transfer system and those clearing systems that currently settle through the ACSS protocol run by the CPA, but in addition, could apply to a range of clearing and settlement systems as diverse as the Winnipeg Futures Exchange and the Mutual Fund Clearing System which are not currently considered to be part of the payments system. Thus while it seems likely that, in the first instance, the Bank of Canada will designate only the Large Value Transfer System under the Act, there is scope for prospective application of its provisions that are well beyond the current limitations of the payments system defined by transfers between accounts at deposit-taking institutions.

Section 13(2) of the Act provides the power to make regulations deeming other entities to be "financial institutions" within the meaning of the Act, provided that the other entities are engaged primarily in the business of providing financial services, providing the potential for non-deposit taking institutions to be brought partially within the ambit of federal legislation if they should wish to participate in the payments system. Thus, the Act may be viewed as a step towards Parliament claiming "legislative competence over the national financial system, including its financial markets and the new financial instruments and clearing and settlement systems that serve them."[5]

Prosecution of these broader aspects of the Act will require further clarification of the role of the Bank of Canada, and an extension of its authority vis-a-vis that currently invested in the CPA. We consider this appropriate because, by comparison with the CPA, the Bank of Canada has three clear advantages in identifying and implementing public interest policies in the payments system:

- It has strong incentives to ensure that the payments system functions smoothly so as to implement monetary policy. It will have an incentive to see efficiency-enhancing advances in technology brought into the settlement process as quickly as possible, and must of course consider the implications of these innovations for the framework within which monetary policy is implemented;

- It is largely independent of the commercial motivations that will necessarily underlie the actions of private sector members of the CPA;

- The legislative requirement that settlement occur through Bank of Canada settlement accounts provides the Bank with much of the power that it needs to impose its views on settlement systems in the private sector.

Why Do Non-Members of the CPA Want Access to the Payments System?

Defining Access

One implication of the CPA Act is that only institutions eligible to be members of the CPA may enter payments items for clearing and settlement. All firms and consumers who purchase demand account or credit card services from one of these institutions have indirect access to the payments system. In the following, we use the term access to mean the ability to participate directly in the payments system.

Economies of Scope and the Demand for Access

Competition in the financial services marketplace is being driven by economies of scope (common costs in the production and/or distribution of financial services) which make joint production more efficient than individual production. Economies of scope in the financial sector result from technological change and new patterns of consumer demand,[6] and cut across traditional industry, institutional and product relationships. As Coase[7] and Stigler[8] pointed out in classic papers, firms engage in a series of distinct functions that define the scope of their activities. The precise configuration of the firm results from the costs of contracting for the supply of inputs necessary for the production process, and this in turn depends on economies of scope as well as the viability of specialized firms associated with each function of the firm. Technological change and economic growth may alter both the economies of scope associated with particular functions and the viability of separate firms associated with them. Static industry-specific regulation that offers exclusive privilege to select firms will be incapable of implementing the optimal configuration in the market.

In the financial sector, computerization has provided firms with the ability to manage information much more effectively and has focussed competition on distribution costs. Because there are common elements in the demand for many financial services products that have traditionally been produced by separate sectors, an enhanced ability to manage information has facilitated the diversification of the products and

services produced and distributed by financial sector firms. As a consequence, market forces and consumer demand are driving firms in each of the three traditionally distinct industries in the financial services sector banking, insurance, and funds management - to become more general financial services providers. The common elements in the demand for these products and in pricing risk and credit products may make it optimal for financial services firms, and cheaper for consumers, to purchase all of their financial services from one retailer "one-stop-shopping". For a retail financial services firm to be effective in meeting consumer demand for a range of complementary products does not, however, require that the retailer produce all of these products in-house. Many standardized financial services products (such as mutual funds, insurance policies and term deposits) may be produced by one firm and sold by another.

Mutual funds, independent investment dealers and insurance companies already transfer value from their customers' accounts on demand, but they are unable as a practical matter to provide payment on demand. This is because these institutions are unable to provide a mechanism through which the customer receives value directly. They must either provide a cheque drawn on a bank, or transfer the funds into a bank account on which a cheque can be drawn or from which cash can be demanded. The Competition Tribunal[9] accepted:

- that non-deposit taking financial institutions compete directly with members of the CPA for certain financial services;
- that for the provision of these services efficient access to the payments system is necessary; and
- that they have "valid concerns" about the restrictions that the CPA Act currently imposes.

In these circumstances, industry-specific regulation of the type epitomized by the CPA Act increasingly appears to be inappropriate:

- the legitimate business interests of a wide range of non deposit-taking firms require direct access to the payments system;
- banks may not have a comparative advantage in offering new payment instruments and technologies such as demand accessible mutual funds and smartcards, or may as a minimum prefer to offer these services through joint ventures with non-banks[10] (which would mean that the joint venture was not eligible for CPA membership);
- restricting these firms access to the payments system creates a barrier to the introduction of new competition; and

- the restructuring of the market may ultimately lead to the development of new banking institutions (e.g., with wholesale and payments services divisions spun off to the market) which could not be accommodated by the CPA Act.

Is Interac An Essential Facility?

Competition authorities should require a firm to allow its competitors to use facilities that it has built when those facilities are essential for competition in the relevant market. Demand for access to the payments system, especially as it is articulated in the recent *Interac* case, suggests that there may be an active role for competition policy to play in providing access to the payments system for these firms.

Economics of Essential Facilities

In general, networks reveal attributes that do not fit the conventional textbook model of competition. But these non-conventional features need not imply an essential facility. David Evans and Richard Schmalensee[11] set out five typical attributes of networks.

- network externalities: when a consumer joins the network, existing users of a network get more value from the network. The telephone network is an obvious example. In turn, network externalities yield;

- increasing returns: as more users join a network its value on average increases to each user. For example, in credit cards networks, enhanced numbers of card carriers mean that more merchants will accept payment through these credit cards. The more merchants who honour the card, the more valuable the card is to consumers so more consumers will demand the card;

- positive feedback: as networks grow and their value to each subscriber increases, it becomes easier at the margin to recruit more subscribers;

- tipping: because of the value of size, allegedly inferior technologies can sometimes (and perhaps only for a limited time) dominate superior technologies; and

- lock-in: because of the value of collective membership in the network, in the absence of a collective decision, individual users may be reluctant to switch to a superior technology, that could, for example, be an entrant to an established market.

What matters in detecting an essential facility is whether non-members of a service network can duplicate the network technology as a feasible alternative, either for entry or to gain membership in the established network system. This feasibility means that outside firms may inaugurate a new service via investment

in a new and different network or the credible threat to do so may alone elicit competitive prices from the existing network within its current or increased capacity. For example, the presence of several competing domestic bank, trust and loan companies is evidence that the efficiencies from size permit several deposit-taking institutions to survive. The presence of two credit card networks that appear to date to be sustainable is evidence that the efficiencies from size permit at least two networks to be currently sustainable.

In contrast, when an input is both essential and cannot be feasibly duplicated at effective costs, then the combination of natural monopoly elements and essential facilities mean that the duplication for non-members of an existing facility is excessively costly. Privately owned essential facilities raise special problems for competition policy because denial of access will provide a means of inhibiting entry to the market. Thus an essential facility market cannot be regulated by conventional competition policy, and may require regulatory intervention to stop the firms that own the essential facility from anti-competitive abuse. The regulatory intervention would dictate the terms under which all firms could access the system, including the access prices that should prevail.

Recent competition litigation in both Canada and the US has focussed on what, if any, essential facility is present in financial service networks. In general, competition enforcement agencies are wary of joint ventures among competing firms and the potential that joint ventures have for anti-competitive abuse. The most obvious example is that the joint venture may facilitate co-operative pricing. In any industry with open entry, non-competitive pricing arrangements would soon encounter discipline. This need not be the case if the joint venture represents an essential facility that becomes a barrier to entry. For example, existing network members exclude entrants who would otherwise impart downward competitive price pressure on the existing members. Frustrated entrants have an obvious incentive to overclaim entry impediments. They may be looking for a subsidy by utilizing the assets of established firms at prices below corresponding costs to facilitate their entry. The challenge to competition authorities is to be capable of disentangling these incentives and effects when evaluating a particular set of industry facts.

A critical issue in deciding on the competitive merits of entry into networks is first to decide whether any aspect of the accompanying technology represents an essential facility. For example, participation in the direct debit, credit card or cash dispensing business may benefit from the positive externalities associated with participation in a wider network, but participation in that network may not be strictly necessary for effective competition. The ability to settle obligations to third parties (merchants and third-party acquirers) may be the only element of the business that is truly essential. The clear implication of this for competition policy is that misidentification of what is the essential facility can lead to inappropriate intervention by the competition authorities and further, that this intervention will not be sufficient to enhance competition.

Furthermore, if the essential facility can be duplicated in a cost-effective fashion but is unique only because of regulation, then deregulation will inject further competitive vigour into the market. Specifically, credit card networks require their members to be part of the payment association and membership in that is

constrained through regulation. Liberalizing membership in payments associations could mean that other financial institutions could join the existing payment association or form competing payments associations. Competing payment associations would require a central payment facility to net out claims across payment mechanisms. With deregulation and competition, a surviving single payment mechanism would mean that this technology would be an essential facility. With competing payment mechanisms and a central clearing operation, it would be the central clearing operation that was the essential facility. It is the essential facility that requires regulatory attention with attendant rules of access pricing.

Director of Investigation v. *Bank of Montreal et al.* (the "Interac Case")

Interac manages an electronic messaging system that provides its members with shared network services for the implementation and clearing of cash dispensing and direct-debt payments. Access is obtained through Automated Teller Machines ("ATM") and Interac Direct Payment ("IDP") terminals by using a card, on which is encoded the customer account identification, matched with a personal identification number. A key feature of Interac is that it facilitates the settlement of counterparty obligations through EDI transmission of net claims information to the settlement architecture managed by the CPA.

In *Interac*, the charter members of Inter as well as Interac Inc. were alleged to have abused their dominant position in the market for shared electronic services. These services were necessary to provide consumers with the ability to use a card issued by an institution eligible to be a member of the CPA to access accounts held at that institution. A group of intervenors (including life insurers and mutual fund managers) opposed the consent order on the grounds that it did not provide them with the ability to issue cards that would access funds held with them. Under the Consent Order, they could only issue cards using sweep account arrangements with an institution eligible to be a member of CPA. A key feature of these sweep accounts is that they provide for the card to be issued on either an account with a CPA member for each individual customer (a Type 1 sweep account) or an omnibus account (a Type 2 sweep account) held with a CPA member. The terms on which these sweep accounts are provided do not allow institutions such as insurers or mutual fund managers to provide their customers with these facilities at a price that is competitive.

The Consent Order provides for competition in pricing of services at ATM/IDP terminals and for the entry of third party acquirers and service providers. These seem likely to provide minimal benefits to Canadian consumers because there is no strong evidence that these services are currently undersupplied. Canada has among the highest number of ATMs per capita of any developed country. In the face of (a) economies of scope between acquiring and issuing,[12] and (b) a barrier to entry in the latter (because CPA rules require that only institutions eligible for CPA membership can issue cards which allow the generation of payment instructions), then firms undertaking only the acquiring function are unlikely to be competitive with the incumbents. With respect to the indirect access provided for non-deposit taking institutions through the provisions for sweep accounts, the Tribunal commented:

> Until the CPA acts, non-FIs and FIs alike will be unlikely to commit to any indirect access arrangement given the costs of disrupting the arrangement. The CPA may choose never to act. Or it may impose restrictions that limit permissible sweeps to Type 1. In either case, the DCO provision removing the prohibition against sweeps from Interac will have no effect. Consumers would thus reap little benefit from the DCO.

In the Consent Order, the Tribunal recognized that, while the benefits to consumers might be negligible, the Director had achieved all that could be achieved conditional on four factors:

(a) the narrow definition of the market as including only the shared electronic services of institutions eligible to be CPA members was appropriate and necessary given the existing legislation relating to the payments system in Canada;

(b) the decision of Interac to use the CPA to settle transactions was not an anti-competitive act;

(c) the prohibition on non-deposit taking institutions participating in the clearing mechanism of Interac is a matter that the CPA has the power to regulate; and

(d) the lawful actions of the CPA could not be challenged by the Tribunal.[13]

Essentiality and Interac

In *Interac*, the Statement of Grounds and Material Facts contains numerous references to the shared electronic messaging system as an essential facility. For example,

(a) "... by the late 1980s it had become essential for deposit-taking financial institutions to join Interac in order to access its shared electronic network services to compete effectively in the supply of retail financial services in Canada" (para. 24); and

(b) in the face of growing consumer demand for cash dispensing and IDP services "... it became essential for financial institutions to connect to the Interac Shared Services in order to retain their customer base and to compete effectively in other financial services markets" (para. 54).

These sentiments were repeated in the arguments of counsel for each of the Director, Respondents, and Intervenors, although they used the term 'essential' in different ways. What is clear is that the Statement of Grounds and Material Facts used the term 'essential' in the specific context of the shared services of CPA members, not in the context of access to the payments system as a whole.

In line with the arguments set out above, however, the fact that Interac displays network externalities does not mean that it is an essential facility. Only if it is not feasible to duplicate the network technology is

the facility essential. We have substantial doubts that Interac is an essential facility because the messaging system could be reproduced at relatively modest cost. The Mutual Fund Clearing System ("MFCS") is an example of the extent to which non-deposit taking institutions may set up electronic messaging networks that are the technical equal of the facilities provided by the CPA. Because members of the MFCS cannot be members of the CPA, the MFCS uses certified cheques to settle daily bilateral net claims. By comparison with EDI settlement, this is inefficient in two important respects. First, it increases the transactions costs associated with clearing and settlement. Second, it increases risk in the system by delaying ultimate settlement for the transfers processed through the MFCS. The ability to participate directly in the payments system, not the ability to access Interac, represents the essential facility.

Do Concerns About Prudential Regulation Justify The Existing Barriers to Entry in the Canadian Payments System?

The arguments of the Respondents in *Interac*, and various publications of the CBA and the CPA, claim that payments system participation should only be available to institutions with the power to offer transferable deposits as part of their core business powers. This is justified as a means of ensuring that only institutions regulated to and meeting a high prudential standard will be participants in the payments system, and thus, as a means of ensuring the stability of the system. In this section we consider the merits of limiting participation to deposit-taking firms and the interrelated arguments about the basis for prudential quality that have been put forward.

Payment Instruments Should Be Drawn On Deposits

Deposits may be defined as liability instruments with a fixed nominal capital value that are issued by deposit-taking institutions - they have both a functional and a legal definition. The link between deposits and payment instruments is built upon the historical convention that banks redeemed deposits in cash (specie) on demand. Banks offered their customers chequing privileges as a means of economizing on the use of cash in the economy, and internalizing the transfer process within the banking system by making arrangements for these transfers to be cleared through a payments mechanism. Cheques are a particular type of bill of exchange drawn on a deposit account at a bank (defined to include all members of the CPA), and are regulated under the *Bills of Exchange Act*. Cheques, as well as other types of bills of exchange, may be used to transfer funds by order to a third party, but a bill of exchange that is transferable to a third party does not become a cheque unless it is drawn on a deposit account at a bank. Bills of exchange drawn on deposit accounts have certain legal attributes that make them superior to those of other bills of exchange. But it is straightforward to change the meaning of the term 'bank' within the *Bills of Exchange Act* so as to include all financial institutions. For example, this Act was already altered to include trust, mortgage loan, and credit union organizations in the CPA.

The problem with limiting the issue of payment instruments to deposit-taking institutions is that "... deposit-taking is a privileged and highly regulated activity in Canada."[14] If participation in the payments system is limited to deposit-taking institutions, then membership in the payments system also becomes a privileged

activity. The restriction on competition in the payments system appears to be unwarranted because it excludes instruments such as smartcards and money market mutual funds that are functionally similar to deposits.

A key distinction between deposits and other instruments such as mutual fund shares is that the latter do not have a fixed capital value. This creates the potential for some asset risk in the payments system: value which appears to be available for transfer to a third party on one day may not be there the next day (if the value of the assets declines) when the payment item is cleared. While this asset risk is an issue that must be considered in the development of broader payments system access, we agree with the Competition Tribunal that noted in its Reasons:

> ...none of the evidence presented to us (including by the respondents who are, after all, important CPA members) indicated that the concerns about asset risk raised by the working group [of the CPA] with respect to Type 2 arrangements cannot be dealt with in a way which allows such arrangements to operate effectively.[15]

Only Deposit-taking Institutions Can Manage the Liquidity Risk Associated with Payments Services

The holding of demand accessible funds and participation in the payments system require that institutions maintain higher levels of liquidity than would be necessary if demand access was not provided. The current members of the CPA are not, however, the only institutions that possess or can acquire the knowledge necessary to manage liquidity risk, and the issue of deposits is not necessary for the effective management of liquidity risk. Nor is CPA membership and access to Bank of Canada liquidity support necessary: those firms without it must simply adjust their internal liquidity management accordingly. For example, the money market funds offered by mutual fund managers are in fact classic examples of highly liquid portfolios of short-term securities against which demand access could reasonably be provided.

Counterparty Risk Can Only be Assessed with Respect to Other Deposit-Taking Institutions

We find unconvincing the claim that counterparty risk in the payments system can only be assessed with respect to other deposit-taking institutions, with a common regulatory framework. This is because:

- deposit-taking institutions or direct clearers would not be required to accept levels of counterparty risk that they found unacceptable. Counterparty risk is assumed as a matter of contractual agreement and it is common for members of clearing systems to set bilateral and multilateral limits on counterparty claims;

- deposit-taking institutions already deal on a daily basis with those other financial institutions that would access the payments system under more liberal rules. As a result, deposit-taking institutions already possess much of the information that they need to assess the risk associated with any counterparty obligations in the payments system;

- many of the institutions that require access to the payments system are much larger, more stable, and more easily monitored than the small trust companies who currently have the right to be members of the CPA. Major insurance companies, investment dealers, telecommunications companies, and other entities that might participate in the payments system represent counterparty risks that are lower than many institutions that hold participation rights in the CPA; and

- even if it were true that wider access to the payments system results in current CPA members having to bear higher monitoring costs than they presently do, this need not imply any inefficiency. The assessment of efficiency rests on a comparison of the private costs that are imposed and the public benefits that are associated with increased competition.

CDIC Membership is Necessary for Participation in the Payments System

The CBA and the CPA have claimed that deposit insurance is required to protect the integrity of the payments system by minimizing the possibility of runs on deposit-taking institutions. This argument is at odds with the publicly stated desire of CBA members to opt out of the deposit insurance scheme.[16] It is also difficult to reconcile with the facts that:

- Canadian financial history of the last century does not provide any examples of either solvent banks that were forced to close as a result of a 'run', or financial crises that caused the breakdown of the domestic payments system;[17] and

- deposit insurance is not relevant to the risk associated with the payments system: the counterparty obligations of financial institutions are not insured by the CDIC, even though the holders of the deposit accounts from and to which funds are being transferred may have such insurance (within the limits for coverage provided by CDIC).

Prudential Regulation

Perhaps the most fundamental claim is that stability in the payments system requires that only institutions with and regulated to the highest prudential standards should be allowed to participate in the system, and that only deposit-taking institutions meet this standard. While we agree that high prudential standards are consistent with stability in the system, the claim that only deposit-taking institutions meet this standard is without merit because:

- it is inconsistent with the record of failures of deposit-taking institutions during the last 15 years;

- the life insurance industry is subject to prudential regulation by the same agency as the deposit-takers ("OSFI") but is currently excluded from the payments system;

- it is inappropriate to link participation in the payments system to the regulatory regime of one industry: other types of firms may meet similar objective standards and qualify for participation; and

- allowing non-deposit-taking institutions to participate in the payments system will improve the stability of the payments system, since these firms may squeeze out many of the low quality deposit-taking institutions that currently participate in the system.

Conclusion

The current restrictions on access to the payments system that are enshrined in the CPA Act and other Canadian legislation are best understood as arising from the historical convention that linked demand access to funds with the provision of chequable bank deposit accounts. Other institutions now have the need and the capability to participate in the payments system. Incumbent CPA members maintain that broader access to the payments system will reduce its stability and efficiency. Despite such claims, it is likely that wider access to the payments system will benefit competition in payment system services and instruments.

The Wallis Committee Report:[18] A Model for Canada?

The Existing Payments Infrastructure in Australia

The Australian payments system has three key management bodies: the Reserve Bank of Australia ("RBA"), which is the central bank, the Australian Payments System Council ("APSC") and the Australian Payments Clearing Association ("APCA"). It suffers from the same problem as the payments system in Canada: incumbent control of regulation and operational procedures that increasingly represents a barrier to competition among banks, insurance companies and fund managers.

The RBA has overall responsibility for management of the payments system, and thus sets prudential standards in addition to conducting the exchange settlement accounts. In addition, it operates a settlement system, Austraclear, which processes 35 percent of direct entry payments, and will operate the settlement infrastructure for the Real-time Gross Settlement System that is currently being established.

The APSC is a non-statutory body chaired by the RBA. It has monitoring responsibility, and its charter requires it to act in the public interest to improve overall payment system stability, efficiency and competitive equity. It has, however, lacked the authority to establish meaningful performance benchmarks.

The APCA was formed to oversee new entry to the payments system and to manage and co-ordinate the operation of effective payments, clearing and settlement systems. Individual "providers of payment services" must operate according to its rules. It provides the regulatory and procedural frameworks for clearing, and

cooperates with the RBA to establish these with respect to settlement. It does not, however, process payments; this function is performed by a variety of different clearing and settlement systems operating according to the rules established by the APCA.

The big four Australian banks dominate decision making within the APCA. The Wallis Report notes that in Australia there are concerns about the efficiency implications of a structure that provides the large incumbent institutions with the power to determine payments system policy. The Report argues that "... continued reliance on cooperative arrangements in the absence of specific performance benchmarks and clear policy objectives may impede the overall level of efficiency of the payments system."

The Approach of the Wallis Report

The Report recommends deregulation of entry to the Australian payments system based on principles which are in many respects similar to those articulated in Quigley's (1996) paper[19] on the Canadian payments system. In particular, it recommends the removal of industry specific (especially deposit-taking) criteria for participation in the payments system, and to facilitate this, it suggests the establishment of a Payments System Board ("PSB") within the RBA as a means by which the central bank may manage new entry. The PSB would have the responsibility for "implementing policies to improve payments system efficiency ... and enhancing the competitive framework, consistent with overall systemic stability."[20] Specifically, the Wallis Report suggests that the PSB should facilitate new entry to the payments system through:

- provision for non-deposit-taking institutions to issue payment instruments and participate in clearing and settlement systems;
- opening of membership in the APCA to any institution licensed by the PSB;
- the establishment of transparent minimum standards for the issue of payment instruments, as well as participation in clearing and settlement; and
- the establishment of a framework for the issue of payment instruments (such as smart cards) by institutions that are not members of the Australian Prudential Regulatorion Commission (the "APRC").

Access to Clearing and Settlement Facilities

The Wallis Report recommends that the PSB should provide and regulate two types of approval in the payments system: a clearing and settlement approval for banks and other institutions meeting appropriate prudential standards, and a clearing approval for those institutions involved only in clearing. The criteria for these approvals "should be transparent and based on objective tests with the following features:"[21]

- participants should be regulated to control the risks they pose to the central bank and other participants in clearing and settlement arrangements. This would be expected to differ according to the particular clearing stream for which settlement is desired;

- to ensure regulation is effective and problems can be resolved promptly, the RBA and APRC should co-operate closely in the conduct of regulation of participants. Prudential and operational conditions of access would be reflected in applications received from participants that are not subject to regulation by the APRC;

- participation should be limited to those with extensive transactions to settle on behalf on non-associated third parties; and

- subject to operational integrity considerations, the value of payments in the clearing stream, and consequently the risk to the system, should also be a factor in liberalizing entry.

