CANADIAN COMPETITION RECORD

COMMENT AND ANALYSIS

THE CONSENT ORDER PROCESS: POST-*ULTRAMAR* AND LOOKING AHEAD

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Editor's Note: Since this paper was written, the proposed amendments to the *Competition Act* in Bill C-23 have in fact been passed and come into force in the form discussed in this paper.

Introduction

In April 2000, the Competition Tribunal refused to issue a draft consent order ("DCO") put forward at that time by the Commissioner of Competition and Ultramar Ltd. with respect to Ultramar's proposed acquisition of Coastal Canada Petroleum Inc., an operator of a petroleum products terminal and wholesale supply business in the Ottawa area.[2] In essence, the Tribunal refused to issue the order because it found that certain supply obligations, in what was principally a behavioural remedy, were not sufficiently well defined to be effective and enforceable.[3] Specifically, the DCO required Ultramar only to offer to supply to independent marketers a minimum volume of refined petroleum products and fuel ethanol at wholesale prices. The Tribunal held that this obligation was insufficient to remedy the concerns identified by the Commissioner.

Although some commentators suggested that the Tribunal's refusal to issue the DCO in *Ultramar* would take the consent order process "back to ground zero" and undermine confidence in the Tribunal's process,[4] the Tribunal has, since *Ultramar*, issued consent orders in five separate merger proceedings.[5] In doing so, the Commissioner and the Tribunal have shown a willingness to accept both structural and behavioural remedies and to expedite certain steps in the consent order process in appropriate circumstances.[6]

In this article, we discuss certain aspects of the consent order process in light of the post-*Ultramar* merger consent orders. In this regard, our primary focus is on the *Chapters* consent order proceeding, which involved significant behavioural elements as well as intervenors and the filing of numerous comments. We also briefly consider some initial issues arising in connection with the currently proposed amendments to the consent order provisions in Part VIII of the Act.[7] Contrary to the original intention of those proposed amendments, in their current form they risk adding greater risk and uncertainty to the consent order process.

Post-*Ultramar* Consent Orders

Chapters/Indigo Merger

On January 11, 2001, the Commissioner initiated an inquiry into the proposed acquisition by Trilogy Retail Enterprises L.P. of the majority of the shares of Chapters and the proposed subsequent merger of Chapters and

Indigo, two leading operators of bookstores in Canada. After a detailed investigation, including information requests and the issuance of orders under section 11 of the *Competition Act,* and negotiation of a resolution with the parties, the Commissioner applied to the Tribunal on April 18, 2001 for a consent order under sections 92 and 105 of the Act.[8]

The Commissioner's Filings

Relevant Markets

The Commissioner's filings focused on two relevant product markets: (a) "the sale of English-language trade books through large-format and small-format retail stores, and their online presences" (the "downstream market"); and (b) "the purchase ... of English-language trade books from publishers by book retailers with large-format and small-format stores, complemented by their online presences" (the "upstream market").[9] Textbooks and French-language books were excluded from the relevant product markets by virtue of their specialized and distinct customer base.[10] Moreover, the Commissioner excluded specialty stores, book clubs, mass merchandisers, university bookstores and the online sites maintained by these channels from the downstream market because they "do not provide meaningful competition to large- and small-format bookstores".[11] The Commissioner also excluded these channels from the upstream market because, "[for] the bulk of publishers, such limited retailers do not represent effective substitutes for the vast majority of titles in their catalogues" [12]

The Commissioner defined the relevant geographic dimension of the downstream market as being "an area limited by a radius determined by the drawing area from which each store obtains the bulk of its customers".[13] Moreover, although the Commissioner acknowledged that the "Internet's geographic dimension is at least national", he noted that "there remains a local aspect to Internet sales as they often involve further or complementary transactions at the consumer's local Chapters or Indigo".[14]

With respect to the upstream market, the Commissioner noted that "[publishers] located in Canada are generally concerned with securing retail channels through which they can increase their total volume of domestic sales".[15] As a result, the Commissioner alleged that the relevant geographic upstream market was national.[16]

Market Shares

The Commissioner estimated that the combined entity's share of total English-language trade book sales in the downstream market ranged from a low of 48.0% in Vancouver to a high of 84.2% in Calgary.[17] Moreover, the Commissioner alleged that Chapters and Indigo would "have a 100% share of the [large-format store] category in each metropolitan area in which they overlapped".[18] In the upstream market, the Commissioner estimated that the combined entity would account for approximately 55-70% of purchases.[19]

Barriers to Entry

The Commissioner found that "sustainable, timely and effective entry in the form of multi-market large-format or small-format bookstores [was] not likely".[20] In this regard, the Commissioner indicated, among other things,

that (a) most urban markets were largely saturated; (b) exclusive covenants seriously limited the ability of competing booksellers to enter the market; (c) the sunk costs associated with opening a large-format store and building an e-commerce platform were very high; and (d) Chapters and Indigo had the benefit of the first-mover advantage.[21] The Commissioner also noted that Indigo was the only entrant in the last ten years that planned to "achieve a large scale and compete with Chapters".[22]

Draft Consent Order

To address the Commissioner's concerns, the parties agreed to a DCO which required Chapters to offer for sale 13 large-format stores, ten small-format stores, certain online assets, certain trade names and a distribution facility.[23] (Prior to the merger, Indigo operated 15 large-format stores. It also offered books over the Internet through Indigo Online Inc., a majority owned subsidiary.)

The DCO also required Chapters to commit to certain minimum acceptable terms of trade with suppliers and imposed restrictions with respect to its enforcement of restrictive covenants, store openings and re-entry into the wholesale business.[24] The terms of trade established minimum acceptable parameters with respect to payment periods, discounts and returns. They also precluded certain types of discrimination among publishers and prohibited Chapters from closing any large-format stores without taking certain steps pursuant to an orderly plan. In addition, they included a "most-favoured nation" clause which ensured that Chapters would receive the same terms of trade that publishers provided to its direct competitors when purchasing articles of like quality and quantity. All disputes arising out of or related to the terms of trade are required to be resolved through a self-enforcing arbitration mechanism.[25]

Filing of Comments and Requests for Leave to Intervene

On April 17, 2001, Chapters filed a motion for an order shortening the time period for filing comments and requests for leave to intervene from 21 days to 10 days after publication of the consent application in the *Canada Gazette*. In support of its motion, Chapters argued that, among other things, the proposed merger had received extensive media coverage since November 28, 2000, the general terms of the proposed settlement were made public by the Commissioner in a new release on April 5, 2001,[26] and many industry representatives had participated in the negotiations and had already commented on the DCO.[27]

In granting Chapters' motion, the Tribunal stated that the unusually wide publicity surrounding the proposed merger, the wide consultation with industry stakeholders and the serious financial problems of the publishers convinced it "that there would be no unfairness caused to persons seeking to file comments or requests for leave to intervene".[28] While the Tribunal did issue an order shortening the time period for filing comments and requests for leave to intervene, it expressed some concern over the fact that the Commissioner's notice of application was not filed until 13 days after the proposed settlement was made public. In this regard, the Tribunal noted that "a high level of diligence must be demonstrated by the parties in bringing an application before the Tribunal promptly after an agreement is reached, particularly when the matter is urgent".[29]

Request for Leave to Intervene and Comments

A request for leave to intervene was filed by Anil Amlani and Bruce Barr on May 8, 2001.[30] Messrs. Amlani and Barr were members of a group of investors that was considering whether to make a bid for the assets to be divested. They sought to make representations that, to be effective, the divestiture package should be enlarged and be comprised of stores with different mixes of customer bases.

In the course of its decision, the Tribunal noted that the test for granting leave to intervene is well established.[31] Specifically, the Tribunal stated that it must be satisfied of the following before it will grant an applicant's request for leave to intervene: (a) the matter alleged to affect the person seeking leave to intervene must be legitimately within the scope of the Tribunal's consideration or must be relevant to the Tribunal's mandate; (b) the person seeking leave to intervene must be directly affected; (c) all representations sought to be made by the person seeking leave to intervene must be relevant to an issue specifically raised by the Commissioner; and (d) the person seeking leave to intervene must bring to the Tribunal a unique or distinct perspective that will assist the Tribunal in deciding the issues before it.[32]

In granting Messrs. Amlani and Barr's request for leave to intervene, the Tribunal held that, as "potential bidders", they were directly affected by the DCO.[33] The Tribunal also found that Messrs. Amlani and Barr could "offer a unique and distinct perspective with respect to a relevant issue, that of the effectiveness of the draft consent order and the likelihood that there will be a buyer for the designated assets".[34] However, after weighing the unique and distinct perspective that could be provided by Messrs. Amlani and Barr against the need for an expeditious hearing, the Tribunal decided to limit the participation of Messrs. Amlani and Barr to making submissions regarding the effectiveness of the structural aspects of the DCO.[35]

In addition to the request for leave to intervene, a total of nine comments were filed with the Tribunal.[36] Although most of the comments were filed either in support of or in opposition to the proposed remedies contained in the DCO, the comments filed on behalf of two landlords were intended to inform the Tribunal that certain leases contained restrictions with respect to the use of the leased premises and that any transfer, amendment or release under the leases would require their consent.

Questions to Counsel

Prior to the hearing, the Tribunal sent several questions to counsel for the parties and the intervenors.[37] In general, these questions focused on, among other things, the ability of the Tribunal to interfere with third party contractual rights; how the effectiveness of the remedy could be assured in the context of a partial divestiture; and whether the inclusion of an arbitration clause resulted in the Tribunal delegating its authority to a third party arbitrator. The questions also sought clarification of certain terms included in the DCO.

At the hearing, the Tribunal noted that the written answers that it received from the parties before the hearing clarified many of the questions and issues raised by the panel with respect to the DCO and resulted in an expeditious hearing.[38] In fact, the Tribunal determined that it was unnecessary to address most of the questions during the hearing in light of the answers provided by the parties.

Section 11 Orders

In the course of its investigation, the Bureau obtained very broad section 11 orders from the Federal Court against Chapters, Indigo and Trilogy. Notwithstanding that the parties reached an agreement before the orders were returnable, the Bureau nevertheless insisted that many of the provisions in the orders be complied with.

Decision

After a short hearing (of less than one day), the Tribunal issued the consent order on June 8, 2001 in the form of the DCO requested by the parties and released its written reasons on July 13, 2001. In the course of its reasons, the Tribunal noted that, among other things, the fact that the EBITDA[39] of the retail stores included in the divestiture package was approximately 156% of Indigo's was highly relevant to its conclusion that the DCO was likely to be effective.[40]

Notwithstanding the relatively high EBITDA, Chapters was unable to sell any of the retail stores and, pursuant to the consent order, a trustee was appointed for that purpose in September 2001. Early in January 2002, the Bureau publicly stated that the time period for the trustee's appointment had expired without any divestitures being made and that the assets had reverted to the merged entity.[41] The trustee was quoted as indicating that general market conditions and restrictions on foreign ownership of retail bookstores in Canada made it difficult to secure a buyer.[42]

Lafarge/Blue Circle

On January 8, 2001, Lafarge and Blue Circle jointly announced Lafarge's proposal to acquire all of the shares of Blue Circle, a competitor in the cement, ready-mix concrete, aggregates and asphalt/paving businesses. The Commissioner's inquiry into the proposed acquisition (which began in early 2000 as part of a hostile bid which did not materialize) included, among other things, information requests, wide consultation with industry participants and experts in Canada and the U.S., and extensive discussions and cooperation with representatives of the U.S. Federal Trade Commission.

The Commissioner's Filings

After negotiating a resolution with the parties, the Commissioner applied to the Tribunal for a consent order on June 15, 2001.[43] Included with the Commissioner's pleadings was a detailed economic report prepared by an economist with the Enforcement Economics Division of the Bureau analyzing the cement, ready-mix concrete, aggregates and asphalt/paving markets and the impact of the merger in those markets.[44]

In his filings, the Commissioner alleged that the proposed acquisition was likely to prevent or lessen competition substantially in the provision of cement, ready-mixed concrete, aggregates and asphalt/paving in certain markets in Ontario.[45] The Commissioner's conclusions were based on a number of factors, including Lafarge's high post-merger market shares, the competitive structure of each of the relevant markets, the extent of effective remaining competition, and barriers to entry.[46]

Draft Consent Order

To address the Commissioner's concerns, Lafarge agreed to divest numerous assets, including the following: (a) Blue Circle's cement operations in Ontario, along with several related terminals located in the U.S.; (b) a large majority of Blue Circle's ready-mix concrete and aggregates operations located in Ontario and Hull, Quebec; and (c) Blue Circle's hot-mixed asphalt/paving (road construction) operations in Brantford and London, Ontario.[47] Lafarge also agreed to provide certain technical assistance to purchasers of the assets to be divested for a period of up to six months from the date of divestiture and to allow purchasers the opportunity to employ certain employees.[48]

In the Niagara Peninsula, Lafarge acquired Blue Circle's sand supply business, the principal supplier of sand to cement companies in that area. Although Lafarge did not compete in that business, the Commissioner stated that "the potential anti-competitive impact of this acquisition hinges on Lafarge's ability to leverage it into other product lines".[49] To address this concern, Lafarge agreed to offer to supply sand from the relevant Blue Circle operation to all purchasers at commercially reasonable and non-discriminatory prices and terms.[50] In this regard, it may be noted that the Tribunal in *Ultramar* had suggested that an obligation on Ultramar to negotiate reasonable commercial terms with independent marketers might have addressed the deficiencies in the DCO; however, the parties did not take up the invitation to amend the DCO in this regard.

No comments or applications to intervene were filed and the Tribunal issued the consent order on August 1, 2001 following a short hearing.

UGG/Agricore Acquisition

On September 6, 2001, the Commissioner initiated an inquiry into the proposed acquisition of Agricore Cooperative Ltd. by United Grain Growers Limited. According to the Commissioner's filings, the Bureau's preliminary examination and inquiry into the proposed acquisition included, among other things, information requests; meetings with competitors and government agencies in Western Canada; facility tours; over 30 interviews with market participants; a review of written submissions from UGG and various market participants; the issuance of orders under section 11 of the Act against UGG, Agricore and 18 third-party competitors and suppliers; and discussions with representatives of the U.S. Federal Trade Commission.

After identifying certain concerns and negotiating a resolution with UGG, the Commissioner filed an application for a consent order with the Tribunal on December 17, 2001.[51] As in the *Lafarge* case, the Commissioner filed with his application, in addition to a statement of grounds and material facts and a consent order impact statement, a detailed economic report analyzing, among other things, the "competitive process in the grain-handling industry in local markets in Western Canada".[52]

The Commissioner's Filings

The Commissioner's filings focused on three relevant markets: (a) the purchasing and handling of grain at primary elevators in certain local markets in Western Canada; (b) the purchasing of canola in certain local

markets in Western Canada; and (c) the processing of canola in the region "encompassing the major grain growing regions in Western Canada and the Northwestern [U.S.]".[53] The Commissioner also alleged that the proposed acquisition would likely substantially lessen competition in the market for port terminal grain handling services in the Port of Vancouver.[54] However, this allegation is being dealt with in a separate application filed with the Tribunal on January 2, 2002.[55]

With respect to the market for the purchase and handling of grain, the Commissioner concluded that the proposed acquisition would combine the two largest grain handling companies in Alberta and Manitoba and result in the merged entity having high market shares in certain markets in Manitoba and Alberta.[56] Moreover, the Commissioner also concluded, among other things, that (a) there were no acceptable substitutes for primary grain elevator purchasing and handling services; (b) barriers to entry were high because of the existing excess capacity of the incumbent grain companies and the significant sunk costs likely to be incurred by a new entrant; (c) Agricore had been a strong competitor to UGG; (d) the remaining competitors would not be able to prevent a substantial lessening of competition resulting from the merger in those markets; and (e) U.S.-based primary grain elevators do not compete in the affected markets.[57]

With respect to the markets for the purchasing and processing of canola, the Commissioner was concerned about the possible flow of competitively sensitive information between a partnership in which Agricore United held a minority interest and one of Agricore United's major shareholders.[58]

Draft Consent Order

To address the Commissioner's concerns, the parties agreed to a draft consent order which required Agricore United to, among other things, (a) offer to divest up to seven primary elevators in Western Canada; and (b) maintain non-public information regarding its canola seed processing investment confidential and separate from its major shareholder.[59]

Although one comment was filed with the Tribunal, it did not call into question the enforceability or effectiveness of the DCO. The Tribunal issued a consent order on February 19, 2002 following a short hearing.

Abitibi/Donohue

On February 14, 2000, Abitibi-Consolidated Inc. announced its intention to acquire Donohue Inc., another newsprint producer. After a detailed investigation, which included the issuance of section 11 orders against the merging parties and several industry participants, the Commissioner concluded that the transaction, which was completed in April 2000, would likely result in a substantial lessening or prevention of competition in the supply of newsprint in Eastern Canada.[60]

In order to address the Commissioner's concerns, Abitibi provided an undertaking to divest its Port-Alfred newsprint mill in Ville-de-la-Baie, Québec.[61] In the event that the mill was not divested within a specified period of time, the undertakings provided for the sale of the mill by an agent pursuant to an order issued by the Tribunal on the consent of Abitibi and the Commissioner.[62]

Abitibi was unable to sell the mill and therefore an agent was appointed pursuant to the undertakings to effect the divestiture. The Tribunal issued an order formalizing the agent's appointment as well as the agent sale process on February 21, 2002 after a short hearing.[63]

In addition to providing for the agent sale process, the order requires Abitibi to supply fibre to any purchaser of the mill "from the same sources of supply and in no less than the same quantities as were supplied to the [mill] during the 2000 calendar year".[64] In this regard, the order also requires that fibre be supplied at fair market value and, if desired by a purchaser, that the supply agreements be long-term.[65]

Quebecor/Groupe Videotron

On November 10, 2000, the Commissioner applied for a consent order in connection with Quebecor Inc.'s proposed acquisition of Le Groupe Videotron Ltée.[66] In his pleadings, the Commissioner alleged that the proposed acquisition would likely result in a substantial lessening and prevention of competition in the French-language television advertising market in the Province of Quebec. More specifically, the Commissioner alleged that the proposed acquisition would give Quebecor control of TVA Inc. and TQS Inc. which, together, accounted for more than half of all French-language television advertising revenues in the Province of Quebec.[67]

To address the Commissioner's concerns, Quebecor agreed to a DCO requiring it to divest its interest in TQS, conditional upon the CRTC approving its proposed acquisition of TVA.[68] In the event that Quebecor was unable to divest this interest by December 31, 2001, the DCO provided for the appointment of a trustee to effect the sale.[69] The DCO also contained restrictions on the use of confidential information and required Quebecor to maintain the commercial viability of TQS for the duration of the order.[70]

The Tribunal issued the consent order on January 15, 2001 following a short hearing. Quebecor completed the divestiture of its interest in TQS on February 15, 2002.

Conclusion

The cases discussed above demonstrate that the Tribunal's decision in *Ultramar* has not taken the consent order process "back to ground zero" or irretrievably undermined confidence in the Tribunal's process. Rather, the Commissioner and the Tribunal have shown a willingness to accept both structural and behavioural remedies and to expedite certain steps in the consent order process where appropriate. The Tribunal's provision of written questions in advance of the hearing has also helped to expedite the process.

The Tribunal is clearly conscious of not being a "rubber stamp" for DCOs and continues to take an active role in this process. However, where the Commissioner's filings demonstrate a clear and rational connection between the alleged (and presumed) substantial lessening or prevention of competition and the remedies in the DCO, the Tribunal has, since *Ultramar*, continued to issue consent orders on an expeditious basis, even orders containing behavioural remedies. In this regard, the average time between the filing of an application for a consent order and the issuance of an order by the Tribunal since *Ultramar* has been less than 60 days.

These cases do, however, raise some significant concerns related to the Bureau's approach to evidence gathering and filings for consent orders. First, in some cases, the Commissioner has insisted that the merging parties comply with broad section 11 orders relating to the markets subject to the DCOs in question even after the parties had reached a settlement and agreed to a consent order to be filed with the Tribunal. Such section 11 orders typically require very extensive document and computer searches and divert significant resources and management time away from the demands of running and, to the extent permitted, integrating the merged businesses, in addition to imposing very significant out of pocket costs for legal fees, copying charges and other expenses.

The Bureau has indicated that it "makes every effort to construct the requests for both records and written returns as narrowly as possible, having regard to the legitimate need for as complete a set of information as possible on which to make decisions regarding the ultimate disposition of an inquiry".[71] It has also stated that, in determining the "extent of the information sought, [it] seeks to balance its role of safe-guarding the public interest in restoring and maintaining competitive markets against the burden that the inquiry process places on targets and industry participants".[72] Notwithstanding these comments, we understand that the Bureau considers that it needs to assemble a very wide scope of information and evidence before filing an application for a consent order because of a concern that the Tribunal may engage in a wide-ranging examination and expect the Bureau to provide evidence of underlying premises and conclusions, such as the basis for defining the relevant product and geographic markets. However, in light of the Tribunal's indication in a number of cases that it will presume the substantial lessening or prevention of competition alleged by the Commissioner,[73] and the indication in *Chapters* that the parties should exercise diligence in bringing the matter to the Tribunal promptly after an agreement is reached, in our view, the Bureau is imposing an unnecessary burden and delay on the parties. Furthermore, the tremendous cost and delay imposed on the parties risks undermining the incentives to engage in the consent order process in the first place.

Second, although less significantly, in our view the filings for a consent order could be streamlined and made clearer and more comprehensible. Separate filings of affidavits, statements of grounds and material facts ("SGMFs"), consent order impact statements ("COISs") and expert reports can be unnecessarily duplicative and confusing. In our view, the process would be assisted by combining at least the SGMF and COIS into one document that more clearly and concisely identifies the alleged substantial lessening or prevention of competition and explains how it is addressed by the DCO. The expert reports should be eliminated from the initial filings. To the extent that such a report may contain relevant and required information, that information should be included in the SGMF or COIS and need not be duplicated in a further filing on the record.

Proposed Amendments

The proposed amendments contained in Bill C-23, *An Act to amend the Competition Act and the Competition Tribunal Act*, will, if implemented, result in significant changes to the consent order process.[74] In summary, Bill C-23 provides for the automatic and immediate registration of consent agreements.[75] Upon registration, a consent agreement will have the same force and effect as if it were an order of the Tribunal.[76] The Tribunal will

continue to have the power to rescind or vary a consent agreement upon the consent of the parties or if it finds that, among other things, the circumstances that led to the making of the agreement have changed.[77]

As originally proposed, Bill C-23 provided that a consent agreement had to be "based on terms that could be the subject of an order of the Tribunal", but could also include other terms, "whether or not they could be imposed by the Tribunal".[78] Following hearings of the House of Commons Standing Committee on Industry, Science and Technology, however, the Bill was amended on the recommendation of the Commissioner to revise the above quoted language and add subsection 106(2) to the Act which would allow any person "directly affected" by a consent agreement to apply, within 60 days after the registration of the agreement, to have one or more of its terms rescinded or varied.[79] The Tribunal may grant the application if it finds that "the terms could not be the subject of an order of the Tribunal".[80] (The full text of the proposed new sections 105 and 106 of the Act is included in Appendix "A" below.)

