

CANADIAN COMPETITION RECORD

COMMENT AND ANALYSIS**JOINT DOMINANCE**

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The abuse of dominance provisions in section 79 of the *Competition Act* apply where, among other things, “one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business”. Where all the elements of section 79 are established, the Competition Tribunal may make an order prohibiting “all or any of those persons” from engaging in the relevant practice of anti-competitive acts. The implication of these references is that section 79 was intended to apply, among other things, to situations where two or more persons “control” a business in circumstances where at least some of them would not be considered to control that business on their own.²

To date, the case law under section 79 has not addressed the issue of joint dominance in a contested context. Nevertheless, there are a number of industries in Canada that have become increasingly consolidated but where no one competitor is clearly dominant in itself. For example, in a recently issued Interpretation Bulletin on the application of the abuse of dominance provisions to the retail grocery industry, the Commissioner of Competition states that, as a result of mergers in the retail food sector over the past decade, “the Bureau estimates that the four largest supermarket chains now account for approximately 75% of total Canadian food store sales”.³

The Commissioner has also begun to cite the risk of an interdependent exercise of market power as a concern in merger investigations with greater frequency. For example, with respect to the Bayer/Aventis CropScience merger, the Commissioner required a divestiture to address the wheat grass herbicide market notwithstanding that the merging parties’ combined market share post-merger would have been less than 35%. The Commissioner alleged that Bayer and the leading competitor, Syngenta, would have accounted for over 70% of the market post-merger.⁴ In addition, increased industry concentration rather than unilateral market power of the merged entity was the basis of the Commissioner’s concern in the proceedings commenced with regard to the Ultramar/Coastal Canada proposed merger. The Commissioner was concerned about the merger’s impact on the market for the provision of terminal facilities for the storage of refined petroleum product and the wholesale supply of refined petroleum product to independent third party purchasers in the Ottawa region. The Commissioner was concerned that, following the proposed merger, all four local terminal operators would be integrated refiners.⁵ Particularly if this trend continues, it may be expected that greater focus will come to bear on the potential application of section 79 to situations where two or more significant competitors, no one of which is clearly dominant, engage in conduct that, for example, excludes competitors or potential competitors from a market. Furthermore, it may be in the interests of merging parties to point to the potential for the Commissioner to challenge the merged entity’s conduct under section 79 as a means to partially address any concerns about a possible subsequent interdependent exercise of market power.

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The potential for section 79 to apply to agreements among competitors outside of the hard core cartel context may also come under increasing scrutiny in the context of consideration of the need for amendments to the criminal conspiracy provisions in section 45 of the Act. In particular, it may be necessary to assess the scope of section 79 in relation to any new civil provision which may be proposed to address agreements between competitors that do not involve hard core cartel behaviour. A two track approach with criminal sanctions for hard core cartel behaviour that no longer requires competition to be unduly lessened, and a civil track for other types of agreements which would be subject to an application to the Competition Tribunal for a remedial order if it was concluded that the agreement was likely to prevent or lessen competition substantially, was proposed by a report of the Standing Committee on Industry, Science and Technology⁶ and supported by a government response.⁷

Joint Dominance by Means of an Agreement

Initially, some commentators suggested that the reference to “one or more persons” in section 79 was intended to apply only to situations where an entity and its affiliates control a market, while the conspiracy provisions in section 45 were intended to address agreements by unaffiliated competitors.⁸ However, particularly in light of the fact that section 79(7) contemplates that both section 45 and 79 could apply to the same conduct, the better view would appear to be that, where two or more participants in an industry are engaging in anti-competitive acts pursuant to an express agreement, they may be held jointly to substantially or completely control the relevant class or species of business for the purposes of section 79. For example, the *Interac* case involved a consent order proceeding where the respondents operated the dominant electronic financial services network in Canada through an agreed set of by-laws and regulations.⁹ The *AGT Directory* case is sometimes described as involving “joint dominance”. However, in that case, the Director characterized each of the respondents individually as dominating the telephone directory publishing business in their respective territories. In other words, they did not jointly dominate a single market.¹⁰

The Competition Bureau’s July 2001 Enforcement Guidelines on the Abuse of Dominance Provisions (the “Abuse Guidelines”) take the position that some form of co-ordination between firms must exist to establish joint dominance and “something more than mere conscious parallelism must exist before the Bureau can reach a conclusion that firms are participating in some form of coordinated activities”.¹¹ In commenting on a draft of the Abuse Guidelines, the Competition Law Section of the Canadian Bar Association also took the position that there “must be more than mere conscious parallelism” to attract a finding of joint abuse.¹²

The Abuse Guidelines then state that “the ability of a group of firms to coordinate actions without entering into an explicit agreement can be addressed under the abuse provisions”.¹³ This comment would appear to acknowledge that a “tacit” agreement can be inferred from circumstantial evidence, just as the courts can do to find an agreement for the purposes of the conspiracy offence in section 45 of the Act.¹⁴ The Abuse Guidelines then list five factors that the Bureau will consider in inferring “control” by a group of firms namely:

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- (a) whether the group of firms collectively accounts for a large share of the relevant market;
- (b) any evidence that the alleged coordinated behaviour is intended to increase price¹⁵ or is for the purpose of engaging in some form of anti-competitive act;
- (c) any evidence of barriers to entry into the group, or barriers to entrants into the relevant markets;
- (d) any evidence based on the particular facts of the case that members of the group have acted to inhibit intra-group rivalry; and
- (e) any evidence that a significant number of customers cannot exercise countervailing power to offset the attempted abuse.

It would seem, however, in the context of the Abuse Guidelines' discussion as a whole, that this list is not intended to suggest that the presence of these factors substitutes for a finding of an agreement, as opposed to potentially assisting in the finding of an agreement.

More recently, the Bureau considered the possible application of a joint dominance theory in the context of an inquiry into the exhibition and distribution of motion pictures in Canada.¹⁶ It was alleged, among other things, that the major exhibitors insist that the major distributors supply them with licenses to exhibit major motion pictures on an exclusive basis and not supply commercially valuable motion pictures to independent exhibitors. The Bureau released a Backgrounder that included the following comment:

The Bureau also tested a possible theory that the major distributors, together with [the major exhibitors], were jointly dominant in their respective markets, and were in some way coordinating the distribution of motion pictures in order to prevent competition from other exhibitors in Canada. However, an analysis of all evidence obtained, including an independent expert's report, concluded that any theory of joint dominance involving both distributors and exhibitors cannot be supported. The apparent preference of major distributors to deal with either [one or the other of the major exhibitors], and the practice of licensing a motion picture to only one exhibitor in a local area, are not anti-competitive acts. There is no evidence that these practices have resulted in a substantial lessening or prevention of competition.¹⁷

It appears that the tested theory was that joint dominance existed separately in each of the distribution and exhibition markets and that there was some co-ordination between the distributors and exhibitors within the scope of section 79. It is not clear whether the Bureau found insufficient co-ordination between the industry participants to constitute joint dominance, or whether the Bureau did not come to a conclusion on that issue after finding that other necessary elements of section 79, namely a practice of anti-competitive acts and a substantial lessening or prevention of competition, were not present.