Prudential Standards and Access

The Wallis Report concludes that increased competition in the payments system is possible without jeopardizing systemic stability if each participant meets appropriate prudential standards. Implicit in this conclusion is acceptance that prudential standards should vary with the level and type of participation in the payments system. In the case of high-value settlement, where failure to settle carries most risk for systemic stability, participants would be regulated to the same international standard as banks. For operation only in clearing systems, lower standards may apply. Non-deposit taking institutions should be able to settle directly retail electronic payments subject to:

(a) meeting reasonable capital, collateral and liquidity requirements;

(b) inspection programs to verify operational capability;

(c) structural separation of the payments entity from other aspects of the business; and

(d) evidence that they undertake extensive payments business on behalf of non-associated third parties.

Applicability of the Wallis Report to Canada

In its focus on deregulation to promote competition, the Wallis Report mirrors the views about the CPA expressed in this paper. The key element of this deregulation relevant to the essential facilities debate is that the Wallis Report assumes that central bank settlement accounts represent the only essential facility in the payments system. It recommends that the externalities associated with systemic and counterparty

risk in the payments system be controlled by clearly defined standards rather than industry-specific regulation, and it assumes that competition is feasible in the remainder of the market.

Conclusion

We consider it unlikely that Interac is an example of an essential facility because it does not meet the test of being impossible to duplicate at a reasonable cost. What is essential for competition in the modern retail financial services market is access to the payments system, not access to Interac.

The current framework for regulation of the payments system in Canada creates a major dilemma for competition policy because of its propensity to inhibit entry and the introduction of new products and services. Regulations that restrict the delivery of retail payments services to members of the CPA substantially lessen competition by prohibiting the introduction of new products and technologies by non-member institutions, and by providing a framework which facilitates anti-competitive co-operation between the incumbents in the market.

Competition will be important in achieving the efficiency objective of public policy in the payments system. The underlying presumption of the CPA Act, that the emergence of an electronic payments system would require the statutory provision of a common carrier framework, has proven to be false. Technological change has enhanced rather than reduced the potential for competition in the provision of payments system services. Deregulation, not the application of the essential facilities doctrine, is the approach most likely to enhance the efficiency of financial services markets in Canada. The Wallis Report recommends removing the power of the incumbents to determine the terms on which entry may occur, and develops a set of transparent standards for entry that are not institution-specific.

Notes

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[1] R.S.C. 1985, c. C-21, s.5 (the "CPA Act").

[2] Canada (1975) at 7.

[3] M. Anvari, "The Canadian Payment System" in David B. Humphrey, ed., *The U.S. Payment System: Efficiency, Risk and the Role of the Federal Reserve* (Boston: Kluwer Academic, 1990) at 98.

[4] The CPA Act defines a "payment item" as a bill of exchange drawn on or payable through a member of the CPA and any other class of items approved by a Canadian Payments Association by-law. For the purposes of defining the term "cheque" as a bill of exchange drawn upon funds held at a bank, the 1980 amendment to the *Bills of Exchange Act* defines a bank as an institution that is eligible to be a member of the Canadian Payments Association. This paragraph draws heavily on B. Crawford, *Crawford and Falconbridge on Banking and Bills of Exchange*, 8th ed. (Toronto: Canada Law Book Inc., 1986) at 1094.

[5] B. Crawford, "The *Payment, Clearing and Settlement Act, 1996*" (1997) Can. Bus. L.J. (April) at 1.

[6] Examples of these economies include the joint costs of identifying demand for insurance and banking products, and common elements in insurance and credit risk. For a detailed discussion of the economies of scope between

banking and insurance products, see Horstmann, Mathewson and Quigley, *Ensuring Competition* (Toronto: C.D. Howe Institute, 1996) at 36-46.

[7] R. Coase, "The Nature of the Firm" (1937) *Economica* 4, at 386-405.

[8] G. J. Stigler, "The Division of Labor is Limited by the Extent of the Market" (1951) J. Pol. Eco. at 185-193.

[9] *Director of Investigation and Research* v. *Bank of Montreal et al.* (1996), No. CT 95/2 (Comp. Trib.) at 66.

[10] An example is provided by the Danish legislation which is designed to facilitate the issue of smartcards by non-banks. The dominant supplier of smartcards in Denmark is a joint venture between a bank and a telephone company.

[11] D. Evans and R. Schmalensee, "A Guide to the Antitrust Economics of Networks" (1996) 10:2 Antitrust at 36-40.

[12] 'Issuing' refers to the issue of cards that access the ATM and direct-debit networks. Under CPA rules, this must be restricted to deposit-taking institutions. 'Acquiring' refers to the ownership of the ATM and direct-debit terminals which is not (under the terms of the Consent Order) now restricted to CPA member institutions. The fact that the dominant participants in Interac at present are both Issuers and Acquirers suggests that there may be symmetries or joint costs associated with these two activities which provide significant economies of scope in joint production.

[13] McKeown J., concurring, noted that the Director had not explained why the Consent Order was not delayed until the CPA had acted on their consideration of sweep accounts, so that the Tribunal had that opportunity to assess what the impact on competition might be (see *Director of Investigation and Research* v. *Bank of Montreal et al., supra*, note 9 at 69).

[14] Affidavit of B. Crawford in the matter of *Director of Investigation and Research* v. *Bank of Montreal et al., ibid.*

[15] *Ibid.* at 66.

[16] Canada, Senate Standing Committee on Banking, Trade and Commerce, *Regulation in the Federally-Regulated Financial Services Industry: Striking a Balance* (Ottawa: Queen's Printer, 1994). See also Canadian Banker's Association, Submission to the Senate Standing Committee on Banking, Trade and Commerce, *Financial Services Policy Regulation: The Paramountcy of Consumer Choice* (6 April 1995) at 43; and Canadian Payments Association, *Access to the Payments System: A CPA Perspective* (Ottawa: CPA, 1997).

[17] J.L. Carr, G.F. Mathewson and N.C. Quigley, *Ensuring Failure* (Toronto: C.D. Howe Institute, 1994).

[18] Australia, *Financial System Inquiry Final Report* (the "Wallis Report") (Canberra: Australian Government Publishing Service, 1997).

[19] N. C. Quigley, "Public Policy and the Canadian Payments System: Risk, Regulation and Competition," in J.M. Mintz and J.E. Pesando, eds., *Putting Consumers First: Reforming the Canadian Financial Services Industry* (Toronto: C.D. Howe Institute, 1996).

[20] *Supra*, note 18 at 386.

[21] *Ibid.* at 406.

CANADIAN COMPETITION RECORD

ABUSE OF DOMINANCE AND TIED SELLING: SOME THOUGHTS ON THE *TELE-DIRECT* CASE

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Introduction

The Competition Tribunal decided its fourth contested abuse of dominance case,[1] *Canada (Director of Investigation of Research)* v. *Tele-Direct (Publications) Inc. and Tele-Direct (Services) Inc.* on February 26, 1997.[2] In addition, two other abuse cases[3] have been determined on consent, although one of the consent cases, *Interac*, was subject to some significant dispute as a result of participation by intervenors. The other consent case, *Canada (Director of Investigation and Research* v. *AGT Directory Limited,* [1994] C.C.T.D. No. 24 (QL) (hereinafter "*CANYPS*"), was in fact round one of the Director's yellow pages fight. The *Tele-Direct* case also involved a very significant tied selling element.

Tele-Direct was the most extensive of the reviewable conduct proceedings to date. As the Tribunal noted, the time between the filing of the application and the decision was in excess of two years (including eleven months during which the Tribunal reserved its decision). The Tribunal found it to be the most complex case presented thus far. In fact, the Tribunal stated that the decision involved five cases, a tied selling case, and an abuse of dominance case in respect of agents, consultants, publishers and trade-marks.[4]

The case is effectively summarized by Karen Groulx in an earlier article in the *Record*.[5] We also provide a summary in our paper "Yellow Pages at First Blush: Some Preliminary Thoughts on the Tele-Direct Case".[6] We do not seek to summarize the decision here, nor do we review all or even most aspects of it. What follows is a comment on selected aspects of the case as they may be relevant to the development of the jurisprudence of abuse of dominance and tied selling.

Product Market Discussion

The conclusion reached by the Tribunal, that telephone directory advertising is a separate market from other types of local advertising, is, impressionistically at least, not a particularly controversial one. Certainly there is overlap with other advertising media, but it seems to us to be uncontroversial that telephone directory advertising is less similar to other types of advertising than, for instance, advertising in weekly newspapers is to that in daily newspapers. One is always suspicious of a narrow product market, but we

submit that intuitively the product market defined in *Tele-Direct* seems to be more likely to be correctly defined than was the product market found in *Southam.*[7] In the Tribunal's exhaustive review of the evidence as to substitutability between directory advertising and other forms of local advertising, no evidence was mentioned which would cause one to re-evaluate that impression.[8]

One interesting aspect of the product market analysis was the Tribunal's express review of the ability of Tele-Direct to price discriminate against those with the greatest need for telephone directory advertising. Tele-Direct's prices for larger advertisements, or those with additional colours, were proportionately higher than for smaller advertisements. The logic was that those who were most dependent on telephone directory advertising were likely to place larger, more colourful advertisements. By charging proportionately more for such advertisements Tele-Direct price discriminated against those with a greater need for Yellow Pages advertisements. The Tribunal determined that Tele-Direct's ability to price discriminate reduced the ability of those who could switch to other advertising media to discipline its pricing. This led the Tribunal to the conclusion that there was less discipline on Tele-Direct due to advertisers with a willingness and an ability to switch between advertising media than would have been the case if it could not price discriminate. Therefore, Tele-Direct's market power was not circumscribed, to the degree it might otherwise have been, by those advertisers with the least difficulty in switching media. There was, however, no discussion of the possible beneficial output-maximizing effects of price discrimination.

An encouraging aspect of the Tribunal's product market analysis was that, throughout, the Tribunal maintained its focus on the key question - that is, is telephone directory advertising subject to competitive pressure in a real or significant way from other media? There were some examples in the evidence of attention paid to other media, by Tele-Direct, and some very limited examples of switching between media; and of use by some advertisers of other media in ways similar to that which they used telephone directory advertising. That said, the fundamental question is, and the focus of the Tribunal remained, whether there was real competitive pressure on telephone directory advertising publishers from other media. The evidence suggested that there was not.

A disappointing aspect of the decision, however, and in our view a fundamental difficulty with the case, was that while the Tribunal reviewed the product market in respect of directory publishing in very considerable detail, that was not the only product market relevant to the decision. The case involved tied selling allegations between the publishing or advertising space market, and the market for advertising services. It also involved allegations of abuse of dominance not only in the advertising space market, but also in the "services" market, aimed at competing suppliers of advertising agency services, and at consultants who advised on the placement of telephone directory advertising. The "services" market included the sorts of things (i.e., advertising design and advice as to placement, number and size of advertisements) necessary to create a directory advertisement and efficiently use telephone directory advertising. The Tribunal failed to undertake any serious analysis of what the advertising service market was, what sorts of participants were in the market, whether the market was broader than just services in respect of telephone directory advertising, and what the barriers to entry, if any, were in that marketplace.

By failing to pay any significant attention to the key aspects of this services marketplace, we submit that the Tribunal was led astray in concerning itself overmuch with that marketplace. We submit that any analysis of that market would have suggested both that the market is much wider than advertising services specifically for telephone directories and, in any case, that the barriers to entry into that marketplace were very low. If we are correct in those assumptions it is difficult to imagine how there could be any serious worry about anti-competitive effects in such a marketplace. As the Tribunal did not undertake that review, however, we argue that it was overly concerned with assumed anti-competitive consequences in a marketplace that was in fact highly contestable.

In *Tele-Direct* the Tribunal was consistent with its approach to market power articulated in earlier cases. That is, it found that a high market share, together with barriers to entry, will typically be sufficient to support a finding of market power.[9] Thus, the Tribunal continues to be willing to find market power based on market share and barriers. This, taken together with a relatively low threshold for finding a substantial lessening of competition, had suggested that a firm which enjoys a large market share in an industry with some barriers, and which takes perfectly understandable steps to maintain its sales, risks an order against it under the abuse of dominance provisions.[10] However, as noted below, we argue that the Tribunal in *Tele-Direct* has shown some welcome restraint in seeking to distinguish anti-competitive conduct from hard competition on the merits.

Interestingly, in *Tele-Direct*, in addition to indirect indicia of market power, there was direct evidence of Tele-Direct's supra-competitive profits both through the fact that Tele-Direct made very significant contributions (in excess of 40% of its revenues) to the Telcos, and the fact that new entrants had to price at a 30% or 40% discount to Tele-Direct, yet were still profitable.[11]

The conclusion that Tele-Direct enjoyed market power in the publishing of telephone directories is, subject to the development of new on-line products noted above, it is submitted, largely uncontroversial. It is a market which likely tends toward monopoly. Church and Ware argue:

> Yellow Pages are a classic print media network product - the tendency to monopoly is strong, because (i) a new entrant has to persuade a whole set of advertisers to switch simultaneously, by creating expectations that entry would be viable and sustained; and (ii) households are likely to keep and refer to only the directory with the most complete listings.[12]

As well, the Tribunal considered whether competition from other forms of advertising, not within the defined publishing or advertising space product market, provided a competitive discipline on Tele-Direct. We are of the view that it was useful for the Tribunal to have undertaken that analysis. The delineation of product markets as an analytical tool in competition analysis does not mean that all products outside the defined market have no influence on activity within the market, or that all products within the defined market would have equal influence on the activity of the Respondent. There is always a continuum, and a line has to be drawn somewhere along it. While defining markets is an important analytical tool, it is only a tool, aimed at addressing the underlying reality of market power. Wherever the line is drawn as to the

product market boundary, that is only a somewhat arbitrary line. Products just inside the line may not impose much more discipline than those just outside the line. The reality, rather than just the threshold characterization, must be borne in mind.[13] While the Tribunal's discussion of market power in *Tele-Direct* does not address this point expressly, its analysis does implicitly recognize this fact, and then rejects the argument of discipline from outside the market on a factual basis. It is submitted, however, that the Tribunal's recognition that discipline may come from outside the product market is an important aspect of the decision.

Tied Selling

One Versus Two Products

Perhaps the most interesting aspect of the case was the issue of tied selling. In the tied selling case, the Director alleged that the tying product was directory advertising publishing, or advertising space, and that the tied product was directory advertising services. He alleged that as a condition of supplying advertising space in Yellow Pages directories, Tele-Direct required or induced customers to acquire another product from it - directory advertising services. The two products were provided as a bundle, in that Tele-Direct was unwilling to debundle (i.e.; sell the space at a discount without a service component) - or to pay commission to other services providers except for a small portion of the marketplace which met its commissionability criteria (essentially the very high end of the market). For the vast majority of the demand for directory advertising Tele-Direct would not unbundle, and therefore advertisers were forced either to purchase their advertising services from Tele-Direct as part of the bundled package, or to pay the same price for the bundled package but purchase advertising advice separately at an additional cost.

Determining whether there are one or two products in a tied selling case is always a thorny matter.[14] As a matter of first impression, if one characterizes the "service" function as really a "sales" function (i.e., selling the space in the directory), one would not be inclined to conclude that the product and the sales efforts necessary to sell the product are really two products. Whether one chooses to sell a product through an employed sales force, or whether one wishes to hire third parties and pay them for the purpose of selling a product, hardly seems to change the question as to whether there are one or two products in existence.

The Tribunal concluded that:

> A fundamental requirement of tying is the existence of two products, the tied product and the tying product. It is implicit in the determination of whether there are one or two products that efficiency considerations must be taken into account. We consider the demand for separate products and efficiency of the bundling are the two 'flip sides' of the question of separate products. Assuming demand for separate products, if efficiency is proven to be the reason for bundling, there is one product. If not, there are two products.[15]

The Tribunal observed that the Supreme Court of the United States in the *Jefferson Parish*[16] case found that there cannot be two products unless there is a demand for the tied product separate from the tying

product, such that it is efficient to offer them as separate products. That is, if the efficiency of offering the products as a bundle or single offering is such that there will not be separate demand for one, there is no tie. The Tribunal further noted that there must be buyer (advertiser) demand for the separate product.[17]

The Tribunal struggled with the question as to where on the spectrum there was separate demand for independent services. It noted, citing the arguments of Tele-Direct's expert, Michael Trebilcock, that at the very low end of the scale, when the advertiser is simply paying a premium for a bold listing or the like, there is very little creative content, and it was almost certain that the advertiser would not find it efficient or appropriate to employ a separate agent. Therefore there was likely not a separate demand for services, or separate product, at that very low end of the market.[18] The question was where, between that low end and the high end "national" accounts, where the accounts were made commissionable by Tele-Direct without the involvement of the Competition Tribunal, ought the line be drawn as to one versus two products.

The independent agents apparently indicated in interviews with the Director that they would not be interested in servicing accounts below about $10,000 in annual revenue.[19] The Tribunal concluded therefore that the agents regarded themselves at a cost disadvantage vis-à-vis Tele-Direct in dealing with smaller customers. Another way of saying the same thing may be that in the larger accounts there will tend to be more services required, and greater economic justification for such services. On the small accounts, the service component is likely much lower - whether provided by Tele-Direct or independently - and the effort is probably much closer to a pure sales function.

The Tribunal accepted there was no separate demand for advertising services for small customers, but for larger customers it concluded that advertising space and advertising services represented separate products. There was independent demand for services, and Tele-Direct did not demonstrate to the satisfaction of the Tribunal that it was inefficient to supply the products separately. The Tribunal's conclusion was that advertising space and advertising services constituted two product markets down to the level of six markets (i.e., six regions within Tele-Direct's marketplace). Tele-Direct divided Ontario into seven regions and Quebec into six regions. Therefore, any advertiser in all of Ontario or all of Quebec, or some combination totalling six regions, should, in the Tribunal's view, be a commissionable account. Below six regions, the Tribunal concluded that there was only a single product.

The Tribunal's conclusion, that above a certain revenue level or number of markets level there were two products, but below that level there was one, due to efficiency and demand considerations, may be correct; but it has such a artificial and arbitrary feel to it that we are left with significant doubt. As Tele-Direct's expert, Michael Trebilcock, argued, why would Tele-Direct have made some but not all accounts commissionable if it were acting for anti-competitive reasons? If Tele-Direct was not acting for anti-competitive reasons, but rather efficiency enhancing reasons, why should the Tribunal second guess the line which Tele-Direct itself drew? The Tribunal's reasons for second guessing where Tele-Direct chose to draw the

commissionable/non-commissionable line are not fully persuasive. Tied selling cases are always tricky in respect of determining one versus two products. *Tele-Direct* may be a particularly difficult case in that regard.

Substantial Lessening of Competition

The Tribunal's consideration of substantial lessening of competition, with respect to tied selling, takes less than two pages. Almost a page of that is devoted to a discussion of a technical issue in the drafting of the statute. Its conclusion on the point was that the value of the accounts which were subject to a tie, but which would not be subject to a tie if there were an order requiring that six market and above accounts not be tied, was approximately $19 million a year (of a total demand of approximately $1 billion). The Tribunal noted that this was in excess of 50% of the total current commissionable market (approximately $30 million) and stated, "[b]oth in relative and absolute dollar terms, the amount of revenue affected by the tie is undoubtedly sufficient to conclude that there is a substantial lessening of competition."[20]

The Tribunal has, to date, not grappled in any significant way with the meaning of the term "substantial lessening of competition" in a tied selling, abuse, or exclusive dealing case. It is submitted that this is the very heart of the Act.[21] In *Nielsen,*[22] as in *NutraSweet,*[23] the Tribunal noted that a substantial lessening of competition is something which adds to or preserves market power. Here, in relation to tied selling, the Tribunal did not even offer that rather cryptic and not fully satisfying view. It simply said because $19 million of commerce was subject to the tie, that represents a substantial lessening of competition. If that really is the test, then it is not much of a test.

The key, it is submitted, to determining whether there has been a substantial lessening of competition is the competitive effects. Does the conduct injure the economy in some significant way? Does it reduce consumer, or total, welfare? A tied sale in respect of a billion dollars of commerce, but without any significant injury, should not be enjoined.

This point is made by Church and Ware, where they state:

> The Tribunal spends little time on the economic analysis of tying in its 371 page decision. For such a central issue in the case, this is disturbing. A partial explanation is that the Tribunal apparently regards Section 77 as almost a *per se* prohibition of tying. Once a tie was accepted, the Tribunal's measure of 'substantial lessening of competition' is related only to the likely size of the business of independent agents excluded by the current arrangements (of course, this is not a *net* loss of business - much of this business would be taken up under the tie by Tele-Direct and other telcos). An economic assessment would involve estimating the effect of the tie on total surplus, which may be difficult to accomplish without a major exercise in data collection and econometric work, and even then is probably subject to a wide margin of error. If ties were almost always welfare decreasing, then the Tribunal's *per se* approach might be justified on grounds of economy of judicial resources; however, current theoretical work suggest that this is not the case.[24]

It may be, as in this case, that once one concludes that products are separate products because there is not an efficiency reason to offer them together, then it is not a big step to conclude that breaking the tie would be pro-competitive (although we would argue otherwise), particularly if one is concerned about barriers to entry into the directory publishing business.[25] It is submitted, however, that if the conduct is to be enjoined, the Director, and the Tribunal, should articulate the injury to the economy to which the tie - or the anti-competitive acts - give rise. Failing to do so essentially reads out the requirement that the Director show a substantial lessening of competition, except in purely quantitative terms as to the volume of commerce.

One can imagine a scenario in which Tele-Direct's logical goal in discouraging independent service providers might have had little to do with the consequences in the tied market for advertising services. Rather, by discouraging widespread effective sales and service organizations dealing with Yellow Pages, such organizations might not exist to guide advertisers to other publishers.[26] This would have the advantage (for Tele-Direct) of requiring independent publishers to enter with the provision of a sales/service function in addition to the publication of a directory, and it would eliminate an effective independent and knowledgeable source of advice to potential advertisers and independent publishers. That might have also reduced the ability of new publishers to demonstrate credibility, if there were few independent organizations which could "vouch" for them.

In addition to making entry more difficult for independent publishers, reducing the number of suppliers of independent advertising services might have had another beneficial effect for Tele-Direct. Tele-Direct's internal sales force was presumably motivated primarily by the desire to increase Yellow Pages advertising. There may be questions of where a listing should most efficiently be placed - or how many headings it should be placed under. It would be in the interest of Tele-Direct to have as many different headings for similar services as possible, to convince advertisers to list under those headings, and then to persuade competing advertisers that they should also be listed under the various headings. Similarly, it would be in the interest of Tele-Direct to persuade one advertiser to place a larger or more colourful advertisement (at a higher cost), and then to persuade competitors of that advertiser that they will be disadvantaged unless they also place such an advertisement. Agents earning commissions might be similarly motivated, although to a much lesser degree. Further, if they handle other types of advertising for the client as well, there would be little likelihood of them over-selling Yellow pages for the sake of that commission revenue.

For all of the above reasons, the question of tied selling in the *Tele-Direct* case is particularly interesting. Not, we submit, related specifically to the effect of exclusion of alternate suppliers of advertising services on the services market (because we suggest that market is fully contestable), but for the effect such exclusion might have in the market for telephone directory advertising. Absence of independent and effective service organizations, with knowledge of telephone directory advertising might have, at least arguably, raised the barriers to entry into the publishing business. It might also have increased the opportunities for additional revenues to be reaped in the publishing business through over-selling. It seems to us that the Tribunal could have had a fair bit to say about possible substantial lessening of competition. We regard the fact that it did not and apparently thought that it need not or did not have evidence to do so - as regrettable.