Having regard to the automatic registration of consent agreements originally proposed by Bill C-23, some commentators had suggested that the Tribunal would be turned into a "registry office" or "post office".[81] In this regard, even under Bill C-23 as currently proposed, the Tribunal will no longer be required to determine, as a precondition to its registration (and effectiveness as an order), whether a consent agreement will, in all likelihood, eliminate the substantial prevention or lessening of competition that is presumed to arise from the merger (i.e., the test established in *Air Canada* and other consent order cases).[82] It may well be that, in many cases, a consent agreement will effectively become an order of the Tribunal without any oversight or involvement by the Tribunal until and unless the parties make an application under subsection 106(1) based on changed circumstances or the consent of the parties.

However, the implications of the proposed new subsection 106(2) should not be overlooked. Pursuant to that provision, any person directly affected by a consent agreement may apply to the Tribunal within 60 days after the registration of the agreement to have one or more of its terms rescinded or varied, and the Tribunal may rescind or vary the order if it finds that "the terms could not be the subject of an order of the Tribunal". While it is not entirely clear how the Tribunal will interpret this new standard, it would seem to invite the Tribunal to apply the same standard that it did in *Ultramar*, namely whether the terms of the agreement are effective and enforceable. Thus the case law relating to the Tribunal's past consideration of DCOs will likely continue to be relevant in the context of subsection 106(2) applications.

Second, a wide range of persons may potentially be "directly affected by a consent agreement" and be in a position to bring an application under subsection 106(2) if it is in their interests to do so. In the context of applications to intervene, the Tribunal has held that its orders are capable of directly affecting a broad range of persons, including, among others, suppliers, employees, proposed bidders and other industry participants, even if they did not meet the other criteria for intervention or received only very limited intervention rights.[83] As a result, many interested third parties will likely be able to obtain standing to bring applications under subsection 106(2) of the proposed legislation if it is implemented. In addition, it is not clear whether applicants will have to meet the other criteria previously applied to applications to intervene in consent orders, such as the requirement

to demonstrate that the applicant brings a unique or distinct perspective to the proceeding, that its proposed representations are relevant to an issue specifically raised in the parties' pleadings, or that the applicant has sufficient facts already in its possession to support the representations it proposes to make.[84]

The proposed amendments would also provide the Tribunal with the power to award costs in respect of proceedings under Part VIII of the Act, which would appear to include a challenge under subsection 106(2) of the Act. The risk of costs may deter frivolous or vexatious applications. However, given the Tribunal's encouragement of intervenors in prior cases, such as *Ultramar*, there would appear to be wide scope for interested persons to challenge a consent agreement without a serious risk of a significant costs award.[85]

Third, under the current consent order process, the Tribunal's options are limited to either issuing the DCO as presented to it by the parties or rejecting it (possibly with an indication of amendments that would enable the Tribunal to issue the order). However, if Bill C-23 becomes law as proposed, in the context of a subsection 106(2) application, the Tribunal would have the power not only to rescind the agreement, but also (and alternatively) to vary one or more of its terms, presumably even without the consent of the Commissioner or the respondent. Notwithstanding that Bill C-23 contains no express limit on the Tribunal's powers to vary the terms in a consent agreement upon a successful application being brought under subsection 106(2), the Federal Court of Appeal's decision in *Air Canada* (with respect to a variation based on changed circumstances) suggests that the Tribunal's powers in this regard could be limited to ordering dissolution of the merger or divestiture of specified assets (namely the powers contemplated in section 92 in the absence of consent).[86] However, the Commissioner has suggested that a more expansive approach would be appropriate under the proposed amendments. For example, in his remarks before the House of Commons Standing Committee on Industry, Science and Technology on November 7, 2001, the Commissioner commented that a "third party should have in our view a right to have a term rescinded of right, if we did something the Tribunal couldn't have done". Similarly, the Commissioner also commented that subsection 106(2) "would make it possible for a third party directly affected by a consent agreement to apply to the Tribunal for a change to an agreement, on the grounds that the relevant terms could not have been the subject of an order of the Tribunal". Even with a more restrictive view of the Tribunal's powers under the proposed subsection 106(2), the risk of an application under that provision would add significant uncertainty to the process for merging parties who, having consented to a set of remedies, could, for example, find themselves exposed to an order to divest additional assets. This is of particular concern since the Tribunal and the courts have held that the Tribunal's mandate under the merger provisions is to issue a remedy which effectively eliminates the substantial lessening of competition, even if the least intrusive of the possible effective remedies "goes further than is strictly necessary to restore competition to an acceptable level".[87] In other words, the Tribunal may find itself compelled to order a divestiture of a package of assets extending beyond the relevant market or that contemplated in the consent agreement if it finds that the remedy in the consent agreement is insufficient.

If the Tribunal applies this standard in the context of a presumed substantial lessening of competition in a consent agreement, there may be a significant disincentive for parties to enter into a consent agreement. Practically speaking, in many cases merging parties have entered into consent order settlements with the Bureau not

because they agree that the transaction is likely to lead to a substantial lessening of competition, but because of the significant costs involved in contested proceedings, such as delays with respect to closings, integration and realization of synergies, as well as the cost and distraction of management time. (For example, more than six years elapsed from the time the notice of application was filed in *Southam* until the issuance of the final order, while *Superior Propane* is still continuing more than three years after the notice of application was filed.) Subsection 106(2) risks effectively treating a consent agreement as an admission of a substantial lessening or prevention of competition and exposing the parties to a transaction to a wider set of divestitures than they would have been prepared to consent to. This expanded scope will itself create an incentive for "affected parties" to bring applications under subsection 106(2). For example, if the DCO in *Ultramar* had been presented to the Tribunal after being registered as a consent agreement under the Bill C-23 provisions, and was challenged by one of the independent marketers, the Tribunal could conceivably have ordered the divestiture of assets, even though that was not contemplated by the DCO.

In some cases, it may be an acceptable approach to delay closing of the transaction for 60 days past the date on which the consent agreement is registered or until the final resolution of any subsection 106(2) proceeding. It may also be possible to make a consent agreement contingent on the absence of an application or order under subsection 106(2) of the Act, or a favourable ruling of the Tribunal in any such proceeding. However, this may not be a practical option in the case of time sensitive mergers, such as unsolicited takeover bids, where, in the past, closings occurred pursuant to hold separate undertakings or orders and the parties subsequently negotiated or implemented consent orders, such as in the *Lafarge, Chapters* and *United Grain Growers* cases described above. Also, in such cases, there will be less incentive to enter into a consent agreement rather than contest the Commissioner's findings if any affected party can effectively turn the consent agreement into a contested remedy hearing.

Following the 60 day period or resolution of any subsection 106(2) application, there would still be some conceptual risk of a variation pursuant to subsection 106(1), but affected parties or other complainants would need to persuade the Commissioner to apply for a variation and the Commissioner would need to demonstrate a change in circumstances in order to persuade the Tribunal to vary the order in the absence of the respondent's consent, which is no different from the current situation.

Conclusion

In summary, Bill C-23 risks creating less certainty and greater exposure for merging parties and greater incentive for affected persons to seek variations to consent agreements. As such, Bill C-23 may deter parties from expediting closing in cases with significant competition issues. On the other hand, parties may take some comfort from the post-*Ultramar* decisions of the Tribunal in which the Tribunal has issued consent orders in the form applied for by the parties, even where the consent order included significant behavioural elements.

Appendix "A"

Proposed Amendments to Sections 105 and 106 of the *Competition Act* in Bill C-23 as Passed by the House of Commons on December 10, 2001 and the Second Reading in the Senate on February 5, 2002

105.(1) The Commissioner and a person in respect of whom the Commissioner has applied or may apply for an order under this Part, other than an interim order under section 103.3 or a temporary order under section 104.1, may sign a consent agreement.

(2) The consent agreement shall be based on terms that could be the subject of an order of the Tribunal against that person.

(3) The consent agreement may be filed with the Tribunal for immediate registration.

(4) Upon registration of the consent agreement, the proceedings, if any, are terminated, and the consent agreement has the same force and effect, and proceedings may be taken, as if it were an order of the Tribunal.

106.(1) The Tribunal may rescind or vary a consent agreement or an order made under this Part other than an order under section 103.3 or 104.1 or a consent agreement under section 106.1, on application by the Commissioner or the person who consented to the agreement, or the person against whom the order was made, if the Tribunal finds that:

(a) the circumstances that led to the making of the agreement or order have changed and, in the circumstances that exist at the time the application is made, the agreement or order would not have been made or would have been ineffective in achieving its intended purpose; or

(b) the Commissioner and the person who consented to the agreement have consented to an alternative agreement or the Commissioner and the person against whom the order was made have consented to an alternative order.

(2) A person directly affected by a consent agreement, other than a party to that agreement, may apply to the Tribunal within 60 days after the registration of the agreement to have one or more of its terms rescinded or varied. The Tribunal may grant the application if it finds that the person has established that the terms could not be the subject of an order of the Tribunal.

Notes

[1] The authors represented Trilogy Retail Enterprises LP, Chapters Inc. and Indigo Books & Music Inc. in connection with the *Chapters* consent proceeding and United Grain Growers Limited and Agricore Cooperative Ltd. in connection with the *United Grain Growers* consent proceeding.
[2] *Canada (Commissioner of Competition)* v. *Ultramar Ltd.* (2000), 6 C.P.R. (4th) 519.
[3] *Ibid.* at 534-535.
[4] See, for example, W. Grover, "Pricing Practices: The Van Duzer Report" (Paper delivered to Roundtable on *Competition Act* Amendments, Insight Conference, Toronto, 25 May 2000, at 14-15).
[5] See *Quebecor* (2000), *Chapters* (2001), *Lafarge* (2001), *United Grain Growers* (2001) and *Abitibi* (2001). For a discussion of the Tribunal's decision in *Ultramar*, see J. Bodrug, "Competition Tribunal Dismisses Application for Consent Order for Ultramar/ Coastal Canada Petroleum Merger" (2000) 20:1 Can. Comp. Rec. 87.
[6] For example, as discussed below, the consent orders issued in the *Chapters, United Grain Growers, Lafarge* and *Abitibi* proceedings contained both structural and behavioural remedies. In addition, the Tribunal agreed to abridge the time for filing comments and requests for leave to intervene in the *Chapters* proceeding.
[7] Although the focus of this paper is on mergers, the proposed amendments affect all consent orders sought under Part VIII of the Act. Moreover, similar amendments are proposed with respect to consent orders sought pursuant to section 74.12 of the Act relating to deceptive marketing practices. In addition, the proposed amendments would, in certain circumstances, allow private parties to file consent agreements with the Tribunal pursuant to a new section 106.1 of the Act in relation to refusal to deal, exclusive dealing, tied selling or market restriction proceedings.
[8] *The Commissioner of Competition* v. *Trilogy Retail Enterprises* L.P., CT-2001/003 (Comp. Trib.).
[9] *Ibid.*, Statement of Grounds and Material Facts, April 18, 2001, paras. 41 and 83.
[10] *Ibid.* para. 34.
[11] *Ibid.* para. 41.
[12] *Ibid.* para. 81.
[13] *Ibid.* para. 42.
[14] *Ibid.* para. 43.
[15] *Ibid.* para. 82.
[16] *Ibid.* para. 82.
[17] *Ibid.* para. 47.
[18] *Ibid.* para. 45.
[19] *Ibid.* para. 84.
[20] *Ibid.* para. 67.
[21] *Ibid.* paras. 57, 58, 64 and 65.
[22] *Ibid.* para. 54.
[23] *Supra* note 8, Draft Consent Order, April 18, 2001, para. 3.
[24] *Ibid.* paras. 25-29.
[25] *Supra* note 8, Consent Order, June 6, 2001, para. 32.
[26] Competition Bureau, News Release, "Competition Bureau Reaches Agreement with Trilogy, Chapters and Indigo" (5 April 2001).
[27] *Supra* note 8, Memorandum of Agreement of the Respondents, April 17, 2001, para. 6.
[28] *Supra* note 8, Reasons for Order Regarding Comments and Intervention, April 24, 2001, para. 11.
[29] *Ibid.* para. 10.
[30] *Supra* note 8, Request for Leave to Intervene on Behalf of Anil Amlani and Bruce Barr, May 8, 2001.
[31] *Supra* note 8, Reasons and Order Regarding Request for Leave to Intervene, May 17, 2001, para. 10.
[32] *Ibid.*
[33] *Ibid.* para. 11. Compare with *Canada (Director of Investigation and Research)* v. *Canadian Pacific Ltd.* (1997), 74 C.P.R. (3d) 37, where the Tribunal denied the application for leave to intervene by a prospective purchaser, Newfoundland Capital Corporation Limited.
[34] *Ibid.* para. 12.
[35] *Ibid.* para. 16. The Tribunal, however, indicated that it would consider allowing Messrs. Amlani and Barr to lead evidence with respect to the structural aspects of the DCO if either the Commissioner or Chapters sought to lead evidence on that issue. *Ibid.* para. 17.

[36] These comments were filed by or on behalf of The Book Shelf of Guelph, Tanners Books, the Association of Canadian Publishers, the Canadian Booksellers Association, Cambridge Shopping Centres Limited, Owners and Manager Scarborough Town Centre, the Canadian Publishers' Council, Talon Books Ltd. and HarperCollinsCanada Ltd.
[37] *Supra* note 8, Notice to Counsel, May 24, 2001.
[38] *Supra* note 8, Reasons Regarding Consent Order, July 13, 2001, para. 4.
[39] Earnings before interest, taxes, depreciation and amortization.
[40] *Supra* note 8, para. 33.
[41] M. Strauss, "Stores Revert to Indigo as Sale Fails" *The Globe and Mail* (9 January 2002) B1.
[42] *Ibid.*
[43] *Commissioner of Competition* v. *Lafarge S.A.*, CT-2001 004 (Comp. Trib.).
[44] *Ibid.*, Affidavit of Haldor P. Pallson, June 14, 2001.
[45] *Ibid.*, Statement of Grounds and Material Facts, June 15, 2001, para. 1.
[46] *Ibid.* para. 7.
[47] *Supra* note 43, Consent Order, August 1, 2001 ("Lafarge Consent Order"), para. 12.
[48] *Ibid.* paras 22-23.
[49] *Supra* note 43, Consent Order Impact Statement, June 15, 2001, para. 41.
[50] *Supra* note 43, Lafarge Consent Order, para. 42.
[51] *Commissioner of Competition* v. *United Grain Growers Ltd.*, CT-2001/007 (Comp. Trib.).
[52] *Ibid.*, Affidavit of Haldor P. Pallson, December 10, 2001.
[53] *Ibid.*, Statement of Grounds and Material Facts, December 17, 2001 ("UGG SGMF"), paras. 17, 39, 40, 68 and 76.
[54] *Ibid.* para. 17.
[55] *Commissioner of Competition* v. *United Grain Growers Limited*, CT-2002/001 (Comp. Trib.).
[56] *Supra* note 51, UGG SGMF, at para. 13.
[57] *Ibid.* paras. 45-56.
[58] *Ibid.* para. 62.
[59] *Supra* note 51, Draft Consent Order, December 17, 2001, paras. 8 and 41-43.
[60] Competition Bureau, News Release, "Competition Bureau Requires Divestiture to Resolve Concerns with Abitibi-Consolidated's Acquisition of Donohue Inc." (13 February 2001).
[61] *Ibid.*
[62] *Ibid.*
[63] *Commissioner of Competition* v. *Abitibi-Consolidated Inc.*, CT-2001/009 (Comp. Trib.).
[64] *Ibid.*, Consent Order, February 21, 2002, para. 10.
[65] *Ibid.*
[66] *Commissioner of Competition* v. *Quebecor Inc.*, CT-2000 005 (Comp. Trib.).
[67] Competition Bureau, Information, "Competition Bureau Files Application for Consent Order Regarding Divestiture of TQS by Quebecor" (10 November 2000).
[68] *Supra* note 66, Draft Consent Order, November 10, 2000, paras. 11-12.
[69] *Ibid.* para. 13.
[70] *Ibid.* paras. 24 and 26.
[71] P. Humber, "The Use of Section 11 Orders Under the Competition Act" (Address to the Canadian Bar Association, 21 September 2001) [unpublished].
[72] *Ibid.*
[73] See, for example: *Canada (Director of Investigation and Research)* v. *Air Canada* (1989), 27 C.P.R. (3d) 476 at 514 (Comp. Trib.); *Canada (Director of Investigation and Research)* v. *Imperial Oil Limited*, CT-89/3 (January 26, 1990) at 14; and *Canada (Director of Investigation and Research)* v. *Bank of Montreal* (1996), 68 C.P.R. (3d) 527 at 537.
[74] 1st Sess., 37th Parl., 2001 (2nd reading (Senate), 5 February 2002).
[75] *Ibid.* section 14.
[76] *Ibid.*
[77] *Ibid.*
[78] 1st Sess., 37th Parl., 2001 (1st reading, 5 April 2001).
[79] *Supra* note 74, at section 14.

[80] *Ibid.*

[81] See: S. Wong, Remarks to the Standing Committee on Industry, Science and Technology (November 6, 2001); and M. Trebilcock, Remarks to the Standing Committee on Industry, Science and Technology (November 6, 2001).

[82] *Air Canada*, *supra* note 73.

[83] See, for example: *Canada (Director of Investigation and Research)* v. *Canadian Pacific Ltd.* (1997), 74 C.P.R. (3d) 37 at 43 (Comp. Trib.).

[84] See, for example: *Canada (Director of Investigation and Research)* v. *Air Canada* (1992), 46 C.P.R. (3d) 184 (Comp. Trib.); *Washington* v. *Canada (Director of Investigation and Research* (1998), 78 C.P.R. (3d) 479 (Comp. Trib.); *Canada (Director of Investigation and Research)* v. *Tele-Direct (Publications) Inc.* (1995), 61 C.P.R. (3d) 528; and *Canadian Pacific*, *ibid.*

[85] *Supra* note 2 at 527. The Tribunal suggested that Mr. MacEwen, who had filed comments on behalf of MacEwen Petroleum Inc., be asked if he wished to appear before the Tribunal.

[86] *Director of Investigation and Research* v. *Air Canada* (1993), 49 C.P.R. (3d) 417.

[87] *Canada (Director of Investigation and Research)* v. *Southam Inc.* (1997), 71 C.P.R. (3d) 417 at 446 (S.C.C.).

THE DRAFT ENFORCEMENT GUIDELINES ON ABUSE OF DOMINANCE IN THE RETAIL GROCERY SECTOR

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Introduction

In December 2001, the Competition Bureau released for public comment its draft guidelines on the enforcement of the *Competition Act*'s abuse of dominance provisions in the Canadian retail grocery sector[1] (the "Grocery Guidelines"). These Grocery Guidelines are the latest in a series of guidelines and bulletins produced by the Competition Bureau and aimed at providing the business and legal communities with a more transparent and predictable enforcement policy and a better understanding of the Bureau's approach to anti-competitive practices. The Grocery Guidelines are also the third in a series of guidelines issued by the Competition Bureau on abuse of dominance, following the general *Enforcement Guidelines on the Abuse of Dominance Provisions* (the "General Guidelines"), which were released in August 2001[2], and the *Draft Enforcement Guidelines on Abuse of Dominance in the Airline Industry*, published in February 2001[3] but which have not yet been finalized (the "Airline Guidelines").

As the Competition Bureau stated in the General Guidelines, the abuse of dominance provisions form, together with the merger review and the criminal conspiracy provisions, the cornerstone of Canadian competition policy legislation, and the issuance of another set of guidelines in this area is a reflection of this priority.

The purpose of these Grocery Guidelines is to provide grocery firms with a better understanding of how the *Competition Act* provisions on abuse of dominance will be applied to them.[4] However, while the Grocery Guidelines are the second set of industry-specific guidelines on abuse of dominance, their scope is much more limited than the detailed regulatory framework proposed by the Bureau for the airline industry in the Airline Guidelines.

Rationale for the Grocery Guidelines

Given that the Grocery Guidelines are not in any significant respect different from the General Guidelines released by the Bureau in August 2001 and are far from being nearly as long (75 pages including appendices) or as technical as the General Guidelines, one is first left to wonder as to why the retail grocery industry requires a separate set of guidelines with respect to abuse of dominance. Arguably, the General Guidelines and the abuse of dominance provisions of the *Competition Act* are sufficiently broad to target allegedly abusive practices in any industry, including the retail grocery industry, and the General Guidelines have benefited from the case law arising from the first six cases heard by the Competition Tribunal since the 1986 enactment of section 79[5] (although no case has ever proceeded to the Competition Tribunal with respect to abuse of dominance in the retail grocery sector).

Unfortunately, the Grocery Guidelines do not address this question of the rationale for those industry-specific guidelines in any meaningful way; the Bureau simply states in the guidelines that the retail grocery sector represents more than a quarter of total retail trade in Canada, with annual sales of nearly $60 billion.[6] Furthermore,

following an increasing number of mergers in the past 10 years, it is described as a relatively concentrated industry where the four largest supermarket chains are now estimated to account for approximately 75% of total Canadian food store sales. Be that as it may, the Grocery Guidelines are not very instructive for the business and legal communities on the rationale for industry-specific guidelines in this case.

The *Competition Act* is a legislation of general application which applies in the same manner to numerous industries. Exceptionally, certain industry-specific provisions, such as those with respect to airlines[7], or specific exemptions under the Act such as those relating to bank mergers[8], apply to specific industries. In such a legislative context, one would expect that industry-specific guidelines should generally be viewed by the Competition Bureau as exceptional in order to avoid creating the false perception that the rules or their application, in some industries, may be different from those in others, or that certain industries have become the specific target of investigation and enforcement by the Bureau. While the Bureau makes an effort to specifically mention, in the Grocery Guidelines, that this is not the case here,[9] the lack of a clear rationale for the Grocery Guidelines leaves it open to question as to why the retail grocery industry needs special attention. This is particularly true in view of the fact that, to our knowledge, the retail grocery industry has not been the subject of exceptional investigation by the Competition Bureau under the abuse of dominance provisions. There also appears to be no question that the exceptional situation which led the Competition Bureau to single out the airline industry (dominance by a single entity, alleged potential for predation, etc...) in the Airline Guidelines and in a specific set of abuse of dominance provisions does not exist in the retail sector of the Canadian grocery industry.

As the Competition Bureau itself alludes to in the Grocery Guidelines[10], it rather seems that the Grocery Guidelines are essentially a response to particular concerns which had been expressed by some Canadian politicians (through the unsuccessful proposal of amendments to the abuse of dominance provisions of the Act) with respect to certain alleged business practices of retailers in the retail grocery sector in Canada. Their origin can be traced back to Bill C-402, a private member's bill introduced in the House of Commons by Liberal M.P. Mr. Dan McTeague.[11] That bill proposed to amend section 78 of the Act to add certain behaviors to the list of anti-competitive acts, including requiring a supplier to pay an unjustified fee to the retailer in order to impede or prevent a supplier's entry into or expansion in a market, and squeezing, by a vertically integrated retailer, of the margin available to a non-integrated competitor in order to impede or prevent that competitor's entry into or expansion in the market. Bill C-402 died on the Order Paper with the dissolution of Parliament on October 22, 2000, but it was clear that it was targeted to the retail grocery industry as well as to the gasoline industry.