What, If Anything, Short of an Agreement Is Sufficient to Constitute Joint Dominance?

There are some indications that the abuse of dominance provisions were intended to be more expansive than the former monopoly offence which, as discussed below, had similar language that was arguably interpreted to

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require an agreement among the relevant competitors to constitute a shared monopoly. A 1985 Consumer and Corporate Affairs guide commenting on the new abuse of dominance provisions stated that the concept of “one or more persons” substantially controlling a business was retained from the monopoly provision in the *Combines Investigation Act* (the “Combines Act”) so that the new legislation would:

...continue to allow the application of the law to behaviour engaged in by unaffiliated persons. This means that in some circumstances the section would apply to so called “joint dominance” situations.

Consideration was given to restricting the application of the law to a single firm with an appropriately lower threshold of market power such as “dominant market position.” During the course of consultations, support was expressed for both alternatives. However, there are very few industries in Canada in which only one firm controls its market. Consequently, it was determined that “joint dominance” combined with a “substantial or complete control” test would provide greater protection for small business and consumers.¹⁸ [emphasis added]

The purpose of the 1986 amendments to the Act, including the replacement of the criminal monopoly offence with the civil abuse of dominance provisions, was arguably to provide a new legislative scheme that would be more effective and enforceable. Accordingly, the legislative scheme of the present Act may provide greater scope for the Competition Tribunal to adopt a purposive approach and find that an agreement is not necessary for two or more entities to jointly control a business for the purposes of section 79 where the conduct in question has an anti-competitive effect and meets the other criteria contemplated by section 79.

Prior to the issuance of the Abuse Guidelines, a senior member of the Bureau staff commented that section 79 “clearly envisages [joint dominance] situations which do not involve an [express] agreement to control the market” and suggested that the Tribunal may ultimately establish a minimum threshold for joint dominance that “may well be considerably less than an explicit agreement . . . one possible approach might be to look for a common anti-competitive purpose or some other common facilitating device”.¹⁹

Also prior to the Abuse Guidelines, a former Director of the Bureau articulated the following expansive definition of joint dominance:

Joint dominance is a broad concept that encompasses a range of practices through which a group of firms in an industry can exercise market power collectively. Such conduct may occur without an explicit agreement and often falls short of behaviour that violates antitrust conspiracy provisions. It may include the operation of common facilities in ways that exclude potential entrants from a market, the joint use of vertical restraints to entrench the market position of incumbent firms and strategic entry deterrence through signalling behaviour. In view of the high levels of concentration in many Canadian industries, the potential abuse of market power by jointly dominant firms takes on a particular significance.²⁰ [emphasis added]

Church and Ware have suggested that oligopolists may “control” a market even in the absence of an agreement:

It would seem possible and sensible to argue that the conditions for the collective exercise of market power exist when there is a small number of firms, barriers to entry are high, and there is a facilitating practice. The facilitating practice not only decreases competition between firms

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and thereby increases the (collective) exercise of market power, it also allows inference of joint exercise of market power. In this context, the anticompetitive act or behaviour which is socially undesirable is the facilitating practice. The abuse provisions could be used to obtain an order prohibiting oligopolists from adopting facilitating practices which sustain collusion.

The provisions of the *Act* also clearly allow for the possibility that oligopolists who engage in exclusionary acts to deter entry or exclude competitors may be subject to antitrust liability. It does not appear that coordination and adoption of similar anticompetitive practices [are] necessarily required. Section 79(1)(b) requires only that the firms have, or are, engaging in a practice of anticompetitive acts, that is the practice applies to the entire set of anti-competitive acts undertaken by all the firms alleged to have joint control. However, the question of joint control must still be established. In this context, it will be interesting to see if evidence of unified control or agreement between firms in an industry will be required. Small numbers of firms and barriers to entry should be sufficient to establish "collective" market power and thus control for the purposes of addressing industry-wide behaviour which is predatory or exclusionary.²¹ [emphasis added]

Similarly, Trebilcock *et al.*, have commented that:

Finding joint dominance even in the absence of an explicit agreement may be in keeping with the pragmatic approach to monopolization found in the modern *Competition Act*. This is especially so given the difficulty, both in fact and as a matter of theory, of proving an "agreement" under the criminal conspiracy provisions when the firms in question have not explicitly agreed to set prices.²²

The authors review the anti-competitive effects of a number of facilitating devices such as pre-announcing price increases, use of delivered pricing to increase transparency, meet or release clauses and most favoured nation clauses and further comment that:

It thus may be appropriate under section 79 to conclude that a group of firms acting in parallel fashion are jointly dominant and that the facilitating device used by the firms constitutes an anti-competitive act: the device substantially lessens competition.²³

In the recent *Airtours* decision, the Court of First Instance ("CFI") overruled the European Commission's earlier finding that the proposed merger of two travel agents, Airtours and First Choice, would create a collective dominant position among the merged entity and the next two leading tour operators. The CFI found that there are three necessary conditions for a finding of collective dominance:

- (1) sufficient market transparency for each member of the dominant oligopoly to be able to know how the other members are behaving in order to monitor whether or not they are adopting a common policy;
- (2) adequate deterrents such as punishment mechanisms to ensure that tacit co-ordination is sustainable over the long term, in order to prevent cheating; and
- (3) that the parties' tacit co-ordination would not be undermined by current and future competitors or customers.²⁴

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Of course, in a merger review, the analysis is forward looking while, in an abuse of dominance case, the analysis looks back to the actual conduct that has occurred in the marketplace. Nevertheless, if the Commissioner did seek to apply section 79 in a joint dominance context, it may be helpful, if not necessary, to demonstrate that the relevant market is transparent, actual deterrence or punishment has occurred, and competitors and customers did not respond sufficiently to undermine any tacit co-ordination.

Presumably the argument for an expansive approach to section 79 in a joint dominance context is that, by engaging in parallel exclusionary conduct, the collectively dominant firms “control” the relevant business because their conduct has an exclusionary, disciplinary or predatory effect on competitors or potential competitors. (In a single firm context, the Tribunal has held that “control” means market power in the economic sense.)²⁵ If, in the joint dominance context, “control” can mean simply the blocking of access to the relevant market, it may not matter that such an effect was accomplished by independent actions of industry participants as opposed to having been brought about by an agreement or mutual understanding. The same effect and end result occurs in both cases.

At the same time, however, it should be recognized that it is often difficult to distinguish anti-competitive joint dominance from situations that are simply the result of a highly competitive market, such as where four closely situated gas stations all sell gas at the same price. Further, it can create significant uncertainty in the market and possibly deter competitive behaviour if individual non-dominant firms have to be concerned about the independent conduct of their competitors exposing the firm to an investigation or enforcement action under section 79.

Indications that an Agreement is Required for Joint Dominance

Legislative history. Prior legislative proposals, which were not adopted by Parliament, expressly sought to encompass conscious parallelism in the abuse of dominance provisions.²⁶ Conscious parallelism was dropped from later proposals after receiving significant criticism from the business community.²⁷ It can therefore be argued that, since proposed Bills which specifically permitted remedial orders in respect of conscious parallelism were not passed by Parliament, the absence of express reference to this concept in the legislation that was passed suggests an intention that conscious parallelism not be included within the scope of the current section 79.