Leverage Between Advertising Services and Advertising Space, and Between Regulated and Unregulated Markets

Tele-Direct advanced, through Michael Trebilcock, an argument about the lack of ability to leverage monopoly profit from one market to another. Insofar as products (advertising space and services) are used in fixed proportion one to the other, the argument goes, there is no economic advantage to be obtained by alleged tied selling, because the monopolist can achieve its full monopoly rent in the single monopoly market, so no tie is necessary, or economically harmful.[27] Therefore, the argument is that any tying which Tele-Direct undertook was undertaken for efficiency enhancing purposes rather than purposes designed to lessen competition.

The Director successfully challenged the argument on the basis that there was not a demand for fixed proportions of services and advertising spaces. A better advertising result might be achieved for the same or even less money by more efficient use of advertising space, but it would not be in Tele-Direct's interest to pursue such options. Therefore, since the products were not necessarily used in the same proportion to one another it was at least theoretically possible that Tele-Direct could have leveraged its monopoly power through a tie.[28] However, as we note above, that does not provide an answer to the question: why would Tele-Direct have permitted some untied (i.e., commissionable) accounts, but not others, unless it was proceeding on the basis of maximizing efficiency?

Aside from this aspect of leveraging, one of the issues about which one might be concerned in a case of alleged monopolization and tied selling by a subsidiary of a regulated (at least until recently) monopoly, is that the Telcos might have been engaged in an effort to adjust returns as between their regulated and unregulated businesses. They might have sought to maximize their cost base upon which the regulatory returns are to be calculated, or they might seek to push as much of their costs into their regulated business as possible, where they have a regulated rate of return, and try, based upon that, to undercut their competitors in the non-regulated portion of the business. That might be a way to avoid the conclusion that monopoly profits cannot be leveraged into another market via a tied sale.[29]

In fact, however, it appears that neither of those interesting issues presented themselves in the case. The Tribunal specifically found that Tele-Direct was not seeking to expand its capital base for regulatory purposes,[30] and in fact Tele-Direct was paying Bell a very large (in excess of 40% of revenues) amount for the relatively few services which Bell provided to it.[31] This acted as a subsidy for local phone rates. Therefore, it did not appear that Tele-Direct was moving its costs out of its unregulated and into its regulated business for the purpose of then undercutting competitors and earning supra-competitive profits in the unregulated portion of its business by having reduced its costs, and enjoying regulated returns on such costs in the other side of the business.

The Remedy - Rate-Setting

The Tribunal concluded that given the given the anti-competitive effect of the tie which it had found (for six market and above advertisers), a remedy was appropriate in respect of tied selling for all purchasers at or above six market advertising. Tele-Direct was ordered to unbundle space and services for those markets, either by providing separate pricing for space and services, or expanding its definition of commissionable accounts. The Tribunal noted, however, that it would be up to Tele-Direct to pay such commission as it chose in the unbundled marketplace, but the commission must be such that it was not economically non-viable for customers to purchase space from Tele-Direct and use agency services. The Tribunal noted that a 15% commission rate had historical precedent, was accepted by the industry and appeared to be a workable number. However, it was not sure that it had power under section 77 to set such a rate, and in fact noted that it ought not be a rate-setting body. If Tele-Direct chose not to offer the 15% rate, however, it could not pay a commission which continued to induce a tie.[32]

Given its finding as noted above, the Tribunal ordered that Tele-Direct not continue to engage in tied selling in respect of the supply of advertising space and advertising services for customers advertising in six, seven and eight markets. The Tribunal declined to set or mandate a minimum rate of commission payable by Tele-Direct to agents in respect of the provision of services in the market to be "untied". It noted:

> [T]he setting of a commission rate by the Tribunal is not, in our opinion, envisioned by the powers given to it under section 77 of the Act regarding tying or in the general jurisdiction given to the Tribunal under section 8 of the *Competition Tribunal Act*.[33]

Of course, the express powers contained in section 77 in respect of tied selling are that:

> [T]he Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in such exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.[34]

Consequently, one might take issue with the Tribunal's view of its statutory powers, although, it is submitted, the Tribunal's concerns about the difficult implications of rate setting on an ongoing basis are persuasive.

At the same time, and despite the Tribunal's indication that the rate to be set by Tele-Direct must be "appropriate", and that it must not continue to constitute an inducement to tie services and advertising space, there may well be an opportunity for Tele-Direct to continue to discourage alternate advertising service suppliers. In their submission the intervenors DAC and NDAP noted:

> In the absence of a comprehensive regulatory scheme involving cost separations and/or structural separation, the respondents will have both the incentive and the means to establish prices that will maintain their control of the market.[35]

It is submitted that the concern expressed by the intervenors is a valid one. At the same time, the Tribunal's reluctance to become a rate-setter is also entirely understandable. This may, however, be some further evidence that the question of separate products is indeed very difficult in the *Tele-Direct* situation, and "untying" the offering may not be entirely workable in a real world setting.

Statutory Issue Regarding Tied Selling

Tele-Direct argued that the wording of section 77(2) required that the substantial lessening of competition necessary for the making of an order must be found in the market for the tying product, given specific exclusionary effects mentioned in section 77(2) are said to be in "the" market in which the respondent is a major supplier. In fact, the recently demised Bill C-67[36] would have amended the Act to change the word "the" to the word "a", specifically to address this issue, perhaps in response to Tele-Direct's argument in this case. Apparently, the Director need not have worried, as the Tribunal concluded,

> While the definite and indefinite articles can be read in different ways, the section should be read in a way that makes sense. Since tying generally, and certainly in this case, involves 'leveraging' from the tying product market to the tied product market, it is only sensible to assess the effects of the practice, or the substantial lessening of competition, in the target or tied product market.[37]

It is interesting that the Tribunal was prepared effectively to rewrite the statute to make it "make sense". Whether or not that is good statutory interpretation, it may have been a practical approach in the case. We note, however, that the substantial lessening of competition in *Tele-Direct*, if a detailed analysis had been done by the Tribunal of that aspect of the test, might have been found to be in the tying product market - i.e., the advertising space market. At least one arguably anti-competitive effect of the tie may have been to raise the barriers to entry into the business of publishing directories. The anti-competitive effect in the services market, as we argue, may have been small. Thus, "the" market for the tying product may have been the one to be concerned about in any case.

Abuse of Dominant Market Position

Abuse of Dominance Overview of the Allegations

Advertising Directories or Space Market

Turning to the abuse of dominance allegations, one set of allegations related specifically to the directory advertising publishing (or space) marketplace. The Director alleged that Tele-Direct's anti-competitive acts included its targeted, aggressive, response to the broad based publishers which entered the marketplace particularly two such publishers, White and DSP.

Advertising Services

Agencies

The Director also alleged abuse of dominance by Tele-Direct in the market for advertising services - specifically, advertising agency services. As noted above, this is the marketplace in which agencies for telephone directory advertising were paid commission, but competed with Tele-Direct's own internal sales force. The alleged anti-competitive acts by Tele-Direct in respect of the agents included squeezing the return available to agents by transferring functions to, withholding services from and making terms of supply to agents more onerous, and discriminating against agents by providing space to them on less favourable terms than those available to Tele-Direct's internal sales force.

Consultants

As well, the Director alleged that various activities of Tele-Direct aimed at advertising consultants constituted anti-competitive acts in the broad telephone directory advertising market. Consultants were firms which advised advertisers how to save money by advertising more efficiently in telephone directories. Typically consultants were paid a percentage of the savings achieved. The allegations of anti-competitive acts vis-à-vis consultants included a number of matters, but essentially boiled down to a "dirty tricks" campaign, centred on refusing to deal with or respond to consultants or customers who used consultants.

Anti-Competitive Acts

The first item of note in respect of abuse of dominance portion of the decision was the Tribunal's attempt to wrestle with the distinction between anti-competitive acts and hard competition on the merits. This review occurred primarily in the context of Tele-Direct's actions respecting rival publishers of broad based telephone directories (i.e., in the publishing or advertising space market). Tele-Direct proposed a bright line test - that conduct which a non-dominant firm would have undertaken in similar circumstances could not be an anti-competitive act. The Tribunal declined to accept that argument. While it recognized the utility of attempting to distinguish in some clear way between anti-competitive acts and other conduct, the Tribunal noted that the range of possible conduct and circumstances was so broad that it could not lay down such an absolute test.

It is submitted, however, that the Tribunal was quite sympathetic in fact to the argument that many of Tele-Direct's actions worked to the benefit of customers. Particularly vis-à-vis Tele-Direct's response to entry by competing broad based telephone directories, the so called targeting, where Tele-Direct provided benefit to customers in those markets in order to more effectively compete with the new entrant, the Tribunal declined to find that such conduct constituted anti-competitive acts.

The two independent publishers of broad based directories active in Tele-Direct's area were DSP (a division of Southam) which published in Sault Ste. Marie, Elliot Lake and Wawa, and White Directory, which published in Niagara Falls, St. Catharines and Fort Erie. White and DSP priced advertising at a discount of between 30% and 40% below Tele-Direct's rates. In response to the entry of these publishers, Tele-Direct provided price freezes, advertiser incentive programs, engaged in significant advertising and promotional expenditures, and provided enhancements to the directories in the competing areas. In some of the years where the competing directories were offered there were no price increases in those areas, whereas Tele-Direct imposed price increases elsewhere. As well, Tele-Direct offered incentives to renew or increase advertising in areas where there were competing directories, whereas incentives were only available to those who increased advertising in other areas. It also added product enhancements (e.g.. community listings, four colour formats, postal codes, talking yellow pages, etc.) to directories in competitive areas, but not in other areas.

The Director alleged that the new entrants were targeted for vigorous competitive attack by Tele-Direct, and that Tele-Direct leveraged its monopoly rents from other geographic areas to subsidized near-predatory approaches to the markets in which rivals had entered or were threatening to enter. The Tribunal, in response, stated:

> If the Director is arguing that the actions of Tele-Direct constitute the anti-competitive act of targeting merely because its actions in markets in which broadly-scoped entry was occurring were different from those in markets where no such entry had occurred, we do not accept the argument. Targeting cannot be distinguished as an anti-competitive act merely by the fact that there is a differentiated response. Targeting, in the sense of differentiated response to competitors, is a decidedly normal competitive reaction. An incumbent can be expected to behave differently where it faces entry than where it does not. One competes where there is competition. Similarly, there may be gradations of reaction depending on the nature of the competitive threats.[38]

The Tribunal went on to wonder whether targeting does not simply mean a differentiated response where there is entry, and how such conduct could be distinguished from competition on the merits.

The evidence was that Tele-Direct was intending to make competition for the entrant "an expensive proposition" at the expense of current profits to Tele-Direct, with the object of influencing the future conduct of the entrants. However, it was primarily trying to do so through the mechanism of offering a better product at lower cost. Tele-Direct was not losing money, even in the competitive markets.

The Tribunal stated a critical question to be whether there was a reasonable likelihood that future entry would be discouraged by Tele-Direct's actions and if so, were those negative effects greater than the benefits of the improved product offering and lower prices offered by Tele-Direct. The Tribunal also noted that it had serious reservations about the Director's characterization of Tele-Direct's response to entry being of overwhelming intensity. Other than the subjective statement by Tele-Direct that it sought to make competition an expensive proposition - i.e., to deter further entry or expansion there was no objective evidence to distinguish between the normal competition one would expect to see when there is a competitor

on the scene, and some anti-competitive response. Predatory pricing was not alleged, and no test for the predatory response was proposed by the Director. The Tribunal stated that:

> Decisions by the Tribunal restricting competitive action on the grounds that the action is of overwhelming intensity would send a chilling message about competition that is, in our view, not consistent with the purpose of the *Act* ... We are concerned that, in the absence of some objective test, firms can have no idea what constitutes a 'competitive' versus an 'anti-competitive' response when responses like those by Tele-Direct in this case are involved (e.g., price freezing or cutting, incentives, product improvements, increased advertising).[39]

That is, the Tribunal found that it could not draw a line between the response that Tele-Direct would have made ignoring the impact on other markets and simply dealing with the fact of competition in the markets in question, and that aspect of the response which was attributable to an attempt to deter expansion by such competitors or others.

Further, the Tribunal noted that it was very difficult to determine what remedy would be applicable to the alleged targeting, and that the Director's requested remedy - that only two but not three types of targeting could not was essentially arbitrary. Ultimately, it concluded as follows:

> Considering the difficulty in circumscribing 'targeting' so that it does not result in discouraging desirable competitive activity, we do not find that Tele-Direct's conduct with regard to pricing, promotion and changes to its directories in the competitive markets, in particular in the Sault Ste. Marie and Niagara areas, is anti-competitive.[40]

This approach is in some contrast to the Tribunal's approach in *NutraSweet,*[41] where contract terms such as "Most Favoured Nation" clauses or "Meet or Release" clauses, which, the evidence showed, were sought by the customers,[42] were enjoined as anti-competitive acts by the Tribunal.[43]

It is submitted that the Tribunal is correct in its view that it is virtually impossible to set down hard and fast guidelines as to what will or will not be an anti-competitive act in all circumstances, but that the inclination it has demonstrated in *Tele-Direct*, to treat conduct which provides competitive benefits to consumers or customers as being unlikely to constitute anti-competitive acts, is a welcome approach. Given the difficulty in distinguishing anti-competitive consequences as a result of the alleged targeting, the Tribunal, rightly it is submitted, declined to make an order. There is some irony, however, in that such conduct might be challengeable as criminal, pursuant to section 50(1)(b). While the *Carnation*[44] case would provide some arguable defence for Tele-Direct, the broad scope of the language of section 50(1)(b) is the best argument for its repeal.[45]

The Director had suggested that Tele-Direct's failure to assist a rival could constitute an anti-competitive act. Tele-Direct disputed that proposition as a matter of law. The Tribunal's comments on the point were technically *obiter*, but it stated:

> As stated above, as a general proposition, competitors should not be required to assist one another.[46]

The Tribunal, however, noted that in a given section 79 case there may in fact be an obligation to assist a rival, and that failure to do so may constitute an anti-competitive act in the correct circumstances. There has been some discussion in the American jurisprudence as to the obligation to assist a rival, with no clear answer in all circumstances.[47] Tele-Direct cited a Canadian monopolization and conspiracy case asserting that there is no requirement to assist a rival.[48] The Tribunal is probably correct in its conclusion that one has to look at the specific facts of the case to determine whether the failure to assist constitutes an anti-competitive act, but it is also probably correct that one should be suspicious of arguments that failure to help a rival is anti-competitive.

Turning to the Tribunal's consideration of Tele-Direct's alleged anti-competitive acts aimed at the consultants, Tele-Direct's conduct towards them reads rather like a dirty tricks campaign. The Tribunal concluded that there were more than innocent errors at stake by Tele-Direct, and in fact to some extent there was sabotage of the consultants and their customers through Tele-Direct's willingness to sacrifice the interests of customers in order to injure consultants. In this regard, the Tribunal's summary of Tele-Direct's conduct is reminiscent of its summary of the Respondent's conduct in *Laidlaw*.[49]

The Tribunal concluded that there was no doubt that Tele-Direct was trying to make life difficult for the consultants as it did not want them to have any legitimacy in their dealing with customers. This gave rise to increased cost for the consultants, who had to do business in a roundabout way, and had a negative effect on the credibility of consultants with customers. As well, of course, customers might well have legitimate concerns that if they used a consultant, their orders could be subject to some gamesmanship by Tele-Direct which they would not risk if they did not use the consultant.

Despite these findings, the Tribunal showed restraint in making an order against Tele-Direct vis à vis consultants. It found that the increased costs experienced by consultants as a result of this conduct were not particularly significant. As well, the Tribunal found that the negative effects on the reputations of the consultants were due largely to the general environment created by Tele-Direct, rather than specifically alleged anti-competitive acts. Further, because dealing directly with the consultants would add additional costs for Tele-Direct, the Tribunal concluded that there was a valid justification for Tele-Direct not dealing with them.

The Tribunal, however did find that refusing to accept orders from customers, and other discriminatory acts undertaken when Tele-Direct knew or believed that consultants had been involved in the creation of the order, were anti-competitive acts. In fact, it noted that Tele-Direct did not attempt to provide a business justification for such conduct. It also found that statements or actions by Tele-Direct to discourage advertisers from dealing with consultants by indicating that advertisers who did so would be disadvantaged by Tele-Direct also constituted anti-competitive acts.

Control or Market Power

The Tribunal's analysis of control or market power, vis-à-vis the advertising space, or publishing market, has been discussed above. The Tribunal's considerations of market power vis à vis the services marketplace suffered from its failure to carefully consider the relevant characteristics of that marketplace, which we have noted above. The Director argued that Tele-Direct had control or market power in the advertising agency services market, particularly given that most services were supplied via a tied sale, and that Tele-Direct enjoyed a very large percentage of all such sales. The Tribunal disagreed. It noted that in respect of the Director's tied selling case it had found a separate market only with respect to services for larger accounts. The Tribunal concluded that Tele-Direct did not have direct control or market power in the currently commissionable directory advertising service market, as it only had a modest market share of about 25%.

The Director also argued that Tele-Direct was leveraging its control in the market for publishing telephone directories in the services market. The Tribunal acknowledged that if it was proved that Tele-Direct was using its market power in publishing as leverage to obtain market power in the advertising services market, that could be sufficient to meet the control requirement of section 79. Ultimately, the question was not answered, as there was no finding of a substantial lessening of competition regarding Tele-Direct's activities toward advertising agencies. However, it is submitted that the concept of leverage of control from one market into another, particularly into a market in which the allegedly dominant firm has a low market share and in which there appear to be low barriers to entry, is potentially troubling.[50]

The problem with regard to control of a market in respect of advertising services is again, as we noted above, that having failed to review the economic characteristics of that market, the Tribunal could not effectively analyze whether or not Tele-Direct could have control or market power in it. To refer, as the Tribunal does, to a 'commissionable directory advertising services market', is to illustrate that whatever the Tribunal is talking about, it is not an economic marketplace. We argue that Tele-Direct did not and could not have control or market power in any services marketplace, but by failing to explicitly examine the market in question we believe that the Tribunal did not focus on the key issues vis-à-vis the services marketplace, and was not in a position to comment helpfully on the question.

Turning from considerations of control or market power respecting advertising agents to the question as it concerned consultants, the Tribunal noted that for the Director to be successful in his allegations in relation to consultants he was required to have demonstrated that Tele-Direct and the consultants were competitors. Notwithstanding that they give very different kinds of advice with respect to telephone directory advertising, however, the Tribunal found that they did provide competitive services. They provided advice which a customer could use to achieve an advertisement in the Yellow Pages. The finding, therefore, was that the consultants and Tele-Direct were participants "in the broad telephone directory advertising market", which Tele-Direct controlled.[51]

The Tribunal, it is submitted, did not engage in a detailed analysis as to what the market was, or whether there was control by Tele-Direct. As noted, it simply concluded that the consultants and Tele-Direct are participants in the broad directory advertising market, which Tele-Direct controlled. The Tribunal had already found that advertising agencies provided advertising services, which was a separate market from the market for advertising space or publication of telephone directories. In respect of consultants, however, the Tribunal refers to the "broad telephone directory advertising market". It is a troublesome statement, more so because there is limited analysis of the marketplace effects of Tele-Direct's conduct aimed at the consultants. As with agencies, entry into the consulting business is likely to have relatively low barriers. It may, however, be that the existence of effective, vigorous consultants in respect of telephone directory advertising does discipline Tele-Direct's market power in the advertising space marketplace. Because the Tribunal does not expressly discuss the issue in any detail, and because its market definitions seem somewhat inconsistent from one portion of the decision to another, the question is unclear.

Substantial Lessening of Competition

With respect to Tele-Direct's alleged anti-competitive acts aimed at rival suppliers of advertising agency services, the Tribunal noted that some of Tele-Direct's acts appeared to have injured agents to some extent, and there was limited business justification for at least some of them. Nevertheless, it noted that the Director had not demonstrated that the acts were or were likely to prevent or lessen competition substantially. It noted that in determining whether there was a substantial lessening of competition, as found in *NutraSweet*,[52] the Tribunal must consider whether the anti-competitive acts engaged in preserve or add to the respondent's market power.

The Director argued that Tele-Direct was extending its market power from the advertising space market to the advertising services market through the anti-competitive acts. The Tribunal noted that the Director had therefore to show that Tele-Direct was likely to achieve market power in the services market. It noted that Tele-Direct had about a 25% market share in the commissionable portion of the services marketplace, and that that would suggest that even if Tele-Direct were engaged in anti-competitive acts it was not successful in obtaining market power. It concluded that the effect of these acts was not substantial, or the independent agents would not hold 75% of the marketplace, or there would be evidence of decline in the agents' share over time. Since that was not the case, the Tribunal rejected the abuse of dominance allegations against Tele-Direct with regard to the conduct respecting agents in the advertising services marketplace on the basis of a failure to demonstrate a substantial lessening of competition. The Tribunal stated:

> We are not unmindful that some of Tele-Direct's actions in respect of agents seemed wilful and senseless. However, the Competition Tribunal does not exist to regulate industry practices generally. Rather, it has jurisdiction only to remedy the substantial prevention or lessening of competition and where this has not been proved, no remedy can be ordered.[53]

The Tribunal's conclusion that there was not a substantial lessening of competition in the advertising services market in respect of advertising agencies, despite what appeared to be anti-competitive acts, is interesting. It had first declined to find, as invited by Tele-Direct, that there could be no control by Tele-Direct in the services marketplace because of its low market share (25% or so). It then went on, however, to find that there was not a substantial lessening of competition because of the low market share.

It is submitted that while the result vis-à-vis the agencies is probably correct low market share or not, with low barriers to entry it is hard to see how there could be a significant problem in that market the analysis may be worrisome. Had the Tribunal decided that Tele-Direct did not have control, or enjoy market power, in that marketplace because of the low market share, or because of the ease of entry, then the discussion would not have reached the question of substantial lessening of competition. However, to find no substantial lessening of competition because of a low and stable market share is to invite the Tribunal in future cases to continue to assume injury to competition where there is a high market share and barriers to entry.

With regard to the consultants, the Tribunal noted that the competitive effectiveness of consultants had been reduced as a result of Tele-Direct's practices. The consultants experienced higher costs and had more difficulty attracting business. While they serviced a relatively small portion of the market, Tele-Direct was forced to respond positively to them by improving its servicing of customers. Thus, consultants had had and could continue to have a significant positive influence on Tele-Direct's level of service to its customers.

The Tribunal noted that it was difficult to arrive at a numerical determination of the effect on consultants of the practice of discriminatory acts, but that their ability to compete was limited and fragile as compared with Tele-Direct's virtual monopoly through its control of publishing. The Tribunal stated:

> Where a firm with a high degree of market power is found to have engaged in anti-competitive conduct, smaller impacts on competition resulting from that conduct will meet the test of being 'substantial' than where the market situation was less competitive to begin with. In these circumstances, particularly [given] Tele-Direct's overwhelming market power, even a small impact on the volume of consultants' business, of which there is some evidence, by the anti-competitive acts must be considered substantial.[54]

The Tribunal's analysis of substantial lessening of competition vis-à-vis consultants is unsatisfying. As noted, it focused on the impact on the volume of the consultants' business.[55] While it expressly referred to the effects on competition, the Tribunal appears to have been thinking primarily about the effects on the competitor - i.e., the consultants. It notes that "even a small impact on the volume of consultants' business ... must be considered substantial."[56] With respect, it is submitted that it is not the impact on the consultants' business one should be thinking about, but rather the impact on the economy. In fact, the effects on the consultants may be relatively minor but the effect on competition might be much more significant if the effect of the consultants is to keep Tele-Direct "honest". On the other hand, if entry is easy, perhaps negative, even catastrophic, effects on consultants are irrelevant to competition. Since the Tribunal does not enter into that analysis, we do not know.