If this is indeed the origin of the Grocery Guidelines, rather than any other particular concern with respect to the retail grocery industry, it would have been helpful for the Competition Bureau to mention it in the introduction to the Grocery Guidelines. In any event, it would be useful for the Bureau to at least explain the rationale for such highly exceptional industry-specific guidelines.

Relationship with the General Guidelines

Turning now to the contents of the Grocery Guidelines, the Competition Bureau first states that nothing in these guidelines specific to the retail grocery sector deviates from the general enforcement approach outlined in the

General Guidelines, which detail the Bureau's approach in investigating cases involving alleged abuse of dominance.[12] This is important for the business community, and for the retail grocery sector in particular, as it confirms that, even though specific guidelines are intended to be put in place for this business sector, the Bureau's approach to abuse of dominance in the retail grocery sector will be consistent with its overall approach[13].

Abuse of dominance occurs when a dominant firm in a market, or a dominant group of firms, engages in conduct intended to eliminate or discipline a competitor and to deter future entry by new competitors, and when this conduct either prevents or substantially reduces competition. This will not change in the Grocery Guidelines.

The essential elements of the abuse of dominance provisions are:

- one or more persons substantially or completely control, throughout Canada or any part thereof, a class or species of business;
- that person or those persons have engaged in, or are engaging in, a practice of anti-competitive acts; and
- the practice has had, is having or is likely to have, the effect of preventing or lessening competition substantially in a market.[14]

It has been held that a person "controls or substantially controls a business" if they possess market power, that is, the power to profitably set prices above competitive levels for a considerable period of time (which the Competition Bureau generally considers to be one year)[15]. In order to assess market power, one has to delineate the relevant market and the Tribunal has held that "class or species of business" is synonymous with relevant product market[16]. With respect to defining the relevant geographic market, the Tribunal has adopted an approach similar to product market determination, that is, to identify the universe of effective competitors or substitute providers of a product through economic approaches such as the hypothetical monopolist paradigm.[17]

To date, all of the contested abuse of dominance cases before the Competition Tribunal have involved market shares in excess of 90%, which established a convincing case of market power. While the Tribunal has said that no issue of dominance would arise with respect to a market share below 50%[18] and that a 25% market share fell well short of a level that might indicate market power, the Competition Bureau has taken the position, in the General Guidelines, that a market share in excess of 35% would generally prompt further investigation.[19]

To be liable under section 79, a firm must also engage in the practice of anti-competitive acts. The *Competition Act* contains no general definition of what would constitute an anti-competitive act but simply provides, at section 78, a list of illustrative examples of what may constitute anti-competitive acts for the purposes of determining whether an abuse of dominance has occurred. The Tribunal has made it clear that the list of anti-competitive acts in section 78 is not exhaustive and, in fact, the Tribunal has effectively expanded the list in its decisions.[20] The common feature of all actions considered to be reviewable under section 79 is that they are performed for an anti-competitive purpose, which generally involves a predatory, exclusionary or disciplinary effect on a competitor.[21]

The final element that must be proven before the Tribunal can make an order under section 79 is that the practice of anti-competitive acts has resulted or will likely result in a substantial lessening or prevention of competition. The factors to be considered here in determining whether there has been a substantial lessening of competition are similar to the factors relating to market power[22].

Since section 79 came into force, the Commissioner has brought eight applications under this section, four of which were contested and three of which were resolved through consent order proceedings; one is still pending[23].

The Scope of the Grocery Guidelines

As their title indicates, the Grocery Guidelines are intended to relate to alleged dominance by grocery retailers as opposed to other participants in the grocery industry, such as manufacturers or distributors. Indeed, the concerns which led to Bill C-402 were about alleged dominance by retailers as opposed to grocery product manufacturers or distributors. Yet, the Grocery Guidelines address many issues which do not appear to be specific to the retail grocery industry and to retailers as they contain several comments and illustrations directed at the manufacturer-distributor level, giving the impression that there are specific concerns at these levels as well. In fact, in many sections of the Grocery Guidelines, the Bureau seems to have even greater concerns with the activities of sectors of the grocery and food industry other than the retail grocery sector.

If there are indeed abuse of dominance concerns at the manufacturer-distributor level, these would hardly be limited to the retail grocery industry and should not be included in interpretative guidelines which are meant to be targeted specifically at this industry.

Market Dominance

If we look at the Grocery Guidelines' substantive analysis of the application of the abuse of dominance provisions to the retail grocery sector, the Guidelines provide industry-specific directions on how the Competition Bureau intends to determine whether market dominance exists in the retail grocery industry. And, as is the case in the General Guidelines, the Bureau considers market dominance to be synonymous with market power (that is, the ability to profitably maintain prices above competitive levels for a significant period of time). The central issue here is therefore the proper identification of the relevant markets.

On the issue of relevant market definition, the Grocery Guidelines define the relevant product market using the traditional approach to grocery products (a basket of grocery and food products sold in full-line supermarkets), referring to precedents dating back to 1987 and 1990 rather than to more recent - late 1990s – cases where the Competition Bureau looked at the retail grocery sector in the mergers area.[24] The Guidelines would clearly be more relevant and persuasive if they referred to those more current precedents, such as the recent retail grocery sector merger cases involving Loblaw and Sobeys[25].

Traditionally, the grocery product market has indeed been viewed as a basket of grocery and food products sold in full-line supermarkets, and the Bureau contemplates retaining this approach in the Grocery Guidelines. However, one would expect that grocery retailers, and full-line supermarket chains in particular, will question the accuracy

of such a narrow product market approach as the advent of new format retailers such as the big box discount stores, mass merchandisers, Internet retailers, warehouse clubs, drug stores, speciality stores, convenience stores and other non-traditional grocery stores containing large grocery items, have significantly modified the structure of the business in recent years. The Grocery Guidelines indeed acknowledge that the traditional approach based on full-line supermarkets serves only as a starting point for analysis, because many households no longer maintain specific shopping patterns. Though this would arguably appear to be a recognition of the evolving nature of the retail grocery business (where sources of competition now expand much beyond traditional full-line supermarkets), the Grocery Guidelines are not very instructive as to how the Competition Bureau intends to deal with the relevant product market definition in this new context and to what extent it will depart from the traditional approach. The Grocery Guidelines indeed appear to acknowledge that restricting the relevant product market to full-line supermarkets contemplates too narrow a product market in view of the emergence and continuous growth of non-traditional forms of grocery retailers.

Given the significant developments that have occurred in recent years on the supply-side of the retail grocery business (with a much more diverse source of food stores) as well as on the demand-side (with a much larger variety of purchasing habits and patterns among consumers), it would be useful if the Grocery Guidelines were more specific as to how the Competition Bureau's approach to the relevant product market will reflect those changes. The days where full-line supermarkets could be considered as a distinct and definite market in the retail grocery area appear to be over and this is something that the Bureau should address more directly in the Grocery Guidelines in order for these to be a useful guide for the business and legal communities.

On the geographic side, the Grocery Guidelines[26] intend to determine geographic retail markets for groceries through the location and size of supermarkets and existing grocery shopping patterns, as well as a calculation of how far consumers will travel to buy the core bundle of household food requirements. The Competition Bureau intends to use "a reasonable average travel time"[27], as opposed to the marginal travel time, to establish the local geographic markets. Consideration will also be given to the market targeted by individual stores in their advertising, home deliveries, shopper surveys, and other data. Generally, in most urban markets, a travel time of five to ten minutes by car – representing five to seven kilometres – serves as a reasonable proxy for determining the parameters of a geographic market, states the Bureau in the Grocery Guidelines.

Unfortunately, the Grocery Guidelines do not explain why the Competition Bureau has retained an average travel time approach, as opposed to a marginal travel time, to define the geographic market. The real question, as outlined in the *Merger Enforcement Guidelines*[28] with the hypothetical monopolist test, is the impact of a price increase on the marginal customers, not on the average customers. That is, an hypothetical significant and non-transitory price increase by all suppliers in a given area that would result in the loss of so many customers at the margin that the price increase would not be profitable. Defining markets with a reference to average travel times thus results in a too narrow geographic market for the purpose of competition analysis.

In addition, the geographic market approach proposed by the Bureau in the Grocery Guidelines will also likely prove to be too narrow in view of the changing consumer patterns of the retail grocery industry. Consumers are now known to shop at a variety of stores to fulfil their regular grocery needs and are more ready to travel

distances to reach those stores. Rather than defining the relevant geographic market strictly on the basis of travel time, the Competition Bureau could perhaps consider some of the criteria used by the grocery industry to define the trading area of a given store, such as the relevant competition in a given area (which goes far beyond traditional full-line supermarkets and grocery stores), hours and days of operation, urban as opposed to rural contexts, physical and traffic pattern barriers, the existence of specific commercial centers or local centers, parking space, etc.

That being said, in order to assess whether a firm has market power in the relevant market, the Grocery Guidelines[29] state that the Competition Bureau will look at a number of factors, three of which are highlighted in the guidelines: market share, including share stability and distribution; barriers to entry, including the conduct allegedly engaged in by the dominant firm(s); and other market characteristics, including extent of technological change, extent of excess capacity, and customer or supplier countervailing power. It appears from the Grocery Guidelines, however, that there may be other elements, as is the case with the General Guidelines. The Grocery Guidelines fail to specify what those other factors could be, and it would be useful for the final version of the Guidelines to specify what they are. The list appears to be non-exhaustive but it would be useful for the Competition Bureau to include a more detailed discussion of other factors which are likely to be taken into account.

On market share[30], the Bureau intends to use sales revenues in the retail grocery industry to calculate market concentration levels. And, in accordance with the General Guidelines, the Grocery Guidelines state that a market share of less than 35% will generally not give rise to concerns of market power or dominance while a market share of 35% or more and, in the case of a group of firms alleged to be jointly dominant, a combined market share of 60% or more will generally prompt further examination. While this is consistent with the General Guidelines, it must be observed that, in recent merger cases involving the retail grocery sector, the Commissioner has generally refrained from intervening in local geographic markets where the post-merger market share of the merging entities was less than 45%. Unquestionably, these market shares should be measured according to the availability of grocery products among all competing sources, and not only the traditional full-line supermarket retailers. All the emerging non-traditional grocery stores should be included in the calculation of total market share. That being said, we understand that, for purposes of consistency with the General Guidelines, the Competition Bureau may have no choice but to refer to the 35% threshold for unilateral dominance. While the reference to the 35% threshold echoes what was mentioned by the Bureau in the General Guidelines, it is still a far cry from what the Competition Tribunal has determined is likely to constitute a situation of dominance, that is, more than 50%[31].

Anti-competitive Acts

The Grocery Guidelines then outline[32] how the Competition Bureau intends to assess potential anti-competitive behavior in cases involving the retail grocery sector. The Bureau's approach to assessing potentially anti-competitive acts in the grocery sector is to determine whether they are exclusionary, predatory or disciplinary with respect to other competitors in the relevant market. And, to do so, the Grocery Guidelines state that the

Bureau will focus on determining whether the activities in question i) facilitate raising rivals' costs or reducing rivals' revenues, ii) involve predatory conduct aimed at eliminating or disciplining competitors; and/or iii) encourage interdependence or tacit collusion among firms[33].

Similar comments are made in the General Guidelines but one nonetheless wonders how activities allegedly encouraging inter-dependence or tacit collusion among firms can fit within the general test outlined in the guidelines, that is whether potentially anti-competitive acts are "exclusionary, predatory or disciplinary" with respect to other competitors in the relevant market.

The retail grocery industry offers a variety of allowances, fees and promotional arrangements that are key elements of business relationships, including "slotting fees", "pay to stay" fees and production promotions schemes, and the Competition Bureau will assess those on a case by case basis to determine their anti-competitive effects.

In the area of raising rivals' costs[34], the Competition Bureau says it is concerned with a dominant grocery firm or group of firms entering into agreements with manufacturers, distributors, or retailers to preclude competitors' access to facilities through pre-empting access to the distribution system or shelf space in retail outlets or by the use of exclusive agreements. Though it is not stated clearly in the Grocery Guidelines, it should be made clear that in the absence of a substantial lessening of competition, raising rivals' costs does not provide a sufficient basis for the Competition Tribunal to make an order under the abuse of dominance provision.

The Grocery Guidelines note that, where dominance has been established and anti-competitive activities have been alleged, the Competition Bureau will determine whether market power is being maintained or enhanced through anti-competitive activities such as exclusive rights (for example, manufacturers or distributors having market power through the control of significant brands and requiring retailers wishing to carry their brand to refuse to carry or to restrict the number of competitors' products listed in their stores) and slotting allowances or other listing fees (for example, the payment of a slotting fee used to acquire exclusivity or to tie up sufficient shelf space to preclude other competitors from entering or expanding into the market, or contracts restricting the amount of shelf space and placement of products to a limited number of SKUs for competitors or requiring some form of price parity with competitors).

It should be noted, however, that the hypothetical situation listed in the Grocery Guidelines under section 5.2.1(a) on exclusive rights, where a core product or group of products in the household bundle of groceries is supplied by only one manufacturer or distributor in a given market, does not seem very realistic. Very rare are the cases where a supplier of one grocery item, or of a group of products in the bundle of groceries, will be in such a near monopolistic situation.

Section 5.2.1(a) of the Grocery Guidelines discusses exclusive rights from different perspectives. For example, a retailer requiring an exclusive right to sell as a pre-condition to selling a manufacturer's goods; or manufacturers or distributors offering an exclusive right to retail particular goods to one retailer or group of retailers in a market. There is obviously a significant difference between a retailer requesting an exclusive right, which could be

specific to the retail grocery sector, and a manufacturer granting an exclusive right for its own reasons on its own initiative, which would apply to many industries in addition to the retail grocery sector. Arguably, the Grocery Guidelines should only be concerned with the former.

While the Grocery Guidelines refer to "retailers with market power" who may be contravening the abuse provisions by soliciting rents in the form of fees or slotting allowances, most examples cited by the Bureau in the Guidelines on raising a rival's costs again appear to deal with abuse of dominance not by grocery retailers but by manufacturers supplying their products to retailers. The only detailed, specific example provided in the Grocery Guidelines, the reference to Heinz Canada at section 5.2.1(c), is precisely that. Such examples are not specific to the retail grocery sector. In fact, vertical restraints such as slotting allowances or pay to stay fees (to which the Grocery Guidelines refer) are not particular to the retail grocery sector and are the kind of arrangements that can be found in a number of other industries including books, software and electronics. It is a bit puzzling to note that such anti-competitive conduct described in the Grocery Guidelines could relate more to the manufacturers than to the grocery retailers and are not specific to the retail grocery sector. If they can apply to manufacturers in any business sector, why are these highlighted in Grocery Guidelines which are meant to be specific to the retail grocery sector? Why have industry-specific guidelines at all if most examples of abuse of dominance relate to the behavior of upstream suppliers?

Similarly, the section of the Grocery Guidelines on slotting allowances appears once again to focus on the potential for such fees to reflect an abuse of dominance by a manufacturer, rather than a retailer. This issue of slotting allowances[35] is a complex one and has given rise, in the United States, to extensive consultations which have been conducted by the Federal Trade Commission in the last two years.[36] These consultations looked closely at the issue but were not in a position to conclude on the exclusionary effect of those practices and on whether these exclusivity arrangements were causing any consumer harm.

While the Competition Bureau lists a set of contractual clauses that it considers problematic, it would be helpful if the reasons for singling out these particular contract clauses were discussed in the Grocery Guidelines. Most of the clauses are not uncommon in the retail grocery sector and if the Guidelines are to be helpful and to reduce uncertainty for the business and legal communities, the Bureau should clarify and explain why these clauses were specifically looked at.

In the area of predatory conduct[37], the Grocery Guidelines indicate that complaints received by the Competition Bureau about pricing practices of grocery retailers have alleged predatory conduct aimed at eliminating or disciplining competitors, usually involving low prices on frequently purchased items or low prices offered by a new entrant on a broad selection of SKUs. In the case of selling a number of SKUs below cost, the Bureau indicates that the competitive impact of a loss leader selling under 50 SKUs in a store stocking 17,000-23,000 SKUs is too limited to represent substantial lessening of competition. However, contrary to the Airline Guidelines, the Grocery Guidelines remain fairly silent on the thresholds for predatory conduct and on the notion of avoidable costs. It may be that the Competition Bureau prefers it this way but it would be useful in that context to at least make cross-references to the extensive discussion of these issues in the Airline Guidelines.

On this issue of predatory pricing, the Competition Bureau simply states that it occurs when there is selling bellow some measure of costs. The Grocery Guidelines do not discuss what is considered an appropriate measure of costs in the context of the retail grocery sector. Similarly, there is no indication as to what are the "normal" or "typical" mark-ups in this industry.

The Grocery Guidelines also state that the Competition Bureau generally accepts that most large scale entrants incur losses in the first six months, but that subsequent significant deviations from normal mark-ups and pricing strategy to cover costs represent direct evidence of predatory pricing.

On the issue of interdependence or tacit collusion[38], the Grocery Guidelines recognize that there has been no evidence to date of co-ordinated behavior in the retail grocery sector. However, the Competition Bureau says it puts a priority on reviewing changes in the structure of the industry and emerging trends in the market that could facilitate greater co-ordination among competitors in the retail grocery industry. Given the Bureau's prior observation, one is left to wonder as to why a specific reference is made at all to interdependence or tacit collusion amongst firms in the retail grocery sector as this sort of co-ordinated behavior has not raised any concerns in recent history nor is there any indication that it might be the case in the future. If there is anything which prompts the Competition Bureau to refer specifically to concerns about co-ordination between competitors in the retail grocery sector, it should be specifically mentioned in the Grocery Guidelines. If there is nothing specific, then there is no point in highlighting this anti-competitive behavior in the Grocery Guidelines. This is something which is already addressed in the General Guidelines and, in those circumstances, a specific cross-reference to the General Guidelines would be sufficient in the absence of any specific concern regarding the retail grocery sector.

What is also of concern is the fact that many of the practices described in the section of the Grocery Guidelines on interdependence are commonplace and often pro-competitive. It is only when these practices are engaged in by one or more firms that jointly control the market, one in which entry barriers are high, that these practices could be problematic under the abuse of dominance provision.

Lessening of Competition

Finally, on the issue of "preventing or lessening competition substantially"[39], the Grocery Guidelines say nothing specific to the retail grocery sector and simply restate the general position of the Bureau on the issue in the General Guidelines.

It appears that the last element of a substantial prevention or lessening of competition has received insufficient emphasis throughout the Grocery Guidelines. It may be that there is nothing specific to the retail grocery sector in respect of substantial prevention or lessening of competition and, if that is the case, a cross reference to the General Guidelines on this point would again be useful. This is also another reason to question the usefulness of industry-specific guidelines on abuse of dominance in this sector.

Conclusion

In view of the limited Canadian jurisprudence on abuse of dominance, the release of the draft Grocery Guidelines may be seen as good news for the retail grocery sector. But the fact that they provide little that is specific to the retail grocery sector raises the question as to the need or usefulness of such industry-specific guidelines. Given their limited scope, they appear unlikely, once promulgated, to have the same effect as the General Guidelines or even the Airline Guidelines. Furthermore, they appear to focus more on manufacturers and distributors than on grocery retailers, referring to factual situations which are often not specific to the retail grocery sector but could apply to many other business sectors.

Notes

[1] The draft guidelines are available online at the Competition Bureau's website at http://strategis.ic.gc.ca/SSG/ct02321e.html. It should be observed that the Bureau's website does not indicate that these guidelines are in "draft" form.
[2] These guidelines are available online at the Competition Bureau's website at http://strategis.ic.gc.ca/SSG/ct02209e.html.
[3] These draft guidelines on the airline industry are available online at the Competition Bureau's website at http://strategis.ic.gc.ca/SSG/ct02118e.html.
[4] Grocery Guidelines, s. 1.
[5] *Canada (Director of Investigation of Research)* v. *Nutrasweet* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) [hereinafter *Nutrasweet*]; *Canada (Director of Investigation and Research)* v. *Laidlaw Waste Systems* (1992), 40 C.P.R. (3d) 289 (Comp. Trib.) [hereinafter *Laidlaw*]; *Canada (Director of Investigation and Research)* v. *AGT Directory Ltd.* (1994), Trib. Dec. No. CT 9402/19 [hereinafter *AGT Directory*]; *Canada (Director of Investigation and Research)* v. *D&B Companies Ltd.* (1994), 58 C.P.R. (3d) 353 (Comp. Trib.) [hereinafter *D&B Companies*]; *Canada (Director of Investigation and Research)* v. *Bank of Montreal* (1996), 68 C.P.R. (3d) 527 (Comp. Trib.) [hereinafter *Interac*]; *Canada (Director of Investigation and Research)* v. *Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1 (Comp. Trib.) [hereinafter *Tele-Direct*]. Since then, the Tribunal has heard two other applications: *Canada (Commissioner of Competition)* v. *Air Canada (2001)*, Trib. Dec. No. CT 2001/002, and *Canada (Commissioner of Competition)* v. *Enbridge Services Inc.* (2001), Trib. Dec. No. CT 2001/008 [hereinafter *Enbridge*].
[6] Grocery Guidelines, s. 2.
[7] *Competition Act*, ss. 79.1 ff.
[8] *Ibid.*, s. 94(b).
[9] Grocery Guidelines, s. 3.
[10] *Ibid.*, s. 1.
[11] Bill C-402 is one of nine bills that died on the Order Paper in December 2000 and which are identified on the Competition Bureau's website at http://strategis.ic.gc.ca/SSG/ct02179e.html.
[12] Grocery Guidelines, s. 3.
[13] Though this raises again the question as to why particular guidelines are needed at all for the retail grocery industry.
[14] *Competition Act*, s. 79(1).
[15] *Laidlaw, supra* note 5 at 325; *Tele-Direct*, *supra* note 5 at 82; *D&B Companies*, *supra* note 5 at 254; *Nutrasweet*, *supra* note 5 at 28. General Guidelines, s. 3.2.1(d).
[16] General Guidelines, s. 3.2.1(a).
[17] *Ibid.*, s. 3.2.1(b).
[18] *Laidlaw, supra* note 5 at 317.
[19] General Guidelines, s. 3.2.1(d).
[20] See for example, *D&B Companies*, *supra* note 5 at 257. General Guidelines, s. 3.2.1(b).
[21] *Nutrasweet*, at 34.
[22] General Guidelines, s. 3.2.3.
[23] *Nutrasweet, Laidlaw, AGT Directory, D&B Companies, Interac, Tele-Direct* and *Enbridge*. The ongoing case before the Tribunal involves proceedings against Air Canada.
[24] Grocery Guidelines, s. 5.1.2.