Contrast to section 77. Section 77 of the Act expressly provides that an order may be made with respect to exclusive dealing, tied selling or market restriction if, among other things, the substantial lessening of competition results either because the conduct is engaged in by a major supplier of a product or because it is “widespread in a market” It seems clear that an agreement among competitors is not required for the purposes of section 77. Accordingly, if Parliament had intended a similar result under section 79, it could easily have used the same language that appears in section 77.

Jurisprudence under the Combines Act. The reference in section 79 to “one or more persons” controlling a business repeats the relevant wording of the former monopoly offence in the *Combines Act*.²⁸ In the *Large Lamps* case, a proceeding involving charges against competitors in the electric lamp industry under both the

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monopoly and the conspiracy provisions of the *Combines Act*, Pennell, J. initially commented that he had difficulty accepting the defendants' suggestion that the words "one or more persons" are "actually to be [read] as one or more persons in a proprietary or contractual relationship"²⁹ Pennell, J. added that:

To me the wording of the section foresees a combination of circumstances whereby one or more persons, inclusive of independent corporations, through the co-ordination of their activities work together as a unit. For the sake of convenience, I will refer to this situation as a shared monopoly. But monopoly control is something more than a number of persons, each acting for himself, controlling a large part or all of the business of a particular commodity.³⁰ [emphasis added]

Pennell, J. held that "the accused worked together as a unit through the device of the sales plans,³¹ identical price lists and consignment system, the end result being an effective power to control the market".³² In requiring at least a "co-ordination of activities" to "work together as a unit", Pennell, J. was clearly looking for something beyond conscious parallelism and may have effectively required an agreement or mutual understanding between the parties, not in a formal sense, but in the same sense required for a tacit or express agreement to be found under section 45 of the Act.

It also remains to be seen whether, if an agreement is required, it must relate specifically to the practice of anti-competitive acts.

With reference to the decision in *Large Lamps*, it might be questioned whether it is sufficient to invoke section 79 on a joint dominance theory if two or more persons co-ordinate some of their activities and work together as a unit in a given market with respect to matters that do not constitute anti-competitive acts, but separately and independently engage in anti-competitive acts in the same market. For example, might the parties to a lawful joint production arrangement risk the issuance of an order under section 79 if they separately and independently engage in exclusionary distribution policies with respect to the product produced by the joint venture?

Other Considerations

Anti-competitive purpose. Some commentators have argued that it may be difficult to apply a joint dominance theory in the absence of an agreement among the relevant suppliers of a product because of the need to show an anti-competitive purpose in order for conduct to be part of a practice of anti-competitive acts. If the relevant firms are simply engaging in conscious parallelism and following an industry leader after considering their own circumstances, it may be difficult to categorize their conduct as having the necessary predatory, exclusionary or disciplinary purpose, as opposed to simply attempting to survive in the marketplace.³³ On the other hand, in *Laidlaw* and *Tele-Direct*, the Tribunal appeared to move towards an objective assessment of the purpose or nature of the acts in question, at least in the single firm context.³⁴ If the test is objective and the conduct has had a demonstrable anti-competitive effect within the scope of section 79, it would seem that an anti-competitive purpose could be established.

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Market share thresholds. In its discussion of market share in the Abuse Guidelines, after noting that in each of the contested cases to date the respondent was found to have a market share over 85%, the Bureau takes the position that single firm dominance could exist at a market share as low as 35%.³⁵ The Bureau acknowledges the Tribunal's comment in *Laidlaw* that a market share of less than 50% would not give rise to a *prima facie* finding of dominance, but comments that this does not imply that market power could never be found below 50%. If dominance (and the other elements of section 79) could be found at a market share level as low as 35%, practically speaking, there would be less need to rely on the concept of joint dominance as the Commissioner could more frequently challenge and obtain remedies against the leading firm in an oligopolistic industry. The premise noted above in the 1985 Consumer and Corporate Affairs commentary that there are very few industries in Canada in which only one firm "controls" its market would likely not apply if "control" could occur at a 35% market share. Having said that, it is far from clear that market shares in the 35%–50% range could lead to a finding by the Tribunal that a firm substantially "controls" a business for the purpose of section 79.

Given the Bureau's assertion of possible single firm dominance at a market share as low as 35%, it is curious that the Abuse Guidelines take the position that "[i]n 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". This statement seems to imply that the Bureau will not examine under section 79 a group of firms with an aggregate market share of less than 60%. Given that the operative concept is "control", whether in the context of alleged anti-competitive acts by a single firm or by a group of firms, it is not clear why a different market share threshold should apply. If, for example, two or more firms were to engage in a particular practice of anti-competitive acts pursuant to an agreement, why would it require at least 60% of the market to constitute "control" in a joint abuse context if a single competitor with only a 35% share could potentially be considered to exercise single firm control?³⁶ As the CBA has commented, "in dealing with joint dominance, the extent of collaboration between the parties falls on a spectrum ... it is illogical to contemplate that in that broad range of co-operation a single market share could ever constitute *prima facie* evidence of anything".³⁷

Consider, for example, conduct engaged in by two firms with a 35% and 20% market share, respectively. Under the Abuse Guidelines, the first firm could be considered dominant in itself, but the conduct of the two firms together would generally not be further examined under a joint dominance theory. Further, if the two firms acting pursuant to an agreement had market shares of 30% and 25% respectively (for a total of 55%), they would fall below both the single firm and joint dominance thresholds in the Abuse Guidelines while the Commissioner would examine the same conduct if engaged in by a single firm with only a 35% share.

On the other hand, if section 79 does extend in a joint dominance context to unaffiliated entities that are linked by something less than an agreement, there may be a rationale for requiring a higher market share threshold for joint dominance in that context, just as the Bureau's *Merger Enforcement Guidelines* employ a 65% four firm concentration ratio in assessing the risk of an interdependent exercise of market power, in contrast to a single firm 35% threshold.³⁸

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Proposed monetary penalties. If section 79 does extend to situations that involve less than an agreement among competitors, it may be more difficult to justify the imposition of administrative monetary penalties as suggested by the recent Report of the Standing Committee on Industry, Science and Technology and to which the government agreed in principle in its response to that Report.³⁹

Approach to Joint Dominance in Other Jurisdictions

European Union. Article 82 of the EC Treaty (formerly Article 86) prohibits as incompatible with the common market “any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it”. It may be noted that Article 82 does not employ the concept of “control” used in section 79 of the Act.