Despite some concerns with the Tribunal's consideration of what constitutes a substantial lessening of competition, the Tribunal also provided some hopeful statements. As noted above, with respect to advertising agencies the Tribunal stated:

> We are not unmindful that some of Tele-Direct's actions in respect of agents seemed wilful and senseless. However, the Competition Tribunal does not exist to regulate industry practices generally. Rather, it has jurisdiction only to remedy the substantial prevention or lessening of competition and where this has not been proved, no remedy can be ordered.[57]

In our view, that express approach to conduct by Respondents, even if the Tribunal does not appear to be favourably impressed by that conduct, is the correct stance for the Tribunal to take. It is in some contrast to the Tribunal's approach in *Laidlaw*,[58] where the Tribunal found abuse of dominance in respect of Laidlaw's aggressive conduct. One commentator there noted, "[w]hile the company [Laidlaw] may have been a commercial bully, abuse of dominance competition law is not an appropriate vehicle to address such behaviour."[59]

Similarly, when considering the actions directed at consultants, which appeared to particularly annoy the Tribunal, it nevertheless declined to make findings across the board. It noted that some of the negative effects experienced by consultants were not particularly significant or were due largely to the general environment created by Tele-Direct rather than specific anti-competitive acts. It was also accepted that Tele-Direct had a legitimate business justification for not dealing directly with consultants owing to added costs, even though in other respects it clearly disliked the sort of conduct in which Tele-Direct was engaged.

As well, in its discussion of the alleged targeting by Tele-Direct of publishers of general service directories which had entered Tele-Direct's territory, the Tribunal did not characterize such actions - even with some direct evidence of subjective intent to make competition expensive for the competitors - as anti-competitive acts. It did not do so in part, as noted above, because of the difficulty in delineating between anti-competitive acts and competition on the merits,[60] and in part because it expressly noted that it could not determine whether any negative result from such targeting was greater than the positive benefits of improved product offering and lower prices. That kind of balancing, it is submitted, is appropriate, and such approach may not have been evident in earlier decisions.[61]

The Trade-Mark Issue

The discussion of the intellectual property issues in *Tele-Direct* was disappointing - not, it is submitted, because the Tribunal was incorrect in its approach - but simply because the issue was largely beyond debate, and therefore uninteresting. Tele-Direct refused to license its trade-marks to some competitors. It threatened to sue some competitors for using its trade-marks. Insofar as they are valid trade-marks, we are at a loss to understand how that could have been anything but perfectly proper. That is the point the Tribunal makes in its reasons. The power to license is inherent in the grant. The Tribunal also referred to section 79(5), but we submit that that reference is only useful for greater certainty. Even without section 79(5), refusing to let others use your trade-marks ought not be an anti-competitive act.[62]

In the recent case of *Eli Lilly & Co.* v. *Novopharm,*[63] the Federal Court considered a motion by the defendant generic drug manufacturers to add *Competition Act* related defences in an action by Eli Lilly for passing off in relation to its PROZAC drug.

The defendants argued that the license of the PROZAC trade-mark by Eli Lilly to another generic manufacturer (Pharmascience) was in contravention of the Act in a number of respects, including sections 45 and 78. In that case, the allegation was that the license put the defendants at a competitive disadvantage because they could not market their product in an appearance similar to the original PROZAC drug. The Court stated:

> While the defendants characterize this impediment as one related to a conspiracy between the plaintiffs and Pharmascience to injure competition unduly, it is, in reality, a complaint that only Pharmascience and not the defendants may use the plaintiffs' trade-mark with respect to the appearance of fluoxetine hydrochloride. This is a trade-mark issue not a competition issue. If the defendants are unable to use the PROZAC appearance for their fluoxetine hydrochloride, it is not because of the Lilly-Pharmascience license agreement, but because the plaintiffs have a valid trade-mark with respect to the appearance of PROZAC.[64]

Similarly, with respect to the abuse of dominance allegation, the Court noted:

> Second, and more importantly, it is clear the root of the defendants' argument is that they cannot also market fluoxetine hydrochloride in an appearance similar to PROZAC. If they cannot do so, it is because the plaintiffs have a valid trade-mark, not because of the introduction of pms-fluoxetine under the Lilly-Pharmascience agreement.[65]

Thus, the *Eli Lilly*[66] case, like the *Tele-Direct* case, affirms that trade-mark rights, and by implication intellectual property rights generally, insofar as they are exercised in the normal course, will not give rise to a finding of an anti-competitive act. The difficult question is what is the "normal course", and where do such rights end. The facts of the *Tele-Direct* case, however, do not require those questions to be addressed.

We note that no application was brought against Tele-Direct under section 32 of the Act, which provides for remedies where intellectual property rights are used to restrain trade. The language of section 32(1) parallels in large part the language in section 45. However, there are two interesting things to note about section 32 in relation to the *Tele-Direct* situation. First, the remedies section appears to be problematic. The first two remedies provided for in section 32(2) would declare void agreements or arrangements or licenses regarding the use of the intellectual property, or would restrain persons from carrying out or exercising all of the terms of such agreement or arrangement or licence. No such agreement, arrangement or licence existed in the *Tele-Direct* case. The third remedy in section 32(2) provides for the granting of a licence under patent copyright or registered integrated circuit typography, or for revoking the patent. Again, there is no applicability to Tele-Direct's trade-marks. The fourth potential remedy is the expungement or amendment of the registration of the trade-mark, or the registration of the integrated circuit typography, or expungement of the patent. That remedy could apply, but it is a drastic result, and would likely be given only reluctantly. As discussed below, however, we do not think it would have been available in the *Tele-Direct* case in any event. The final remedy available under section 32 is a direction by the court that such

other acts be done or omitted as the Court may deem necessary to prevent any such improper use. Presumably, such an order, for instance that Tele-Direct licence its trade-marks for limited purposes, would be possible to contemplate, although since that remedy is not included in section 32(2) perhaps it is not available.

Second, it is not clear that use of intellectual property rights in respect of services is caught by this section. For whatever reason section 32(1), which defines conduct which can give rise to a remedy under section 32(2), indicates that the injury to competition caused by the use of the intellectual property rights must be in respect of any "article or commodity" that may be the subject of trade or commerce. "Article" is of course defined, and would not include a service. "Product" is defined as including both an article and a service. "Service" is defined as a service of any description. Given the use of the words "article or commodity" in section 32, but the use of the word "product" elsewhere in the Act, including the section which most parallels section 32 (section 45), it is at least strongly arguable that use of intellectual property rights to affect unduly competition in respect of a service (advertising) is not addressed by section 32.

Procedural Issue

One particular procedural issue in the case is worthy of comment. In a number of aspects of the case the Tribunal permitted the Director to advance allegations against Tele-Direct which had not been specifically pleaded in the application, on the basis that the substance of the allegations was known to Tele-Direct throughout much of the proceeding.

While it may be that Tele-Direct was in no way prejudiced or caught off guard by the effective expansion of the allegations of anti-competitive acts during the course of the proceedings, without amendment to the pleadings, it is submitted that this is an important procedural issue. By their nature, abuse of dominance and other reviewable conduct proceedings tend to be broad and wide ranging, exploring many central aspects of ongoing business' conduct. It is important that the pleadings adequately frame the case, so that the Respondents, the Tribunal, and even the Director stay focused on what is at issue and what is not.

It may be that from time to time the Director will have to move to amend his or her pleadings to capture newly discovered or appreciated conduct. However, to informally amend pleadings by simply expanding the scope of matters in issue if the Respondent does not make a fuss when a new item is raised, is an unfortunate way to proceed. It will tend to lead to an ever expanding scope for hearings, and of course it will encourage Respondents to fight every procedural motion or question of relevance vigorously, for fear of acknowledging a broadened scope of the Application.

Conclusion

Stepping back from the detail of the decision to look at the overall issues, there would appear to be a strong argument that telephone directories have enjoyed (although this may not continue) natural monopoly characteristics.[67]

Directories are more useful if they are complete, and more valuable to advertisers if widely used by consumers. Advertisers want to be easy to find in the directory, and so wish to be listed with their competitors. Presumably if they could be listed somewhere else alone (either in another directory or elsewhere in the same directory), they would be happy. However, this is an unrealistic result. If one competitor lists, most will list. The game of multiple listings in one directory and the game of multiple directories is a losing one for advertisers. On balance, advertisers would be delighted with one book and one place for each type of product to be listed. Similarly, a single directory is also the goal of the consumer. We do not want two telephone books in our houses. We want one book containing all the suppliers of the product we are looking for listed together.

Therefore, a single directory per market is the likely and efficient result. While there will be exceptions, it appears from the Tribunal's reasons that one directory is the common result throughout North America, and certainly within Canada. That is likely to be the case with or without the anti-competitive acts or the tied selling found by the Tribunal, or the remedies ordered. Time will tell, but that is our prediction.

Assuming for the moment that there are natural monopoly characteristics in the marketplace for directory publishing - and that as a result the incumbent publisher, given barriers to entry, can obtain at least some monopoly rents - what is the appropriate competition law response? One response might well be to simply acknowledge that this is an inherently difficult market and that monopoly rents will be earned unless there is regulation. Just because Tele-Direct arguably enjoyed, through historical accident, the position of a monopolist in telephone directory publishing, that is not abuse, that is life.[68]

Another response is to accept, as we argue the Tribunal implicitly does as apart of its decision, that while there may be monopoly rents earned, the best way to minimize them is to do what one can within the scope of the *Competition Act* to lower the barriers to entry, so that the threat of competitive entry provides as much competitive discipline as can be achieved. That is, make the market as contestable as you can through the mechanisms of the *Competition Act* and accept that there is going to be a certain amount of rent taking.

All of this is to say that in this case the market with which competition law should, in our view, be concerned, is the directory publishing or advertising space market. Entry into consulting or into the provision of agency services is relatively easy. In any case, those markets are almost certainly broader than services specifically directed to telephone directory advertising. Injury, dirty tricks or any other negative consequences for consultants or agencies should be relevant, we submit, only insofar as the existence of such service providers make the publishing or space market more contestable. As pointed out by Church and Ware,[69] one key result of the various Yellow Pages proceedings was the order that the Telcos provide independent publishers with their directory information in machine readable form. That will lower barriers to entry into publishing. Even if alternate publishers do not enter, lower barriers should mean lower monopoly rents.

As has been argued herein, we are of the view that the existence of independent consultants and agencies in the marketplace may have some effect in lowering barriers in respect of publishing.[70] If so, and if a remedy could be fashioned which did not inhibit competition on the merits, but did enhance the opportunity for participation by consultants and agencies, that would likely make the directory market more contestable, and therefore reduce monopoly rent taking. It is not for the sake of the consultants or the agencies, or for the sake of the advertising services market, but rather because the existence of agencies and consultants may have beneficial effects on the advertising space marketplace, that such a remedy may make sense.

We regard the greatest difficulty with the decision to be its failure to critically consider whether there was, or even could have been, any true competitive concerns in the services marketplace, given that that marketplace was almost certainly broad and highly contestable. Because the Tribunal failed to acknowledge that fact, or consider the issue in any depth, we argue that much of the Tribunal's focus on the services marketplace may have over-stated its importance.

Finally, by way of overall comment, we are of the view that the Tribunal's restraint in making orders or findings of anti-competitive acts or effects in respect of conduct which could be characterized as competition on the merits is welcome. The Tribunal expressly recognized that a finding of anti-competitive conduct could have the effect of chilling beneficial conduct. In our view, this is a healthy development.

The Order

In contrast with the length of the reasons, the Tribunal's order occupies two double-spaced pages. As to its operative paragraphs they read:

Tied Selling

> The respondents are prohibited from continuing to engage in tied selling, namely tying the supply of advertising space by them to the acquisition of advertising services from them, for customers advertising in six, seven and eight markets.

Abuse of Dominant Position

> The respondents are prohibited from engaging in the practice of discriminatory acts relating to consultants and customers of consultants.[71]

While there is some explanatory material in the reasons to flesh out these two paragraphs, they are still rather thin reeds upon which to base the results that the Tribunal seems to have anticipated would flow from its order. Whether the order will give rise to interpretative problems, either immediately or in a changing environment over time, will be a matter of interest. Whether it will affect the marketplace at all is also an open question.

Notes

* With thanks to Sylvie Guilbert, Summer Student, Lang Michener. Also with appreciation to Frank Mathewson for his helpful comments.

[1] The earlier three are *Canada (Director of Investigation and Research)* v. *The NutraSweet Company* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) (hereinafter "*NutraSweet*"); *Canada (Director of Investigation and Research)* v. *Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.) (hereinafter "*Laidlaw*"); and *Canada (Director of Investigation and Research)* v. *The D & B Companies of Canada Ltd.* (30 August 1995), No. CT94/1 (Comp. Trib.); 64 C.P.R. (3d) 216 (hereinafter "*Nielsen*").

[2] No. 94/4 (Comp. Trib.) (hereinafter "*Tele-Direct*").

[3] *Canada (Director of Investigation and Research)* v. *AGT Directory Limited* [18 November 1944] C.C.T.D. No. 24 (QL); and *Canada (Director of Investigation and Research)* v. *Bank of Montreal* (1968), 68 C.P.R. (3d) 257 (Comp. Trib.) (hereinafter "*Interac*").

[4] *Supra*, note 2 at 7.

[5] K. Groulx, Case Comment on *Director of Investigation and Research* v. *Tele-Direct (Publications) Inc. et al.* (1997) 18:1 Can. Comp. Rec. 10.

[6] University of Toronto Roundtable 16 June 1997.

[7] *Canada (Director of Investigation and Research)* v. *Southam Inc.* (1995), 3 F.C. 557 (C.A.). Note, the Supreme Court of Canada decision in *Southam* (1997), 71 C.P.R. (3d) 417 had not been released at the time the Tribunal released its decision in *Tele-Direct*.

[8] Although an on-line service, such as is being launched by the Toronto Star, "City Search", might well be in the same market as a telephone directory.

[9] *NutraSweet*, *supra*, note 1 at 28 - 31; *Nielsen*, *supra*, note 1 at 254 - 256; *Laidlaw*, *supra*, note 1 at 325 331. See also: J. Musgrove "Use of Abuse of Dominance: A Brief Review After NutraSweet, Laidlaw and Nielsen" (1995) 16:3 Can. Comp. Rec. 52.

[10] See B.M. Graham, "Abuse of Dominance Recent Case Law: NutraSweet and Laidlaw" (1993) 38 McGill L.J. 801 at 802, and J. Musgrove, *supra*, note 9.

[11] *Supra*, note 2 at 132-140 and 266.

[12] J. Church and R. Ware, "Abuse of Dominance Under the 1986 Canadian *Competition Act*" to be published in (1997) Rev. Indust. Org.

[13] See Easterbrook, "The Limits of Antitrust" (1984) 63 Tex. L.R. 1 at 22.

[14] See for example: *Grappone, Inc.* v. *Subaru of New England Inc.*, 1988-2 Trade Cas. (C.C.H.) ¶68,299, 858 F. 2d 792 (1st. Cir. 1988); *Eastman Kodak Co.* v. *Image Technical Services Inc.*, 112 S.Ct. 2072 (1992); *Tarrant Service Agency, Inc.* v. *American Standard, Inc. (The Trane Co.)*, 12 F. 3d 609 (6th Cir. 1993), 1994 - 1 Trade Cases ¶70,489, *cert. denied*, U.S. 5 Ct. 6-20-94; *Virtual Maintenance, Inc.* v. *Prime Computer, Inc.* 62 A.T.R.R. 300 (6th Cir. 1992); reh'g, en banc, denied: 1992 U.S. App. LEXIS 8444 (6th Cir. Apr. 13, 1992); vacated, remanded: 506 U.S. 910 (1992); vacated, in part, reaff'd, in part, remanded: 995 F.2d 1324 (6th cir., 1993); op. withdrawn, amended: 11 F.3d 660 (6th Cir. 1993); reh'g, en banc, denied: 1994 U.S. App. LEXIS 4416 (6th Cir. Mar. 3, 1994); cert. denied: sub. nom. *Virtual Maintenance* v. *Computervision Corp.*, 512 U.S. 1216 (1994); *Digidyne Corp.* v. *Data General Corp.*, 734 F. 2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908, 105 St. Ct. 3534 (1985); *Service & Training, Inc.* v. *Data General Corp.*, 737 F. Supp. 334 (D.Md. 1990), *aff'd*, 963 F. 2d 680; *MAI Systems Corp.* v. *Peak Computer*, 991 F. 2d 511, *cert. denied* 114 S. Ct. 671; *Triad Systems Corp.* v. *Southeastern Express Co.*, 1994-2 Trade Cases ¶70,837 (N.D. Cal. 1994); *Jefferson Parish Hospital District No. 2* v. *Hyde*, 466 U.S. 2 (1984); *Fortner Enterprises, Inc.* v. *United States Steel Corporation*, 394 U.S. 495 (1969). See also *Siegal* v. *Chicken Delight*, 448 F. 2d 43, 47 (9th Cir., 1971), *cert. denied* 405 U.S. 955 (1972); *Carpa, Inc.* v. *Ward Food, Inc.*, 536 F. 2d 39 (5th Cir. 1976), 1976-2 Trade Cas. ¶60,995 and *William Cohen & Son* v. *All American Hero, Inc.*, 693 F. Supp. 201 (D.N.J. 1988).

[15] *Supra*, note 2 at 163.

[16] *Jefferson Parish Hospital District No. 2* v. *Hyde* 466, *supra*, note 14.

[17] *Ibid.* at 169.

[18] *Ibid.* at 204.

[19] *Ibid.* at 213.

[20] *Ibid.* at 254.

[21] J. Musgrove, *supra*, note 9 at 60.

[22] *Nielsen*, *supra*, note 1 at 266 - 267.

[23] *NutraSweet*, *supra*, note 1 at 47.
[24] Church and Ware, *supra*, note 12 at 38.
[25] We note, however, that the Tribunal (*supra*, note 2 at 131) rejected the argument that by reducing the power of specialised service agencies, entry into publishing was more difficult. It found there was insufficient evidence for it to make a finding in that regard.
[26] See note 25 - The issue was touched on by the Tribunal, but found to be unproved due to insufficient evidence.
[27] See *Directory Sales Management Corp.* v. *Ohio Bell*, 833 F.2d 606 (6th Cir. 1987); *Beard* v. *Parkview Hospital*, 1990 2 Trade Cases ¶69,154; *Ortho Diagnostic Systems* v. *Abbott Laboratories*, 822 F.Supp 145 (1993); *Southern Pacific Comm. Co.* v. *AT&T*, 1982-83 Trade Cases ¶65,219; amended 1983 - 1 Trade Cases ¶65,373 (D.D.C.); aff'd: 1984 - 2 Trade Cases ¶66,077 (D.C. Cir.). See also H. Hovenkamp, *Federal Antitrust Policy* (St. Paul: West Publishing, 1994) at 371; L. Kaplow, "Extension of Monopoly Power Through Leverage" (1985) 85 Col. L. Rev. 515; J.B. Dunlop, D. McQueen, and M.J. Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis* (Toronto: Canada Law Book, 1987) at 253 - 275.
[28] *Supra*, note 2 at 206 208.
[29] See *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17 (1st. Cir., 1990) for reference to such a possibility.
[30] *Supra*, note 2 at 164 - 165.
[31] *Ibid.* at 132.
[32] *Ibid.* at 255 - 258.
[33] *Ibid.* at 257.
[34] *Competition Act*, Section 77(2).
[35] Final Argument of NDAP/DAC, February 15, 1996, par. 9(a).
[36] Bill C-67, *An Act to amend the Competition Act and another Act in consequence*, 2nd Sess., 35th Parl.
[37] *Supra*, note 2 at 254.
[38] *Ibid.* at 284 285.
[39] *Ibid.* at 294.
[40] *Ibid.* at 300.
[41] *NutraSweet*, *supra*, note 1.
[42] *Ibid.* at 42 43.
[43] See also B.M. Graham, *supra*, note 10 at 827.
[44] *R.* v. *Carnation Co. Ltd.* (1969), 58 C.P.R. 112 (Alta. C.A.).
[45] See J. Musgrove, "Pricing in the Distribution Chain: Rerighting Canada's Pricing Laws" (Address to the Insight Conference, 12 June 1996).
[46] *Supra*, note 2 at 281.
[47] *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985); In fact, an obligation to assist rivals may arise in an essential facilities type setting. The *Aspen Skiing* case may be argued (perhaps wrongly) to be such a case, and in the Canadian context *Interac*, *supra*, note 3, may be such a case. See also *Olympia Equipment Leasing Co.* v. *Western Union Telegraph Co.*, 797 F.2d 370, 375 (7th Cir., 1986, cert. denied); *California Computer Prod. Inc.* v. *I.B.M. Corp.*, 613 F.2d 727 (9th Cir., 1979); *Otter Tail Power Co.* v. *U.S.*, 410 U.S. 366 (1973).
[48] See *R.* v. *Allied Chemical* (1975), 69 D.L.R. (3d) 506, aff'd. (1976), 73 D.L.R. (3d) 767 (B.C.C.A.).
[49] *Laidlaw*, *supra*, note 1.
[50] See cases such as *SmithKline Corp.* v. *Eli Lilly and Co.*, 575 F.2d 1056 (3rd Cir., 1978), cert. denied 439 U.S. 838; *Berkey Photo, Inc.* v. *Eastman Kodak Co.*, *supra*, note 49; *Ortho Diagnostic Systems Inc.* v. *Abbott Laboratories Inc.*, 822 F. Supp. 145 1993; and also see *Viacom Int'l. Inc.* v. *Time Inc.*, 785 F. Supp. 371 (SDNY) (1992); *Twin Labs, Inc.* v. *Weider Health & Fitness*, 900 F. 2d 566 (2nd. Cir.) (1990); *Fineman* v. *Armstrong World Industries, Inc.*, 980 F. 2d 171 (3d. Cir 1992), cert. denied 113 S. Ct. 1285 (1993); *Alaska Airlines, Inc.* v. *United Airlines, Inc.*, 948 F.2d 536 (9th Cir., 1991), cert. denied 112 S. Ct. 1603 (1992), for a discussion of leveraging market power from one market to another. The real issue is whether one is concerned about monopolisation in the second market, where barriers to entry may be low, or whether "distortion" of competition in the second market is what one is concerned about. The court in *Berkey Photo* (at 275) stated, "There is no reason to allow the exercise of [monopoly] power to the detriment of competition, in either the controlled market or any other. That competition in the leveraged market may not be destroyed but merely distorted does not make it more palatable." That view is not accepted in all United States circuits. It is an interesting issue, which is touched on but not resolved in the *Tele-Direct* case.
[51] *Supra*, note 2 at 327.
[52] *NutraSweet*, *supra*, note 1 at 47.