[25] See for example Competition Bureau, Backgrounders "Loblaw Companies Limited – Acquisition of Provigo Inc. in Quebec and Ontario" (12 August 1999) online at the Competition Bureau's website at http://strategis.ic.gc.ca/SSG/ct01560e.html; "Loblaw Companies Limited – Acquisition of certain assets of The Oshawa Group Limited in Atlantic Canada" (12 August 1999), at http://strategis.ic.gc.ca/SSG/ct01559e.html.
[26] Grocery Guidelines, s. 5.1.3.
[27] *Ibid.*
[28] Available online at the Competition Bureau's website at http://strategis.ic.gc.ca/SSG/ct01026e.html.
[29] Grocery Guidelines, s. 5.1.4.
[30] *Ibid.*, s. 5.1.5.
[31] *Laidlaw, supra* note 5 at 317.
[32] Grocery Guidelines, s. 5.2.
[33] *Ibid.*
[34] Grocery Guidelines, s. 5.2.1.
[35] Discussed in the Grocery Guidelines in s. 5.2.1(b).
[36] The final report of the FTC can be found at http://www.ftc.gov/os/2001/02/slottingallowancesreportfinal.pdf.
[37] Grocery Guidelines, s. 5.2.2.
[38] *Ibid.*, s. 5.2.3.
[39] *Ibid.*, s. 5.3.

PARADIGM SHIFT: THE COMPETITION BUREAU'S DRAFT "ENFORCEMENT GUIDELINES FOR ILLEGAL TRADE PRACTICES: UNREASONABLY LOW PRICING POLICIES"

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Introduction

On March 8, 2002, the Competition Bureau released, for public comment, draft guidelines on the enforcement of sections 50(1)(b) and 50(1)(c) of the *Competition Act*, which deal, respectively, with geographic price discrimination and predatory pricing (the "Guidelines"). While the Guidelines, the full title of which is *Enforcement Guidelines for Illegal Trade Practices: Unreasonably Low Pricing Policies*, deal largely with the same subject matter as the existing *Predatory Pricing Enforcement Guidelines* (the "PPEGs"), they approach the issue of unreasonably low pricing *de novo*. Indeed, based on a reading of the Guidelines, anyone unfamiliar with the provisions of the *Competition Act* and pertinent jurisprudence in the area would think that the provisions had been substantially amended since issuance of the PPEGs, or that jurisprudence had rendered the approach set out in the PPEGs invalid. And yet, this is simply not the case.

In this article, we provide an overview and analysis of the Guidelines. In order to put this in context, we first summarize the relevant statutory provisions, jurisprudence and the existing PPEGs. With this done, we summarize the Guidelines, identifying and analysing some of the significant changes from the PPEGs along the way. We conclude the article with a general commentary on the Guidelines, including their significance as a potential indicator of the direction of Canadian competition law enforcement policy.

While our assessment of the Guidelines is set out more fully below, and most notably in the last section of the paper entitled "Paradigm Shift: Signs for the Future of Canadian Competition Law Enforcement?", we would note at the outset that the Guidelines raise a number of questions and concerns. Of these, the most fundamental relate to the purpose of the Guidelines and the scope and direction of the changes that they embody, as well as their failure to do precisely what guidelines should do, namely provide meaningful guidance to business to enable it to compete vigorously in the marketplace while, at the same time, avoiding conduct that runs afoul of the law.

Relevant Statutory Provisions

As is clear from their title, the Guidelines address the Competition Bureau's approach to the enforcement of sections 50(1)(b) and 50(1)(c) of the *Competition Act*. These provisions provide as follows:

> 50.(1) Illegal Trade Practices – Everyone engaged in a business who
>
> ...
>
> (b) engages in a policy of selling products in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening

> competition or eliminating a competitor in that part of Canada, or designed to have that effect, or
>
> (c) engages in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect,
>
> is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

Both provisions, therefore, involve forms of predatory pricing and create criminal offences. Section 50(1)(b) deals with a form of predatory pricing commonly referred to as "geographic price discrimination." Section 50(1)(c) is the *Competition Act*'s principal provision in respect of predatory pricing.[2]

What's Out: The PPEGs, Areeda-Turner, and Canadian Jurisprudence

Generally

Sections 50(1)(b) and 50(1)(c) of the *Competition Act* are not new. They were introduced into the *Competition Act* (or, more properly, its predecessor legislation) in 1935. Given the rarity of predatory pricing in practice,[3] there is only limited jurisprudence under these sections. The Competition Bureau released guidelines on the subject of predatory pricing, the PPEGs, in 1992. The following briefly discusses Canadian predatory pricing jurisprudence and the PPEGs. Since jurisprudence both precedes and follows the PPEGs, we start the discussion with the PPEGs.

The Predatory Pricing Enforcement Guidelines

In the PPEGs, the Competition Bureau defined predatory pricing, in "general terms", as "a situation where a dominant firm charges low prices over a long enough period of time so as to drive a competitor from the market or deter others from entering and then raises prices to recoup its losses."[4] As such, the PPEGs regarded predatory pricing as combining two essential elements: pricing below some measure of costs; and market power sufficient to allow the predator to raise prices following the exit of competitors in order to recoup its losses.

At the same time, the Bureau also noted that, "[w]hile predatory pricing is frequently alleged, relatively few matters have led to formal inquiries by the Director [as he was then called] or referral to the Attorney General for prosecution," which is consistent with the widespread view that "predatory pricing schemes are rarely tried, and even more rarely successful."[5] This, combined with the difficulty that competition law enforcers face in distinguishing between anti-competitive pricing and vigorous price competition, caused the Bureau to adopt a conservative approach to the enforcement of section 50(1)(c) in the PPEGs. In particular, the Bureau recognized that an overly broad enforcement policy can injure competition by creating a "chilling effect" on price competition.[6]

In 1992, the Bureau felt confident about its ability to publish predatory pricing guidelines without creating such a chilling effect. Its confidence, however, was not so strong that it was willing to embark on an active predatory pricing enforcement policy, especially given the relative rarity of predation and the high costs to competition if it erred on the wrong side of caution. Instead, the PPEGs drew on the development by 1992 of "a more

cohesive, analytical approach" to predatory pricing enforcement, which made it possible to identify instances where predatory pricing warranted enforcement action without creating a chilling effect on competition.[7]

The approach adopted by the Bureau in the PPEGs for this purpose involved two stages. Given a usual lack of information to assess relative prices and costs at the outset of an investigation, the Bureau started with a determination of whether a firm had market power, which determination was made in a manner consistent with the framework set out in its *Merger Enforcement Guidelines*. If it appeared that a firm had market power, only then would it consider whether the firm's prices were below some measure of cost. At this second stage, the PPEGs set out three "rules of thumb": (1) prices above average total costs are never unreasonable; (2) prices below average variable costs are unreasonable absent a "clear justification, such as the need to sell off perishable inventory"; and (3) prices that are below average total cost but which cover average variable costs fall within a "grey range" triggering an examination of a "number of surrounding factors," including "the strength of demand, the existence of excess capacity and direct or indirect evidence of intent to use pricing for an anti-competitive purpose."[8]

Applying these rules of thumb requires an understanding of what is meant by "average variable costs" and "average fixed costs." According to the PPEGs, average variable costs included "the costs of labour, materials, energy, promotional allowances, use-related plant depreciation and all other costs that vary with levels of output."[9] Average total costs were defined as "the sum of average variable costs and average fixed costs; that is, costs associated with investment in real plant and machinery and any other fixed assets which do not vary with output produced."[10] "Whenever possible," the PPEGs provided that "reasonably anticipated, rather than book (historical) average variable costs" would be used.[11]

If, having completed the above two-stage approach, the Bureau concluded that a firm may have engaged in unreasonably low pricing, it would consider whether such pricing was engaged in as a "policy" and whether it had "the effect or tendency of substantially lessening competition or eliminating a competitor, or [was] designed to have that effect." With respect to the former, the critical determinant, according to the PPEGs, was evidence of a "deliberate corporate program of pricing" applied "throughout the market being contested by the complainant firm(s)" for "sufficient duration to constitute a price offering in the context of the given market." Conversely, a policy did not include "competitive expedients of brief duration", "defensive reactions to the pricing initiatives or behaviour of competing firms" or "randomly occurring events attributable to specific business circumstances extant in the market at any given point in time."[12]

As for competitive harm, the PPEGs noted that this would often involve an analysis "similar to what has already been considered with respect to showing unreasonably low prices."[13] Presumably, the PPEGs referred here to market power analysis, which jurisprudence has recognized as a necessary condition for anti-competitive predatory pricing. Where market power is present, section 50(1)(c) identifies several types of potential harm in the words "effect or tendency of substantially lessening competition or eliminating a competitor, or [was] designed to have that effect." As such, section 50(1)(c) contemplates harm that is retrospective or prospective, actual or potential and even intended by design but not realized.

Finally, the PPEGs acknowledged that predatory pricing may be dealt with under section 79 of the *Competition Act* as an abuse of dominance. With respect to the relationship between section 50(1)(c) and section 79, the PPEGs stated that the Director would adopt an enforcement approach appropriate to the facts of each case based on such criteria as available remedies and whether the conduct in question was used in conjunction with other types of anti-competitive conduct, with the latter favouring the use of section 79 rather than section 50(1)(c). The PPEGs also indicated that their market power analysis could be "readily applied to the statutory language of section 79 when addressing predatory pricing behaviour," thereby suggesting that the method of analysis would be identical under both provisions.

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In summary, therefore, the PPEGs adopted a conservative approach to the enforcement of the *Competition Act*'s predatory pricing provisions, which conservatism reflected the relative rarity of successful price predation and the difficulty faced by competition law enforcers of distinguishing between anti-competitive pricing and vigorous price competition. Its approach included an initial assessment of market power with a view to determining whether the alleged predator would be able to recoup its losses following the exit of competitors from the market. Where market power was found, the next step would be to determine whether prices charged by the alleged predator were below an appropriate level of costs, which, depending on the circumstances, would be either average variable costs or total variable costs. Absent a legitimate business justification, below-cost pricing in these circumstances would violate the predatory pricing provisions of the *Competition Act*.

Canadian Jurisprudence in Relation to Predatory Pricing

As noted previously, predatory pricing is rare with the result that predatory pricing jurisprudence is limited. To date, there have been two cases of significance under section 50(1)(b) and only a few cases of note under section 50(1)(c).

The only section 50(1)(b) cases of which we are aware are *R.* v. *Carnation Co. Ltd.*[14] and *R.* v. *Perreault.*[15] *Carnation* involved a prosecution under the predecessor Criminal Code provision to section 50(1)(b). The trial decision, which was affirmed by a majority on appeal and resulted in an acquittal of the defendant, Carnation Co. Ltd. ("Carnation"), was only 13 paragraphs in length. Not surprisingly, therefore, it does not contain a detailed analysis of the provision and the requirements for a conviction. This said, the decision is noteworthy for the Court's acknowledgement of the potential for an overbroad interpretation of section 50(1)(b) (as it now is) to injure rather than safeguard competition and its recognition that "meeting the competition" could be a defence to a charge of anti-competitive conduct.[16] As for Perreault, the accused was convicted by a jury, therefore the court's decision contains no analysis of section 50(1)(b).

Section 50(1)(c) has been considered in *R.* v. *Producers Dairy Ltd.*,[17] *R.* v. *Hoffman-La Roche Ltd.* (*Nos. 1 and 2*),[18] *R.* v. *Consumers Glass Ltd. and Portion Packaging*[19] and *Boehringer Ingelheim (Canada) Inc.* v. *Bristol-Myers Squibb Canada Inc.*[20] In addition, the Competition Tribunal addressed the issue of predatory pricing under the *Competition Act*'s civil abuse of dominance provision in *Canada (Director of Investigation and*

Research) v. *Tele-Direct (Publications) Inc.*[21] and *Canada (Director of Investigation and Research)* v. *NutraSweet Co.*[22]

Producers Dairy addressed the meaning of "policy" in section 50(1)(c) in the context of a 48-hour milk price war between Ottawa dairies in 1961. The defendant producers were acquitted on the basis that the 48-hour, "defensive" price reduction did not constitute a "policy" of selling.

In *Hoffman-La Roche*, Hoffman-La Roche was convicted of predatory pricing in relation to two six-month distributions of Valium free of charge to hospitals and governments, which distributions were in response to new competition from Frank W. Horner Ltd. ("Frank Horner"). In convicting Hoffman-La Roche, the court dealt with whether i) there had been a "policy" of selling ii) at prices "unreasonably low" iii) with the effect, tendency or design to substantially lessen competition or eliminate a competitor. According to the court, a "policy" involved conscious conduct by the responsible employees of the accused of a continuing and repetitive nature. The court also held that the purpose of the price cut was irrelevant to whether it was engaged in as a "policy", although intent would be relevant to whether prices were "unreasonably low". With respect to the appropriate measure of costs, the court held that prices that are above short-run historical (book) production costs are never unreasonable, but prices below that level may be unreasonable, depending on the circumstances. The court identified the duration of the prices, the competitive circumstances (including whether the prices are proactive or reactive) and the expectation of long-term benefits for the seller as factors that are relevant to whether prices are unreasonably low. Finally, the court inferred predatory intent on the part of Hoffman-La Roche from internal company documents, the magnitude of the price cuts and the fact that Hoffman-La Roche incurred losses of $2.6 million in order to prevent a forecasted $600,000 encroachment by Frank Horner.

Consumers Glass involved an allegation by a new manufacturer of disposable plastic cup lids that the incumbent, Consumers Glass, had used predatory pricing to try to prevent its entry into the market. The principal issue addressed by the court was the meaning of "unreasonably low" as applied to an incumbent experiencing declining sales and excess capacity and facing a new entrant with sufficient capacity to cover the entire market and charging prices below those of the incumbent. Based on these facts, the court held that pricing below average total cost, but above average variable cost, had been aimed at loss minimization, not predation, and therefore did not offend section 50(1)(c). The court appears to have used short-run rather than long-run variable costs and, in contrast to *Hoffman-La Roche*, criticized use of intent as a factor in determining whether prices are unreasonably low.

In *Boehringer Ingelheim*, Boehringer Ingelheim (Canada) Inc. ("BICI") brought a private action under section 36 of the *Competition Act* alleging that Bristol-Myers Squibb Canada Inc. ("BMS") had engaged in predatory pricing by reducing the price of its pharmaceutical product TAXOL to match, and sometimes undercut, the price set by BICI for its competing paclitaxel product. In granting summary judgment against BICI, the court acknowledged the difficulty in distinguishing between anti-competitive pricing and vigorous price competition[23] and held that matching a competitor's prices can never be predatory.[24]

Finally, the Competition Tribunal addressed the issue of predatory pricing in the context of section 79 in *NutraSweet* and *Tele-Direct*. In *NutraSweet*, the Tribunal dealt with the issue in the context of allegations that The NutraSweet Company ("NSC") had used its U.S. patent "anti-competitively as an instrument for financing below-cost pricing [of aspartame] in Canada" as part of a more general allegation of leveraging by NSC of dominance enjoyed by it as a result of the patent.[25] Noting that the Director "did not present a consistent or coherent case as to the proper measurement of cost for this purpose" and that "the correct definition of 'cost'" in the case was "highly debatable," the Tribunal accepted "for present purposes the view of Areeda and Turner that marginal cost ... is an appropriate standard" and that "because [marginal cost] is so difficult to determine, a proxy for it is normally average variable cost."[26] The Tribunal then proceeded to relate the appropriate measure of costs to capacity, concluding that prices should be above average total cost if a firm is operating at or near capacity, but they should only be required to cover average variable costs if the firm is operating well below capacity. In this case, the Tribunal concluded that prices were not below cost, and that, even if they were, "it [was] highly unlikely that NSC would be able to recoup from Canadian customers the foregone profits resulting from below-cost pricing."[27]

As for *Tele-Direct*, it is noteworthy for the Tribunal's criticism of a novel theory of predation put forward by the Director. In its prosecution under section 79, the Director argued that the "overwhelming intensity" of various competitive responses, both price and non-price, to new entry by a dominant entity constituted an anti-competitive act. The Tribunal refused to apply the theory. While the Tribunal recognized that the alleged conduct could fall within the scope of section 79, the Director had not proposed any objective criteria by which the conduct could be assessed. As such, the Tribunal regarded the Director's theory as an attempt to make out a case of predation while circumventing the necessary elements of a successful predatory pricing claim.[28]

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Given the rarity of predatory pricing in practice, and hence the paucity of predatory pricing jurisprudence, it is not surprising that its treatment of the *Competition Act*'s predatory pricing provisions is less comprehensive than the PPEGs. It is, however, at least for the most part, consistent with the analytical approach set out in the PPEGs and, indeed, supports the PPEGs' approach in numerous respects. Among other things, Canadian jurisprudence has recognized the necessity of market power and recoupment to a successful case of predation and variable costs as the appropriate measure of costs. It also has recognized the risk that overly broad enforcement of these provisions could inhibit legitimate price competition, and therefore endorsed the need for objective standards for determining whether predatory pricing exists.

What's In: The Unreasonably Low Pricing Policies Guidelines and the New Economics

Part 1: Introduction

The Introduction of the Guidelines reiterates a number of the same principles on which the PPEGs were based, including most notably the risk that enforcement of the *Competition Act*'s predatory pricing provisions have a

"chilling effect" on price competition. In fact, the Guidelines' statement of this principle is in some ways stronger than that contained in the PPEGs. The Guidelines point out that "[v]igorous price competition is a hallmark of competitive markets" and that "[d]istinguishing between low prices resulting from illegal behaviour and those stemming from legitimate competitive rivalry can be difficult."[29] As such, the Guidelines state that "[t]he Bureau exercises caution when considering enforcement action against alleged unreasonably low pricing behaviour in order not to inhibit beneficial price competition."[30]

Notwithstanding the Guidelines' reiteration of this fundamental predatory pricing enforcement principle, the substance of the Guidelines is clearly more "enforcement friendly" than the PPEGs. Moreover, the Guidelines, as noted below, are notably ambiguous on such issues as the role of market power in predatory pricing analysis and rely heavily on subjective rather than objective standards, the net result of which is an undermining of the Bureau's purported cautious approach to predatory pricing enforcement. The Guidelines, therefore, constitute a step backward from the PPEGs, which recognized that an enforcement policy in this delicate area of the law must be based on a "cohesive, analytical approach" that enables business to clearly distinguish illegal pricing behaviour from vigorous pricing competition, the latter of which is to be encouraged.[31]

Part 2: Relevant Provisions

Part 2 of the Guidelines sets out the relevant provisions of the *Competition Act*, namely sections 50(1)(b) and 50(1)(c), the text of which is reproduced above.

As the Guidelines point out, these provisions share a number of common elements, namely that i) a person engaged in a "business" ii) engages in a "policy of selling products" iii) "having the effect or tendency of substantially lessening competition or eliminating a competitor ... or designed to have that effect." They differ, however, in the type of "policy of selling products" that they prohibit. Whereas section 50(1)(b) applies to policies of selling products "in any area of Canada at prices lower than those exacted by him elsewhere in Canada", section 50(1)(c) applies to policies of selling products "at prices unreasonably low" without any geographic component of the sort contained in section 50(1)(b). Finally, notwithstanding the centrality of the phrase "Unreasonably Low Pricing Policies" to the title of the Guidelines, it is notable that unreasonably low prices is an element of only one of these provisions, namely section 50(1)(c).

Part 3: Enforcement Considerations

Part 3 of the Guidelines sets out the Bureau's "Enforcement Considerations" in respect of sections 50(1)(b) and 50(1)(c). According to the Bureau, "[i]dentifying truly harmful low-pricing behaviour requires that a delicate balance must be struck; otherwise, anti-competitive activity might go unchecked, or legitimate price competition might be inhibited."[32] Keeping in mind that, as noted previously, the Guidelines ultimately fail to adhere to this fundamental principle, they purport to set out to achieve this delicate balance by establishing a three-stage procedure for reviewing predatory pricing complaints: i) "Thresholds for Examination"; ii) "Preliminary Examination"; and iii) "Formal Inquiry". The Guidelines also discuss the option of addressing predatory pricing

complaints under section 79 of the *Competition Act* and the possibility of alternative case resolution rather than resolution by prosecution.

Stage 1: Thresholds for Examination

The first stage of the three-stage procedure, "Thresholds for Examination", consists of "an initial assessment to confirm that the alleged behaviour is not legitimate price competition, and also to ensure that the Bureau pursues enforcement actions where unreasonably low pricing is likely to harm the competitive process."[33] Presumably, this stage acts as an initial "filter" to identify complaints that can be dismissed without extensive fact-gathering and analysis. The PPEGs created a similar filter by making the first stage of the "unreasonably low pricing" an examination of market characteristics to determine whether the alleged predator has market power since "precise price/cost data applicable to [an] alleged predator may not be readily available to the Director at the outset of a typical investigation".[34] It is surprising, therefore, that the Guidelines take the opposite approach by considering first whether the alleged predator is selling at prices that are above cost. Only upon such consideration, if "prices appear to be below cost," will the Bureau define the relevant market.[35]

The PPEGs made it clear that the purpose of defining the relevant market was to determine whether a firm has market power. In contrast, the Guidelines associate market definition with the general objective of determining the "competitive effects of alleged anti-competitive behaviour", but an explicit acceptance of market power as a necessary element to a case of predatory pricing is absent. While market power is referred to subsequently in the Guidelines, their silence on this point in Part 3 is remarkable since market power is so central to competition analysis, which leads one to suspect that its omission may be intentional. This suspicion is reinforced by the Guidelines' abandonment of recoupment as a necessary element of predation and its discussion of "Low Pricing Resulting from Market Expansion" in Part 5, as discussed below. Stated briefly, the ambiguity of the Guidelines on the role of market power in predatory pricing analysis raises the question of whether the Bureau continues to regard market power as essential to the type of harm that is required to make out a successful predatory pricing claim.

Similarly ambiguous are the considerations that the Bureau will take into account in assessing the harm to competition in the defined market. The Guidelines provide that the Bureau will not examine further alleged low pricing by a firm if i) it has a market share of less than 35% and its share is not "considerably" greater than its rivals or ii) it has more than 35% market share but barriers to entry into the market are low. On the other hand, the Bureau will continue to examine a complaint beyond the "Thresholds for Examination" stage if barriers to entry are significant and i) the firm has a market share of more than 35% or ii) its market share is considerably greater than its rivals. While these criteria are for the most part consistent with the PPEGs, relevant jurisprudence and conventional understandings of market power analysis, they raise the possibility that "competitive harm" may be possible if a firm has a market share less than 35% but its market share is considerably greater than its rivals. Additional explanation of the circumstances in which this might occur would be helpful, since the Guidelines offer no assistance at all in determining when the Bureau would take the position that a firm could meet these criteria.

Stage 2: Preliminary Examination

If a complaint meets the "Thresholds for Examination" criteria, it proceeds to the second stage, "Preliminary Examination", where the Bureau "pays particular attention to the duration, frequency, depth and pattern" of the low-pricing behaviour. Notwithstanding the significance attached to whether prices are below cost at the previous "Thresholds of Examination" stage, the Guidelines recognize that "information about the low-pricing firm's costs might be limited at this early stage of the process."[36] If the alleged predator is a well-established firm expanding into a new market, the Bureau also considers whether the low pricing represents a temporary introductory price or can be explained by some other legitimate business objective. Presumably, the Bureau would look for similar justifications in other cases, as well, although its reference to legitimate business objectives, for reasons unknown, is limited to incidences of expansion into new markets. Notably absent from this stage of analysis is any consideration of market characteristics and, more particularly, whether the alleged predator has market power.