In the *Italian Flat Glass* case, the CFI stated that, given the proper evidence:

There is nothing, in principle, to prevent two or more independent economic entities from being, on a specific market, united by such economic links that, by virtue of that fact, together they hold a dominant position *vis à vis* the other operators on the same market. This could be the case, for example, where two or more independent undertakings jointly have, through agreements or licenses, a technological lead affording them the power to behave to an appreciable extent independently of their competitors, their customers and ultimately of their consumers.⁴⁰

The question of whether the economic links contemplated by the *Italian Flat Glass* case could be established only by agreements or other forms of explicit collusion within the meaning of Article 81 or also by oligopolistic interdependence was addressed in the subsequent *Compagnie Maritime Belge* case.⁴¹ In that decision, the European Court of Justice (“ECJ”) initially commented that collective dominance within the meaning of Article 82 means a dominant position:

held by two or more economic entities legally independent of each other, provided that from an economic point of view they present themselves or act together on a particular market as a collective entity.⁴²

The ECJ also held in *Compagnie Maritime Belge* that “the existence of an agreement or of other links in law is not indispensable to a finding of a collective dominant position”. The ECJ added that “such a finding may be based on other connecting factors and would depend on an economic assessment and, in particular, on an assessment of the structure of the market in question”.⁴³ One commentator has suggested that this amounts to a confirmation by the ECJ that:

...in a specific case, structural factors of the market can also be sufficient to serve as a basis for the finding of collective market power provided they allow the undertakings to act like a collective entity in the external relationship *vis-à-vis* competitors, trading partners and consumers. However, there has so far been no case in the context of Article 82 in which the Commission or the European courts would have considered the connecting element required for a collective dominant position as existing solely in oligopolistic market interaction. The assumption of collective dominance was, in these cases, always based upon the existence of agreements or other forms of collusion in the sense of Article 81(1).⁴⁴

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United States. Section 2 of the U.S. *Sherman Act* provides that “every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign agents, shall be deemed guilty of a felony ...”. U.S. courts have generally been reluctant to adopt a “shared monopoly” theory under section 2 of the *Sherman Act*:

The notion that two *competitors* could conspire to monopolize is, seemingly, antithetical. Two competitors could conspire to oligopolize, which would constitute an illegal section 1 conspiracy in restraint of trade, but it would not constitute an offence under a literal reading of section 2.⁴⁵

Thus, the reluctance of the U.S. courts to apply the concept of “joint monopolization” appears to be focussed on the term “monopolize” which is present in section 2 of the *Sherman Act*, but not section 79 of the Act or Article 82 of the EC Treaty.

Some attempts have been made to address situations of joint dominance under section 5 of the *Federal Trade Commission Act* which declares “unfair methods of competition [to be] unlawful”. In the *Ethyl Corp.* case the Federal Trade Commission (“FTC”) held that four leading domestic producers and sellers of lead anti-knock gasoline additives had violated section 5 by unilaterally adopting certain price signalling practices. The FTC concluded that these practices violated section 5 even in the absence of evidence of collusion because they had a “significant adverse effect on competition by promoting price uniformity at supra-competitive levels”.⁴⁶ The Second Circuit vacated the FTC’s order on the following grounds:

In our view, before business conducted in an oligopolistic industry may be labelled “unfair” within the meaning of §5 a minimum standard demands that, absent a tacit agreement, at least some indicia of oppressiveness must exist such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct ... In short, in the absence of proof of a violation of the anti-trust laws or evidence of collusive, coercive, predatory, or exclusionary conduct, business practices are not “unfair” in violation of §5 unless those practices either have an anticompetitive purpose or cannot be supported by an independent legitimate reason ... In the present case the FTC concedes that the petitioners did not engage in the challenged practices by agreement or collusively. There is no evidence of coercive or predatory conduct.⁴⁷

The Second Circuit also indicated that there was an absence of evidence of a substantial lessening of competition from the challenged practices. The Court also expressed concern that the FTC’s principle of liability failed “to discriminate between normally acceptable business behaviour and conduct that is unreasonable or unacceptable”, thus opening the door to arbitrary or capricious administration of section 5.

The FTC has on two other occasions sought to use section 5 to obtain structural relief in the form of divestiture for industry-wide practices which allegedly amounted to shared monopoly. However, both cases were dismissed without any FTC decision on the merits.⁴⁸ Nevertheless, the above quoted passage from *Ethyl* suggests that there could be some circumstances involving oppression, but short of an agreement, that would constitute an unfair practice by a group of competitors.

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Conclusion

While there are strong indications that section 79 of the Act should be read to apply in a joint dominance context only where the relevant industry participants have an express or tacit agreement, some uncertainty will remain until the Tribunal has an opportunity to rule on the issue in the context of a contested proceeding. The key issue is the meaning to be ascribed to the concept of "control" in this context. One could envisage the Tribunal adopting a purposive interpretation of the concept of "control" that would focus on the effect of the challenged conduct, namely that a group of firms could be considered to "control" a business for the purpose of section 79 if their conduct has the cumulative effect of excluding or disciplining competitors or potential competitors from that business. Arguably, however, the legislative history and an ordinary reading of section 79 ought to restrict its application to joint dominance to clearer forms of control by means of an agreement. It may also make sense to interpret the extension of the abuse provisions to joint dominance as being limited to agreements in order to provide a non-criminal alternative to proceeding under section 45 of the Act in some circumstances. Practically speaking, however, the Tribunal may not have an opportunity to address this issue in the near future in part because in cases that raise issues of joint dominance it may be difficult for the Commissioner to establish other elements of section 79 (such as an anti-competitive purpose) and it may be easier to address a situation of joint dominance under section 77 of the Act if the conduct involves exclusive dealing, tied selling or market restriction.

Notes

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² For a discussion of joint dominance see also C.S. Goldman & J.D. Bodrug, eds., *Competition Law of Canada* (Huntington, NY: Juris Publishing, 2001) at §9.03.

³ Canada, Competition Bureau, *Interpretation Bulletin: The Abuse of Dominance Provisions (Sections 78 and 79 of the Competition Act) as Applied to the Canadian Grocery Sector* (November 2002) at s. 2.

⁴ *Commissioner of Competition v. Bayer AG* (May 2002), CT-2002/03-1d, Statement of Grounds and Material Facts at para. 111 (Comp. Trib.).

⁵ See the *Commissioner of Competition v. Ultramar Ltd.* (April 2000), CT-2000/001 (Comp. Trib.) and J. Bodrug, "Competition Tribunal Dismisses Application for Consent Order for Ultramar/Coastal Canada Petroleum Merger" (2000) 20:1 Can. Comp. Rec. 87.

⁶ Canada, House of Commons, Standing Committee on Industry, Science and Technology, "A Plan to Modernize Canada's Competition Regime" (23 April 2002) (available online at <http://www.parl.ca/infocomdoc/37/1/inst/studies/reports/indurp06/03-cov-e.htm>).

⁷ Canada, Industry Canada, "Government Response to the Report of the House of Commons Standing Committee on Industry, Science and Technology 'A Plan to Modernize Canada's Competition Regime'" (1 October 2002) (available online at [http://www.ic.gc.ca/cmb/wel-comeic.nsf/vrtf/specialreport/\\$file/govtresponse.pdf](http://www.ic.gc.ca/cmb/wel-comeic.nsf/vrtf/specialreport/$file/govtresponse.pdf)).