[53] *Supra,* note 2 at 322.
[54] *Ibid.* at 365.
[55] *Ibid.*
[56] *Ibid.*
[57] *Ibid.* at 322.
[58] *Laidlaw, supra,* note 1.
[59] B. M. Graham, *supra,* note 10.
[60] See *R* v. *Allied Chemical, supra,* and *Caterpillar Tractor Co.* v. *Ed Miller Sales and Rentals Ltd* (1996), 41 Alta.L.R. (3d) 217 (C.A.) at 230, "Competitors often dislike each other, and competitors almost always want to hurt each other's business. Indeed, not to want that might skirt some provisions of the *Competition Act* ... It is commonplace that competition is not only legal, but often mandated, because its absence can be a serious crime."
[61] See *NutraSweet* and *Nielsen, supra,* note 1.
[62] For some discussion of these issues, see the cases of *National Phonograph* v. *Menck,* [1911] A.C. 336; *Incandescent Gaslight Co.* v. *Cantelo* (1895), 12 R.P.C. 262; *Incandescent Gaslight Company* v. *Brugden* (1899), 16 R.P.C. 179; *Dunlop Rubber Co. Ltd.* v. *Long Life Balloon Depot,* [1953] 3 All E.R. 197; *Columbus Gramophone Company* v. *Vanner* (1916), 33 R.P.C. 104 (Ch. D.); *Mirror Chemicals* v. *Rhone-Poulanc S.A.,* [1965] S.C.R. 284; *Canadian Marconi* v. *Normende Phoenix Ltd.* (1962), 22 Fox. Pat. C. 176 (Ex. Ct.); *Molnlycke AB* v. *Kimberly - Clark of Canada Ltd.* (1991), 132 N.R. 315, 36 C.P.R. (3d) 493 (F.C.A.); *The Copeland - Chatterson Company* v. *Hatton* (1906), 37 S.C.R. 652; *United Shoe Machinery Co. of Canada* v. *Brunet,* [1909] A.C. 330 (P.C.), which indicate that intellectual property rights are frequently circumscribed, and that, since the grant, particularly of a patent, includes the right to prevent others dealing with the goods, that larger right necessarily includes the smaller right of preventing those goods being dealt with except under expressly prescribed conditions. Impairment of competition inherent in the rights expressly provided for in the *Patent Act* is not undue. (See *Columbus Gramophone Company* v. *Vanner* and *Kimberly-Clark of Canada Ltd.* v. *Molnlycke AB* (1982), 61 C.P.R. (2d) 42. See also *Zelon Industries* v. *Bonar & Benis* (1978), 39 C.P.R. (2d) 5; *Berleuer Gramophone Co.* v. *Scythes* (1916), 31 D.L.R. 787 (Sask. S.C.); and *NutraSweet, supra,* note 2).
[63] (1996), 68 C.P.R. (3d) 254 (F.C.T.D.).
[64] *Ibid.* at 258.
[65] *Ibid.*
[66] *Ibid.*
[67] Church and Ware, *supra,* note 12 at 39.
[68] See *Berkey Photo, Inc.* v. *Eastman Kodak Company,* 603 F.2d 263 (2d Cir. 1979) 479; *United States* v. *Grinnell Corporation,* 384 U.S. 563 (1966); *Barry Wright Corp.* v. *ITT Grinnell Corp.,* 724 F.2d 227 (1st. Cir. 1983).
[69] Church and Ware, *supra,* note 12.
[70] But see *supra,* note 25.
[71] *Supra,* note 2 at 370.

COOPERATION BETWEEN COMPETITORS UNDER THE CANADIAN *COMPETITION ACT*

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The following is a paper that was presented at the March 6, 1997 conference in New York City on Antitrust Issues in Today's Economy, organized by the Conference Board, and is reproduced with permission.

Overview

Part I of this paper provides a brief outline of the legal framework within which arrangements between competitors are assessed under Canadian competition law. Part II provides a short summary of the general approach that has been taken to such agreements by the Director of Investigation and Research under the *Competition Act* (the "Act") and his staff in the Competition Bureau over the last few years.[1] It remains to be seen whether Mr. Konrad von Finckenstein, Q.C., who was appointed Director on January 29, 1997,[2] will modify the approach of his predecessors to horizontal restraints.

Part III of the paper: (i) summarizes the approach that has been taken in Canada to information sharing and other forms of cooperation between competitors; (ii) highlights the types of information sharing that can give rise to significant risks under the Act; (iii) describes the circumstances in which such risks can arise; and (iv) attempts to provide some helpful suggestions for reducing those risks. In Part IV, the paper briefly identifies various implications that arise from the subtle differences between the Canadian and U.S. approaches to cooperation between competitors, for businesses contemplating proposals with a cross-border dimension.

I. The General Legal Framework

(i) *Section 45 and Other Potentially Applicable Provisions of the Act*

Canada's antitrust laws are contained in the Act, which is federal legislation of general application that applies to all sectors of the economy, with certain limited exceptions. Although the provinces have passed some trade practices legislation, that legislation generally is not a factor with respect to the issues discussed in this paper. In short, in contrast to the U.S., antitrust law in Canada falls exclusively subject to federal jurisdiction.

The provision of the Act which is most relevant to a general discussion of cooperation between competitors is section 45. Subsection 45(1) provides:

Every one who conspires, combines, agrees or arranges with another person

(a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any product,

(b) to prevent, limit or lessen, unduly, the manufacture or production of a product or to enhance unreasonably the price thereof,

(c) to prevent or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of a product, or in the price of insurance on persons or property, or

(d) to otherwise restrain or injure competition unduly,

is guilty of an indictable offence and is liable to imprisonment for a term not exceeding five years or to a fine not exceeding ten million dollars or to both.

Other provisions in the Act which prohibit the entering into or implementation in Canada of certain types of agreements between competitors include:

- section 46, which prohibits the implementation of directives or other communications from persons outside Canada for the purpose of giving effect to conspiracies entered into outside Canada that, if entered into in Canada, would have contravened section 45;

- section 47, which prohibits bid rigging where the agreement in question is not made known to the person calling for or requesting the bids at or before the time when a bid is submitted by one or more of the parties to the agreement;

- section 49, which prohibits certain types of agreements between two or more federal financial institutions, for example, agreements with respect to the rate of interest on a deposit or loan, the amount of any charge for a service provided to a customer or the amount or kind of loan to a customer; and

- paragraph 61(1)(a), which prohibits attempting by agreement, threat, promise or like means to influence upward, or discourage the reduction of, the prices at which another person offers to supply or advertises a product within Canada. Given that this price maintenance prohibition has been applied to a number of situations where a person attempted to influence upward his competitors' prices through threats,[3] and given that it clearly proscribes agreements to achieve that same result, there is a material risk that paragraph 61(1)(a) may be applied to conventional horizontal agreements, or even attempted agreements, to increase prices.[4]

It addition, it may be noted that:

- section 86 of the Act provides an exception from the conspiracy (and exclusive dealing) provisions of the Act for specialization agreements which meet certain conditions[5] (unfortunately, these provisions have never been utilized);

- the non-criminal abuse of dominance provisions in section 79 of the Act may be applied to explicit agreements between jointly dominant firms,[6] as well as to the interdependent exercise of market power falling short of a criminal agreement;[7] and

- section 95 of the Act provides an exemption from the merger provisions of the Act for joint ventures formed otherwise than through a corporation, to undertake a specific project or program of research, provided that the joint venture meets certain conditions[8] (unfortunately, these provisions have never been utilized).

It may also be noted that the Act appears to contemplate that mergers can be challenged under the conspiracy provisions in lieu of the (non-criminal) merger provisions, although, as a practical matter, it is unlikely that the Director would recommend charges under the conspiracy provisions in respect of a merger unless egregious circumstances were present.[9]

The Supreme Court of Canada in *R.* v. *Nova Scotia Pharmaceutical Society et al.*[10] (commonly referred to as the "*PANS*" case) characterized section 45 as creating "a partial rule of reason", lying somewhere between the U.S. *per se* and *rule of reason* approaches, because it allows a court to consider the "anti-competitive effects of the agreement ... [but] ... does not permit a full-blown discussion of the economic advantages and disadvantages of the agreement".[11] By comparison, sections 47 (bid rigging), 49 (agreements between federal financial institutions) and 61 (price maintenance) create *per se* offences.

The partial rule of reason approach in section 45 contrasts sharply with the full blown balancing of anticipated anti-competitive effects and efficiencies that is contemplated in the provisions of the Act relating to mergers and specialization agreements. The fundamental difference in the approach to agreements between competitors falling within the scope of section 45, on the one hand, and mergers on the other hand, can lead to the paradoxical situation where complete integration through a merger of the operations of two leading competitors in a market can avoid challenge under the Act, while a lesser form of cooperation possibly could violate the conspiracy provisions of the Act.

As might be expected, the Crown has encountered significant difficulty obtaining convictions in contested cases under section 45, primarily because that involves establishing, on the criminal burden of proof (i.e., beyond a reasonable doubt), that competition has been or is likely to be prevented or lessened substantially in a relevant market. Although the Crown has had some sporadic success in prosecuting smaller cases,[12]

the last major contested case which resulted in a conviction was in 1980.[13] For the most part, parties either agree to plead guilty (e.g., where the facts are straightforward or where there is a concern about minimizing the risk of treble damages action(s) in the U.S. by avoiding Canadian legal proceedings),[14] or cases are dropped or settled by way of some form of alternative case resolution.[15]

The offences created by paragraphs 45(1)(a) to (d) have four elements — two *actus reus* elements and two *mens rea* elements.[16] Taking as an example paragraph 45(1)(c), which has accounted for the substantial majority of the charges laid under section 45, to establish the *actus reus* of the offence, the Crown must prove beyond a reasonable doubt:

1. the existence of a conspiracy, combination, agreement or arrangement to which the accused was a party;

2. that the conspiracy, combination, agreement or arrangement, if implemented, would likely prevent or lessen competition unduly (as noted below, it is not necessary for it to have been implemented);[17]

3. the accused had subjective intent in respect of the first of the above-described elements of *actus reus* (i.e., had the intention to enter into the agreement and had knowledge of the terms of that agreement); and

4. the accused was aware, or ought to have been aware (because a reasonable business person familiar with the line of business in question would have been aware), that the effect of the agreement would be to prevent or lessen competition unduly.[18]

(ii) *The First Element Required by Section 45*

With respect to the first element of the offence, the words "conspire, combine, agree or arrange" all "express the act of agreeing".[19] Until this act occurs, a mere intention or design on the part of one or more of the accused to effect an anti-competitive agreement or arrangement does not contravene section 45.[20]

It is not necessary for the Crown to prove that there were any acts in furtherance of the agreement.[21] Once a person enters into an agreement proscribed by section 45, an offence is committed, even if the person later refuses to put the plan into effect[22] or makes no attempt to enforce the agreement.[23] An offence also is committed even if "the agreement could not have been successfully carried into execution".[24] In short, "the crime is in the conspiracy", not in the acts that it contemplates.[25] However, such acts "may be evidence of the agreement".[26]

It is now well accepted in Canada that in oligopolies or markets characterized by a dominant firm and a small fringe, it may be entirely rational and legitimate for consciously parallel behaviour to result either

from completely independent action or from interdependent action that falls short of an unlawful agreement. At this point in time, it is difficult to draw any conclusions regarding the likely position of the courts and the Bureau, other than that conscious parallelism, without more, is not likely to be found to contravene section 45.[27] As in the U.S., the Bureau and the courts generally require the presence of "plus factors" before they will consider interdependent behaviour to have crossed the line that separates it from concerted conduct which falls within the scope of section 45.[28]

Such "plus factors" may include enforcement activities,[29] simultaneous adoption of facilitating practices,[30] unexplained meetings, efforts to keep such meetings or other communications secret or undecipherable,[31] and conduct which can be explained only by the existence of an agreement.[32]

(iii) *The Second Element Required by Section 45*

With respect to the second element of the offence, the requirement that the agreement be likely to prevent or lessen competition "unduly", the Supreme Court of Canada has defined "undueness" in terms of a serious or significant effect on competition.[33] In determining whether an agreement is likely to have a serious or significant effect on competition, the Supreme Court has articulated a two-part inquiry relating to (i) the structure of the market, and (ii) the behaviour of the parties.[34] The objective of evaluating the structure of the market is to determine the degree of market power possessed by the parties to the agreement.[35] A "moderate" amount of market power, i.e., the ability to behave relatively independently of the market, is required to trigger the potential application of section 45,[36] and in the absence of market power, it can be presumed that section 45 does not apply.[37] It is the Director's view that "market power" is the "ability of firms to profitably influence price, quality, variety, service advertising, innovation or other dimensions of competition" in an anti-competitive manner.[38]

In assessing market power, "market share alone is not determinative"; various other factors are also relevant, such as the number of competitors, market concentration, barriers to entry, product differentiation and countervailing power.[39]

Turning to the behavioural aspect of the section 45 assessment, the Supreme Court noted that "the object of the agreement is without doubt the most important behavioural element in the inquiry, but others may be relevant, such as the manner in which the agreement has been or will be carried out and, in general, any behaviour that tends to reduce competition or limit entry".[40] The relationship between market structure and behaviour then must be examined since it is "the combination of the two that makes a lessening of competition undue".[41] No particular combination of market power and behaviour is required and a "particularly injurious behaviour may trigger liability even if market power is not so considerable".[42]

The vast majority of the reported cases involving convictions under section 45 have involved some form of agreement with respect to prices,[43] which the Supreme Court of Canada highlighted as being one of the

"examples of possible combinations of market power and behaviour likely to injure competition that will be 'undue' under [s. 45(1)(c)] of the Act".[44] The Supreme Court made a similar observation with respect to "market sharing" agreements,[45] which may have been intended to refer to market allocation as well as customer allocation agreements. While virtually all of the market allocation cases that have been brought under section 45 also have involved some form of price fixing,[46] there is little doubt that a pure market allocation agreement between firms with market power would give rise to very serious concerns under section 45. Most of the customer allocation cases that have led to convictions under section 45 are bid-rigging cases that pre-dated the enactment of the *per se* prohibition on bid rigging set forth in section 47 of the Act, which came into force in 1976.[47]

Other types of agreements which have been found to contravene section 45 also invariably have involved some element of price fixing, i.e., group boycotts in support of price fixing agreements,[48] and concerted refusals to deal with one or more identified classes of persons.[49]

In the past, it was commonly believed that if the parties to an agreement had less than a 50% market share, it was unlikely that the agreement would contravene the conspiracy provisions. However, in light of the Supreme Court's statement that a "moderate" amount of market power may be sufficient to trigger the potential application of section 45, a conservative "bright line" test would now be a combined market share around 35%, which is the threshold employed by the Director in the *Merger Enforcement Guidelines* and the *Predatory Pricing Enforcement Guidelines* to distinguish between mergers or conduct that may result in a substantial prevention or lessening of competition (i.e., enable the parties to profitably influence price or other dimensions of competition) and those that are unlikely to do so.

(iv) *The Third Element Required by Section 45*

With respect to the third element of the offence, the subjective intent requirement:

> [T]he Crown must prove that the accused had the intention to enter into the agreement and had knowledge of the terms of that agreement. Once that is established, it would ordinarily be reasonable to draw the inference that the accused intended to carry out the terms of the agreement, unless there was evidence that the accused did not intend to carry out the terms of the agreement.[50]

In this respect, "mere words purporting agreement without an assenting mind to the act proposed are not sufficient."[51] Further, where an accused simply pretends to go along with a conspiracy "for lawful reasons and other than the attainment of its stated objects", the mental element will be lacking.[52] However, "a person who initially had an intention to carry out the conspiracy but subsequently 'refuses to put the plan into effect...' is nevertheless guilty, because all the ingredients of conspiracy can be found in the accused's conduct".[53]

(v) *The Fourth Element Required by Section 45*

With respect to the final element, the objective intent requirement, "the Crown must demonstrate that the proof, viewed objectively (i.e., by a reasonable business person), establishes that the accused was aware or ought to have been aware that the effect of the agreement entered into ... would be to prevent or lessen competition unduly".[54] Although the Supreme Court has observed that "the Crown could, in most cases, establish the objective fault element",[55] the Crown failed to do this in the first and only case to date in which the objective intent element has been considered. There, the Court found that the case before it was not the type of case that the Supreme Court was referring to when it made the above-noted comments regarding the ability of the Crown to establish this element, and contrasted the "intricate and complicated effects of the various dealings between the [pharmacists'] Society/Association, the member pharmacies, the Government Plan and the third party insurers" with "a straight price fixing case".[56]

While subjective intent going to the effects of the agreement is not required, parties to an agreement who have market power probably would be convicted if the Crown established that the purpose or intention of the parties was to prevent or lessen competition unduly.[57]

(vi) *Private Actions*

In addition to the possibility of criminal prosecution, section 36 of the Act permits private parties to bring a civil action to recover damages suffered as a result of a violation of any criminal provision of the Act, together with any investigatory or legal costs relating thereto. Although the ability to bring a private action is not dependent upon whether the Crown successfully prosecutes and obtains a conviction, subsection 36(2) deems that evidence of a conviction, in the absence of any evidence to the contrary, is proof that the person against whom the action is brought engaged in the conduct. Moreover, any evidence given in the criminal proceedings as to the effect of such conduct on the plaintiff is evidence in the civil action. However, no action may be commenced more than two years after the date of the "offence", unless criminal proceedings were or have been commenced, in which case the limitation period expires two years from the date on which the criminal proceedings were finally concluded. It may be noted that an action under section 36 does not preclude any other civil causes of action that may exist, for example for unlawful interference with economic interests and for conspiracy.[58]

Notwithstanding section 36, civil actions have been relatively uncommon in Canada. This may be explainable by the fact that only single damages may be recovered, and the plaintiffs ordinarily would be required to pay the defendants' costs in an unsuccessful action.

II. General Enforcement Policy and Practice Towards Horizontal Restraints

The Director has made it clear on several occasions over the last few years that enforcement of the conspiracy provisions of the Act is a high priority for the Bureau and that he intends to pursue vigorously suspected

violations of those provisions.[59] To this end, he has pursued a policy of extracting increasingly large "record" fines.[60] This policy appears to be directed toward getting fines closer to the new $10 million ceiling under section 45 of the Act, thereby ensuring that fines function as "more than a licence fee".[61] This is in keeping with the government's intention to "send a clear signal to the courts that Parliament considers conspiracy to be a very serious criminal offence and that offenders should be dealt with by a firm hand".[62] There are reasons to believe that the U.S. approach of setting fines at a level which is "greater than the expected profits from successful collusion" will soon be embraced.[63]

In addition to pursuing increased fines, the Director has made it clear that he intends to recommend to the Attorney General of Canada more frequently that charges be laid against individuals.[64] This is consistent with a suggestion made in the 1990 Supreme Court of Canada *Thomson Newspapers Ltd.* decision that imprisonment may be "necessary if the objectives of combines legislation are to be realized".[65] In September 1996, an individual was sentenced to one year in jail for contravening section 45 and other provisions of the Act, marking the first time that an individual had received a prison term under section 45.[66] More recently two other individuals pleaded guilty to offences under section 45 and each was given a one year "conditional sentence"[67] to be served while continuing to reside in the community.[68]

In pursuing criminal and non-criminal matters under the Act, the Director has considerable formal investigatory powers at his disposal. These powers become available once the Director commences a formal inquiry under section 10 of the Act,[69] "are typically exercised without warning"[70] and can impose substantial costs upon those subject to the exercise of such powers. Unlike in the United States, where the primary investigative tool in antitrust matters is the grand jury subpoena, in Canada the initial compulsory process of choice in criminal antitrust matters, particularly in section 45 matters, is the search warrant. Searches in Canada under section 15 of the Act typically are executed as "down raids" by Bureau officers, occasionally assisted by the Royal Canadian Mounted Police.[71]

In addition to the search warrant powers available under section 15, section 11 allows a Canadian court to order the production of documents, the interview of persons under oath and the preparation of information returns. Section 11 also provides that a person may not refuse to answer a question asked pursuant to an order issued under that provision; however, no testimony given by such person may be used or received against him in any criminal proceedings other than for perjury.

Pursuant to section 16 of the Act, a search also could involve the search of computer records, using quite sophisticated techniques. These techniques include the ability to recover files and file fragments thought to have been erased long ago. They also include the ability to access and search computer files located in foreign jurisdictions which are linked to Canada through a company wide-area-network system. We understand that in at least one case, Bureau staff took the position that section 16 of the Act authorizes the seizure of all data, including data located in foreign jurisdictions, accessible through computers on premises named in a search warrant.[72]

In the last few years, senior government officials in both Canada and the United States have indicated that the number of cross-border investigations is increasing,[73] and that information sharing and cooperation are increasingly becoming more important.[74] In this context, the governments of both Canada and the United States have taken steps to increase the extent of cooperation and information sharing between them. These steps have recently included the signing on August 3, 1995 of an agreement between Canada and the United States regarding the application of their competition and deceptive marketing practices laws;[75] the passage in the United States of the *International Anti-Trust Enforcement Assistance Act* (the "IEAA"); the extension in 1991 of the extradition treaty between Canada and the United States to offences punishable by the laws of both countries by imprisonment for a term exceeding one year or any greater punishment (which includes anti-trust offences); and the signing on March 18, 1985 of the treaty between the government of Canada and the government of the United States of America on mutual legal assistance in criminal matters (the "MLAT"), which came into force on January 14, 1990. The impact of these developments has perhaps been greatest in the area of criminal conspiracies, as reflected in a number of recent high profile cases.[76]

Notwithstanding the increasing cooperation of Canadian and U.S. enforcement authorities, Canada has a long history of a more compliance-oriented and less litigious enforcement approach to its competition laws than appears to be the case in the U.S.[77] The compliance-oriented approach in Canada has been the subject of numerous Bureau speeches, the Bureau's bulletin on the Director's program of compliance and the Strategic Alliances Bulletin. As noted in the latter document, the Director endeavours to facilitate compliance under the Act by providing confidential advisory opinions in respect of specific *proposed* conduct. Given that such advisory opinions are a function of the facts provided to the Bureau, "the degree of comfort provided by the Director in offering an opinion on a specific alliance will be directly proportional to the information the parties provide on the likely competitive effects of the alliance".[78] The Director's approach to advisory opinions is further explained in the following passage:

> In providing an opinion, the Director neither regulates conduct nor pronounces on the legality of the proposal. Instead, the Director will indicate whether a proposal is likely to provide grounds to initiate an inquiry under the Act. The parties remain free to adopt or pursue a particular course of action notwithstanding a negative opinion from the Director with the understanding that they may, following investigation, be challenged by either a referral to the Attorney General for prosecution under the criminal provisions or an application filed with the Competition Tribunal under the reviewable provisions.[78a]

In contrast to the U.S. practice under the U.S. DOJ's Program of Business Review Letters, advisory opinions issued by the Director remain confidential. Given this confidentiality and the potential comfort that may be obtained from an advisory opinion, parties to proposals involving competitors which are potentially procompetitive often give serious consideration to seeking an advisory opinion in respect of such proposals.

III. Benchmarking, Information Exchanges and Other Forms of Cooperation Between Competitors

(i) *Overview*

There has been increased recognition in antitrust circles on both sides of the border of the procompetitive potential of certain types of information sharing between competitors.[79] Notwithstanding the fact that the conspiracy provisions of the Act do not permit a balancing of increased efficiencies or other public benefits against anti-competitive effects, Parliament's recognition of the potential benefits of certain forms of cooperation between competitors is reflected in subsection 45(3) of the Act, which provides a defence for agreements that relate only to one or more of a list of matters which include:

- the exchange of statistics or credit information;
- cooperation in research and development;
- the defining of terminology used in a trade, industry or profession;
- the defining of product standards; and
- the adoption of measures to protect the environment.

However, subsection 45(4) removes the defence where the agreement has lessened or is likely to lessen competition unduly in respect of prices, quantity or quality of production, markets, customers, channels of distribution or if the agreement is likely to restrict any person from entering into or expanding a business in a trade, industry or profession. As a practical matter, this provision, together with the Bureau's typically cautious approach to subsections 45(3) and (4),[80] has considerably narrowed the potential scope of subsection 45(3).

In any event, many types of potentially procompetitive information sharing agreements which firms increasingly are interested in pursuing may not fall within the various categories listed in subsection 45(3). This includes agreements to exchange information regarding certain categories of costs (e.g., warranties, inventories, packaging, corporate travel, training, employee benefits), production techniques, distribution methods, quality control, aggregated pricing and output information, management techniques, customer preferences, information systems and benchmarking.