Stage 3: Formal Inquiry

At the conclusion of the "Preliminary Examination", the Bureau "will recommend whether or not there is reason to believe that an offence has been, or is likely to be committed," in which case the Commissioner may commence a formal inquiry. Since the only activity on the part of the Bureau at this stage identified in the Guidelines is the use of the Commissioner's formal powers to obtain information, the decision to commence a formal inquiry would appear to mean that the Commissioner has determined that an offence has been committed and all that remains is for the Bureau to gather additional evidence required to take enforcement action against the alleged predator. Upon completion of an inquiry, the "Bureau will decide how the cases should be resolved."

Notwithstanding the suggestion that the "Bureau will decide" how cases should be solved, it is clear that, legally, the Bureau does not have unfettered discretion in this regard. While it may identify what it believes to be an appropriate means for resolving a case, the Bureau is not the only entity involved in the resolution process. If the Bureau concludes that criminal prosecution is desirable, the Commissioner refers the matter to the Attorney General for Canada, who then makes his or her own determination of whether to prosecute. Similarly, the Bureau may determine that alternative case resolution (i.e., settlement) is appropriate, but settlement is possible only if the Commissioner succeeds in negotiating settlement terms with the alleged predator. Even in the case of an application to the Competition Tribunal under the civil provisions of the *Competition Act*, the Commissioner acts as "prosecutor" with the Competition Tribunal having the ultimate authority to determine how the case should be resolved.

Other Enforcement Considerations: Section 79 and Alternative Case Resolution

In addition to explaining its three-stage procedure for considering allegations of predatory pricing, Part 3 of the Guidelines explains the circumstances in which it will consider addressing predatory pricing under section 79 of the *Competition Act* and settling cases through alternative case resolution rather than by prosecution.

With respect to the relationship between sections 50(1)(b) and 50(1)(c) and section 79 of the *Competition Act*, the Guidelines are consistent with the PPEGs insofar as they suggest that the Bureau will consider which provisions to use on a case-by-case basis, including the appropriateness of available criminal and civil remedies. Factors such as a history of non-compliance and particularly egregious conduct will support seeking a criminal remedy, while section 79 is more likely to be used in circumstances where unreasonably low pricing is part of "a broader pattern of anti-competitive acts."[37] While generally consistent, the Guidelines' treatment of the relationship between these provisions also differs in one significant way. Whereas the PPEGs indicated that "predatory pricing may be dealt with under section 79 or section 50(1)(c),"[38] thereby suggesting that the provisions are equally available to the Commissioner for prosecutions, the Guidelines suggest that there may be a distinction in the types of predatory pricing that may be dealt with under these provisions. In particular, the Guidelines state that the Bureau "will pursue allegations of unreasonably low pricing under section 79 when there is a dominant player, or a dominant group of firms, in the market."[39] Combined with the Guidelines' relative silence on the subject of market power, the Guidelines may be interpreted as implying that there is a distinction between the criminal and civil provisions with market power (dominance) being a required element only of the latter.

As for alternative case resolution, the Guidelines note that a full inquiry or judicial proceedings can be avoided through the use of written undertakings or, in some cases, even with the Bureau's contacting the alleged offender and explaining the law. The omission of any reference to proceeding before the courts or the Competition Tribunal on a consensual basis is not mentioned, which seems strange given the increasing preference of the Commissioner in the civil context to require consent orders rather than undertakings to settle cases.

Part 4: Elements of Unreasonably Low Pricing

Having set out its enforcement considerations in Part 3, the Bureau then discusses its interpretation of the specific elements that must be proven under sections 50(1)(b) and 50(1)(c). Generally, these elements consist of i) a person engaged in a "business" who ii) engages in a "policy of selling products" such that iii) one of the prescribed anti-competitive effects occurs, namely "the effect or tendency of substantially lessening competition or eliminating a competitor" or a policy that is "designed to have that effect". In addition, section 50(1)(b) requires that the policy of selling involve "selling products at prices lower in one area of Canada than in another", while section 50(1)(c) requires that it involve "selling products at unreasonably low prices."

<u>A Person Engaged in a "Business"</u>

The view respecting what constitutes a "business" set out in the Guidelines consists of a restatement of the definition of a business contained in section 2(1) of the *Competition Act*. As such, it is uncontroversial.[40]

<u>Policy of Selling Products</u>

The Guidelines' discussion of what constitutes a "policy of selling products" is also uncontroversial, with one exception. The Bureau "considers whether the selling activity of the firm in question is a legitimate short-term

competitive tactic, or whether it is sufficiently long term or repetitive to be considered a pricing strategy,"[41] which is consistent with the view of the Ontario Court of Appeal in *Producers Dairy*, where the accused were acquitted on the basis that a 48-hour, "defensive" price reduction did not constitute a "policy" of selling. Similarly, the Guidelines state that "a particular price which applies to one, or relatively few, market transactions is unlikely by itself to constitute an unreasonably low pricing policy", which resembles the view expressed in *Hoffman-La Roche* that sales made on a one-time basis, as opposed to on an ongoing or repetitive basis, are unlikely to be a "policy."

At the same time, the Guidelines appear to misconstrue the court's conclusions in *Hoffman-La Roche*, where it was held that intent could be relevant to whether prices were "unreasonably low" but not to whether there had been a "policy of selling."[42] Observing that in *Hoffman-La Roche* the court held that a "policy of selling" requires that it be shown that there be "planned and deliberate course of conduct by responsible employees",[43] the Guidelines cite as an example of this "evidence that a program is aimed at eliminating a competitor through below-cost pricing". It is important to note, however, that, in *Hoffman-La Roche*, the court identified the requirement that an accused "engage or be involved in a policy or deliberate and continuing programme of selling articles at unreasonably low prices" at a stage of its analysis that focused solely on the issue of a policy of selling rather than the unreasonableness of the prices in question, the latter being the subject of a separate, subsequent analysis.[44]

As such, the interpretation set out in the Guidelines is incorrect. Instead, a more faithful interpretation would appear to be that contained in the PPEGs, which, as noted previously, stated that the critical determinant of whether a "policy" exists is whether there is evidence of a "deliberate corporate program of pricing" applied "throughout the market being contested by the complainant firm(s)" for "sufficient duration to constitute a price offering in the context of the given market."[45]

Finally, the Guidelines state that "it is not necessary to show that the low-pricing behaviour was officially authorized by the company." Apart from the previous reference to conduct that is "planned and deliberate" on the part of "responsible employees", however, the Guidelines do not provide any indication as to what constitutes sufficient authorization by the company to make it a "policy of selling" for which the company may be potentially liable.

Anti-competitive Effects

The largest part of Part 4 of the Guidelines deals with anti-competitive effects, which in turn is divided into separate sections for i) effect or tendency of substantially lessening competition, ii) effect or tendency of eliminating a competitor and iii) designed to substantially lessen competition or eliminate a competitor.

(i) Effect or tendency of substantially lessening competition

The first substantive reference in the Guidelines to "market power" appears in the discussion of "effect or tendency of substantially lessening competition," where a substantial lessening of competition is associated with

the creation, preservation or enhancement of "market power." While reference is made to the detailed explanation of market power in the Bureau's *Merger Enforcement Guidelines* and in jurisprudence of the Competition Tribunal, the Guidelines also identify and discuss the "principal indicators" of market power, namely market shares and levels of concentration and barriers to entry into the relevant market. The Guidelines also identify actual behaviour of a firm, in particular its ability to engage in anti-competitive conduct, as a "good indication" of market power.

With respect to market shares and levels of concentration, the Bureau notes that "the greater the level of concentration in a relevant market, the more likely it is that a policy of unreasonably low pricing will adversely affect competition and competitors." Accordingly, the Bureau will consider whether the alleged low-pricing policy has "maintained or increased the market share of the alleged low pricing incumbent firm." The Bureau also states that "[e]vidence of persistently high market shares can be an indicator of market power", provided the high shares are maintained through anti-competitive rather than "legitimate means, such as greater efficiency or better products".[46] Similarly, the relative size of market shares may be an indicator of market power since, for example, "a firm with relatively moderate market share may be able to exercise market power if that share is considerably greater than its rivals."[47] As noted previously, the Bureau does not provide additional insights into this factor, with the result that firms in markets characterized by such a market structure are left with considerable uncertainty as to how the Bureau would approach a market power analysis.

In addition to market shares and levels of concentration, the Bureau identifies conditions of entry and exit as an important factor in determining whether competitive harm is likely to occur. Oddly, however, the Guidelines describe the importance of these conditions by highlighting their relevance to a firm's ability to "recoup the money it lost as a result of its below-cost pricing."[48] Similarly, in addressing the time period within which new entry must occur, the Guidelines state that "the Bureau will consider the time it is likely to take the firm to raise prices and recoup the costs of the pricing strategy."[49] Both of these statements seem inconsistent with the position stated subsequently that "while an ability to recoup losses will continue to be a factor to be considered, it is not a necessary element to be proven under paragraphs 50(1)(b) and 50(1)(c)."[50]

The Guidelines discuss three types of barriers to entry or exit: structural barriers, behavioural barriers and so-called "reputational effects" Examples of structural barriers identified in the Guidelines are barriers to international and interprovincial trade, sunk costs and regulatory requirements, as well as economies of scale or scope, scarcity of production inputs and lack of access to necessary technology, all of which may prevent or inhibit new entry.

Behavioural barriers include factors such as technical service, reputation, geographic proximity and established buyer/seller relationships that influence buying decisions and may make it difficult for new firms to establish a presence in the market. Behavioural barriers also include strategic behaviour by incumbents to impede or delay new entry. The Guidelines provide four examples of strategic behaviour that it will consider as contributing to barriers to entry in a market:

- using excess capacity to increase output and depress prices in response to an entry attempt;
- excessive investment in research and development or advertising;
- pre-emptive acquisitions of inputs required by an entrant to enter the incumbent's market; or
- pre-emptive expansion of capacity.

While there is some overlap between these examples and examples of strategic behaviour in the PPEGs, there are also differences. The PPEGs included the existence of exclusive dealing or tying arrangements, which have been omitted from the Guidelines. Conversely, "pre-emptive acquisitions of inputs" and "pre-emptive expansion of capacity" have been added. As for the other examples, they appeared in the PPEGs, although use of excess capacity to deter entry appeared in the PPEGs in a modified form.

Arguably the most significant type of condition of entry or exit identified are "reputational barriers", which refer to the deterrence of entry by "establishing a reputation for unreasonably low pricing." According to the Guidelines:

> By demonstrating its willingness to price below cost, a firm can signal to potential competitors that it will respond aggressively if they attempt to enter its markets. The creation of a barrier to entry by virtue of reputation can increase a firm's market power and enhance the exclusionary effects of its conduct.[51]

This notion of "reputational effects" did not appear in the PPEGs, nor are we aware of jurisprudence, apart from a single Australian case that, as discussed below, is of limited, if any, persuasive value in Canada, in which it has been applied successfully.[52]

The inclusion of reputational effects, as well as certain of the behavioural effects (e.g., "excessive investment in research and development or advertising" and a reputation for deterring entry by use of excess capacity to drive down prices), as bases for concluding that barriers to entry or exit are high raises the difficulty that such effects cannot be assessed on any objective ground. While the Guidelines do not go so far as to make such effects a basis of liability,[53] barriers to entry or exit are best assessed on the basis of factors that are susceptible to objective measurement, such as sunk costs, economies of scale, international trade barriers etc. Indeed, this becomes evident by the criteria set out in the Guidelines for determining whether reputational effects are present, which include "deep pockets" to cover the costs of a pricing strategy and an "analysis that compares the subject market(s) with conditions in other 'similar' markets where the firm is not present", such as a comparison of whether "the firm's sales and profits in markets in which it operates are higher for a substantial period than are typically observed for firms operating in *similar* markets."[54] These criteria, in addition to lacking objectivity, are so vague and complex that they could prove unworkable in practice.[55] Indeed, they undermine the very objective of "guidelines" in that they ultimately provide no guidance at all to businesses seeking to comply with the law. The result, therefore, could be a chilling effect on price competition contrary to the stated objectives of the Guidelines.[56]

The Guidelines also adopt the position that, while the ability to recoup losses, whether in the market where the low pricing took place or in another market, is an indication of market power, it is not a necessary component of a predatory pricing offence. According to the Bureau, recoupment is not necessary, because "it may be rational for a firm to adopt a low-pricing policy and sacrifice present profits in order to preserve the long-term stability of an existing market structure" or to "assist in establishing an industry standard to exclude others or maintain market control."[57] Setting aside the fact that these alternative motivations appear to involve forms of recoupment, the Guidelines' rejection of recoupment as a necessary element of predatory pricing runs contrary to predatory pricing jurisprudence in Canada and abroad, which has consistently recognized that recoupment is a necessary component of a predatory pricing offence.[58] Indeed, the Guidelines contradict the view expressed by the Bureau in its own *Abuse of Dominance Guidelines*, which were published only eight months prior to the Guidelines.[59] In support of its position, however, the Guidelines cite an Australian case that is of little if any persuasive value in Canada, and in most other countries with similar competition laws.[60]

(ii) Effect or tendency of eliminating a competitor

The Guidelines state that elimination of a competitor requires that the competitor has "in fact, gone out of business or is otherwise no longer in a position to be an effective competitor in a particular market" or that such an effect is likely to occur.[61] While this is consistent with the plain meaning of the statute, the Guidelines' further position that strategic-pricing behaviour that deters entry also constitutes a form of "elimination" is not. A competitor cannot be eliminated if it does not exist. If Parliament had intended such deterrence to fall within the scope of sections 50(1)(b) and 50(1)(c), it would have used language similar to that in other provisions with respect to "substantial prevention or lessening of competition."[62]

Keeping in mind the importance of market power in predatory pricing analysis generally, consideration of market power is particularly important in respect of section 50(1)(b) and 50(1)(c)'s reference to elimination of a competitor. While it is clear that market power should be a required element of a predatory pricing case based on an effect or tendency of lessening competition, both as a matter of policy and law, it is not clear from the statutory language that market power should be required as a matter of law in a case based on elimination of a competitor. The maxim that competition law should protect competition rather than competitors suggests that market power should be required in both cases, as does the Bureau's stated objective of enforcing sections 50(1)(b) and 50(1)(c) in a manner that does not inhibit beneficial price competition, but the language of these provisions is not so clear. As such, it would be helpful to know the Bureau's position on the relevance of market power to an "elimination of a competitor" case.

(iii) Designed to substantially lessen competition or eliminate a competitor

The Guidelines provide that a low-pricing policy falls within the scope of sections 50(1)(b) and 50(1)(c) of the *Competition Act* if it is "designed" to have the effect of substantially lessening competition or eliminating a competitor even if the policy is "entirely ineffective in achieving its objective." While such an approach could be reasonable in cases based on potential future effects of low-pricing policy, it is difficult to conceive of a situation in which the Bureau should enforce against an alleged predator whose policy has failed, in fact, to have

one of these anti-competitive effects. Keeping in mind the Bureau's desire to enforce the *Competition Act's* predatory pricing provisions in a manner that does not inhibit beneficial pricing competition and the fine line between vigorous price competition and predatory prices, it would be difficult for the Bureau to justify enforcement in circumstances where actual events do not support the elements of the case which it is required to demonstrate in order to secure a conviction (e.g., an ability to cause injury to competition).[63]

Section 50(1)(b) – The Geographic Dimension

The principal distinction between section 50(1)(b) and 50(1)(c) is that the former applies in respect of selling products "in any area of Canada at prices lower than those exacted by him elsewhere in Canada." Given the potentially wide scope of these words, the Bureau rightly points out that "[r]equiring a firm to charge the same prices in all of the markets in which it operates risks inhibiting legitimate price competition."[64] Accordingly, the Bureau will only seek to enforce section 50(1)(b) where such policies "ultimately harm the process of competition."[65]

Section 50(1)(c) – "Unreasonably Low Prices"

Whether prices are "unreasonably low" involves both a price-cost comparison and, if prices are below cost, a determination of whether they may be justified as reasonable on the basis of some legitimate business purpose.

With respect to the price-cost comparison, the Guidelines depart from the PPEGs in two important ways. First, the Bureau now recognizes "avoidable cost", rather than variable costs, as the relevant measure of costs, with avoidable costs defined as "all costs that could have been avoided by a firm had it chosen not to sell the product(s) in question" and which "[i]n general, ... do not include sunk costs." The second departure is the elimination of the grey area (i.e., between average variable costs and total variable costs) recognized in the PPEGs. Avoidable costs are now the sole measure of costs used to determine whether prices are below cost for the purposes of section 50(1)(c).

The Guidelines do not provide a rationale for either of these departures, which is troubling given the acceptance of variable costs by Canadian courts and the Competition Tribunal, as well as its widespread acceptance by U.S. courts.[66] Apart from achieving consistency with the civil predatory pricing provisions added to the *Competition Act* for application in the airline industry and the position taken by the Bureau in the *Abuse of Dominance Guidelines*,[67] the only obvious rationale for the adoption of avoidable costs would appear to be that avoidable costs include a portion of fixed costs, thereby raising the threshold for below-cost pricing. On the other hand, the definition of variable costs in the PPEGs (i.e., "the costs of labour, materials, energy, promotional allowances, use-related deprecation and <u>all other costs that vary with levels of output</u>" [emphasis added]) could, arguably at least, be broad enough to include costs that, while normally considered fixed, were nonetheless variable insofar as they were incurred as a result of, for example, adding new capacity. Moreover, even if one accepts the Bureau's view that avoidable costs are a more appropriate measure for the purposes of economic theory, it does not follow that use of avoidable costs makes sense as a matter of <u>law</u>. The abandonment of variable costs as the legal standard for measuring costs in favour of avoidable costs is highly problematic since

avoidable costs involve a costing concept that, unlike variable costs, is relatively unknown to business persons and accountants, which problem is compounded by the absence of meaningful direction in this regard in the Guidelines. As such, the use of avoidable costs generates uncertainties that, contrary to the Guidelines' stated objective, increase the risk of the Bureau's enforcement policy having a chilling effect on legitimate price competition.

The Guidelines also address the issue of the time periods over which the cost-based analysis is carried out and over which the costs of the firm are avoidable. Unfortunately, the Guidelines offer little guidance in this regard, beyond the fact that resolution of the second issue "will depend ... in part on the standard amount of time taken by a firm's management to assess business performance and implement any required changes." Otherwise, they cite only "availability of price and cost data", which bears no relation to the issue of costs, and the need to "take account of random variations of demand." Even the time period over which the predation occurred was overlooked as a relevant factor.

On the other hand, the Guidelines provide useful clarification concerning measurement of costs in multi-product firms. They confirm that the same measure of costs – avoidable costs – rather than fully allocated costs will apply in this context as well. As such, the Bureau's enforcement approach will permit, and indeed encourage, firms in industries characterized by high fixed costs, for example in relation to infrastructure, to exploit economies of scope.

If the Bureau determines that prices are not below cost, it concludes that unreasonably low pricing has not occurred. Even if prices are below cost, however, the Guidelines recognize, as have Canadian courts, that they are only unreasonable in the absence of some legitimate business justification. Among such justifications identified in the Guidelines are:

- the sale of excess, obsolete or perishable goods, or products for which demand is shrinking at below-cost prices;
- below-cost pricing in cases of temporary cost or demand increases to retain customers or build inventory in the face of increased future business;
- below-cost pricing to induce customers to try a new product;
- below-cost pricing combined with high volumes to gain production experience, thereby increasing efficiency and allowing it to recoup its costs; and
- matching the low prices of a competitor.

In each of these cases, the Bureau will examine the purported business justification based on the particular competitive context.

Of the above justifications, the most significant is arguably the last: matching the low prices of a competitor. The Guidelines acknowledge that, as recognized by the court in *Boehringer Ingelheim*,[68] "meeting the competition" can be a business justification for below-cost pricing. However, the Guidelines also suggest that this will not

always be the case. According to the Guidelines, meeting the competition will not be a valid business justification where there is a "qualitative difference between the products being offered by the rival companies" such that "matching prices would, in effect, be 'undercutting'."[69] As with the Guidelines' focus on reputational and behavioural effects as factors affecting conditions of entry and exit, the Guidelines' suggestion that "price matching" may in certain circumstances be "price undercutting" provides an example of the Guidelines' widespread use of subjective tests that undermine the ability of the Guidelines to provide meaningful guidance to businesses.[70] They also provide an example of the Bureau's seeking to formalize in the Guidelines positions taken by the Commissioner in litigation before the Competition Tribunal involving predatory pricing allegations against Air Canada. Setting aside the issue of the validity of the Bureau's position in that case, it is clear that the Bureau's qualified acceptance of "meeting the competition" as a defence to predatory pricing has implications for businesses far beyond the airline industry since the vast majority of products are differentiated from competing products in some way. Indeed, the Bureau provides no indication of the criteria on which it will determine whether a price matching is in fact price undercutting owing to a "qualitative difference" in products, although such differences could conceivably be found solely on the basis, for example, of the relative strengths of competing products' trademarks.

Part 5: Low Pricing Resulting from Market Expansion

The Guidelines contain a section devoted to the use of unreasonably low pricing by a well established firm trying to expand into a new market. According to the Guidelines:

> ... this is unlikely to happen if the new entrant's market share is relatively small and it lacks operations elsewhere, but it becomes more feasible when the firm operates in similar businesses in other markets, has "deep pockets", and has behaved in an aggressively competitive, and possibly anti-competitive, fashion in other markets. Such an entrant could finance its low-pricing strategy from its earnings in other markets, a parent with deep pockets or superior access to financing, and consequently be able to enter a new market and sustain losses for an extended period of time.[71]

While the Guidelines recognize that some "promotional pricing" by the entrant is understandable, they identify a number of factors that the Bureau will consider in determining whether such pricing has become "unreasonable," including the relative price differences compared to other markets and whether the new entrant has achieved a foothold in the new market. In addition, the Guidelines identify several factors that, in the Bureau's view, make unreasonably low pricing by a new entrant "more likely", including whether "the conduct would harm competition in the market."

Accepting that the Bureau is correct in its assessment that unreasonably low pricing concerns normally arise in respect of established firms trying to protect or extend existing market dominance by deterring or disciplining new entrants, it does not follow that the case of expansion by well established firms into new markets requires a separate analysis. The issues in each case are the same, namely whether a firm is engaged in below-cost pricing with the result that market power is created, maintained or enhanced. In its market expansion analysis, the Bureau abandons this central tenet of competition law, and drifts into the domain of protecting competitors

rather than competition. Indeed, its statement that unreasonably low pricing is "more likely" where "conduct would harm competition in the market" suggests that the Bureau could seek to enforce against a firm using below-cost pricing to build significant market share in a market (as opposed to ceasing the below-cost pricing upon having attained a foothold) even if the firm did not, as a result, achieve market power in that market. In the absence of its having created market power through some anti-competitive act, however, there can be no harm to competition even if certain of the firm's competitors lose sales to the entrant.

Part 6: Enforcement Outcomes

The Guidelines conclude with a brief overview of possible enforcement outcomes of a Bureau examination, in particular prosecution, other remedies (i.e., injunctions and prohibition orders under sections 33 and 34 of the *Competition Act*) and discontinuance. Oddly, the discussion includes discussions of the civil right of action in section 36 and the Bureau's program of advisory opinions, neither of which are an "enforcement outcome" in the sense used elsewhere in the Guidelines. Conversely, the potential for proceedings, whether on an adversarial or consensual basis, under section 79 is not addressed at all.