⁸ A.B. James, "Abuse of Dominant Position: A Discussion of Joint Dominance and Anti-competitive Acts" (Insight Conference on Competition Law in Canada: How the New Competition Act Will Affect Canadian Business, Toronto, Ontario, 17 February 1986) at 6.

⁹ *Director of Investigation and Research v. Bank of Montreal* (December 1995), CT-1995/02-1b, Statement of Grounds and Material Facts at para. 49 (Comp. Trib.).

¹⁰ See *Director of Investigation and Research v. AGT Directory Limited* (September 1994), CT-1994/002-1b, Statement of Grounds and Material Facts at para. 71 (Comp. Trib.).

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¹¹ Section 3.2.1(e).

¹² Canadian Bar Association, National Competition Law Section, *Submission on Draft Abuse of Dominance Guidelines* (October, 2000) at 12. Elsewhere (at 11), the CBA comments seem to imply that there could be a finding of joint dominance in a situation of "conscious parallelism plus, with no agreement whatsoever", although it is not clear what types of behaviour would fall into that category.

¹³ Section 3.2.1(e).

¹⁴ See section 45(2.1) of the Act which confirms that a court may infer the existence of a conspiracy with or without direct evidence of communication between or among the alleged parties. Courts have been willing to infer an agreement where the accused's conduct can be explained only by the existence of such an agreement. Courts have also drawn adverse inferences from conduct that appears to have been directed towards enforcing or concealing the existence of an agreement, complaints about competitors' conduct, and parallel exclusionary activities directed at new entrants or other third parties. See *Competition Law of Canada*, *supra* note 2 at §8.03[2].

¹⁵ It is not clear that a price increase is an anti-competitive act for the purposes of section 79 as it is not exclusionary, disciplinary or predatory with respect to competitors or potential competitors. In *Canada (Director of Investigation and Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Comp. Trib.), for example, the Tribunal held a market sharing agreement between potential competitors to be beyond the scope of section 79.

¹⁶ "Inquiry into the Exhibition and Distribution of Motion Pictures in Canada", Competition Bureau, Government of Canada, 12 December 2002 (available online at <http://strategis.ic.gc.ca/ssg/ct02479e.html>).

¹⁷ *Ibid.* at 3.

¹⁸ Minister of Consumer and Corporate Affairs, *Competition Law Amendments: A Guide* by The Honourable Michel Coté (Ottawa: Minister of Supply and Services, December 1985) at 22.

¹⁹ G. Menard, Deputy Director of Investigation and Research (Civil Matters), "Comments for Panel Discussion on the Law of Economics of Mergers and Abuse of Dominant Position" (1996 Annual Competition Law Conference, Canadian Bar Association, Competition Law Section, 27 September 1996) at 18.

²⁰ H.I. Wetston, Q.C., "Developments and Emerging Challenges in Canadian Competition Law" (1992) Fordham Corp. L. Instit. 195 at 211.

²¹ J. Church & R. Ware, "Abuse of Dominance under the 1986 Canadian *Competition Act*" (Paper prepared for The Review of Industrial Organization, March 1997) at 12. [footnotes omitted]

²² M. Trebilcock *et al.*, *The Law and Economics of Canadian Competition Policy* (Toronto: University of Toronto Press Inc., 2002) at 513.

²³ *Ibid.* at 514.

²⁴ Case T-342/99 *Airtours v. European Commission*, June 6, 2000. In *Ultramar Ltd.*, *supra* note 5, the Commissioner, in his filings, identified the following characteristics in the Ottawa region wholesale supply market which he alleged provided an opportunity for the exercise of market power by the wholesale suppliers (in the context of his challenge to Ultramar's proposed acquisition of a petroleum product terminal facility from Coastal Canada): (1) homogeneity of refined petroleum products, (2) repeated and frequent interaction among suppliers, (3) a small number of firms engaged in wholesale supply, (4) posted price transparency, (5) multi-market contact among integrated wholesalers, and (6) common vertically integrated structure. (See Statement of Grounds and Material Facts, para. 39 and Consent Order Impact Statement, paras. 21, 22 and 41.)

²⁵ See *Director of Investigation and Research v. Laidlaw Waste Management Systems Ltd.* (1992), 40 C.P.R. (3d) 289 at 325 (Comp. Trib.). It may also be noted, however, that the Supreme Court of Canada has suggested that the degree of market power required under section 79 is higher than that required under section 45 of the Act: *R. v. Nova Scotia Pharmaceutical Society*, [1992] S.C.R. 606 at 654.

²⁶ Bill C-42, which was introduced into Parliament on March 16, 1977 (but not passed) as part of the proposals for the Stage II Amendments to the *Combines Act*, provided, in section 31.73, that a new Competition Board could make a prohibition or remedial order with respect to monopolization where, among other things, a small number of firms achieved or sought substantial control of a relevant market and did so by "adopting closely parallel policies or matching conduct". Section 31.73 provided that the Board could make a finding of joint monopolization "notwithstanding that the parallel policies or matching conduct adopted by [the firms] was based on nothing more than a mutual recognition of their interdependence and that there was no agreement or arrangement between or among them". Following extensive consideration of Bill C-42, the government introduced Bill C-13 in November 1977 (which also was not passed). Bill C-13 proposed a new civil reviewable matter, section 31.73, referred to as "joint monopolization". Joint monopolization was defined as "a situation where a small number [of unaffiliated firms] achieve substantial control or entrench such control [in a market] by adopting closely parallel policies or closely matching conduct of an exclusionary character" which has the

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effect of restricting entry, foreclosing a competitor's sources of supply or sales outlets, eliminating a competitor by predatory pricing, or coercing a competitor to restrict competitive behaviour. Subsection 31.73(6) provided that the Board could make an order in respect of joint monopolization "notwithstanding that the parallel policies or matching conduct adopted by [the firms] involved no agreement or arrangement between or among them". See J.W. Rowley & W.T. Stanbury, eds., *Competition Policy in Canada, Stage II, Bill C-13* (Institute for Research on Public Policy, 1978) at 154-67.

²⁷ This criticism is summarized by W.T. Stanbury in "Monopoly, Monopolization and Joint Monopolization: Policy Development and Bill C-13" at 155-58 in Rowley & Stanbury, *ibid.*

²⁸ The *Combines Act* defined "monopoly" as "a situation where one or more persons either substantially or completely control throughout Canada or any area thereof the class or species of business in which they are engaged...".

²⁹ *R. v. Canadian General Electric Company Ltd.* (1976), 15 O.R. (2d) 360 at 370 (H.C.).

³⁰ *Ibid.* at 407. See also *ibid.* at 412.

³¹ "Sales plans" were the mechanism used by the members of the oligopoly to clearly define the market and distribution channels, as well as to curtail the extensive price cutting that had occurred in the industry prior to 1959. The sales plans published by each party were virtually identical, and covered aspects of distribution, the sale and supply of large lamps to the companies' distributors and agents, and subsequently, by such agents and distributors to trade customers. The sales plans fixed the price of the large lamps at each level of exchange, and provided a fixed discount at which different customers could purchase the products.