There have not been any cases under the Act in which persons were convicted for doing nothing more than entering into an agreement to exchange information. Whenever a conviction was entered against accused parties who were found to have exchanged information, the court found that the accused also had engaged in other behaviour such as agreeing to fix, stabilize or increase prices; engaging in enforcement activity; and/or engaging in acts against self-interest.[81]

Nevertheless, there can be serious risks under the Act associated with the pursuit of information sharing and other cooperative activities by *competitors* which individually or collectively have market power. For the most part,[82] cooperative activities involving firms in a vertical relationship or in different product or

geographic markets (i.e., firms that are not *competitors*) are not likely to contravene the conspiracy provisions of the Act.[83] In addition, firms competing within the same relevant market that collectively do not have market power would incur little risk in engaging in exchanging information or engaging in other forms of potentially procompetitive activities with each other.[84] However, where such firms have market power, the two principal risks under the Act associated with benchmarking or other forms of information sharing would be that: (i) the agreement to exchange information, in and of itself, may be found to contravene the conspiracy provisions in section 45 of the Act; and (ii) the communications in furtherance of that agreement inadvertently could lead to other forms of communication regarding matters that can give rise to even greater risks under section 45.[85]

An agreement to engage in some form of potentially procompetitive exchange of information with another entity ordinarily will satisfy at least two of the previously described four elements in section 45, i.e., the "agreement" element and the requirement that there be an intention to enter into that agreement, together with knowledge of its terms. Contrary to what business persons who are unfamiliar with the conspiracy provisions of the Act sometimes believe, it is entirely possible to contravene those provisions by agreeing to exchange information, even if there is no additional agreement to fix prices, allocate territories, reduce output or engage in other more obviously anti-competitive conduct.[86]

Indeed, ostensibly unilateral exchanges of information between two or more competitors, made in the expectation of reciprocity, could be found by a court to satisfy those two elements of section 45.

Once a court found the above-noted two elements of section 45 to have been met, the issue would then become whether the agreement likely would prevent or lessen competition unduly if (not when) implemented. If that third element were found to be satisfied, the fourth objective intent element would "in most cases" likely be satisfied as well. That is to say, "the Crown could, in most cases, establish the objective fault element that the accused as a reasonable business person would or should have known that ... the likely effect of the agreement" would be to prevent or lessen competition unduly.[87]

(ii) *Factors Considered by the Bureau*

The principal sources of guidance from the Bureau regarding its approach to information sharing and other potentially procompetitive forms of cooperation between competitors are the Bureau's 1995 Strategic Alliances Bulletin,[88] and a 1993 speech (the "Chandler Speech") by Mr. Harry Chandler, a senior member of the Bureau who at that time was Deputy Director of Investigation and Research (Criminal Matters).[89] The Strategic Alliances Bulletin provides the following general statement of the Bureau's approach:

> The exchange of information will not necessarily give rise to competition issues under the conspiracy provisions. Indeed, competitive markets function more efficiently when information is relatively free and openly available to market participants. At the same time, it is recognized that information exchanged among competitors who collectively possess market power may have serious adverse effects on competition, depending upon the nature and timing of the information exchange.[90]

The Chandler Speech noted that in determining "whether or not information exchanged among industry participants may breach the conspiracy provision, the Bureau would consider the following factors":[91]

(a) the structure of the market in which the parties to the agreement compete;

(b) the size of the geographic market affected;

(c) whether the parties to the agreement have engaged in additional conduct that might suggest the existence of an anti-competitive goal; and

(d) the nature of the information exchanged.

These will be discussed in order below.

The Strategic Alliances Bulletin adds to this list the requirement that the parties to the information sharing agreement have market power.[92] This factor will be discussed together with the market structure factor in the next section.

In addition, the Strategic Alliances Bulletin notes that the Bureau also considers whether the parties have taken various steps to reduce the risks under section 45. These and other steps which can be taken to reduce risks will be discussed in Parts III (v) and (vi) below.

(a) Market Structure/Market Power

With respect to the market structure factor, the Chandler Speech simply noted: "Of particular concern would be whether the industry is one which is highly concentrated and subject to high barriers to entry."[93] The Strategic Alliances Bulletin elaborates, by stating:

> Where markets are characterized by high levels of concentration, barriers to entry and relative stability, information exchanges in respect of sensitive commercial information may reduce uncertainty about rivals' competitive responses and so act to further temper rivalry. When the products involved are relatively homogenous and firms compete across a limited number of competitive variables, the risk that such exchanges will have significant adverse effects on competition is further heightened.[94]

As suggested earlier, given the Supreme Court of Canada's explicit recognition that agreements between firms which do not individually or collectively possess market power are not likely to have anti-competitive consequences,[95] it is unlikely that firms which collectively account for less than 35% of a relevant market would be convicted under section 45 for having agreed to benchmark or otherwise exchange information.[96] All other things being equal, as the collective market share of the parties to an information sharing agreement increases above this threshold, the risk of contravening section 45 also increases.

Similarly, the risks faced by firms with a collective market share in excess of 35% increase directly with the difficulties new entrants would encounter in becoming effective competitors. The Director employs a two-year standard in both the MEGs and the Predatory Pricing Enforcement Guidelines in assessing ease of entry. That is to say, those guidelines indicate that he is unlikely to accept arguments relating to the ease with which new competitors could enter the relevant market, where he is not satisfied that "sufficient entry into the relevant market would occur to ensure that a material price increase would not likely be sustainable in a substantial part of the relevant market for more than two years".[97] The U.S. Department of Justice and Federal Trade Commission adopt a similar position in their 1992 *Horizontal Merger Guidelines.*[98]

Although a court might take a different position in a criminal proceeding, or in a civil proceeding brought pursuant to section 36 of the Act,[99] the two-year standard is a reasonable rule of thumb to use in assessing whether the Director is likely to conclude that entry would be sufficiently easy to ensure that parties to a proposed agreement could not exercise market power for a sustained period of time.

In short, if the market is highly concentrated, is characterized by significant entry barriers and is already characterized by a high degree of stability, e.g., parallel price movements, exchanging the types of information described below can be very risky. Likewise, if the exchange of benchmarking or other information is likely to materially increase market transparency or otherwise reduce uncertainty, it inadvertently could facilitate greater stability, e.g., a greater convergence of prices, reduced discounting and/or reduced fluctuations in market shares, or it could be perceived as being likely to have that effect.[100]

In this context, either the information exchange agreement itself could be challenged or it could be perceived as a facilitating practice that is part of a broader agreement to increase prices, stabilize prices or otherwise prevent or lessen competition unduly. In this regard, the courts have drawn the distinction between spontaneous, unaided conscious parallelism and induced conscious parallelism. For example, Mr. Justice Lerner in *Armco* approvingly quoted the following statement by a former Director: "It is one thing for such oligopoly characteristics to develop of themselves without collusion; *it is quite another matter for members of an industry to make a conscious effort collectively to bring them about.*"[101]

Similarly, in the *Fatty Acids* case, which involved the exchange of statistics on fatty acid production, inventory and shipments, the European Commission stated:

> By effectively applying the agreement, the parties have shown their genuine commitment to the market stabilisation objective underlying it. Through the exchange of information they artificially increased transparency between them by obtaining knowledge of each other's activities which they would not have had in the absence of the agreement. The Commission considers that this will inevitably have led them to temper their competitive behaviour towards each other.[102]

It follows that an information exchange in the type of market described above could be viewed as a significant "plus factor" which raises a real question as to whether the information exchange: (i) is part of a broader anti-competitive agreement; or (ii) is likely to facilitate interdependent behaviour among market participants.

(b) Size of the Geographic Market

With respect to this factor, the Chandler Speech notes: "The Bureau would consider the scope of the market affected by the information exchange, whether it be local, provincial, national or North American."[103] While it is not clear from this whether the Bureau is more likely to be concerned with anti-competitive effects in larger markets, it is reasonable to assume that such typically would be the case.[104] Of course, to the extent that a broadening of the geographic dimension of the market results in expanding the number of competitors in the market and reducing market shares, the scope for anti-competitive results would decrease.

(c) Conduct "Plus Factors"

With respect to this factor, the Chandler Speech states: "The Bureau's concern in this regard is whether the ... [parties have] engaged in policing activities including the imposition of penalties and sanctions on its members to achieve an anti-competitive goal."[105] If there is any conduct which could raise an inference of anti-competitive intent, this would substantially increase the risks of pursuing the information exchange.[106] As noted earlier, the Supreme Court of Canada has explicitly held that "[t]he object of the agreement is without doubt the most important behavioural element in the inquiry".[107] A similar inference in this regard could be raised by a public statement by one of the parties which suggests that the information exchange will promote greater stability in the industry. An adverse inference also could be raised if the information exchange appeared to exclude unfairly certain competitors, thereby placing them at a competitive disadvantage; or if there were evidence suggesting that discussions had included matters beyond the purported scope of the information exchange.

(d) The Nature of the Information Exchanged

With respect to this factor, the Chandler Speech cautions: "The Bureau would be concerned if the information exchanged related to sensitive areas such as a firm's marketing strategies or its methods of determining its prices."[108] Elsewhere, the Chandler Speech states that in an Advisory Opinion regarding a proposal to publish a petroleum industry survey which would show the petroleum association's members' price forecasts and the methods used in forecasting those prices, the Bureau "cautioned that the published survey would increase the potential for price signalling and, thus, could be a vehicle for an agreement to raise prices of certain products".[109]

The Chandler Speech further underscored the risks associated with exchanging "price information" in a brief discussion of information sessions convened by natural gas aggregators to inform producers of their marketing efforts and persuade them to support proposed contracts.[110] This emphasis on the risks associated with exchanging price-related information (including discounts, rebates, etc.) is consistent with U.S. jurisprudence[111] and enforcement practice.[112]

Nevertheless, as discussed below, the exchange of historic price-related information (i.e., more than a few months old) has significantly less potential to facilitate coordinated conduct than the exchange of current or future prices. The exchange of information with respect to current or future prices is particularly risky[113] and should only be pursued where there is an objectively ascertainable legitimate reason for such exchange.[114] Similarly, while exchanges of information with respect to costs, trading terms, capacity utilization, margins and strategies can be very risky, the risks associated with such exchanges are significantly less for information that is several months old. The risks associated with exchanging current or future data relating to these types of matters is reflected in the following passage of the Strategic Alliances Bulletin:

> [W]hen particularly sensitive information important to rivalry is shared, this may be more likely to be viewed as behaviour injurious to competition. In this regard, exchanging information in respect of current or future pricing, costs, trading terms, or marketing strategies significantly heightens the risk of inquiry by the Director.[115]

(iii) *Additional Factors*

In assessing whether an information exchange agreement is likely to significantly increase the likelihood of coordinated behaviour, another factor that will be relevant is the degree of transparency in the market. For example, if there were substantial confidential discounting taking place in the market, the exchange of list prices would be less risky than if all pricing, including discounts, rebates and other allowances, were transparent.[116]

A related factor is the value and frequency of typical transactions in the market. As the Director has recognized: "Interdependent behaviour often becomes increasingly difficult as the frequency and regularity of sales of the relevant product decrease, and as the value of each sale increases."[117] This is because:

> ... departures from interdependent situations become harder to detect and retaliate against as the frequency and regularity of sales decrease. In addition, the incentives to engage in secret discounting and other concealable competitive initiatives increase with the value of individual sales.[118]

(iv) *Balancing Anti-competitive and Pro-competitive Effects*

As noted earlier, if an agreement to exchange information is likely to prevent or lessen competition unduly, it will be no answer to state that the agreement will give rise to substantial cost savings or other efficiencies. In *Howard Smith*, the Supreme Court of Canada stated:

> The statute proceeds upon the footing that the preventing or lessening of competition is in itself an injury to the public. It is not concerned with public injury or public benefit from any other standpoint.[119]

More recently, in *PANS*, Gonthier J. paraphrased this passage in the following terms:

> Considerations such as private gains by the parties to the agreement or counterbalancing efficiency gains by the public lie therefore outside of the inquiry under [s. 45(1)(c)]. Competition is presumed by the Act to be in the public benefit. The only issue is whether the agreement impairs competition to the extent that it will attract liability.[120]

Gonthier J. then compared the foregoing with the U.S. approach as follows:

> Section [45(1)(c)] of the Act lies somewhere on the continuum between a *per se* rule and a rule of reason. It does allow for discussion of the anti-competitive effects of the agreement, unlike a *per se* rule, which might dictate that all agreements that lessen competition attract liability. On the other hand, it does not permit a full-blown discussion of the economic advantages and disadvantages of the agreement, like a rule of reason would. Since 'unduly' in s. [45(1)(c)] leads to a discussion of the seriousness of the competitive effects, but not of all relevant economic matters, one may say that this section creates a partial rule of reason.[121]

What is less clear is whether section 45 permits a balancing of anti-competitive effects in respect of one dimension of competition against procompetitive effects likely to result from an agreement in respect of another dimension. Although at least one member of the Department of Justice has suggested that such balancing would not be permitted,[122] the courts and the Director have yet to take a position on this issue. In our view, it would be entirely reasonable to take the position that, for example, in determining whether a proposed agreement which likely would have the ancillary effect of restricting competition with respect to packaging or service would contravene section 45, such anti-competitive effects should be balanced against any increased competition with respect to price, innovation or other dimensions of competition that are likely to result from the agreement.[123]

(v) *The Bureau's Suggested Steps to Reduce the Risks*

After listing the factors which the Bureau will assess in evaluating the likely effect of an information exchange on competition, the Chandler Speech offers the following "suggestions to avoid coming into conflict with the *Competition Act*":[124]

1. Information exchanges should be of a generalized nature and non-company specific.

2. Individual firms should be free to determine which policies to follow on their own.

3. Information should be based on past historical data. There should be no indication of future prices or trading terms.

4. Associations should exercise extreme caution in the formulation and implementation of guidelines in relation to important competitive aspects of their business.

5. Where there is collection of data from industry participants (market share, pricing, etc.), it should be collected by an independent firm, and the collection of these data should ensure that the anonymity of members is preserved.

6. The results from the data collected should be publicly available. The prospect of a wider audience, be they non-members or the general public, will reduce the likelihood of anti-competitive effects.

7. Associations should avoid any policing to coerce members to follow association guidelines.

8. No sanctions should be imposed on members who choose not to follow association guidelines.

These and other suggestions will be briefly addressed below.

1. Aggregating Data and Preserving Anonymity

The first and fifth of the above-mentioned suggestions overlap. To ensure that information is generalized and non-company specific, it should be exchanged through a third party with responsibility for making sure the data are aggregated in a way that virtually guarantees that recipients of the data are not able to ascertain or easily deduce competitor-specific information.[125] This appears to be the hallmark of a significant number of information exchange arrangements which have been the subject of positive business review letters from the U.S. Department of Justice in recent years.[126] It also appears to be a requirement of the European Commission with respect to exchanges of most types of information.[127]

2. Absence of Coercion

Parties proposing information exchange agreements should not attempt to coerce other firms to participate in those arrangements, to participate in certain aspects of those arrangements or to otherwise restrict their freedom of action, as such action will raise a "red flag" for the Bureau.[128] In addition, as the European Commission has pointed out, information sharing arrangements should not restrict the ability of the parties thereto to determine their market behaviour independently.[129] To reduce the risk of any question arising in this regard, the correspondence and other documentation relating to the information exchange arrangement should make it clear from the outset that the arrangement is being pursued voluntarily and that no one has been coerced to join the agreement or to participate in a particular aspect of the agreement.

3. Restrict the Information Exchanged to Historical Data

To the extent that the exchange of current and future information has much more potential for influencing market behaviour than the exchange of historical data, it is generally recognized to be much more risky. The U.S. Health Care Guidelines (1996), which apparently have been acknowledged to have wide applicability outside the health care industry,[130] require exchanged information to be more than three months old to qualify for the "antitrust safety zone".[131] As noted earlier, the Bureau's 1995 Strategic Alliances Bulletin highlights the risk that "exchanging information in respect of current or future pricing, costs, trading terms or marketing strategies significantly heightens the risk of inquiry by the Director".[132]

4. Do Not Add or Share Recommendations or Analysis

Adding recommendations and analysis to information exchanges can raise an inference of an agreement that goes beyond the mere exchange of information, thereby significantly increasing the risks associated with participating in the information exchange. In this regard, the Strategic Alliances Bulletin suggests: "Firms should be cautious in sharing the analyses on conclusions developed from the information exchange, in order to preserve their ability to act independently beyond the alliance."[133]

5. Collection by Independent Firm

See discussion under #1 above.

6. The Results from the Data Collected Should Be Made Publicly Available

This suggestion reflects a view that the exchanging of confidential information is more likely to have anti-competitive effects than the exchanging of information that subsequently is made public. In many cases, parties to an information exchange agreement will not be prepared to embrace this suggestion. For example, domestic competitors may prefer to abandon an information exchange proposal rather than have to agree to make the data publicly available, and therefore accessible to their foreign competitors. Where a legitimate reason can be established for not making the data collected publicly available, such as vulnerability to competitors who are not parties to the information exchange, that would provide a reasonable basis for arguing that an adverse inference should not arise.[134]

In the absence of a legitimate reason for not publicly disclosing exchanged information, there may be more risk associated with exchanging confidential information than with exchanging information that has been made publicly available. To avoid this risk, information should be made public either before it is exchanged or soon after it is exchanged.

7. Avoid Policing Activities and Sanctions

Policing activities and sanctions raise an inference of both coercion and an understanding that goes beyond the mere exchange of information. Such activities have weighed against the accused in several conspiracy cases.[135] By contrast, the absence of such activities has weighed in the accused's favour.[136]

(vi) *Additional Suggestions to Reduce the Risks*

In addition to the Bureau's foregoing suggestions, the following suggestions should also be seriously considered:

8. Document the Purpose of the Information Exchange

Parties pursuing information exchange arrangements should ensure that the legitimate purpose and objective of the arrangement is well documented. In addition, all documentation generated externally and internally should reflect the sincere belief, intention and understanding of the parties that: (i) the exchange of information will be limited to that which is clearly described in the documentation; (ii) there are no additional agreements or understandings between the parties; and that (iii) there is no expectation that the information exchange will lead to any change in the parties' market behaviour which might be perceived to be anti-competitive.

9. Keep Information Exchanges Infrequent

To the extent that frequent information exchanges provide greater scope for facilitating coordinated conduct, they are much more risky than "one-off" information exchanges or even irregular information exchanges. As one commentator has observed: "Infrequent and irregular exchange of information may be seen as inconsistent with planning or collusion to avoid competition. Frequent and/or regular exchanges may more easily be interpreted as facilitating agreements not to compete."[137]

10. When Benchmarking, Select Only the Best-in-the-Class Competitor

The potential risks associated with competitor benchmarking can be reduced by restricting such benchmarking initiatives to the "best-in-the-class" competitor. As one commentator has observed:

> This lends support to a company's claims that its motive is to improve efficiency and not to seek some form of anticompetitive agreement. Industry-wide benchmarking among all competitors may give rise to an inference that the genuine purpose of the activity is collusion and not continuous improvement.[138]

To further reduce the risks, an effort should be made to identify whether different competitors are the "best-in-the-class" with respect to different functions, as benchmarking one function with competitor A and another function with competitor B, etc., ordinarily will be less likely to facilitate coordinated action than benchmarking a broad range of activities with one or more competitors.

11. Limit Contacts with Competitors to Low-Risk Personnel

A further step that can be taken to reduce the risks associated with benchmarking and other forms of information sharing is to limit contacts with competitors to technical persons or others who are not in marketing, sales or otherwise in a position to: (i) provide competitors with information that has the potential to have anti-competitive results; or (ii) enter into a common understanding with a competitor on behalf of the firm.[139] An additional precautionary measure that can be put in place is to require approval from a senior manager or in-house legal counsel before each desired exchange of information with a competitor. In any event, as one commentator suggests:

> [F]irms must train employees who engage in benchmarking and accompanying intelligence gathering to identify potential antitrust problems and to seek legal advice when confronted with situations raising antitrust risk. While employees do not have to become antitrust experts, they should be given practical antitrust seminars and written compliance materials to enable them to become antitrust literate.[140]

12. Do Not Engage in Other Communications with Competitors

Parties contemplating benchmarking or other forms of cooperation with competitors should take whatever precautions are necessary to ensure that their communications with competitors are limited to a clearly defined and circumscribed category of cooperative activity. In addition, a record should be kept of each communication and the arrangement should be reviewed quarterly or semi-annually to ensure that it is being operated according to the initial understanding and is not having an unforeseen effect on the parties' competitive behaviour.

Where information is exchanged through a third party, there should be no communications with competitors regarding competitively sensitive information. Where price lists or other competitor documentation is obtained from customers or other market surveillance activities, it should be made clear in writing on the face of the document how, when and by whom the document was procured.

13. Seek the Bureau's Views

Given the risks involved in pursuing a benchmarking arrangement or other information exchange with one or more competitors, prudence dictates that serious consideration be given to approaching the Bureau once a tentative agreement is reached with respect to the type of proposed information exchange and the measures designed to reduce the competition law risks. The approach to the Bureau can be informal or formal. If informal, "an initial reaction" can be requested on either a no-names, hypothetical basis (e.g., the proposal can be described in terms of company A and company B in industry X), or it can be requested on the basis of fuller facts. The informal approach has the advantage of obtaining feedback more expeditiously. However, that feedback will necessarily be preliminary in nature and highly qualified.

By contrast, a more formal approach, in the form of a request for an advisory opinion under the Bureau's Program of Advisory Opinions, has the advantage of providing much greater comfort if a positive advisory opinion is granted. The downside is that it will require a much more detailed submission to the Bureau and typically will take several weeks or even months before the advisory opinion is obtained. Of course, as with any approach to the Bureau, another downside is that it alerts the Bureau to something that may not otherwise have come to its attention.

IV. Implications that Differences in the Canadian and U.S. Legal Regimes Have for Multinational Enterprises Doing Business in Canada

The fact that the Canadian approach to horizontal agreements is in some ways less inclusive and in some ways more inclusive than its U.S. counterpart has significant practical implications for multinational enterprises doing business in Canada. These implications can be grouped into three broad categories: (i) arrangements likely to be legal in the U.S. but not in Canada; (ii) arrangements likely to be legal in Canada but not in the U.S.; and (iii) arrangements that can be structured in a way which minimizes antitrust risk in both jurisdictions, by taking certain precautionary steps.

(i) *Arrangements Likely to Be Legal in the U.S. but Not in Canada*

For the reasons explained in Parts I and III of this paper, the fact that a particular type of horizontal cooperation is legal in the U.S. does not necessarily imply that it will be legal in Canada. In short, any arrangement which is likely to unduly lessen or prevent the process of competition in respect of an important dimension of rivalry (e.g., price, service, quality) may be found to be illegal in Canada, even if the arrangement is likely to lead to substantial efficiencies or procompetitive effects in respect of other dimensions of rivalry.

Specifically, while it is entirely possible that the creation of a new product which likely would not be developed by one or more of the parties in the absence of the proposed arrangement and which likely would not unduly prevent or lessen any existing or potential competition, might withstand scrutiny under section 45,[141] (following the type of reasoning employed by the U.S. Supreme Court in *Broadcast Music, Inc.* v. *Columbia Broadcasting*[142]) it is far less clear whether an efficient arrangement which likely would prevent or lessen *existing* or *likely future* competition with respect to price, service, quality, innovation or distribution would withstand such scrutiny.

For example, an arrangement between competitors to embrace a common distribution network, to reduce emissions of pollutants, or to benchmark with respect to matters which comprise a significant proportion of the parties' total costs, might be found to contravene section 45, even though it might increase efficiencies or increase competition in other ways.