Paradigm Shift: Signs for the Future of Canadian Competition Law Enforcement?

As noted at the outset of this article, the most fundamental questions and concerns raised by the Guidelines relate to the purpose of the Guidelines and the scope and direction of the changes that they embody, as well as their failure to do precisely what guidelines should do, namely provide meaningful guidance to business to enable it to compete vigorously in the marketplace while, at the same time, avoiding conduct that runs afoul of the law.

With respect to the purpose of the Guidelines, the Commissioner justifies changes in the Guidelines on the basis that they "reflect a modern perspective on low-pricing issues," apparently taking account of "changes in the economy as well as developments in economic thinking".[72] Unfortunately, the Guidelines do not expand on this point, leaving the reader to ascertain the changes underlying the revisions to the Bureau's predatory pricing enforcement policy. A more detailed justification for the changes would have been helpful, particularly given the significant departure that they represent from jurisprudence in Canada and in other jurisdictions, including the United States. Furthermore, even a cursory reading of the Guidelines suggests that the Commissioner's stated justifications for issuance of the Guidelines are incomplete. The significant treatment in the Guidelines of such issues as expansion of dominant entities into new markets, avoidable costs as the appropriate measure of costs, reputational and behavioural effects and "price matching" suggest that the Guidelines are also motivated by a desire to formalize certain positions taken by the Commissioner in litigation before the Competition Tribunal involving allegations of predatory pricing against Air Canada.[73] Thus, the Bureau's approach to predatory pricing in the airline industry, which was initially portrayed as necessary to respond to allegedly unique characteristics of that industry, has become part of its "mainstream" enforcement policy. Furthermore, given that the Tribunal has yet to rule in the case, the Bureau's decision to issue the Guidelines at this time raises serious concerns about its role, relative to that of the Tribunal, with respect to enforcement of the *Competition Act*.

The Commissioner's summary of the changes embodied in the Guidelines relative to its existing predatory pricing enforcement policy, as set out in the PPEGs, is also far from complete. In the Guidelines' Preface, the Commissioner identifies three principal changes: i) abandonment of recoupment of losses as a necessary element of unreasonably low pricing; ii) the adoption of avoidable costs as the appropriate measure of costs; and iii) a new section addressing unreasonably low pricing in the specific context of market expansion. In fact, the Guidelines represent a far more significant departure from the Bureau's existing enforcement policy than he suggests. Other significant changes not mentioned by the Commissioner include ambiguous treatment of market power as a required element in predatory pricing cases, an apparent departure from the maxim that competition law protects competition rather than competitors in its analytical framework respecting market expansion and an increased reliance on subjective rather than objective criteria for the enforcement of the *Competition Act's* predatory pricing provisions. Taken together, these changes in the Bureau's enforcement approach are extraordinary and troubling.

Oddly, the only jurisprudence referred to in the Guidelines in support of its radical changes is a decision of the Australian Federal Court of Appeal.[74] Such reliance is odd in that, at least in our experience, Australian law is not normally cited as a persuasive authority for the purposes of interpreting Canadian competition law. More significantly, the decision itself is of questionable value, which the Competition Bureau implicitly recognizes through its reliance on the case only for those selected principles that support the revised enforcement approach set out in the Guidelines. In particular, while the decision supports certain aspects of the Guidelines, including its treatment of recoupment, it is at odds with approaches to predatory pricing used in the competition laws of major jurisdictions around the world.[75] The radical nature of the Australian decision is perhaps best summed up by the conclusion of one of the judges that "below-cost pricing" is not an essential element of predatory pricing since predatory pricing "is no more than a price set at a level designed to eliminate a competitor or keep a potential competitor from the market," thereby putting it at odds with the overwhelming weight of economic and legal thinking in relation to predatory pricing.[76] Accordingly, the Guidelines' reliance on the case, while convenient, is puzzling since it ultimately undermines the credibility of the changes that the Guidelines seek to introduce.

With the above in mind, even if one were to assume, for the sake of argument, that the approach proposed by the Australian Federal Court of Appeal were based on sound economic thinking, it does not follow that such thinking should necessarily be reflected in competition enforcement policies. There is value in consistency, especially in an area such as predatory pricing where the cost of "getting it wrong" can be so high. New rules create new uncertainties, especially where new, unfamiliar measures replace old, understood measures and objective criteria are superseded by subjective ones. All of this has led one U.S. antitrust enforcement official to warn policy makers against "innovation" in this area, where, because "pricing decisions typically have to be made very quickly," "predictability is uniquely important" and "[c]ompanies should be encouraged to price aggressively and promptly."[77] Indeed, in *Hoffman-La Roche*, the trial judge observed that "[e]conomic theory cannot control the legal determination of reasonableness".[78] The Guidelines defy this observation and elevate theory to the status of law without regard to the difficulties of applying the theories that inspire them.

Such innovations are particularly dangerous in the case of a country like Canada, which, unlike Australia, must ensure that its economic policies take account of its proximity to the United States and the integration of its economy into a broader North American economy. Canadian competition authorities need to be mindful that competition law does not exist in a vacuum, but rather is an important aspect of economic policy that should contribute to the competitiveness of Canadian businesses rather than erecting competitive disadvantages for them.[79] Enforcement policies that are ambiguous or rely extensively on subjective rather than objective criteria, however, could have an opposite effect by creating a chilling effect on competition that is unique to Canada. Indeed, this aspect of the Guidelines, by departing from enforcement approaches in other jurisdictions, contradicts the Bureau's efforts at working with other national competition authorities to "enhance global convergence".[80]

Finally, it is ironic that the brief note on interpretation at the beginning of the Guidelines states that they "are not intended to restate the law." The enforcement approach set out in the Guidelines represents a substantial departure from both the PPEGs and the existing predatory pricing jurisprudence, in addition to the enforcement approach taken in other major jurisdictions. Furthermore, while the Guidelines reiterate the same concerns as the PPEGs with regard to enforcing the provisions in a cautious manner so that legitimate price competition is not inhibited, they do not adhere to this fundamental principle. Such aspects of the Guidelines as its ambiguous treatment of market power, an apparent departure from the maxim that competition law protects competition rather than competitors, increased reliance on subjective rather than objective criteria, a departure and rejection of commonly accepted cost measures in favour of new, less understood measures, contradict the Bureau's purported cautious approach to enforcement. They also cause the Guidelines to fail in what should be their principal objective, namely, to provide meaningful guidance to business to enable it to compete vigorously in the marketplace while, at the same time, avoiding conduct that runs afoul of the law.

Notes

[1] Lawson Hunter is a former Director of Investigation and Research and the head of the Competition Group of Stikeman Elliott. Jeffrey Brown is an Ottawa-based member of Stikeman Elliott's Competition Group.

As noted in this article, several aspects of the Competition Bureau's draft *Enforcement Guidelines for Illegal Trade Practices: Unreasonably Low Pricing Policies* suggest an attempt by the Bureau to formalize in the guidelines positions taken by the Commissioner of Competition in litigation before the Competition Tribunal involving predatory pricing allegations against Air Canada. See *The Commissioner of Competition* v. *Air Canada*, CT-2001/002. It should be noted that Stikeman Elliott is counsel to Air Canada in that litigation.

[2] Since sections 50(1)(b) and 50(1)(c) are in Part VI of the *Competition Act*, section 36 of the *Competition Act*, which creates a limited right of private action, is also relevant.

[3] The rarity of predatory pricing, in addition to being well documented in legal and economic literature, was recognized by the court in its sentencing of Hoffman-La Roche following its conviction in *Hoffman-La Roche, infra* note 18. See *R.* v. *Hoffman-La Roche Ltd.* (*No.2*) (1980), 119 D.L.R. (3d) 279 (Ont. H.C.J.) at 282:

> I do not feel that there is any evidence of an epidemic of predatory pricing practices in Canada today. Indeed, most Canadians would probably wonder why the defendant was prosecuted at all for what it did. The potential ill effects of predatory pricing is not a problem that concerns very many Canadians. Predatory pricing is not a business tactic that is widely used in this country to eliminate or reduce competition. In fact, there have been only very few prosecutions under s. 34(1) since its original enactment. I am told that this is the first time there has been a conviction in Canada for this offence. Thus, there seems little public need for a severe penalty in this case to serve as an example to others about to engage in similar criminal activity, because there do not seem to be many

> such others poised, ready to give away their products in an effort to thwart competition. On the contrary, too few business enterprises in Canada seem willing to lower their prices to compete vigorously for business in that way.

The court contrasted predatory pricing with a "far more serious problem" of businesses trying "to keep prices up to ensure maximum prices", "thereby stifling competition", noting in this regard the "narrow line between vigorous competition and predatory pricing." *Ibid.*

[4] PPEGs, at i. The PPEGs stated that the "concept of predatory pricing is best illustrated" by:

> ... a dominant firm in a market setting its prices so low, over a long enough period of time, that it may drive one or more of its competitors from the market, or deter other companies from entering the market, or both. Following the exit of competitors from the market, or upon successfully deterring new entry, the predator is expected to raise prices significantly in an attempt, in the now less-competitive market it had created, to recover the costs incurred (i.e., losses or forgone profits) during the period of predation.

Ibid., at 1. According to the Bureau, this situation was "precisely the type of conduct" that it seeks "to identify in response to situations brought forward for examination under the statute." *Ibid.* For a similar, jurisprudential, view of the "classic example" of the "evil of predatory pricing" see *Hoffman-La Roche No. 1, infra* note 18 at 33.

[5] See *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) ("*Brooke Group*"), which many regard as, along with *Matsushita Electric Industrial Co., Ltd.* v. *Zenith Radio Corp.*, 475 U.S. 574 (1986), the high-water mark of an era of considerable scepticism about the viability of, and hence the need for antitrust concern for, predatory pricing schemes. The PPEGs suggest that the U.S. Supreme Court's observation in *Brooke Group* also holds for Canada, where "pricing behaviour of the sort prohibited by the [*Competition Act*] has proven to be a rare rather than a common occurrence in Canada." PPEGs, at 1. See also *supra* note 3.

[6] PPEGs, at Preface.

[7] See PPEGs, at 1:

> In the years since the enactment of the statute, enforcement experience and developments in economics have produced an analytical framework which helps to identify pricing behaviour which is truly harmful to competition, as distinct from that which does not require corrective action. As a result, predatory pricing, which is subject to the competition laws of many nations, has become a better understood phenomenon internationally in more recent times, and its treatment from a competition policy viewpoint now benefits from a more cohesive, analytical approach.

[8] PPEGs, at ii and 10-11.

[9] PPEGs, at 10-11.

[10] PPEGs, at 11.

[11] *Ibid.*

[12] *Ibid.* at 12.

[13] *Ibid.*

[14] [1968] A.J. No. 11 (Alta. S.C.) aff'd (1969), 4 D.L.R. (3d) 133 (Alta S.C. App. Div.) ("*Carnation*").

[15] [1996] A.Q. no. 2660 (Que. S.C) ("*Perreault*").

[16] The following extracts from the trial judgement are particularly noteworthy in this regard:

> Combine legislation, as I see it, does not compel Carnation within legal limits from being aggressive. Such legislation is not designed to lessen competition, let alone to stifle it. Healthy competition is our life blood; it is our economic stream. There was no threat here by Carnation to take over Alpha or Pacific [its competitors] or put them out of business. There was, I think, a certain amount of what I chose to call during the course of the trial "disciplinary action", of short duration, but not of the nature of being designed to effect the lessening of competition.
>
> ...
>
> Down to the year 1959, Carnation held a very small fraction of the business in British Columbia, Pacific being dominant. The same held true in Alberta, in that while Carnation did have a larger volume of Alberta business than it did in British Columbia, it still in Alberta was greatly overshadowed by Alpha. ... Carnation, I am convinced, became genuinely concerned about its failure to be competitive in Alberta and in British Columbia. Carnation felt that its competitors were guilty of unethical and unfair business practices. ...
>
> ...
>
> It is to be remembered that Alpha were most aggressive competitors, and I don't blame them for that; I give them marks; but Carnation resorted to a temporary expedient to meet an aggressive competitor. I think Carnation's

efforts were not designed to lessen competition, but in a firm desire to demonstrate to Alpha and Pacific alike that competitively there must be fair play, even between rivals.

...

... I am satisfied that Carnation's actions were to meet the competition of Alpha; that no offence has been committed; that to construe section 412(1)(b) of the Criminal Code in a fashion to support a conviction, would be unwarranted; it would be oppressive; and it would defeat the very purpose of the said section of the Combines Investigation Act, which has now swallowed it up, and I am considering the said Act as a whole.

[17] (1966), 50 C.P.R. (2d) 265 (Ont. C.A.) ("*Producers Dairy*").

[18] (1981), 58 C.P.R. (2d) 1 (Ont. C.A.), affirming (1980), 109 D.L.R. (3d) 5 (Ont. H.C.J.) and (1980), 119 D.L.R. (3d) 279 (Ont. H.C.J.) (respectively, "*Hoffman-La Roche*", "*Hoffman-La Roche No. 1*" and "*Hoffman-La Roche No. 2*").

[19] (1981), 33 O.R. (2d) 228, 124 D.L.R. (3d) 274 (S.C.) ("*Consumers Glass*").

[20] (1998), 83 C.P.R. (3d) 51 (Ont. Gen. Div.) ("*Boehringer Ingelheim*").

[21] (1997), 73 C.P.R. (3d) 1 (Comp. Trib.) ("*Tele-Direct*").

[22] (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) ("*NutraSweet*").

[23] In particular, the court said:

While the predatory pricing provision, properly applied, undoubtedly furthers the goal of providing competitive prices in the long term, it nevertheless is the sole provision in the Act that prohibits price reductions. If it could be used, in certain circumstances, as the plaintiff argues, to prevent one competitor from meeting the prices offered by another, then it would be capable of being used to achieve an anti-competitive effect. It could be used to impede legitimate competition. I do not believe such a result is intended, or authorized, by the provision.

Boehringer Ingelheim, *supra* note 20 at 62.

[24] As the court put it:

While selling below cost would generally be unreasonable, in some circumstances, it would not. One of those circumstances is the need to meet a lawful, equally low price of a competitor. Competition, he noted, is a battle after all, and competitors must be allowed to engage in the battle, as long as long as they do so within reason.

Boehringer Ingelheim, *supra* note 20 at 61.

It is interesting to note that the court found support for the principle that a price cannot be predatory, even if it is below cost, where it is implemented to meet the lower prices of a competitor in U.S. jurisprudence (*ILC Peripherals* v. *IBM*, 458 F. Supp. 423 (N.D. Cal. 1978), affirmed per curiam sub nom. *Memorex Corp.* v. *IBM*, 636 F.2d 1188 (9th Cir. 1980), certiorari denied, 452 U.S. 972 (1981), Conti Dist. J.). Similarly, in *Hoffman-La Roche No. 1*, Linden J. quoted the U.S. Supreme Court in *U.S.* v. *National Dairy Products Corp.* (1963), 372 U.S. 29, where the court stated that below-cost pricing is not illegal if "certain business exigencies" justify it, including "the need to meet a lawful, equally low price of a competitor." See *Hoffman-La Roche No. 1*, *supra* note 18 at 40. For a more recent discussion of price matching, see *AMR*, *infra* note 52.

[25] *NutraSweet*, *supra* note 22 at 45.

[26] *Ibid.* at 44.

[27] *Ibid.* at 45.

[28] *Tele-Direct*, *supra* note 21 at 199-201.

[29] Guidelines, at 1.

[30] *Ibid.*

[31] *Supra* note 7.

[32] Guidelines, at 3.

[33] *Ibid.*

[34] PPEGs, at 5. See also PPEGs, at 11:

While a complainant may be able to provide valuable evidence at the outset about the alleged predator's pricing behaviour ..., it will seldom be completely evident to the Director what the exact relationship is between the alleged predator's prices and costs. For this reason the two stage approach to the investigation of the "unreasonably low" element of section 50(1)(c) is particularly helpful.

See also Terry Calvani, "Predatory Pricing and State Below-Cost Sales Statutes in the United States: An Analysis", which is available from the Competition Bureau's website at http: strategis.ic.gc.ca/competition. Mr. Calvani, a U.S. antitrust lawyer and former

Commissioner of the U.S. Federal Trade Commission, describes the rationale for using recoupment as an initial filter as follows: "If recoupment is implausible, then one need not undertake the laborious price/cost exercise." And see Bolton, *et al.*, *infra* note 58.

[35] Guidelines, at 3.

[36] *Ibid.* at 5.

[37] *Ibid.* at 6. See also PPEGs, at 2.

[38] PPEGs, at 2.

[39] Guidelines, at 6.

[40] As it merely restates the law as set out in the *Competition Act*, it also fails to illuminate the meaning of "business", but the statutory definition is sufficiently clear that illumination probably is not necessary.

[41] Guidelines, at 8.

[42] As noted previously, the court subsequently rejected the relevance of intent even to the unreasonableness of pricing in *Consumers Glass*.

[43] See *Hoffmann-La Roche No. 1*, *supra* note 18 at 35.

[44] The court's approach in this regard is clear if one considers the court's statement respecting the deliberate nature of a policy in its broader context.

> ... the accused must "engage in a policy of selling articles at unreasonably low prices". Expanding on the language here, the accused must engage in or be involved in a policy or deliberate and continuing programme of selling articles at unreasonably low prices. It is not enough for a violation of this section to sell a few articles accidentally at an unreasonably low price; the selling must be as a result of a conscious decision to do so.

Ibid. at 34 [emphasis added].

[45] PPEGs, at 12.

[46] Guidelines, at 11.

[47] *Ibid.*

[48] *Ibid.*

[49] *Ibid.* at 14. In terms of what this time period will be, the Bureau will begin with two years, then adjust for the nature of the industry.

[50] See Guidelines, at 11 and 14. Interestingly, the Guidelines' highlighting the importance of barriers to entry mirrors the approach set out in the PPEGs. The first sentence of section 2.2.1.2 of the PPEGs, which is entitled "Conditions of Entry", states that: "In the context of a predatory pricing complaint, it is necessary to determine whether or not the alleged predator appears to have the power to recoup its initial losses by raising prices to above-normal levels once its target/rival has been driven from the market."

[51] Guidelines, at 13.

[52] The U.S. Department of Justice argued "a new theory of liability" based on a "supposed 'reputation for predation'" in *U.S.* v. *AMR Corporation et al.*, D. Kan., 99-1180-JTM, 30 April 2001 ("*AMR*"). However, the court rejected "this proposed basis of liability on several grounds," including on the basis that it was "contrary to law." As the court put it:

> No court has adopted such a theory, which would represent a marked departure from existing law. The court can find no case authority, and none has been cited by the government, imposing Section 2 liability on the basis of a reputation for predation created in a separate market.
>
> The government's theory offers no principled basis for the court to distinguish between a general reputation for aggressive but lawful conduct on the one hand, and illegal predatory conduct. Such theories would inherently tend to degenerate, as the government's does, into self-serving complaints about reputation by the defendant's competitors. ...

[53] See, for example, *AMR*, *supra* note 52, and *Tele-Direct*, *supra* note 21.

[54] Guidelines, at 13 (italics in original).

[55] The Guidelines identify the following criteria for determining whether a firm has a "reputation for unreasonably low pricing":

(i) concentration of firms is higher in markets in which the firm operates than in *similar* markets in which it does not;

(ii) the firm's sales and profits in markets in which it operates are higher for a substantial period than are typically observed for firms operating in *similar* markets;

(iii) low prices charged by the firm in the past have resulted in exit and no new entry for an extended period after the low-pricing has been discontinued; and

(iv) higher prices failed to induce new firms to enter the market.

[56] While the Guidelines could create a chilling effect by reason of their more "enforcement friendly" tone and uncertainties generated by ambiguities contained in the Guidelines and their adoption of subjective criteria, the Guidelines could, at the same time, make successful enforcement of predatory pricing claims more difficult. Since section 50(1)(c) creates a criminal offence, each element of the offence must be proven beyond a reasonable doubt. The introduction of subjective elements will greatly complicate the Commissioner's ability to successfully litigate predatory pricing cases, especially since ambiguities are resolved in favour of the accused. At a minimum, it would require considerable resources on the part of the Commissioner to demonstrate the presence of these subjective criteria "beyond a reasonable doubt."

[57] Guidelines, at 14.

[58] See, for example, *Boehringer Ingelheim*, supra note 20 at 56 (quoting the illustration of the predatory pricing contained in the PPEGs, including its reference to recoupment); *NutraSweet, supra* note 22 at 44; *Matsushita Electric Industrial Co., Ltd.* v. *Zenith Radio Corp.*, 475 U.S. 574 (1986).

In fact, it is not even clear that the so-called developments in "economic thinking" on which the Bureau relies for its rejection of recoupment as a necessary condition adopt this position. See P. Bolton, J.F. Brodley and M.H. Riordan, "Predatory Pricing: Strategic Theory and Legal Policy" (Presented at the 9th Annual WZB Conference on Industrial Organization: Antitrust Issues in International Markets, 29 January 2000) at 31 (footnotes omitted):

> While the use of modern economics in proving predatory pricing is novel compared to recent practice in most lower courts, such an advance is implicit in the recoupment standard adopted by the [U.S.] Supreme Court. The recoupment requirement was designed to screen out cases where predation appeared unprofitable and hence irrational. The Court's skepticism about the rationality of predatory pricing was justified by the now dated economic authorities on which the Court relied. However, modern economics has developed new, more sophisticated theories of how recoupment may be achieved consistent with rational behaviour, and thus identifies economic conditions under which a predatory pricing strategy is plausible.
>
> Accordingly, our approach would permit the plaintiff to amplify its proof of predation by showing that under the specific facts of the case, one or more strategic theories are economically plausible and that surrounding economic conditions make recoupment likely in the light of such theory. We emphasize that we are not adding a new element of proof. Proof of predatory pricing under modern theory would augment and complement existing approaches. Plaintiff could still bring a case without advancing modern strategic theory. However, under our proposal a plaintiff could also base proof on well-founded strategic analysis whenever the facts warrant.

[59] See *Enforcement Guidelines on the Abuse of Dominance Provisions* (July 2001), at 23, where it is stated:

> ... Predatory pricing can be profitable to the dominant firm, and hence harmful to competition, if the dominant firm is able to maintain or enhance market power, giving it the ability to recoup the losses from the predatory campaign.
>
> ...
>
> ...
>
> In the case of predatory behaviour by a dominant firm or group of firms, establishing dominance is sufficient to satisfy that market power exists and therefore recoupment is possible.