³² *R. v. Canadian General Electric Company Ltd.*, *supra* note 29 at 408 (footnote added). It may be noted that, in those proceedings, the accused companies were found guilty of conspiring to unduly limit competition pursuant to a predecessor to section 45 of the Act. However, they were acquitted on the monopoly charges on the basis that the Crown had not proved that detriment had actually flowed from the operation of the alleged monopoly.

³³ See T. Kennish, M. Lally & D. Steiner, "A Retrospective on the Canadian Competition Law Experience in Regard to Mergers and Abuse of Dominant Position" (Annual Competition Law Conference, Canadian Bar Association, Competition Law Section, 1996) at 81; and R.J. Roberts, *Roberts on Competition/Antitrust: Canada and the United States*, 2nd ed. (Toronto: Butterworths, 1992) at 290-91.

³⁴ See *Competition Law of Canada*, *supra* note 2 at §9.02[6].

³⁵ Section 3.2.1(d).

³⁶ Presumably, if a firm were found to control a business with a 35% market share, the fact that other competitors engage in the same or similar exclusionary practices could assist the Commissioner in establishing that the leading firm's conduct is having the requisite effect of substantially lessening competition.

³⁷ *Submission on Draft Abuse of Dominance Guidelines*, *supra* note 12 at 11.

³⁸ Section 4.2.

³⁹ *Supra* notes 6 and 7.

⁴⁰ *Societa Italiano Viro SPA v. Commission*, [1992] 5 C.M.L.R. 302 at 358.

⁴¹ Joined Cases C 395-396/96 P *Compagnie Maritime Belge Transports v. European Commission*, [2000] E.C.R. I-1365; [2000] 4 C.M.L.R. 1076.

⁴² *Ibid.* at para. 36.

⁴³ *Ibid.* at para. 45.

⁴⁴ H. Haupt, "Collective Dominance under Article 82 E.C. and E.C. Merger Control in the Light of the Airtours Judgement", [2002] E.C.L. 434 at 438.

⁴⁵ *H.L. Hayden Co. of N.Y. Inc. v. Siemens Med. Systems, Inc.*, 1988-1 Trade Cas. (CCH) P68,104 at 58,707 (U.S. Dist. Ct., S.D.N.Y.). See also *Sun Dun Inc. of Washington v. The Coca-Cola Co.*, 1990-2 Trade Cas. (CCH) P69,244 at 64,876 (U.S. Dist. Ct., Dist. of Maryland).

⁴⁶ *Ethyl Corp.*, 101 F.T.C. 425 (1983) at 605, vacated *sub nom. E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984).

⁴⁷ *E.I. Du Pont de Nemours & Co. v. FTC*, *ibid.* at 139.

⁴⁸ In *Kellogg*, 99 F.T.C. 8 (1982) and in *Exxon Corp.*, 98 F.T.C. 453 (1981). See also *Stone Container Corp.*, May 18, 1998, docket no. C-3806 for an FTC challenge under section 5 with respect to Stone's alleged attempt to increase the prices of linerboard by announcing extraordinary planned downtime and purchasing linerboard from competitors to draw down industry inventory.

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BIG BANK MERGERS UNDER THE *COMPETITION ACT*: TAKING STOCK OF WHERE WE ARE

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Introduction

While it remains unclear when the political climate will be right for large bank mergers to take place, when the time comes, the role of the Competition Bureau will be critical. Moreover, while the overall process of Ministerial approval remains somewhat unclear and unpredictable,¹ enough has been written and said by the Bureau and others,² such that in isolation its process is relatively clear.

In this paper we review this process, the significance of remedies, and some of the more important changes in the financial services sector in recent years. We conclude by noting some of the uncertainties surrounding both the overall process and how the Bureau's role will likely affect the ultimate decision of the Minister of Finance (the "Minister").

Managing the Process

Managing the process of merger review before the Bureau is, in most cases, a fairly clear and predictable task. During the merger wave of the late 90s, the Bureau regularly reviewed over 400 mergers per year. In addition, recent high profile decisions made by the Competition Tribunal in merger cases provide further guidance.³ As a result, while some issues remain,⁴ both the Bureau and the competition bar possess a great deal of experience as to the proper legal and economic analysis involved in merger cases, and as to the best practices available to get deals through the Bureau as quickly as possible.⁵

For example, early contact with the Bureau, proper explanations to industry participants (customers, stakeholders, etc.) and to the public of the implications of a transaction, and detailed submissions, cooperation and assistance to the Bureau are well known to produce more favourable and more timely results. These same general principles apply to bank mergers.

But not everything is the same in the Bureau's review of big bank mergers. Normally, "the way [the review process] would ... work in a merger case is [the Bureau] would raise competition issues and ... would try to have discussions and negotiations with the parties to see if [it] could remedy those concerns short of seeking to block the merger."⁶ However, in a large bank merger, the negotiation of remedies between parties to a merger and the Bureau would first require the approval of the Minister to proceed. As noted in the Minister's *Merger Review Guidelines*:

Using the reports of the Competition Bureau, OSFI, the Finance Committee and the Senate Committee as inputs, the Minister of Finance will render a decision on whether the public interest, prudential and competition concerns that are raised by the transaction are capable of being addressed. If not, the

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transaction will be denied and the process will stop at this stage. If these concerns are capable of being addressed, the Merger Review Process will enter the negotiation of remedies stage. [emphasis added]⁷

As noted by Gaston Jorré, then Senior Deputy Commissioner of Competition with the Bureau, regarding the Bureau's normal approach to the merger review process, "we try very hard to find solutions that work and that allow transactions to proceed ... It's relatively infrequent to reach a position where the only alternative is to block a transaction."⁸

It is important to remember that the last round of big bank mergers never reached the remedy negotiation stage of the merger review process. Despite the Commissioner of Competition leaving it open to the parties to consider whether they wished to negotiate remedies,⁹ the Minister stopped the process three days after the Bureau issued its letters.

Issues are raised, then, as to the process of negotiating remedies with the Bureau. Should they form part of a merger proposal from the outset? In most cases, one would discuss remedies with the Bureau at an early stage to show, at a minimum, that the competition issues are "capable of being addressed". In this sense, the Bureau has helpfully indicated that it "will identify to the merging parties on an ongoing basis any likely anti-competitive issues that may arise."¹⁰

The Role of Remedies

As was noted in the testimony of Gaston Jorré to the Standing Committee on Finance, "[i]t may be worth mentioning that in the bank letters, there were whole areas where there were no issues So there is potentially a lot of room for solutions in many things."¹¹

These public statements send a fairly clear message: the Bureau is open to negotiate remedies. Indeed, that is the normal process. Thus, merging parties, if they are to get their deals reviewed in a timely fashion, and obtain a favourable report from the Commissioner, need to consider remedies as much as possible upfront. Moreover, here, because of potentially conflicting regulatory and political goals (e.g., maintaining employment versus maximizing efficiencies), designing remedies will be extremely difficult. But at a minimum, it is important: (i) for the parties to understand the issues; and, (ii) during the review process, for the Bureau to understand that the lines of communication are open.