Therefore, where competition in any important dimension might be adversely affected to a material degree as a result of a proposed arrangement between competitors, it would be prudent to avoid potential criminal liability by excluding Canada from the arrangement, even if the arrangement would satisfy the U.S. rule of reason analysis. Indeed, given that the Director has made it clear that he adopts the "effects test" approach to the extraterritorial application of the law,[143] it also would be prudent for the parties to ensure that they would continue to compete as before with respect to their sales into Canada (or their purchases from Canada). The fact that an agreement had received immunity under the *Webb-Pomerene Act*,[144] the *Export Trading Company Act*[145] or other U.S. legislation likely would not save it from condemnation under the Act.[146]

Moreover, the reinforced notification obligations under the Canada/US Agreement[147] and the MLAT likely would increase the risk of the Bureau learning of an agreement which *prima facie* appeared to be anti-competitive in some way in respect of Canada, even though it ultimately might be found to be legal in the U.S.[148]

(ii) *Arrangements Likely to Be Legal in Canada but Not in the U.S.*

Where an agreement lessens or prevents competition, but not to the degree that a Canadian court likely would find to be undue, there would be scope for pursuing it in Canada even though it might not be legal in the U.S. Once again, care would have to be taken to ensure that there were no spillover effects on cross-border conduct (in this case, on U.S. inbound or outbound commerce likely to be caught by the "effects test" described in the U.S. *Antitrust Enforcement Guidelines for International Operations* and the case law).[149]

Where a decision is made to pursue a proposed arrangement between competitors in Canada and that arrangement ultimately is challenged, the comparatively low level of fines as well as the opportunity to avoid costly/disruptive searches and reduce vulnerability to private action in the U.S. may weigh in favour of a guilty plea. However, in such circumstances, it would be important to be very careful to limit the Agreed Statement of Facts, which would be filed on the public record and therefore available to a potential plaintiff in the U.S., to the absolute minimum necessary to establish a basis for the guilty plea. For example, the admissions made in the Agreed Statement of Facts should be as narrow as possible with respect to the geographic scope of the agreement, affected customers, products, time periods, etc. It may even be possible to avoid admitting that the agreement actually was implemented.

On the other hand, the requirement on the Crown to prove an "undue" lessening of competition on the criminal burden of proof creates much greater scope for successfully defending a prosecution in Canada than in a prosecution in the U.S. for a *per se* violation of the *Sherman Act*. As noted earlier, the Crown has had significant difficulty winning contested cases under section 45.[150] As markets become increasingly internationalized, it will become increasingly difficult to establish the "undueness" requirement of section 45.

(iii) *Arrangements that Can Be Structured to Reduce the Antitrust Risk in Both Jurisdictions, by Taking Certain Precautionary Steps*

A final category of arrangements which raise implications for parties considering pursuing cooperative arrangements with competitors that have a cross-border dimension are those arrangements which can be structured to minimize antitrust risk in both jurisdictions by taking certain precautionary steps. These are the steps discussed in Parts III (v) and (vi) of this paper. In short, taking the following steps in both Canada and the U.S. can serve to minimize substantially any antitrust risk that otherwise might be associated with pursuing potentially procompetitive arrangements with competitors:

- Aggregate the information in a way which preserves the anonymity of the various parties to the arrangement;
- Use a non-competitor third party to aggregate the information of the various parties to the arrangement;
- Refrain from coercing anyone to become a party to the arrangement or to abide by its terms;
- Refrain from other types of policing activities and avoid the use of sanctions;
- Restrict the information exchanged to historical data;
- Do not add or share recommendations or analysis;
- If possible, make public the existence of the arrangement, as well as the results of any information exchanged (e.g., any aggregated data produced);
- Document the purpose of the arrangement;
- Keep information exchanges infrequent;
- When benchmarking, select parties in different product or geographic markets and in any event select only the best in the class competitor;
- Limit contacts with competitors to low-risk personnel;
- Do not engage in other contacts with competitors; and
- Seek the Bureau's views.

V. Conclusion

The procompetitive potential of benchmarking and other forms of cooperation between competitors is gaining increased recognition. While historic suspicion in Canadian and U.S. antitrust enforcement circles regarding any form of cooperation between competitors appears to be gradually subsiding, there are still risks that certain types of cooperative arrangements may inadvertently facilitate increased coordination between competitors or may be perceived as being intended to have that result.

Broadly speaking, information exchanges and other forms of cooperative arrangements which have the potential to result in higher prices (either directly or through reduced discounts, rebates, trade credit, etc.)

or even in a greater convergence in prices, increased market stability or other parallel behaviour, are the most risky. The types of cooperation that generally are recognized as having the greatest potential to bring about such results include those involving exchanges of information directly or indirectly related to current or future prices, output, margins, the cost of major inputs and capacity utilization.

By contrast, information exchanges and other forms of cooperation between competitors which are confined to employee benefits, travel costs, spare part costs, warehousing costs/methods, warranty costs, packaging costs, bad debts, management techniques, quality control, information systems and, of course, the matters set forth in subsection 45(3) of the Act, typically would be less likely to result in anti-competitive effects. In between these two broad categories of more risky and less risky subjects for cooperation are matters such as production techniques, distribution and marketing methods.

Where market concentration is high, there are risks associated with any form of cooperative arrangements between leading firms in a market. This is particularly so if market transparency also is high and/or if price stability already prevails in the market. Given the Supreme Court of Canada's explicit recognition that agreements between competitors which do not individually or collectively possess market power are not likely to have anti-competitive consequences, it is unlikely that competitors which collectively account for less than 35% of a relevant market would be convicted under section 45 for having agreed to exchange information or engage in other forms of cooperative activities. All other things being equal, as the collective market share of the parties to a cooperative agreement increases above this threshold, the risk of contravening section 45 also increases.

Given that antitrust market definition is not a precise art, business persons' views of their market shares may differ significantly from the views of the Bureau and/or the courts. This consideration, together with the serious potential consequences associated with being convicted under section 45, or even just being the subject of a search and seizure, strongly mitigate in favour of adopting a more conservative market share rule of thumb than the 35% threshold set forth in the MEGs and the Predatory Pricing Enforcement Guidelines.

Accordingly, it is suggested that parties who collectively account for greater than 20% of a relevant antitrust market should exercise caution and give serious consideration to seeking the advice of legal counsel whenever they wish to pursue the possibility of a cooperative arrangement with competitors. The greater the potential that the form of cooperation or the type of information that may be exchanged has for affecting the market in one of the ways described above, or in any other way that may be found to be anti-competitive, the greater is the need for such advice.

In addition, it is important to be aware of the differences between the Canadian and U.S. antitrust laws, and the implications that those differences have for potential forms of cooperation between competitors on both sides of the Canada/U.S. border, or having another cross-border dimension. While there are precautionary

steps that can be taken in a broad range of cases to minimize the scope for antitrust risk on both sides of the border, there no doubt will be other cases that may present insurmountable obstacles in one of the two jurisdictions, e.g., in Canada because section 45 does not contemplate a full rule of reason, or in the U.S. because the form of cooperation might be subjected to a *per se* standard under the *Sherman Act*. In such cases, the prudent course of action would be to exclude the problematic jurisdiction from the proposal.

Notes

[1] The Director is an independent law enforcement officer appointed by the federal cabinet who has statutory responsibility for administering and enforcing the Act. The Competition Bureau provides investigative and administrative support for the Director's statutory functions.

[2] Industry Canada, Release #7551, "New Director of Investigation and Research Appointed" (29 January 1997). See also (1996-1997) 17:3 Can. Comp. Rec. 1.

[3] See *R.* v. *Campbell* (1979), 51 C.P.R. (2d) 284. See also *R.* v. *Schelew* (1982), 63 C.P.R. (2d) 140 (N.B.Q.B.); aff'd (1984), 78 C.P.R. (2d) 102 (N.B.C.A.); and *R.* v. *Mr. Gas Limited* (11 August 1995), 940332 (Ont. Ct. - Gen. Div.). In the latter case, a gas retailer was convicted under paragraph 61(1)(a) for attempting to influence upwards, through the use of threats, the price at which other gas retailers sold their gasoline. The Court found the accused's indication that it would continue to follow a lower pricing policy "amounted to a veiled warning that the [competitor] was facing a gas war if it did not change its pricing policy". (The retailer was acquitted on nine other counts.)

[4] Bureau of Competition Policy, "Competition Policy" (Background Paper, Stage 1) (Ottawa: Consumer and Corporate Affairs Canada, 1976) at 55.

[5] Specifically, the agreement must be made without coercion, any efficiency gains likely to result from the agreement must be greater than and offset the likely effect of any lessening of competition and be unlikely to be attained by the absence of the agreement, and the agreement must also be registered with the Competition Tribunal.

[6] *Director of Investigation and Research* v. *Bank of Montreal et al.* (1996), 68 C.P.R. (3d) 527 (Comp. Trib.). See also *Director of Investigation and Research* v. *AGT Directory Limited et al.*, (18 November 1994), No. CT 9402/19 (Comp. Trib.).

[7] G. Menard, "Abuse of Dominance: Some Reflections on Recent Cases and Emergency Issues", (Address to the Canadian Institute on Competition Law and Competitive Business Practices, 19 May 1996) [unpublished] at 18.

[8] Section 95 of the Act requires the joint venture meet the following conditions: (a) the project would not have taken place without the joint venture; (b) the joint venture will not result in the change in control of any party to the joint venture; (c) the joint venture is governed by a written agreement which imposes an obligation to contribute assets, restricts the range of activities that may be carried out and provides for the termination of the agreement; and (d) the joint venture does not prevent or lessen competition except to the extent reasonably required to complete the joint venture. It should be noted that s. 95 does not exempt parties to a joint venture from the application of the conspiracy provisions under s. 45.

[9] See Industry Canada, "Strategic Alliances Under the Competition Act" (1995) at 5 (hereinafter, the "Strategic Alliances Bulletin"), which suggests that a merger generally will not be reviewed under the conspiracy provisions unless there is a "basis for believing that the acquisition of control is a sham". Another example of where a merger might be reviewed under s. 45 might be where there is evidence that several competitors have participated in discussions to rationalize the industry through one or more mergers. For an example of conduct potentially in violation of s. 45, see *R.* v. *Béton Régional Inc. et al.* (16 January 1995), Ottawa T-58-95 (F.C.T.D.). In this matter, the parties in the context of merger negotiations effectively transferred control of the company to a competitor. The merger was never completed due to concerns under the Act. The parties subsequently were required to enter into a prohibition order pursuant to s. 34(2) of the Act.

For analysis of the Strategic Alliances Bulletin see (1994) 15:3 Can. Comp. Rec. 24 and (1995-1996) 16:4 Can. Comp. Rec. 8.

[10] The predecessor of the Nova Scotia Pharmaceutical Society was the Pharmacy Association of Nova Scotia.

[11] *R.* v. *Nova Scotia Pharmaceutical Society et al.*, [1992] 2 S.C.R. 606 at 650. For a detailed discussion of this decision and its implications, see P. Crampton and J. Kissack, "Recent Developments in Conspiracy Law and Enforcement: New Risks and Opportunities" (1993) 38 McGill L.J. 569. See also C. Goldman and J. Bodrug, "Antitrust Law and Innovation - Limits on Joint Research & Development and Inter-Company Communications in Canada" (1995) Can.-U.S.L.J. 127 at 136 *et seq.*

[12] *R.* v. *Jacques Perreault*, [1996] A.Q. No. 2660 (Qué. Sup. Ct.); *R.* v. *John Tindale* (Ont. Ct. Gen. Div.); R. v. Manigo (14 janvier 1988), 110-22-000902-858, (Qué. Sup. Ct.).
[13] *R.* v. *Albany Felt Co. of Canada Ltd. et al. (No. 1)* (1980), 52 C.P.R. (2d) 189; aff'd (1982), 143 D.L.R. (3d) 691 (Que. C.A.).
[14] On occasion, a significant factor in the decision of an accused to plead guilty is a desire to avoid the possibility of facts coming to light in the context of Canadian proceedings which could help one or more third parties to establish a violation of the *Sherman Act*. A related factor is a desire to void the publicity that may arise in respect of Canadian proceedings.
[15] Options available to the Bureau under its alternative case resolution ("ACR") program include: pursuing a prohibition order under s. 34 of the Act; or requiring the party in question to enter into some form of undertaking. See Consumer and Corporate Affairs Canada, "Program of Compliance" (1989) at p. 10 (hereinafter the "Program of Compliance"). See also H. Chandler, "Getting Down to Business: The Strategic Direction of Criminal Competition Law Enforcement in Canada" (Paper presented to the Insight and Globe & Mail Conference on Emerging Issues in Competition Law, 10 March 1994) [unpublished] at 15.
[16] For a more detailed discussion, see Davies, Ward & Beck, *Competition Law of Canada* (Toronto: Juris Publishing, Inc., 1996) at §8.03 8.05.
[17] *R.* v. *Anthes Business Forms Ltd. et al.* (1975), 26 C.C.C. (2d) 349 at 374 (Ont. C.A.). See also the Supreme Court of Canada's ruling in *PANS*, *supra*, note 11 at 643 and 656; and the Nova Scotia Court of Appeal's decision in that case at (1991) 36 C.P.R. (3d) 173 at 185.
[18] *PANS*, *ibid.* at 660.
[19] *R.* v. *Gage (No. 2)* (1908), 13 C.C.C. 428 at 449 (Man. C.A.). Although the Ontario Court of Appeal once suggested that the words "conspire, combine, agree or arrange" may have materially different meanings (see *R.* v. *Electrical Contractors Ass'n of Ontario and Dent* (1961), 131 C.C.C. 145 at 157), this view does not appear to have received significant support elsewhere in the jurisprudence. (See for example, *R.* v. *Aetna Insurance Co. et al.* (1975), 22 C.C.C. (2d) 513 at 543 (N.S.C.A.), rev'd on other grounds (1977), 30 C.P.R. (2d) 193 (S.C.C.).) Indeed, the Ontario Court of Appeal has subsequently stated that "all four words contemplate a mutual arriving at an understanding or agreement between the accused and some other persons to do the acts forbidden by paras. (a), (b), (c) or (d) of s. [45]". See *R.* v. *Armco Ltd. et al.* (1974), 21 C.C.C. (2d) 129 at 176, aff'd (1976), 13 O.R. (2d) 32 at 41 (C.A.), leave to appeal to S.C.C. refused 13 O.R. (2d) 32n.
[20] *R.* v. *O'Brien* (1954), 110 C.C.C. 1 at 9 (S.C.C.); *R.* v. *Abitibi Power & Paper Co. Ltd. et al.* (1960), 131 C.C.C. 201 at 209 (Que. Q.B.); *R.* v. *Northern Electric Company Ltd. et al.*, [1955] O.R. 431 at 451 (H.C.); *Armco*, *ibid.*; and *R.* v. *Aluminum Co. of Canada Ltd. et al.* (1976), 29 C.P.R. (2d) 182 at 209 (Que. S.C.) (hereinafter "*Aluminum*").
[21] *Container Materials Limited et al.* v. *R.*, [1942] S.C.R. 147 at 159. See also *Abitibi*, *ibid.*; *Howard Smith Paper Mills* v. *R.*, [1957] S.C.R. 403 at 413; and *O'Brien*, *ibid.* at 668.
[22] *O'Brien*, *ibid.* at 669.
[23] *R.* v. *Canadian General Electric Company Ltd. et al.* (1976), 15 O.R. (2d) 360 at 385 (Ont. H.C.) (hereinafter, "*Large Lamps*").
[24] *Howard Smith*, *supra*, note 21 at 412. See also *Anthes Business Forms*, *supra*, note 17, at 367; *Northern Electric*, *supra*, note 20 at 452; and *R.* v. *Chatwin Motors Ltd.* (1977), 37 C.P.R. (2d) 156 at 159 (B.C.S.C.), aff'd (1979), 40 C.P.R. (2d) 106, aff'd (1980), 49 C.P.R. (2d) 7 (S.C.C.).
[25] *Howard Smith*, *supra*, note 21 at 412-13; and *R.* v. *Elliott* (1905), 9 O.L.R. 648 at 650 (Ont. C.A.).
[26] *Northern Electric*, *supra*, note 20 at 452.
[27] See, for example, *Atlantic Sugar Refineries Co. Ltd. et al.* v. *A.G. Can.* (1976), 26 C.P.R. (2d) 14 at 23 (Que. Sup. Ct.), rev'd 41 C.C.C. (2d) 209 (Que. C.A.), rev'd (1980), 54 C.C.C. (2d) 373 (S.C.C.); *R.* v. *Canadian Cement LeFarge Ltd. et al.* (1973), 12 C.P.R. (2d) 12 at 15 *et seq.* (Ont. Prov. Ct.); *Large Lamps*, *supra*, note 23, at 370; *Aluminum*, *supra*, note 20, at 203; and *R.* v. *Cominco Ltd. - Cominco Ltée at atl.*, [1980] 2 W.W.R. 693 at 717 (Alta. S.C.). See also D.H.W. Henry, Address (public Buyer's Group of British Columbia, 12 October 1962), reproduced in Affleck and McCracken, *Canadian Competition Law*, vol. 2 (De Boo) at 45-99 to 45-101.
[28] H. Wetston, "Canadian Competition Law: Current Issues in Canadian Law and Enforcement" (Meredith Memorial Lectures, 30 November 1990) at 7.
[29] See, for example, *Large Lamps*, *supra*, note 23 at 385 and 395; and *Northern Electric*, *supra*, note 20.
[30] For example: adoption of an open pricing policy; advance announcement of price changes or advance circulation of price lists; direct or indirect circulation of price lists to competitors; adoption of net pricing schemes, i.e., elimination of discount structures; public statements immediately prior to that stability, regarding, for example, steps that could

or should be taken to achieve stability, reduce uncertainty or improve profitability; participation in the development of price or fee guidelines; participation in regular meetings or other communications with competitors immediately prior to or during the period of stability; adoption of most favoured nation clauses in contracts; refusal to deal with one or more retailers or suppliers; adoption of common product standards; adoption of similar consignment sales programs; and the adoption of similar delivered pricing systems, e.g., one or more common basing points.

[31] See, for example, *Northern Electric*, *supra*, note 20 at 451-53; and *Abitibi*, *supra*, note 20 at 215 and 228-30. See also *Aluminum*, *supra*, note 20 at 212.

[32] See generally, J. Howard and W. Stanbury, "Oligopoly Power, Co-ordination and Conscious Parallelism" in Matthewson, Trebilcock and Walker, eds., *The Law and Economics of Competition Policy* (Vancouver: The Fraser Institute, 1990) 219 at 234-36; and M. Dambrot and J. Tyhurst, "Conspiracy and Bid Rigging: A Conceptual Framework" (Paper presented to the Insight Conference, 4 December 1989) [unpublished] at 9-12.

[33] *PANS*, *supra*, note 11 at 647.

[34] *Ibid.* at 651.

[35] *Ibid.* at 653.

[36] *Ibid.* at 654.

[37] *Ibid.*

[38] Consumer and Corporate Affairs Canada, "Merger Enforcement Guidelines" (1991) at 3 (hereinafter the "MEGs"). See P. Crampton, "Canada's New Merger Enforcement Guidelines: A 'Nuts and Bolts' Review" 36 Antit. Bull. 883 at 892 ff. For a comparison with the approach of U.S. antitrust enforcement agencies, see P. Crampton, "The DOJ/FTC 1992 Horizontal Merger Guidelines: A Canadian Perspective", 38 Antit. Bull. 665. See also the Strategic Alliances Bulletin, *supra*, note 9 at 3.

[39] *PANS*, *supra*, note 11 at 652-53.

[40] *Ibid.* at 655.

[41] *Ibid.* at 657.

[42] *Ibid.*

[43] The leading cases include *Weidman* v. *Shragge* (1912), 46 S.C.R. 1; *Stinson-Reeb Builders Supply Co.* v. *R.*, [1929] S.C.R. 276; *R.* v. *Container Materials Ltd.*, [1942] S.C.R. 147; and *Howard Smith*, *supra*, note 21. See also *Abitibi*, *supra*, note 20; *Armco*, *supra*, note 19; and *Large Lamps*, *supra*, note 23. The concern with prices traces back to 1888, when Canada's first competition legislation (which contained the origins of s. 45) was being addressed in Parliament. See P.K. Gorecki and W.T. Stanbury, *The Objectives of Canadian Competition Policy 1888-1983* (Montreal: Institute for Research and Public Policy, 1984) and P. Crampton, *Mergers and the Competition Act* (Toronto: Carswell, 1990) at 1 ff and 212-13.

[44] *PANS*, *supra*, note 11 at 657.

[45] *Ibid.*

[46] See, for example, *Howard Smith*, *supra*, note 21; *Abitibi*, *supra*, note 20; *Albany Felt*, *supra*, note 13; *R.* v. *Burrows et al.* (1966), 54 C.P.R. 95 (B.C.S.C.); *R.* v. *McGavin Bakeries Ltd. et al. (No. 6)* (1951), 101 C.C.C. 22 (Alta. S.C.); *R.* v. *Canadian Import Co.* (1933), 61 C.C.C. 114, aff'd (1935), 62 C.C.C. 342 (Que. C.A.); and *R.* v. *Lyons Fuel Hardware & Supplies Ltd.* (1961), 30 D.L.R. (2d) 6 (Ont. H.C.).

[47] See, for example, *R.* v. *Alexander Ltd.* (1932), 57 C.C.C. 346 (Ont. H.C); *R.* v. *D.E. Adams Coal Co.* (1957), 119 C.C.C. 350 (Man. Q.B.); *Lyons Fuel*, *ibid.* See also *R.* v. *J.J. Beamish Construction Co. Ltd. et al.*, [1968] 1 O.R. 5 (C.A.); and *B.C. Lightweight Aggregate Ltd.* v. *Canada Cement La Farge Ltd.* (1979), 103 D.L.R. (3d) 587 (B.C.S.C.) (tort of unlawful conspiracy). Non bid-rigging cases involving customer allocation include *R.* v. *Canadian Coat and Apron Supply Ltd.*, [1968] 2 Ex. C.R. 53; *Canadian Import*, *ibid.*; and *R.* v. *Alpa Industries Ltd. et al.* (1974), 22 C.P.R. (2d) 231 (Ont. H.C.).

[48] See, for example, *McGavin Bakeries*, *supra*, note 46 at 39-40; *Electrical Contractors*, *supra*, note 19 at 162; *Burrows*, *supra*, note 46 at 108-109; and *Stinson-Reeb Builders*, *supra*, note 43 at 335-36.

[49] See, for example, *Howard Smith*, *supra*, note 21; *Northern Electric*, *supra*, note 20; *Stinson-Reeb Builders Supply*, *supra*, note 43; *R.* v. *Clarke* (1908), 1 Alta L.R. 358 (C.A.); and *R.* v. *McMichael* (1907), 18 C.C.C. 186 (Ont. H.C.).

[50] *PANS*, *supra*, note 11 at 659.

[51] *O'Brien*, *supra*, note 20 at 670.

[52] *R.* v. *Lethbridge Concrete Products Ltd. et al.* (1979), 52 C.P.R. (2d) 85 (Alta. S.C.).

[53] *O'Brien*, *supra*, note 20 at 669.

[54] *PANS*, *supra*, note 11 at 660.