[60] See *Australian Competition and Consumer Commission* v. *Boral Ltd.*, [2001] F.C.A. 30 (Aust. Fed. Ct.) ("*ACCC* v. *Boral*"). Even a casual reading of this case rapidly instils scepticism about its persuasive validity in Canada, as evidenced, perhaps, by the Bureau's selective reliance on it for only those principles which support its revised positions in the Guidelines. With respect to reasons to suspect its persuasive value in Canada, we believe the following are instructive:

- Beaumont J. (Merkel J. concurring) found market power based on "(i) Boral's significant share of the market [approximately 35 percent]; (ii) its standing as a large well-funded national operation; and (iii) its reputation for good service and loyalty to its customers" even though "it had, by its own assessment, two 'major competitors' ... and the structural barriers to entry to the CMP [concrete masonry products] market were low, [as] illustrated by the relative ease of entry of C & M [C & M Bricks Melb Pty Ltd.]." *Ibid.* at para. 4.
- Merkel J. acknowledged that the court's "conclusions, and the reasoning that sustains them, may not sit comfortably with the principles that have provided the underpinning for the European and United States case law on predatory pricing," but said that a departure from those principles was justified in the Australian context by 1986 amendments to the Australian legislation, which had been described in Parliament as lowering the legal threshold to "ensure that small businesses are given a measure of protection

from the predatory actions of powerful competitors" who include "major participants in an oligopolistic market and in some cases ... a leading firm in a less concentrated market." *Ibid.* at para. 234.

- The third judge, Finckelstein J., reviewed and rejected the application of conventional economic thinking in respect of predatory pricing in Australia on the following grounds:

  261 It is also necessary to bear in mind the reason why the United States courts have sought to give a precise meaning to the notion of predatory pricing. It was an attempt to provide a standard that could be applied rationally to all circumstances, a "bright line test" that would not depend upon the alleged predator's intent, which was regarded as an unsatisfactory criterion upon which to found liability.

  262 The terms of s 46 suggest that adoption of the test developed in the United States would frustrate the objects of the provision. It must also be remembered that in the United States antitrust legislation is concerned with constraining the behaviour of a monopolist. That is not the focus of s 46. Our section is aimed at regulating a firm with a substantial degree of market power, which would include, but not be limited to, a monopolist. While a monopolist may have the ability to extract a monopoly rent and thus recoup its losses, a firm with only a substantial degree of power may never be in that position. Thus, the test proposed by the trial judge will, for all practical purposes, make it impossible to establish a case of a predatory pricing scheme against a firm that is not a monopolist. Moreover, under s 46 there is no need to have recourse to a test such as "selling below cost plus recoupment" because intent is at the heart of the offence. In my view the trial judge was in error in adopting recoupment as an element of predatory pricing.

- Finckelstein J. further considered "whether below-cost pricing is an essential element of predatory pricing," concluding "[h]ere, again, the answer must be in the negative." *Ibid.* at para. 263. Instead, Finckelstein J. concluded that "the existence of predatory pricing should not be determined by reference to some precise formula or definition," but rather it "is no more than a price set at a level designed to eliminate a competitor or keep a potential competitor from the market." *Ibid.* at 266.

For a discussion of *ACCC* v. *Boral*, see Spier and Baxt, "Australian Newsletter" (2001-2002) 20:4 Can. Comp. Rec. 21.

[61] Guidelines, at 15.

[62] *The Concise Oxford Dictionary*, 9th (Oxford: Clarendon Press, 1995) defines "eliminate" as including "remove, get rid of" and "exclude from further participation in a competition etc. on defeat". See also *ACCC* v. *Boral*, *supra* note 60, where the court applied section 46 of the Australian *Trade Practices Act*, which, in turn, includes as separate elements "(a) eliminating or substantially damaging a competitor" and "(b) preventing the entry of a person into that market or any other market."

[63] In *Hoffman-La Roche*, *supra* note 18, the court held that an accused could be convicted on the basis of intent even if there is no actual anti-competitive effect. The facts in that case, however, are arguably exceptional given the scale of Hoffman-La Roche's giveaway program and evidence of some injury to competition, albeit injury falling short of complete elimination of Frank Horner as a competitor.

[64] Guidelines, at 15.

[65] *Ibid.*

[66] See, for example, *Consumers Glass*, *supra* note 19, *NutraSweet*, *supra* note 22 and *Brooke Groupe*, *supra* note 5.

[67] See *Regulations respecting anti-competitive acts of persons operating a domestic service*, SOR/2000-324 and *Abuse of Dominance Guidelines*, *supra* note 59 at 23.

[68] *Supra* note 20.

[69] Guidelines, at 17.

[70] See, for example, *AMR*, *supra* note 52:

  Finally, the United States argues that American "effectively undercut" its competitors because it not only reduced prices, it also offered a better product at a matching price. Clearly the alternative – requiring American to charge a premium for its allegedly superior quality – would require courts to engage in a series of subjective price comparisons based on intangible values. The government asserts that this is not a manageable rule of law, and that the court should refuse to consider any meeting competition defense. This is not the correct approach, and has been recognized and rejected in the leading treatise authority.

  An established firm may have established buyer loyalty, favored distribution channels, or other product differentiation advantages. If so, a new entrant may have to charge less to induce buyers to try its product. In this situation, for the established firm to meet that nominal price is really to undercut it. But how is a court to decide the requisite premium necessary to equate demand for two somewhat different products? Because the task cannot be performed

with anything approaching precision, courts applying the meeting competition defense of the Robinson-Patman Act have not limited it to meeting the price of identical goods. Nor should courts applying the Sherman Act.

[71] Guidelines, at 18.

[72] Guidelines, Preface.

[73] *Supra* note 1.

[74] *Supra* note 60.

[75] The novelty of its analysis was recognized by the court itself, with one of the judges expressly acknowledging the departure from U.S. and European law and stating that the court's reasoning was based on the unique characteristics of Australian law rather than rejection of the principles recognized in those other jurisdictions *Ibid.*

Interestingly, the U.S. approach, which resembles that set out in the PPEGs, was distinguished on the basis that it seeks to set out a "bright line test" Such bright line tests, however, are precisely what one would expect of a policy that seeks to ensure that enforcement does not inhibit legitimate price competition, which clearly cannot be said about the policy underlying the decision in *ACCC* v. *Boral.*

[76] See, for example, OECD, *Predatory Pricing* (Paris: OECD, 1989), which surveyed various approaches to predatory pricing and recognized that, while differences of opinion exist on the appropriate measure of costs for the purposes of predatory pricing analysis, "there is a clear tendency, even among the 'all factors' proponents, to include some sort of a cost-based test with which to judge pricing." *Ibid.* at 27. See also Bolton *et al.*, *supra* note 58 at 3-4, which defines predatory pricing as "a price that is profit maximizing only because of its exclusionary or anticompetitive effects" but goes on to state that an "operational legal rule" must be based on "tractable measures such as cost, market structure, and recoupment."

[77] T.B. Leary, Commissioner, Federal Trade Commission, "The Need for Objective and Predictable Standards in the Law of Predation," (Speech before the Steptoe & Johnson and Analysis Group/Economics 2001 Antitrust Conference, Washington, D.C. 10 May 2001) (available at http://www.ftc.gov/speeches/leary/learyneedforobjecandpredic.htm).

[78] *Hoffman-La Roche No. 1, supra* note 18 at 38.

[79] See R.D. Anderson & S.D. Khosla, *Competition Policy as a Dimension of Economic Policy: A Comparative Perspective* (Ottawa: Industry Canada, 1995) at 3.

[80] See W.J. Kolasky, Deputy Attorney General, Antitrust Division, U.S. Department of Justice, "International Convergence Efforts: A U.S. Perspective," (Address before the International Dimensions of Competition Law Conference, Toronto, Ontario, 22 March 2002) (available at http://www.usdoj.gov/atr/public/speeches/10885.htm).

GEOGRAPHIC MARKET DEFINITION IN *CANADIAN WASTE SERVICES*

By: Margaret Sanderson and Ralph A. Winter[1]

Introduction

The Commissioner of Competition v. *Canadian Waste Services Holdings Inc. ("Canadian Waste Services")*[2] case involved the acquisition by Canadian Waste Services Inc. ("CWS") of a waste disposal site, the Ridge Landfill, from Browning-Ferris Industries ("BFI").[3] The Competition Tribunal concluded that this acquisition would substantially prevent and lessen competition in the disposal of industrial, commercial and institutional ("ICI") waste from the Greater Toronto Area ("GTA").[4] The Tribunal granted the Commissioner of Competition's application for a divestiture order. As in many merger cases, this decision hinged on market definition, in this case on the exclusion of U.S. suppliers from the geographic market. Among suppliers included by the Tribunal as participants in the market, CWS would have had a post-merger share of 70% of the market for the disposal of ICI waste from the GTA, a share well into the range that indicates a *prima facie* substantial lessening of competition.

This article offers an economic assessment of the *Canadian Waste Services* decision. The decision is a natural candidate for such an exercise because it turned entirely on economics. As Anne Carty and Peter Glossop state in a previous article in the *Record*, the case illustrates the fact that merger cases will increasingly turn largely on economic evidence as the basic legal principles of merger analysis are now well entrenched.[5] In addition, the U.S. firms excluded by the Tribunal from the geographic market definition had collectively a market share of about 20% at the time of the hearing. The exclusion of current suppliers in geographic market definition is extraordinary and in itself demands an examination. Conventional analysis generally leads to a more expansive set of market participants than the set of current suppliers, as in *Hillsdown*[6], because it includes as participants firms that would provide competitive discipline in the event of an increase in price by the merged firm (or, more precisely, a hypothetical monopolist in the defined market) but that do not find it profitable to supply at current prices.[7] Finally, the concept of geographic market definition is intertwined in the decision in a complex way with two other economic concepts: pre-merger market power (the Tribunal was clearly influenced by the evidence on pre-merger market power in its geographic market definition); and price discrimination (part of the accepted evidence for the pre-merger market power was alleged price discrimination in the market). We unravel the logic of the *Canadian Waste Services* decision in this article and assess the economic assumptions and propositions relied upon by the Tribunal in the decision.

Facts and Decision

The facts and reasons of *Canadian Waste Services* have been reviewed very clearly by Carty and Glossop, and we begin with only a brief summary. The waste disposal industry in Southern Ontario involves payment for the transportation of waste to the disposal site as well as the "tipping fee" or fee for waste disposal at the site. All communities in the region demand waste disposal, obviously, but some communities have vertically integrated into ownership of municipal waste disposal sites. Larger cities tend not to adopt this alternative and instead

participate in markets for waste disposal, procuring the services of a number of sites, both very nearby and more distant, including sites located in Michigan. Disposal and transportation services may be purchased separately or from integrated suppliers. A relevant product market accepted by the Tribunal in the case was the disposal of ICI waste from the GTA. Residential waste, the other component of waste disposed of at the sites, was excluded from the relevant product market because the major buyer in the market, the City of Toronto, had a commitment for disposal of some of its residential waste in Michigan waste sites and an option for disposal of the rest. Michigan sites supplied, as we have mentioned, approximately 20% of the market. Critically, however, the market shares forecast by the Commissioner and accepted by the Tribunal differed substantially from these figures, as we shall discuss.

We focus in this article on the pivotal component of the Tribunal's reasoning in the case, that the U.S. waste sites were not participants in the relevant market, namely the disposal of ICI waste from the GTA. That is, the U.S. firms would not represent effective competitive discipline against the exercise of market power in the post-merger market, or by a hypothetical single supplier of the disposal of the GTA's ICI waste. This conclusion rests on three more basic conclusions, outlined below, namely: pre-merger market power, excess capacity in the future, and the indeterminacy of evidence on current shipping patterns.

Pre-merger Market Power

The Tribunal's first reason for excluding the U.S. firms as effective competitors is that market power was exercised in the pre-merger market at the time of the hearing:

> The Tribunal does not regard the American sites as effective competitors <u>now</u>. The non-directed ICI waste that they currently receive from the GTA is largely due to the non-competitive Tipping Fees in Ontario. [211][8] [emphasis added]

In other words, if firms participate in a market only because the prices in the market are supported by noncompetitive conduct on the part of other suppliers, including the merging parties, then these firms should not be regarded as effective competitors.

The conclusion of pre-merger market power rests in turn on an even more fundamental conclusion: that tipping fees are non-competitive because these fees exhibit price discrimination. The Tribunal regards as evidence of price discrimination two kinds of pricing patterns. The first kind of pricing pattern is the charging of higher tipping fees for GTA waste by nearby waste sites than by distant sites. In this regard, the Tribunal cites the statistical evidence by the Commissioner's expert, Professor Baye, which indicates that tipping fees are higher for locations nearby Toronto and then states: "[s]uch targeted pricing by distance is indicative of price discrimination" [81]. The Tribunal cites with approval Professor Baye's testimony that higher tipping fees for nearby sites are a manifestation of market power. The following is the Tribunal's interpretation of Professor Baye's evidence:

> Recognizing that a Transfer Station will incur additional transportation costs to switch to a more distant disposal site, [Professor Baye] views such costs as the costs of switching to a competing disposal site. He further argues that the disposal site has the ability to increase the Tipping Fee

> to that Transfer Station as long as the fee increase is less than the additional transportation cost to the competitor. Hence that disposal site has at least some market power with respect to a particular Transfer Station. [76]

The second kind of pricing behaviour cited as evidence of price discrimination is delivered pricing, the practice whereby the prices that are charged by a single seller vary across the sellers' customers, depending upon the customers' locations:

> Such price discrimination would not be possible if disposal sites accepted non-direct ICI Waste on a free-on-board basis at the disposal site gate. ... [T]he existing practice of delivered pricing indicates that price discrimination is possible in a post-merger environment. This finding supports the delineation of a market that is narrower that the area over which uniform combined transportation and disposal prices prevail. [82][9]

The last sentence of this quotation suggests that the Tribunal may also have drawn a direct link between price discrimination and the exclusion of U.S. firms from the market, by-passing the intermediate conclusion of market power.

Forecast of Demand for Disposal of ICI Waste from the GTA and Supply within Southern Ontario

The demand and supply forecasts for ICI waste disposal capacity in Southern Ontario are pivotal in the decision. The Tribunal narrows the geographic market definition because it accepts the Commissioner's forecast that in the absence of the merger there would be excess capacity in waste disposal available for the GTA's ICI waste disposal within Southern Ontario starting in 2002. Prices were forecast to fall absent the merger because of the excess capacity expected to arise. Given the expected excess capacity, U.S. waste sites – as the most distant firms in the market and therefore the firms with the highest costs – would not be expected to be able to compete.

In accepting the Commissioner's evidence on the matter, the Tribunal concluded that the total "Disposal Capacity at Sites in Southern Ontario Capable of Accepting ICI Waste from the GTA" [emphasis added] would decrease by 10% between 1999 and 2002.[10] Yet the Tribunal also reached the conclusion that the amount of this capacity available for disposal of ICI waste (i.e. not being used for disposal of residential waste) from the GTA would increase by 47%. How did the Tribunal reconcile these two figures? We will not go into the detail of the calculations here, but essentially the Tribunal assigned the entire demand for disposal of residential waste from the GTA to the U.S. sites. This left abundant capacity for ICI waste in Ontario. A small amount of residential waste was committed to the U.S. through a long-term contract – but the Tribunal allocated the entire amount of residential waste to the U.S. because the buyer in the contract (the City of Toronto) had the option of sending residential waste to the U.S. in amounts beyond that contractually committed. The Tribunal found that it was not clear that the volumes of residential waste would be diverted back to Southern Ontario landfills with the increase in capacity starting in 2002.

From the Tribunal's forecast that the capacity available in Southern Ontario for disposal of ICI waste from the GTA would increase by 47% between 1999 and 2002, they deduced that the U.S. waste disposal sites would no

longer be competitive in the market for disposal of this waste. The capacity at the lower-cost, Southern Ontario sites would be more than enough to supply the relevant market.[11]

The Indeterminacy of Evidence on Current Shipping Patterns

Finally, the Tribunal decided that the observed patterns of shipping within the waste disposal industry did not support the conclusion of a broad geographic market. The Tribunal cited the *Merger Enforcement Guidelines* ("MEGs") to this end; more precisely, it extended the quotation by the respondents of Section 3.3.2.8 of the MEGs. (The italicized part of the following quotation is the original quotation from the MEGs by the Respondents; the Tribunal extended the quotation from the MEGs by adding the non-italicized sentences.)

> *Significant shipments of the relevant product from a second area* [Michigan] *into the area* [Ontario] *in relation to which a significant and nontransitory price increase is being postulated generally suggest that the second area is in the relevant market.* However, past trading patterns can be a poor indicator of the extent to which supply sources in the second area are likely to be able to constrain the ability of sellers in the first area to profitably increase prices. Information demonstrating significant shipments from the first area into the second, in and of itself, provides little information regarding the extent to which sellers in the first area are likely to be prevented from being able to profitably increase prices. ... [71] [inserts by author]

In short, the observed shipping patterns of waste are, in the Tribunal's view, inconclusive in their implications for whether the geographic market definition should be narrow (including suppliers in Southern Ontario only) or broad (including U.S. suppliers). While this third conclusion is a "negative result" in that it does not provide a basis for a deduction one way or the other, the conclusion represents an attempt by the Tribunal to reconcile its narrow geographic market definition with the fact that waste is being shipped to the U.S.

As the discussion in this section suggests, the logic of the Tribunal's decision is quite complex. It is useful, prior to assessing the decision, to represent the logic diagrammatically. We do this in Figure 1. We can summarize the logic of the decision with the aid of this figure. The Tribunal characterizes the evidence on the negative relationship between tipping fees and distance to the GTA (1a) as evidence of price discrimination. They also characterize delivered pricing (1b) as evidence of price discrimination. Then from the conclusion of price discrimination the Tribunal deduces that there is pre-merger market power (and therefore that there would be post-merger market power). From the conclusion of pre-merger market power and perhaps from price discrimination directly, the Tribunal draws support for the conclusion of a narrow geographic market: that only Southern Ontario sites should be included in the market. The narrow market definition is supported even more strongly by the forecast that the U.S. firms will be displaced from the market by the emergence of excess capacity among the lower cost, Ontario sites (2). Finally, observed shipping patterns do not, in the Tribunal's view, conflict with the conclusion of a narrow market definition (3).

Assessment of the Decision

In assessing the *Canadian Waste Services* decision, it is essential to be precise at the outset about the definition of the product being sold. Rather than defining the product in general terms as "waste disposal services", think

of the product as empty truck space available in the GTA for the disposal of waste. The production technology in this market is simple: firms produce empty truck space by dumping out a full garbage truck at a waste site and then delivering the empty truck space to the GTA. The product is identical across suppliers – it is hard to imagine a more homogenous product than empty truck space – and this product must all be sold at the same price in transactions in the GTA, as in reality it is.

In this approach, tipping and transportation are viewed simply as two intermediate inputs into the production of empty truck space, the final product. The buyer ultimately cares only about the number of cubic meters of empty truck space provided by a seller, not about the combination of tipping fees and transportation costs that go into production of the empty truck space. From the buyer's point of view, the division of the final price of empty truck space into a tipping fee and a transportation cost is an accounting fiction.[12] Examining separately the tipping fees and transportation costs charged by a particular firm can only lead to confusion in the analysis; the market will clear on the basis of the sum of the two component prices. If a particular firm wants to compete in the market for empty truck space in the GTA, the firm must meet the given market price, and cover both its costs of tipping and its transportation costs at the current price.

Different firms have different costs of producing and delivering empty truck space to the GTA, but location of waste sites has no implication whatsoever for market power. Sites located close to the GTA have no special power to affect the price of empty truck space in the GTA. These firms simply face a lower cost of supplying empty truck space in the GTA, just as a farmer with a particularly high-quality plot of land has a low cost of supplying an agricultural commodity such as wheat. Low production costs do not confer market power in the supply of empty truck space in the GTA.

In a competitive market for empty truck space provided in a specific location, the total prices charged by all firms must be identical; otherwise no buyer would entertain offers from the more expensive seller. If, as a matter of accounting, the total price is to be divided up into a tipping fee and a transportation cost, then it follows that tipping fees must be higher for sites located closer to the GTA.

This is an important implication of a competitive market for empty truck space, because the Commissioner and the Tribunal rely heavily on the high tipping fees charged by nearby sites to claim that market power – a deviation from competitive conduct – is being exercised. In fact, a negative relationship between tipping fees and proximity to the GTA, whereby a close site charges higher tipping fees, is not only consistent with a competitive market structure, it is a necessary implication of a competitive structure. If the organization of the market requires that separate prices be paid for transportation and for tipping – again, a disaggregation of the total price for empty truck space that, from a buyer's point of view, is an accounting fiction – then firms with disposal sites located close to the GTA will meet the single market price for empty truck space by charging a low transportation fee and a high tipping fee. Higher tipping fees for nearby waste sites are not a consequence of market power or price setting in the market but of competitive or price taking behaviour by firms in the market.

To strengthen the intuition underlying this proposition, consider what would happen if nearby firms charged the same tipping fees as more distant firms, following the Tribunal's apparent conception of a competitive, non-

discriminatory market. With transportation prices much lower for nearby firms (the willingness of independent truckers to provide shipping services means that transportation prices must reflect costs), the total price of empty truck space, being the sum of tipping fees and transportation costs, must be lower for disposal provided by nearby sites. What happens in a competitive market for a homogenous commodity where the prices of some firms are lower? There is excess demand at the low-priced firms. The prices will rise (via the higher tipping fee component) until the market is in equilibrium. In short, tipping fees must vary across firms in a competitive market without price discrimination. Referring to the highest arrow in Figure 1 (at 1a), the inference of market power from the negative relationship between proximity and tipping fees is incorrect.

Next, we move to the second arrow in Figure 1: the conclusion by the Tribunal that the variation of tipping fees with the distance to the GTA is evidence of price discrimination. Recall that in discussing Professor Baye's evidence of this variation, the Tribunal said at paragraph 81 that "such targeted pricing by distance is indicative of price discrimination." But even if we accepted for the moment the Tribunal's focus on tipping fees as prices (instead of a focus on the sum of tipping fees plus transportation costs, which is the appropriate concept of price in the market), the conclusion of price discrimination would be incorrect. The variation in tipping fees would represent different sellers charging different prices to the same buyers. Price discrimination refers not to this type of pattern but to the opposite: one seller charging different prices to different buyers. Given our previous conclusion that the tipping fee/proximity relationship does not indicate market power in any case, however, this apparent confusion about the meaning of price discrimination amounts simply to a semantic error.

Continuing down the left hand side of the Figure, the logical link between delivered pricing and price discrimination of some sort (1b) is unassailable. Delivered pricing is price discrimination. In this case, however, it is not price discrimination in the relevant product market. We must distinguish between the relevant product market and the waste disposal industry in Southern Ontario. The waste disposal industry consists not only of the single market for empty truck space in the GTA – the relevant market – but also of the market for empty truck space available in Hamilton, Kingston, Guelph, and so on. The markets comprising the industry are interrelated in that the same suppliers will be providing the product in a number of different markets, i.e. delivering empty truck space to a number of different towns and cities. Not all of these markets will have the competitive structure that prevails for empty truck space in a large city such as the GTA. A waste site is often the sole supplier of empty truck space to some small towns (those towns that have not integrated completely into the provision of their own waste disposal services via a municipal waste dump) and one of many suppliers of empty truck space in a larger city. The market power of the waste dump in a nearby, small town will be constrained by the options available to the small town elsewhere in the industry or via vertical integration, but we should normally expect some markup of price over marginal cost in the sale of empty truck space to the small town. The waste site will therefore charge different prices to different buyers of its empty truck space, and the difference in prices will not reflect simply a difference in costs. This can be labeled price discrimination, but it is industry-wide price discrimination, i.e. price discrimination across a set of markets, not price discrimination within a single market. The distinction is important because it is only price discrimination within a single market that can be construed as evidence of market power in that market. The Tribunal's logical link in Figure 1 (1b) between price discrimination by Ontario firms and the exercise of market power in the relevant market is

therefore invalid. To summarize our assessment of the top part of Figure 1, there is no basis in observed pricing patterns in the industry for an inference of the exercise of market power. Even prior to assessing the link between the exercise of market power in the pre-merger market and the size of the geographic market, we can conclude that no justification can be found in the pricing patterns for a narrow geographic market definition.