Remedies will depend both on the facts of any proposed merger, and on what has changed since the last time. From the last round of bank mergers and the Toronto-Dominion Bank, Canada Trust merger, we know the areas where the Bureau is likely to have its greatest concerns (see the December 11, 1998 letters from the Competition Bureau to (i) the Royal Bank of Canada and the Bank of Montreal (at 2-4) and (ii) the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank (at 2-4) and the January 31, 2000 Competition Bureau Information Notice "Proposed Merger of Toronto-Dominion Bank and Canada Trust, all available on

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the Bureau's website at <http://cb-bc.gc.ca>). As such, an understanding of the changes in recent years is important. That is, what has changed in fact and in law. We now turn to examine a number of changes of importance.

Changes of Importance

There have been some significant changes since 1998. Apparently, the Bureau is not entirely convinced of this, but it at least appears to have an open mind. In response to questions from the Standing Committee on Finance on whether competition in Canada from foreign banks has changed since 1998, Richard Annan, Major Case Director and Strategic Policy Advisor with the Bureau, stated:

Clearly that is something we're going to have to examine very carefully next time. There haven't been significant changes in the market since 1998 in those respects, from what I understand.¹²

In relation to technology, however, he added that: "clearly progress has been made. Alternative distribution mechanisms have continued to grow. That's an important issue for us to look at again."¹³

As noted above, competition law cases are intensely fact driven. Consequently, in the absence of specific proposals, we can only make general observations about changed circumstances. However, even these general observations suggest that the timing for merger proposals between major financial institutions has improved for a number of reasons.

First, the Bureau has greater experience in bank merger review. Moreover, Canada's financial sector regulations have been changed by overhauls to the regulatory framework, many of which were purportedly designed to enhance competition in the financial sector as well. Moreover, the big bank merger review process, at least at the framework level, has been formally articulated in the *Merger Review Guidelines*. However, as in 1998, the question of how far big bank mergers will proceed is dependent on the Minister and the relatively uncertain requirement that they be found to be in the "public interest".

Second, banking has changed, both in Canada and internationally. Two of the Bureau's greatest concerns last time were in personal banking and in SME (small and medium-sized businesses) products,¹⁴ both of which have changed with technology and with a greater availability of alternative sources of financing. Moreover, Canadian banks and others maintain that they are losing ground internationally and that Canada should permit mergers in order to preserve its financial sovereignty.¹⁵

Third, there have been some significant changes in the competition laws of Canada, particularly in relation to the efficiency defence in section 96 of the *Competition Act*.

We now turn to examine these changes in greater detail.

The Regulatory Environment has Changed

The Bureau now has greater experience reviewing major financial sector mergers and believes that it could conduct a review of a big bank merger proposal in much less time than it took the Bureau to conduct its review

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of the proposed Royal Bank, Bank of Montreal merger in 1998. In accordance with the Government's *Merger Review Guidelines*,¹⁶ the Bureau believes it can conduct its review of a big bank merger within five months.

In 1998, the Bureau had not reviewed a merger of big banks since 1961.¹⁷ As a result, the Bureau gained valuable experience in reviewing mergers in the financial sector in 1998.¹⁸ As part of its review, the Bureau generated an extensive database of financial sector knowledge using the Canadian Bankers Association's database augmented by other information, which is available to it in any future merger review.¹⁹

The Bureau continued to increase its financial sector review experience in reviews of other financial sector mergers such as Merrill Lynch's acquisition of Midland Walwyn in 1998,²⁰ its review of the Toronto-Dominion Bank and Canada Trust merger in 1999,²¹ and the subsequent sale of most of Merrill Lynch's Canadian brokerage business to CIBC in 2002. The Bureau gained further experience in the financial sector in its review of the acquisition of Clarica Life Insurance Company by Sun Life Financial Services of Canada and its review of the acquisition of Canada Life Financial Corporation by Great-West Lifeco Inc.²²

Moreover, the last proposed bank mergers²³ came in the midst of a comprehensive review being conducted by the Task Force on the Future of the Canadian Financial Services Sector (the "Task Force") which was initiated by the Government in December of 1996. During that time, there was a sense that banks would wait until the release of the Task Force's report, before proceeding with merger proposals. The Minister made it clear that he would not approve big bank mergers until the Task Force provided its report.

With 124 recommendations in the report, and letters from the Bureau and the Office of the Superintendent of Financial Institutions ("OFSI") identifying concerns with the mergers, the Minister rejected the merger proposals and turned his focus to addressing issues raised by the Task Force's report, rather than to negotiating remedies with the banks.

As the Minister said at that time "we believe the status quo must be changed...[and that] the government will not consider any merger among banks until the new policy is in place".²⁴

That framework is now in place. Unfortunately, whether the time is right for new bank mergers still remains unclear. In addition, the content of the public interest criteria remains opaque. It would be helpful to have guidance on these two issues.²⁵

Additional changes have resulted from the *Task Force Report, Change, Challenge, Opportunity* released in September of 1998. It made 124 recommendations for Canada's financial services sector. The mandate of the Task Force was to "inquire into public policies affecting the financial services sector and make recommendations to enhance"²⁶ areas which included:

- the contribution of the sector to job creation, economic growth and the new economy;
- competition, efficiency and innovation within the sector;

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- the international competitiveness of the sector in light of the globalization of financial services, while at the same time maintaining strong, vibrant domestic financial institutions;
- the ability of the sector to take full advantage of technological advances as they occur and to meet the competitive challenges resulting from the introduction of new technologies; and
- the contribution of the sector to the best interests of Canadian consumers.²⁷

It described the impact of its recommendations as follows:

Our recommendations will make Canada's financial services sector more vibrant and dynamic by enhancing competition. We see stronger and more aggressive credit unions and life insurance companies emerging to challenge the dominant position of major banks. Mutual funds will become stronger competitors as they gain access to the payments system. New, dynamic and well-financed competitors will enter our markets, both from abroad and domestically ... Our recommendations will make our financial services sector more responsive to consumers. [emphasis added]²⁸

The Government adopted a number of the Task Force's recommendations by enacting legislative changes to the financial sector's regulatory framework.²⁹ Many of the following changes were, at least in part, intended to promote competition in the financial sector:

- In 1999, demutualization legislation allowed Canada's largest mutually owned life insurance companies to demutualize, improving insurance companies' access to markets to raise capital; other legislative changes allowed foreign banks to establish operations in Canada without setting up Canadian-incorporated subsidiaries. This enabled foreign banks to use their home capital base to support lending activities in Canada and provided them with "greater flexibility with respect to how they provide financial services in Canada".³⁰
- In 2001, changes enacted by Bill C-8 included: reducing ownership restrictions for banks by increasing the percentage of voting shares of large banks that an investor could hold; allowing small banks to be privately held by commercial entities indefinitely; creating a holding company regime for banks; increasing flexibility for credit unions by increasing their structural flexibility; and improving access to the clearing and settlement of payments system.³¹

These changes were supposed to increase the flexibility of financial institutions to respond to competitive pressures and strengthen their ability to compete. As has been noted elsewhere, over time these changes "will result in a more competitive, innovative, and efficient financial sector."³²

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While the Bureau is not yet entirely convinced that these changes significantly reduce barriers to entry in the financial sector, it does recognize that they are going to have to look at the impact of these changes in future merger reviews.³³

The Financial Sector has Changed both Domestically and Internationally

The financial sector in Canada is changing rapidly.