[55] *Ibid.*

[56] *R.* v. *Nova Scotia Pharmaceutical Society (No. 3)* (1993), 120 N.S.R. (2d) 304 at 339.
[57] *Anthes Business Forms, supra*, note 17 at 373; and *U.S.* v. *United States Gypsum Co.*, 438 U.S. 422 at 444 and 436 n. 13 (1978).
[58] Section 62. See also *Westfair Foods Ltd.* v. *Lippens Inc.*, [1987] 6 W.W.R. 629, aff'd (1989), 30 C.P.R. (3d) 209 (Man. C.A.), leave to appeal to the S.C.C. refused (1990), 30 C.P.R. (3d) 209 (note) (S.C.C.); and S. Ross, "The Evolving Tort of Conspiracy to Restrain Trade Under Canadian Common Law" (1996) 75 Can. Bar Rev. 193.
[59] See, for example, G.N. Addy, Address (Canadian Bar Association, National Competition Law Section, 1 October 1993) at 2 (Speech no. S-11274\93-07); H.I. Wetston, Address (Corporate Counsel Association, 19 August 1991) at 2-3 (Speech no. S-10492\91-15); and H.I. Wetston, "Decisions and Developments: Competition Law and Policy" (8 June 1992) at 16 (Speech no. S-10728\92-07).
[60] See G.N. Addy, Address (Canadian Bar Association's Second Annual Competition Law Conference, 30 September 1994) at 8, and Address (Canadian Bar Association's Third Annual Competition Law Conference, 29 September 1995) at 3, reproduced in (1995) 16:3 Can. Comp. Rec. 1. See also Chandler, *supra*, note 15 at 12-13. In the proceedings in 1990 against various flour companies, each of the three largest participants in a bid-rigging scheme was fined $1 million. At that time, fines were the highest ever. However, the following year a new record was set in the compressed gas proceedings, where three corporations were each fined $1.7 million for conspiracy. More recently, a fine of $2 million was imposed on the Association of Professional Pharmacists of Quebec; and a fine of $2.5 million was imposed against Canada Pipe Company Limited. Both of those fines were levied under s. 45 of the Act. See Addy (1995), *ibid.* at 4. In October 1996, the largest Competition Bureau conspiracy prosecution came to an end with the conviction and sentencing of John Tindale, former president of Canadian Oxygen Ltd. The investigation and prosecution of re-sellers of compressed gas in Canada took six years and resulted in fines totalling a record $6.46 million. See *Tindale, supra*, note 12. Even more recently in February 1997, the Bureau announced the conviction and sentence of Mitsubishi Paper Mills, Ltd. in connection with its participation in a price fixing and refusal to supply scheme involving thermal fax paper. With this conviction, a total of $3.45 million in fines has been imposed to date and the Bureau's investigation of other possible participants is ongoing. See Competition Bureau, Release #7568, "Mitsubishi Paper Mills, Ltd. Pleads Guilty Under the Competition Act and Pays $850,000 Fine in the Thermal Fax Paper Inquiry" (17 February 1997).
[61] Wetston, *supra*, note 28 at 9. See also extracts of remarks by G.N. Addy to the staff of the Bureau, reproduced in (1994) 15:1 Can. Comp. Rec. 5 at 7; and Chandler, *supra*, note 15 at 13.
[62] Consumer and Corporate Affairs Canada, "Competition Law Amendments - A Guide" (1985) p. 27.
[63] Wetston, *supra*, note 28 at 9-10. *R.* v. *Canada Pipe Company Ltd.* (2 October 1995) T-2044-95 (F.C.T.D.) at §3, the Court identified "the volume of commerce affected" as a factor in determining the sentence. The transcript in that case reveals that the fine sought (and ultimately imposed) was "something in the order of 30 per cent" of the accused's sales. See also *R.* v. *Ciment Quebec Inc. et. al.* (19 August 1996), 200-01-015626-967, (Que. Sup. Ct.) where the $5.8 million in fines which was divided among the four accused represented 40% of the volume of affected commerce. See also Crampton and Kissack, *supra*, note 11 at 603 *et seq.* Note that the Bureau recently developed internal guidelines for the use of officers in developing sentencing recommendations to the Attorney General of Canada in criminal matters. See Addy (1994) *supra*, note 60 at 2.
[64] *Supra*, notes 59 and 60. See also, Crampton and Kissack, *supra*, note 11 at 607 *et seq.*
[65] *Thomson Newspapers Limited et al.* v. *Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425 at 514 (*per* La Forest J.).
[66] *Perreault, supra*, note 12. Mr. Perreault was convicted of separate counts of price fixing, price maintenance, predatory pricing and regional price discrimination.
[67] Recent amendments to the *Criminal Code*, which came into force on September 3, 1996, allow for conditional sentences. Pursuant to s. 742.1 of the *Code*, a conditional sentence allows an offender to avoid incarceration and return to reside in the community while being subject to supervision and a strict court order governing his behaviour.
[68] Competition Bureau, Release 7557, "Record Fine of $550,000 Imposed on Individual for Conspiracy Offence Under the Competition Act" (29 January 1997), reproduced in (1996-1997) 17:3 Can. Comp. Rec. 23.
[69] In order to commence a formal inquiry under the Act, the Director must believe on reasonable grounds that a person has committed or is about to commit an offence under the Act, or has failed to comply with a court order or an order of the Tribunal or that grounds exist for the Tribunal to make an order under Part XIII of the Act. The Director may also be compelled to initiate an inquiry by the Minister under the Act or by six Canadian residents who swear an affidavit which sets out the nature of the alleged offence, the names of the persons involved and a concise statement of the evidence supporting their opinion.
[70] Chandler, *supra*, note 15 at 7.

[71] C. Goldman and J. Kissack, "Cooperative Antitrust Enforcement Efforts Between Canada and the United States: Investigations, Information Sharing and Confidentiality in Criminal Proceedings" (Paper presented to the American Bar Association, Section of Antitrust Law Annual Meeting, 6 August 1995) [unpublished] at 5.
[72] J. Rowley and J. Clifford, "Search and Seizure: Canada Gets Tough" (Spring 1996) 10 Antitrust 10 at 12. See also *Competition Law of Canada, supra,* note 16 at §13.06[4].
[73] Addy (1995), *supra*, note 60 at 10.
[74] *Ibid.* For cases involving joint investigations by the Bureau and the U.S. Department of Justice resulting in convictions, see *R.* v. *Kanzaki* (1994), 82 F.T.R. 63; and more recently, *R.* v. *Mitsubishi Paper Mills Ltd.* (17 February 1997) T-125-97 (F.C.T.D.).
[75] Agreement between the Government of Canada and the Government of the United States of America Regarding the Application of their Deceptive Marketing Practices Laws, 3 August 1995 (hereinafter the "Canada/US Agreement").
[76] See *Kanzaki, supra,* note 74; and *Canada Pipe, supra,* note 63. See also Department of Justice, Release, "Antitrust Division Breaks Price Fixing Conspiracy in Disposable Plastic Dinnerware Industry" (9 June 1994).
[77] C. Goldman and J. Kissack, "Current Issues in Cross-Boarder Ciminal Investigations: A Canadian Perspective" (1995) Fordham Corp. L. Inst. 37 at 40, reproduced in (1995-1996) 16:4 Can. Comp. Rec. 81.
[78] Strategic Alliance Bulletin, *supra,* note 9 at 14.
[78a] *Ibid.*
[79] See, for example, the Strategic Alliances Bulletin, *supra*, note 9 at 9; Wetston, *supra*, note 28 at 4; Goldman & Bodrug, *supra*, note 11; J. Kattan, "Facilitating Practices and Section 5: The Evidence of Life After Ethyl" (Address to New York State Bar Association, Section on Antitrust Law, 28 January 1992) [unpublished] at 6; J. M. Gidley, "Emerging Issues in Horizontal Agreements: The Role of Facilitating Practices" (Address to the Practising Law Institute, 13 November 1992) [unpublished] at 14. See also the U.S. Department of Justice's Business Review Letter to Georgia Bankers Association, dated 13 September 1988; and R. Posner, "Information and Antitrust: Reflections on the Gypsum and Engineers Decisions" (1979) 67 Geo. L.J. 1157 at 1203.
[80] See, for example, the Strategic Alliances Bulletin, *supra*, note 9 at 7-8.
[81] See, for example, *Armco, supra*, note 19; *Large Lamps, supra*, note 23 at 395; and *Albany Felt, supra*, note 13. But see the more recent decision in *R.* v. *Clarke Transport Canada Inc.* (1995), 64 C.P.R. (3d) 289 (Ont. Ct.-Gen. Div.) at 297 *et seq* (hereinafter, "*Clarke Transport Canada*").
[82] Information sharing between one or more large firms in a highly concentrated market and a potential entrant is an example of a potentially risky situation that does not involve direct competitors. *Cf.* §4.12 of the Bureau's MEGS, *supra*, note 38, for a brief outline of the Bureau's sole concern with conglomerate mergers. Note also that the Nova Scotia Supreme Court made it clear in *PANS* that it is not necessary for an agreement to be horizontal in order for it to offend s. 45. See *Nova Scotia Pharmaceutical Society, supra*, note 56 at 313.
[83] Strategic Alliances Bulletin, *supra*, note 9 at 5 and 23.
[84] See *PANS*, *supra*, note 11 at 653. The Strategic Alliances Bulletin, *supra*, note 9 at 9 states: "The Supreme Court's discussion of undueness makes it clear that without market power, an information exchange among strategic alliance partners will not be subject to section 45."
[85] It is also possible that a benchmarking agreement or other form of information sharing agreement could be pursued under the price maintenance provisions in s. 61 of the Act. See the Strategic Alliances Bulletin, *ibid.* at 9 n.18. For another discussion of the risks associated with benchmarking and other forms of information sharing, see R. Lusk and S. Neylan, "Benchmarking and Information Sharing" (Paper presented to the Second Annual Conference of the Canadian Bar Association, Competition Law Section, 30 September 1994) [unpublished].
[86] As one leading commentator notes: "[A] facilitating practice may lead to a *further* agreement, but proof of the latter is not essential to finding the *initial* agreement ... [F]or example, an agreement to exchange information may lead to or be part of an agreement to fix prices, but even without the latter agreement, the exchange itself is an agreement that may undesirably facilitate price coordination." See P. Areeda, *Antitrust Law*, vol. 6 (Toronto: Little, Brown and Company, 1986) at 29. See also the Strategic Alliances Bulletin, *ibid.* at 9; J. Shenefield, "Communication and Cooperation Among Competitors: Introduction and Overview" (1993) 61 Antit. L.J. 523 at 524-35; R. Posner, *Antitrust Law: An Economic Perspective* (Chicago: The University of Chicago Press, 1967) at 135-36; and Case 18 of the 1988 United States Department of Justice *Antitrust Enforcement Guidelines for International Operations*, 24 CCH Trade Reg. Rep. at 225-26. The latter guidelines were superseded by the *Antitrust Enforcement Guidelines for International Operations*, issued jointly by the U.S. Department of Justice and the Federal Trade Commission in April 1995.
[87] *PANS*, *supra*, note 11 at 660. Note, however, that this element was not found to have been met when the *PANS* case subsequently proceeded to trial on the merits. See *supra*, note 56 at 333, *et seq.*

[88] *Supra*, note 9.
[89] H. Chandler, "Competition Law Issues in the Upstream Oil and Gas Industry" (1993) 31 Alta. L.R. 72.
[90] Strategic Alliances Bulletin, *supra*, note 9 at 8.
[91] Chandler, *supra*, note 89 at 81.
[92] Strategic Alliances Bulletin, *supra*, note 9 at 8; and Chandler, *ibid.* at 80.
[93] Chandler, *ibid.*
[94] Strategic Alliances Bulletin, *supra*, note 9 at 8.
[95] *PANS*, *supra*, note 11 at 653.
[96] See Crampton and Kissack, *supra*, note 11 at 592-93. The Director uses a 35% market share test in both the MEGs, *supra*, note 38, at §4.2.1, and Department of Consumer and Corporate Affairs Canada, Predatory Pricing Enforcement Guidelines (1992) at §2.2.1.1, to distinguish between situations that are unlikely to result in the unilateral exercise of a material degree of market power and those that may have such results. The 1992 *Horizontal Merger Guidelines* issued by the U.S. Department of Justice and the Federal Trade Commission employ a 35% market share threshold for essentially the same purpose. See 62 Antit. & Trade Reg. Rep. No. 1559 (Special Supplement) (Washington: BNA, 2 April, 1992, at §§2.211 and 2.22).
[97] MEGs, *supra*, note 38 at §4.6.1. See also the Predatory Pricing Enforcement Guidelines, *ibid.* at §2.2.1.2.
[98] *Supra*, note 96 at §3.2.
[99] It may be noted that in *DIR* v. *Hillsdown Holdings (Canada) Ltd. et al.* (1992), 41 C.P.R. (3d) 289 at 329, the Competition Tribunal rejected the use of "rigid numerical criteria" in determining whether a merger is likely to prevent or lessen competition substantially.
[100] Strategic Alliances Bulletin, *supra*, note 9 at 8.
[101] *Armco*, *supra*, note 19 at 147 (Lerner J.'s emphasis).
[102] *Re Fatty Acids: The Community* v. *Unilever NV*, [1989] 4 C.M.L.R. 445 at 456-57.
[103] Chandler, *supra*, note 89 at 81.
[104] Wetston (1992), *supra*, note 59 at 6; and P. Crampton and R. Corley, "Merger Review Under the Competition Act: Reflections on the First Decade", to be published in vol. 65 (Issue 2) Antit. L .J., also published in (1995-1996) 16:4 Can. Comp. Rec. 37.
[105] Chandler, *supra*, note 89 at 81.
[106] See *Anthes*, *supra*, note 17 at 373 ("If the Court could find on the evidence that the purpose or intention of the parties was to prevent or lessen competition unduly, undoubtedly this would be sufficient for a conviction".) See also S. DeSanti and E. Nagata, "Competitor Communications: Facilitating Practices or Invitations to Collude? An Application of Theories to Proposed Horizontal Agreements Submitted for Antitrust Review" (1994) 63 Antit L. J. 93 at 117.
[107] *PANS*, *supra*, note 11 at 655. See also the Strategic Alliances Bulletin, *supra*, note 9 at 9. However, as Moldaver J. held in *Clarke Transport Canada*, *supra*, note 81 at 303-304, "no matter how nefarious the object of the agreement, absent some showing of market power, there can be no violation of section 45(1)(c)".
[108] Chandler, *supra*, note 89 at 81.
[109] *Ibid.* at 79-80.
[110] *Ibid.* at 84-85.
[111] *Cf. Gypsum*, *supra*, note 57 at 441, n.16. See also *Maple Flooring Manufacturing* v. *U.S.*, 268 U.S. 563 at 582-83.
[112] See, for example, the *U.S. Department of Justice and Federal Trade Commission Statements of Antitrust Enforcement Policy in Health Care* 71 Antit. & Trade Reg. Rep. (No. 1777) (Special Supplement) (Washington: BNA, August 29, 1996), at S-13 (hereinafter the "U.S. Health Care Guidelines (1996)". (For example: "Exchanges of future prices for health provider services or future compensation of employees are very likely to be considered anticompetitive"); Gidley, *supra*, note 79, at 13-14; Kattan, *supra*, note 79, at 7-8; B. Henry, "Benchmarking and Antitrust", (1994) 62 Antit. L.J. 483 at 496-97; and M. Weiner, "Benchmarking, Information Sharing and Facilitating Practices: Distinguishing the Legitimate from the Unlawful" (Paper presented to the Insight and Globe & Mail Conference on Emerging Issues in Competition Law, 10 March 1994) [unpublished] at 12 *et seq.*
[113] See the U.S. Health Care Guidelines (1996), *ibid.*; Gidley, *supra*, note 79 at 14; Kattan, *supra*, note 79 at 7; and Chandler, *supra*, note 89 at 81. See also the charges in *U.S.* v. *General Electric Company et al.*, (Indictment filed before the United States District Court for the Southern District of Ohio, Eastern Division, Feb. 17, 1994, at §13) and the Competitive Impact Statement filed on Dec. 21, 1992 in *U.S.* v. *Airline Tariff Publishing Co. et al.*, 58 Federal Register 374.
[114] See, for example, *Reserve Supply Corp.* v. *Owens-Corning Fibreglass Corp.*, 971 F.2d 37 (7th Cir. 1990). This case is discussed in M. Weiner, "Distinguishing the Legitimate from the Unlawful" (1993) 7 Antitrust 22 at 24.

[115] *Supra,* note 9 at 9.
[116] *Anthes, supra,* note 17 at 363; and *R.* v. *Aluminum Co. of Canada et al., supra,* note 20 at 196 and 202-03.
[117] MEGs, *supra,* note 38 at §4.10.2. See also Wetston, *supra,* note 28 at 4.
[118] *Ibid.*
[119] *Howard Smith Paper Mills, supra,* note 21 at 411.
[120] *PANS, supra,* note 11 at 649-50.
[121] *Ibid.* at 650.
[122] J. S. Tyhurst, "Section 45 of the Competition Act: When Does Co-Operation Become Conspiracy" (Paper presented to the Insight Globe & Mail Conference on Emerging Issues in Competition Law, 10 March 1994) [unpublished].
[123] This position is quite different from the argument that rivalry with respect to dimensions of competition not affected by the impugned agreement *continues* to be intense and that therefore competition cannot be unduly prevented or lessened. As the Quebec Court of Appeal pointed out in *Albany Felt, supra,* note 13 at 714, that response is not a defence to a finding that the agreement prevented or lessened competition unduly. In short, "businessmen may [not] choose, and impose upon a market the area of their business where they will allow free competition".
[124] Chandler, *supra,* note 89 at 81-82.
[125] *Cf.* the Strategic Alliances Bulletin, *supra,* note 9 at 9. See also the safe harbours in the U.S. Health Care Guidelines (1996), *supra,* note 112.
[126] See, for example:

- Letter dated 6 January 1997 to Carl W. Mullis, III regarding a proposal by DateCheck, Inc., a Georgia based retail price auditing firm, to purchase and publish lists of product shelf prices;
- "Division finds Data Exchange to combat Rebate Fraud would not be Anticompetitive", 69 Antit. & Trade Rq. Rep. (BNA) 20 July 1995 at 57;
- Letter dated March 8, 1994 to Judy Whalley regarding a proposal by National Telecommunications Data Exchange, Inc. and its member carriers to exchange information about former business customers of the member carriers whose accounts had been closed with undisputed unpaid balances;
- Letter dated 29 January 1993 to Robert D. Paul regarding a joint venture of fifteen wholesale distributors of lawn and garden products;
- Letter dated 13 October 1993 to Daniel Sweeney regarding an information exchange program involving members of Personal Care Distribution Conference Inc.;
- Letter dated 15 June 1993 to B. Lawrence Theis regarding the Colorado Asphalt Producers Association's proposal to initiate an asphalt industry advancement program;
- Letter dated 2 June 1993 to Suzanne Harley regarding the proposed activities of the members of the Nickel Users Purchasing Association Inc.;
- Letter dated 5 July 1994 to Mac S. Dunaway regarding participation by the Portable Power Equipment Manufacturers' Association and its members in a negotiated rule-making proceeding;
- Letter dated 26 October 1992 to William R. Creasey regarding the creation of a data base on individual physician's charges for kidney and liver transplants; and
- Letter dated 23 October 1992 regarding the establishment of a tanker broker panel to provide oil companies with market-based rate estimates for intra-company cargo movement.

This is also one of the requirements for information sharing agreements to fall within the "antitrust safety zone" described in the U.S. Health Care Guidelines (1996). See *supra,* note 112 at S-11 and S-13. It appears that officials of those agencies have acknowledged that the policy statements have wide applicability outside the health care industry: Morgan, Lewis & Bockius, *Trade Associations The New Antitrust Ground Rules,* January 1994, at i.
[127] See *Re Fatty Acids, supra,* note 102.
[128] *Cf.* Strategic Alliances Bulletin, *supra,* note 9 at 9, as well as the 15 June 1993 and 2 June 1993 business review letters referred to at note 126 above.
[129] *Cf.* Butterworths, *Competition Law* (Looseleaf Service) London: 1993, at §184.
[130] See reference to Morgan, Lewis & Bockius, *supra,* note 126.
[131] U.S. Health Care Guidelines (1996), *supra,* note 112 at S-13.
[132] Strategic Alliances Bulletin, *supra,* note 9 at 9. The Strategic Alliances Bulletin then notes that the exchange of such information may also raise issues under the bid-rigging and price maintenance provisions of the Act. *Ibid.* at n.18.
[133] *Ibid.*

[134] *Cf.* W. Snead, "Evaluation Factors for Benchmarking Proposals" (Draft of 6/28/93) at 9, reproduced in *Communications Among Competitors When Does Collaboration Become Conspiracy* (ABA Section of Antitrust Law, 1993) tab 7 at 9-10.
[135] See, for example, *Large Lamps*, *supra*, note 23 at 389-90; *Canadian Coat and Apron Supply*, *supra*, note 47 at 72-73 and 80; *Northern Electric Company Ltd.*, *supra*, note 20 at 458-59; *Electrical Contractors Ass'n of Ontario and Dent*, *supra*, note 19 at 167; and *Abitibi Power & Paper*, *supra*, note 20 at 215 and 226-28.
[136] See, for example, *Anthes*, *supra*, note 17 at 362-63.
[137] Snead, *supra*, note 134 at 9.
[138] *Cf.* W. Slowney, "Benchmarking: Boon or Buzz Word" (1993) 7 Antitrust 30 at 32. See also Henry, *supra*, note 112 at 509.
[139] *Cf.* Henry, *supra*, note 112 at 509.
[140] *Ibid.* at 508.
[141] For example, if a number of firms which were licensed only to compete in a particular province of Canada, and which otherwise would have difficulty offering a viable national service, entered into an arrangement to offer a national service to large customers who had expressed need for such services, there would be a very good argument that this arrangement would not contravene the Act.
[142] 441 U.S. 1 at 22-24 (1979). There, the Court ruled that the defendants "made a market in which individual composers are inherently unable to compete fully effectively". At the same time, it noted that individual composers who belonged to the defendant performing rights societies "have neither agreed not to sell individually in any other market nor to use the blanket license to mask price fixing in such other markets".
[143] C.S. Goldman, Q.C., G.P. Cornish & R.F.D. Corley, "International Mergers and the Canadian Competition Act" (1992) Fordham Corp. L. Inst. 217; and G.N. Addy, "International Coordination of Competition Policies" (Address to the HWWA-Institut für Wirtschaftsforschung-Hamburg, 9-11 October 1991) [unpublished].
[144] 15 U.S.C. §§ 61-66.
[145] 15 U.S.C. §§ 4001-4021.
[146] See the reasoning in *A. Ahlstrom Osakeyhtio* v. *Commission*, [1988] E.C.R. 5193 at 5209 and 5244.
[147] *Supra*, note 75.
[148] The 1995 Agreement requires a party to notify the other party of enforcement activities that are relevant to the other party's enforcement activities, including any investigations that involve: mergers of a company (or its subsidiaries) organized under the laws of the other party; attempts to obtain information located in the other party's territory; anticompetitive activity carried out in the other party's territory; or conduct which may have been approved by the other party. Parties are also required to advise each other of interventions in regulatory or judicial proceedings where such participation may affect the other party's interest and also of the implementation of any remedial orders aimed at prohibiting conduct in the other party's territory. Notwithstanding that the party has been notified of the original investigation, there is an additional requirement to notify the other party seven days in advance of certain types of enforcement action (such as an application to the Competition Tribunal) or the settlement of a matter.
[149] See U.S. Department of Justice and Federal Trade Commission, *Antitrust Enforcement Guidelines for International Operations* (April 1995), at § 3.1 and the jurisprudence cited therein, including *Hartford Fire Insurance Co.* v. *California*, 113 S.Ct. 2891 at 2909 (1993).
[150] The Crown has lost the substantial majority of the contested cases brought over the last 20 years. Some of the more high profile of these have included *Nova Scotia Pharmaceutical Society (No. 3)*, *supra*, note 56; *Clarke Transport Canada*, *supra*, note 81; *R.* v. *Canada Packers* (1988), 19 C.P.R. (3d) 133 (Alta. Q.B.); *Atlantic Sugar*, *supra*, note 27; *Aetna*, *supra*, note 19; *Anthes Business Forms*, *supra*, note 17; *Aluminum*, *supra*, note 20; and *Lethbridge*, *supra*, note 52.

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