We turn next to the Tribunal's forecast of demand and supply in the Southern Ontario waste disposal industry as a basis for a narrow market definition. As we discussed above, the Tribunal forecasts a decline of 10% in capacity at sites in Southern Ontario capable of accepting ICI waste from the GTA, yet forecasts that the amount of this capacity available for ICI waste would increase by 47%. The forecast increase in capacity available for ICI waste was due entirely to the assumption that the City of Toronto would choose to import empty truck space from Michigan for its entire residential waste, leaving Ontario capacity free to serve the ICI waste in the GTA.

This reasoning overlooks the fact that disposal of ICI waste and disposal of residential waste are perfect substitutes in supply. A cubic meter of landfill capacity is an intermediate input into the production of a cubic meter of empty truck space available for ICI waste or for residential waste. There is no difference in technology for disposal of the two kinds of waste. The assumption that the sites in Michigan will win the market competition for disposal of the entire amount of residential waste, but cannot compete in the market for disposal of ICI waste, a perfect substitute in supply, is absurd on its face. Empty truck space is empty truck space, and any forecasts of demand and supply for its use must aggregate the disposal of the two kinds of waste, notwithstanding the exclusion of residential waste disposal from the relevant market in this case because of the contractual alternatives available to the major buyer in that market.

In the long-term contract between the City of Toronto and Michigan disposal sites, some of the residential waste disposal (100 thousand tonnes) is a commitment rather than an amount over which suppliers will be competing in future spot markets. The analysis above regarding aggregation of residential and ICI waste for forecasting purposes applies only to the discretionary component of the contract. However, even the committed part of the contract has some meaning for geographic market determination. At best, the Commissioner could claim that there was some uncertainty in forecasts about whether U.S. firms would be competitive in the future market for disposal of GTA ICI waste. In reality, the entire forecasting exercise is speculative. When there is uncertainty about forecasts, we should turn whenever we can to evidence of market expectations. (Market participants know more about the market than outside forecasters and also commit financial resources based on their forecasts, which competition authorities do not do.) The willingness of buyers in the market to commit some waste to U.S. firms via a long term contract signals a belief by buyers that Michigan firms will be cost effective in the long term. Thus, even the committed part of the City of Toronto contract supports the inclusion of U.S. firms in the relevant market.

The last item on the left hand side of Figure 1 (3) is the consistency of observed shipping patterns across the U.S. – Canada border with the narrow geographic market definition. This conclusion follows the section quoted by the Tribunal from the MEGs and repeated above. But consider the last sentence of this quotation:

> Information demonstrating significant shipments from the first area [Ontario] into the second [Michigan], in and of itself, provides little information regarding the extent to which sellers in the first area are likely to be prevented from being able to profitably increase prices.

In interpreting this section of the MEGs, the Tribunal evidently had in mind that the significant shipments of waste from Ontario into Michigan provided little information about whether sellers in Ontario were likely to be disciplined from being able profitably to increase prices. It is true that shipment of a product from a "first area" into a "second area" conveys little information about whether the first area is a well-defined geographic market. But the Tribunal's reasoning here overlooks the fact that the relevant product is not waste. The product is empty truck space, or the disposal of waste. The shipment of waste from Ontario into Michigan is the importation of the relevant product into Ontario, and is indeed very informative about whether sellers in Ontario are likely to be prevented from being able profitably to increase prices. Our adoption of a precise definition of the relevant product clarifies the issue by placing the focus on the shipment of empty truck space north, not garbage south.

We have disagreed with the Tribunal's interpretation of all three classes of evidence forming the basis for their exclusion of U.S. suppliers from the market. The Tribunal wrongly interprets a negative relationship between distance and tipping fees as a manifestation of market power; the forecasts of supply and demand for waste disposal in Southern Ontario mistakenly disaggregate residential and ICI waste; and the interpretation of shipping patterns confuses the direction of waste shipment with the direction of shipment of empty truck space. In our overall assessment of the logic of the Tribunal's reasoning in *Canadian Waste Services*, as summarized in Figure 1, there remains one important logical link to discuss: the link between pre-merger market power and a narrow geographic market definition. It is important to understand whether evidence of market power should lead to a narrower geographic (or relevant product) market in general, notwithstanding our interpretation that the evidence of market power is misconstrued by the Tribunal in this case. As we have discussed, with respect to this logical link, the main view expressed in the decision is that where some high-cost firms (Michigan landfills) are able to compete in the market only because of the exercise of market power by low-cost, dominant firms, then the high-cost firms are "not effective competitors" [211]. In other words, pre-merger market power supports a narrow geographic market definition, in this view.

In competition law cases outside the merger context, explicit recognition of market power is essential in arriving at the correct market definition. A condition for an abuse of dominance case under section 79 of the *Competition Act*, for example, is that the firm has "control...[of] a class or species of business"[13]; in practice this means a large share of a well-defined competition market. An analyst who applied the hypothetical monopolist test to current prices, in order to define the relevant market in an abuse case, would determine whether a hypothetical single supplier of the firm's product could profit from a small but significant, non-transitory price increase starting from the current price. If it could not, then the analyst's defined market would be expanded beyond the single product sold by the firm. But a firm always raises price to the point where there are substitutes for its product; otherwise a further price increase would still be profitable. Thus, applying the hypothetical monopolist test to current prices when there is in fact a monopolist could lead to an expansion of the market beyond the product sold by the firm – possibly with the false implication that the firm has a small share of the market and therefore no "control...[of] a class or species of business." This mistaken conclusion would follow from this

exercise simply because the firm has exploited its monopoly position to the optimum degree. This is known as the cellophane fallacy, after the decision in *Dupont.*[14] To avoid the cellophane fallacy, market definition outside the merger context should be applied starting from a competitive price (which has to be determined), not from the current price set by the allegedly dominant firm.

Market definition in the context of mergers is different. Intervention by the Tribunal under Section 92 of the Act requires that a merger would lead to a substantial lessening or prevention of competition. "Lessening", to focus on one of the two conditions, clearly means a reduction in competition relative to the pre-merger market price. In the case of two firms that already exploit the maximum market power that could be achieved by them jointly in the pre-merger market (through successful cartelization, or a joint sales agreement, for example), the merger does not lead to a lessening of competition and there is no basis for an application by the Commissioner under Section 92. An application of the hypothetical monopolist test for market definition that took as a benchmark the competitive price level, however, could result in a narrow market definition with the attribution to the merger of a very high increase in concentration, e.g. from two shares of 35% for the merging firms to a share of 70% for the merged firm. An analyst who adopted this methodology, perhaps being wary of the cellophane fallacy, would likely conclude from the increase in calculated concentration that the merger would lead to a substantial lessening of competition. The analyst would be guilty of the "cellophane fallacy fallacy"[15] in that the approach takes no account of the level of competition in the pre-merger market as required by the law. The entire deviation from competition in the post-merger market is mistakenly attributed to the merger. One approach to avoiding the cellophane fallacy fallacy would be to apply the hypothetical monopolist definition from the benchmark of the pre-merger price, rather than the (hypothetical) competitive price.[16] Only a merger that led to a substantial increase in concentration in a market so-defined would lead to a substantial lessening of competition (holding constant all other factors, such as barriers to entry, that also determine the competitive impact of a merger).

At paragraph 73 of the decision, the Tribunal recognizes the cellophane fallacy fallacy, i.e. that the hypothetical monopolist approach to market definition in merger analysis does not take as a benchmark the competitive price:

> The Commissioner states that existing shipment patterns reflect the fact that Michigan and New York landfills have become acceptable substitutes only because of the non-competitive prices in Southern Ontario and that no such shipments would occur if competitive Tipping Fees prevailed. In the Tribunal's view, such an approach to market definition is inconsistent with the hypothetical monopolist approach in which an area is progressively expanded as long as a small but significant and non-transitory price increase would not be imposed over that area even by a monopolist.

The Tribunal is correct in its position at this paragraph that the benchmark price for application of the hypothetical monopolist approach to market definition in a merger case (i.e. in asking whether the hypothetical monopolist could raise price by 5%) is not the competitive price but rather the pre-merger price.

As we have discussed, however, the dominant view in the *Canadian Waste Services* decision is the opposite: that alleged evidence of pre-merger market power (specifically, the alleged evidence of price discrimination as

well as the Tribunal's statement that it "does not regard the American sites as effective competitors now" because the waste disposal they provide "is largely due to the non-competitive tipping fees in Ontario" [211]) justifies a narrowly defined market. It is this view that prevails, in that the Tribunal decides on a narrow geographic market definition on the basis of what it considers to be evidence of price discrimination and hence pre-merger market power. In our view, the Tribunal committed the "cellophane fallacy fallacy" in reaching this conclusion.

Conclusion

The Tribunal's implicit recognition in at least part of the *Canadian Waste Services* decision (paragraph 73) that the cellophane fallacy does not apply to merger cases is a valuable component of the decision, notwithstanding the fact that this view did not prevail in the Tribunal's final analysis. While the hypothetical monopolist test for market definition takes competitive prices as the benchmark outside the merger context, in merger analysis the benchmark must be the pre-merger prices even if these prices reflect the exercise of market power.

We take issue with other dimensions of the decision, however. We disagree with the Tribunal's conclusion that the evidence reveals pre-merger market power or price discrimination; with the conclusion (contrary to paragraph 73) that pre-merger market power, even if it were established by the evidence, would justify the exclusion of U.S. firms from the market; with the exclusion of U.S. suppliers on the basis of demand and supply forecasts in Southern Ontario; and with the Tribunal's statement that the observed shipping patterns are not informative as to geographic market determination.

Where does this leave us, in terms of our own assessment of the competitive impact of the CWS acquisition of the Ridge Landfill on the market for disposal of GTA ICI waste? As we have discussed, this market can be characterized as the market for a homogenous commodity in which suppliers vary in their costs of supplying the product. The supply side of such a market can be represented by a supply curve, as in Figure 2. This supply curve can be described in the usual way as the quantity (on the horizontal axis) that the firms are willing to supply at each price (on the vertical axis). The supply curve can also be described as a ranking of the suppliers along the horizontal axis from lowest-cost to highest-cost, with the supply price at each quantity describing the cost of providing the product on the part of the "marginal firm" at that quantity.

In equilibrium, where supply and demand are equated, all firms except the marginal firm earn revenue greater than the minimal amount that would induce them to remain in the market. This extra revenue above the "supply price" of each firm, however, constitutes not profit but rather a return to scarce, market-specific assets. In this case, the market-specific assets are locations close to the GTA; in the market for wheat, to take another example, the asset would be land that is particularly suitable for growing wheat rather than being used in the next best alternative.[17]

The critical economic principle underlying merger analysis in such a market is that the impact on price of a merger is determined by the impact on the supply price of the marginal firm. Suppose two of the lowest cost firms in the market merge, and attempt to exercise power by reducing output quantity. Paradoxically perhaps,

it is the pattern of costs for the marginal firms, not the costs of the merging firms, that determines the competitive impact of the merger. Specifically, the sensitivity of marginal supply price to a marginal reduction in output in the market (or its inverse, the elasticity of supply at the equilibrium price) determines the increase in market power resulting from the merger. This is because the market price is equal to the cost of the marginal firms in the market.

In *Canadian Waste Services*, the upshot is simple. The marginal firms in the relevant market at the time of the hearing were the Michigan landfills. If a proper forecast of the supply and demand in the Ontario market would predict that the Michigan landfills would retain a not-insignificant share of the market in the future, even if (as according to the Commissioner) landfill capacity increased in Southern Ontario, then these suppliers would remain the marginal firms determining the market price. Because the elasticity of supply of these marginal firms in the GTA was so high (GTA demand was a small share of the total capacity available in the Michigan landfills), the impact of any attempt to exercise market power among low-cost Southern Ontario landfills against buyers in the GTA would not be successful. Before and after the merger, the price would be set by the cost of Michigan landfills supplying the GTA with empty truck space.

While we haven't access in public documents to the full set of data entering the demand and supply forecasts at the centre of the case, two features of the Tribunal's interpretation of the evidence on forecasts are revealing. First, the Tribunal forecast a reduction of 10% in the total capacity of landfills capable of supplying ICI waste disposal to the GTA. Second, the Tribunal accepted a forecast that the Michigan landfills would be competitive with Southern Ontario landfills in the supply of (empty truck space for) the disposal of residential waste, which is a perfect substitute in supply for the disposal of ICI waste. Both of these features are consistent only with a continued presence of the Michigan landfills in the relevant market. Thus, the available evidence suggests strongly that the acquisition by CWS of the Ridge Landfill would not have led to a substantial lessening of competition.

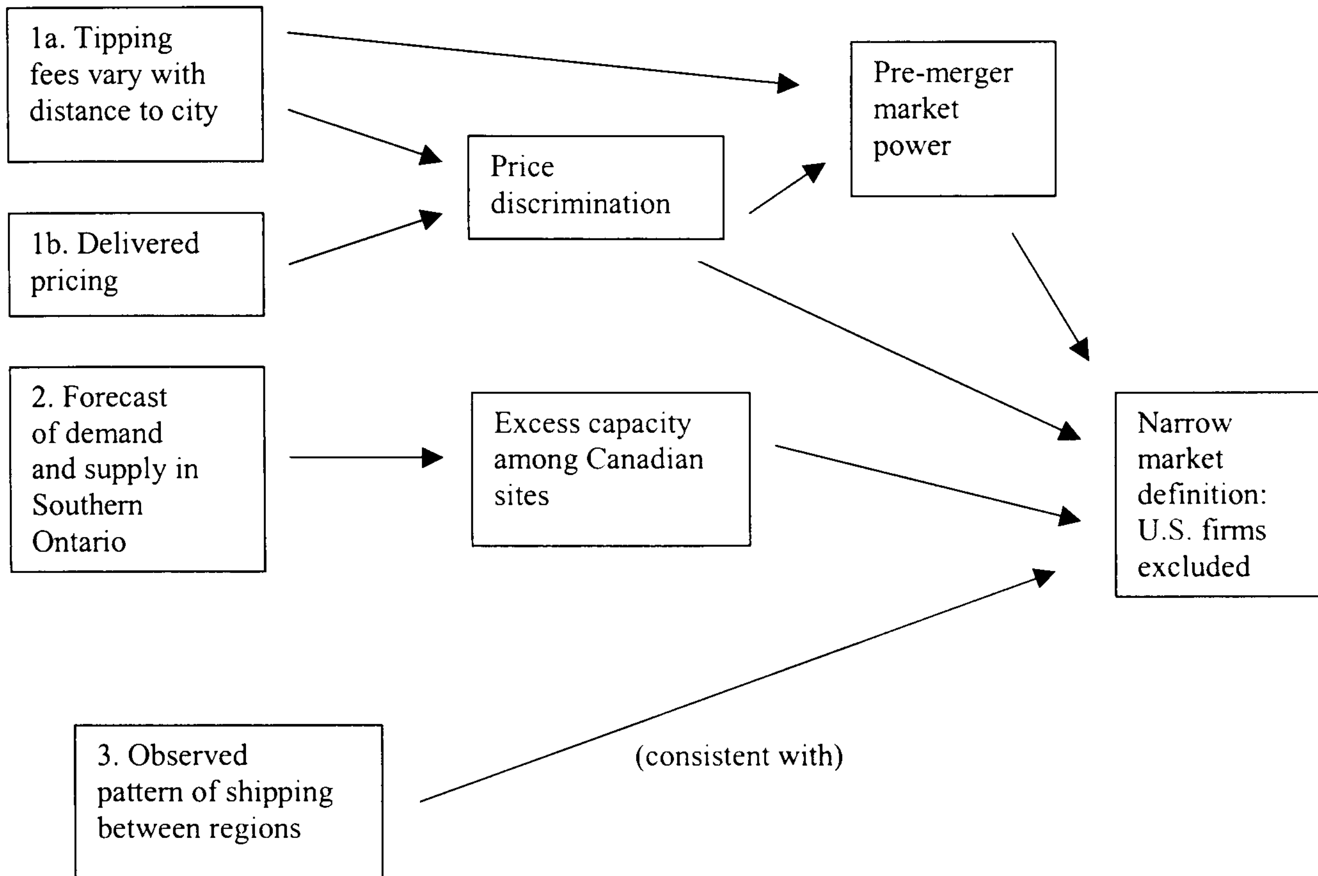

Figure 1: Outline of the Logic in *Canadian Waste Services* Decision

Each arrow represents an inference drawn by the Tribunal in the decision.

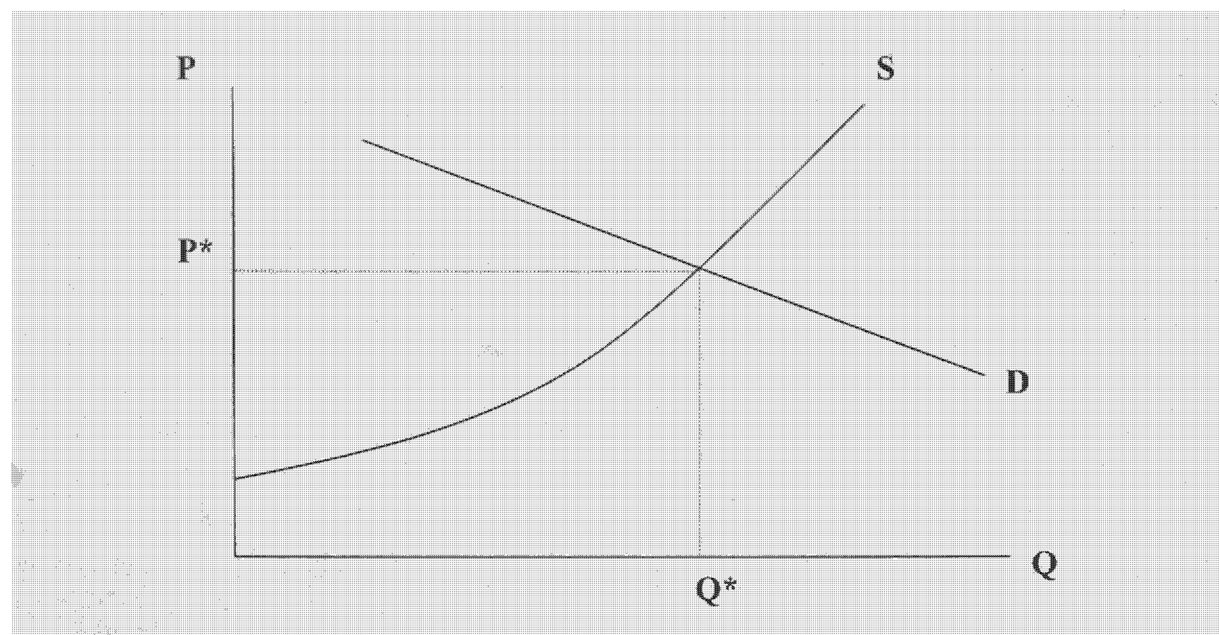

Figure 2: Demand and Supply in the Market for Empty Truck Space

Notes

[1] Margaret Sanderson is a Vice President with Charles River Associates. Ralph Winter is Professor of Strategy, Business Economics and Finance at the University of British Columbia and a Senior Consultant with Charles River Associates. Ms. Sanderson and Professor Winter provided some assistance to CWS in the initial stages of the case. This article relies solely on the public record and was not commissioned by CWS. We are grateful for helpful comments from participants in the Canadian Bar Association Economics & Law Committee Lunch seminar. A fuller development of the conceptual issues in this note is offered in an article, "Profits versus Rents in Antitrust Analysis", forthcoming *Antitrust Law Journal.*

[2] 2001 Comp. Trib. 3. Subsequent to the decision on the merits, the Tribunal issued its remedy decision on October 11, 2001. Economic evidence was also extensively employed throughout the remedy hearing. On November 2, 2001, CWS filed a Notice of Appeal to the Federal Court of Appeal, appealing both the Tribunal's March 28th decision and the Tribunal's remedy decision. In these notes we deal only with the Tribunal's March 28th decision.

[3] There were other assets involved in the transaction with these either raising no competition concerns or being the subject of a consent order between the Commissioner and CWS.

[4] The case also involved disposal of waste originating in the Chatham-Kent municipality. We focus entirely on the disposal of GTA waste in this article.

[5] Carty and Glossop, "Outcome of Waste Industry Case Turns on Economics" (2001) 20:3 Can. Comp. Rec. 20 at 24.

[6] *Canada (Director of Investigation and Research)* v. *Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 at 313 (including the Darling plant in Detroit in the calculation of capacities in the market).

[7] Indeed, we are unaware of any other Canadian merger decision that shrinks the set of current producers in arriving at a set of participants in the defined geographic market.

[8] Numbers cited refer to paragraph numbers in the decision.

[9] As this quotation indicates, from the alleged evidence of price discrimination in the market the Tribunal not only infers market power but may also draw a direct link to the conclusion of a narrow market definition.

[10] *Canadian Waste Services*, at Table 1, preceding [194], the Tribunal estimates the total annual capacity in Southern Ontario will decrease from 3,837,900 to 3,444,500 tonnes per annum between 1999 and 2002.

[11] Implicit in the relevant market decision is the forecast that even at prices slightly higher than those which were to characterize the post-merger market in 2002 and beyond, the U.S. firms would still not be competitive: in general, firms should be excluded from a geographic market under the hypothetical monopolist test only if they would not be competitive at prices slightly higher than the forecast prices in the market.

[12] In the following discussion, we imagine for simplicity that the same firm provides both tipping and transportation services for each cubic foot of empty truck space. Nothing essential changes when this assumption is relaxed to account for the separate provision of each service by different firms, as is frequently observed in the market.

[13] *Competition Act*, s.79(1)(a).

[14] *US* v. *El Du Point de Neours & Co.* (1956), 351 US 377. See W. Landes & R. Posner, "Market Power in Antitrust Cases" (1981) 94 Harvard Law Review 937.

[15] We are grateful to Dany Assaf for suggesting this label.

[16] Another approach would be to estimate the full set of demand and cost conditions for the merging firms and their closest competitors and predict the impact of the merger on the basis of the estimates. This approach avoids the conventional market definition apparatus entirely, but requires more data than are available in many cases.

[17] Of course, land nearer the GTA may be more valuable for reasons other than the low transportation costs of waste disposal; that is, there may be additional reasons why tipping fees of nearby sites are higher.

CANADIAN COMPETITION RECORD

HIGHLIGHTS

PRIVATE ACCESS TO THE COMPETITION TRIBUNAL HAS BEGUN

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ROSS: THE POLITICAL ECONOMY OF THE EFFICIENCY DEFENCE

SULLIVAN: DRAFT "ENFORCEMENT GUIDELINES FOR ILLEGAL TRADE PRACTICES: UNREASONABLY LOW PRICING POLICIES" – THE WAY AHEAD

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