Canada's financial wealth under management has grown from \$3 trillion in 1997,³⁴ to the point where it is expected to exceed \$5 trillion by 2005.³⁵ Financial institutions have proliferated. In 1998, Canada had approximately 3000 financial institutions – encompassing banks, life insurers, finance companies, credit unions, asset managers, and investment dealers.³⁶ In January of 2003, there were more than 8000 financial institutions, including banks, foreign bank subsidiaries, trust companies, life insurance companies, credit unions and *caisse populaires*, mutual fund companies and financing firms.³⁷

There are now more banks in Canada managing more assets than there were in 1997, the year before the proposed mergers. In 1997, the banking industry included 53 banks managing \$1.2 trillion in assets.³⁸ In 2003, that number has grown to 68, including 31 foreign bank subsidiaries and 21 foreign bank branches operating in Canada, and together they manage over \$1.7 trillion in assets.³⁹

There is an increasing presence of foreign bank subsidiaries and foreign bank branches in Canada as demonstrated by their more than 10% increase in wealth managed between 1998 and 2002.⁴⁰ Much of this growth is attributed to foreign bank branches, which were permitted as a result of the legislative changes implemented in 1999.

From 1990 to 2001, the number of credit unions and *caisse populaires* decreased from 2,700 to 1,772 as a result of continuing merger activity,⁴¹ thereby increasing their individual size as competitors in the financial services sector.

Advances in technology are also increasing. Use of online banking doubled from October 2000 to October 2002⁴² and in 2002, ING Direct, which has offered services in Canada for a number of years, became the largest internet bank in the world with four million customers.⁴³ For the Royal Bank of Canada, over 95% of transactions occur outside the branch network.⁴⁴ The Bureau recognizes these changes will need to be examined in future merger reviews.⁴⁵

Internationally, however, Canadian banks are reportedly falling behind. ING Direct and Wells Fargo, both much larger than Canada's largest bank, now conduct significant business in Canada, having first grown in their home markets. In the view of the Honourable Senator Kolber, Chairman of the Senate Banking Committee, "mergers among large banks in Canada ... [are] necessary to ensure the continuing relevance of Canadian banks in Canada as well as worldwide."⁴⁶ [emphasis added] Others have noted that "consolidation within the

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financial services industry can be strategically good for our country. It provides a greater opportunity to develop national champions capable of competing in a global marketplace.”⁴⁷

This is important from the perspective of the Bureau’s merger review process, because section 1.1 of the *Competition Act* states that one of the purposes of the *Competition Act* is to “expand opportunities for Canadian participation in world markets” and to recognize the participation of foreign competition in Canada. The Federal Court of Appeal has stressed that this section is to be used in applying the *Competition Act* to specific cases.⁴⁸ It would be helpful, therefore, to know how the Bureau would apply this principle in a bank merger, given that international competitiveness is likely to be one of the key drivers in any such merger.

There have been Changes in the Competition Laws of Canada: the Efficiency Defence in Section 96 of the Competition Act

As part of the Bureau’s bank merger review process, the BMEGs provide that determinations on the efficiency defence in a bank merger case will be referred to the Competition Tribunal⁴⁹ – that is, however, not so clearly the case today. More recently, the Bureau identified efficiencies as a factor that it would consider in conducting its examination:

The final area we’d have to look at is efficiencies, and this is a possible defence. The efficiencies must outweigh the negative effects on competition, and to count they must not be obtainable by means other than a merger – i.e. through internal growth or joint ventures.⁵⁰

In practice, merger efficiencies will form part of the analysis. How they are incorporated into the analysis, however, remains something of a mystery for now. Since the date of the above statement (December 10, 2002), there has been a significant development in the interpretation of the efficiency defence. The *Superior Propane* case was finally concluded, after four years of litigation, with the January 31, 2003 decision of the Federal Court of Appeal which the Commissioner chose not to appeal, effectively allowing the merger.⁵¹ The case involved the merger of two propane distribution companies and was the first case to test and invoke the so-called efficiencies defence for mergers set out in section 96 of the *Competition Act*. It should be noted that the government is actively seeking to change the efficiency defence in proposed Bill C-249, which is passing through the Senate at the time of writing.

In the *Superior Propane* case, the Commissioner launched several appeals, with the main objection being that the use of the defence in that case permitted a merger to monopoly. Importantly, unlike the *Superior Propane* case, a bank merger would not result in a merger to monopoly, as that term was used in the *Superior Propane* case.

How efficiencies will be considered in a bank merger remains to be seen, but the Bureau seems to be saying publicly that it – as opposed to the Tribunal – will consider the defence at the examination stage of any bank merger proposal before it submits its report to the Minister and, as such, efficiencies will likely be an important factor in the Bureau’s analysis.

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Conclusions

The Bureau recognizes that large bank mergers are a legitimate strategy for banks. That is clear from the issuance of its BMEGs, and from its statements about both its process and the manner in which it determines and negotiates remedies.

In the next round of bank mergers it will be critical to manage the process, to develop and navigate remedies specific to the merger proposal in question, and to properly analyze changed circumstances. Change, innovation, and merger efficiencies will also need to be considered, as will Canada's place in the global banking system.

Uncertainty remains, however, over the timing of merger proposals and the treatment of efficiencies. It also remains to be seen how competition factors will play in to the overall process once the Bureau's report to the Minister is completed. Here, many questions remain, and there is a need for more direction from the government on these issues. Would a negative Bureau ruling defeat a merger? Would a positive one be determinative in its favour? What weight will be given to each report? Some of these issues have been raised in recent hearings, but the response, at least from the Bureau, has been that it has a limited role to play in accordance with its statutory mandate under the *Competition Act*.

Greater clarity on when such mergers might be entertained and how the Bureau's input would be used would benefit all stakeholders in preparing for the challenges and changes that will face the financial services sector in the years to come.

Notes

* The authors are, respectively, Partner, Blake, Cassels & Graydon LLP and Associate, Ogilvy Renault. This paper draws heavily on a paper written by the authors for presentation at the Atlas Information (Canada), 2003 Financial Services Forum, on May 6, 2003, Langdon Hall, Ontario.

¹ See Gordon M. Nixon, *Canada Needs A Clear and Timely Merger Review Process*, POLICY OPTIONS MAGAZINE (March 2003) at 19: ("[A] clear, transparent and predictable process is needed before any bank merger proposals are likely to be submitted to Ottawa for regulatory approval. The public interest [which the Minister of Finance must find a proposed merger of large banks to be in, before giving ultimate approval to proceed,] requires a degree of clarity and predictability...").

² See, for example: *Merger Review Guidelines*, provided in Department of Canada Finance Press Release, *Government Reintroduces Legislation to Create New Policy Framework for Financial Services Sector* (News Release 2001-014, 7 February 2001), available on the Department of Finance Canada's website at www.fin.gc.ca; *The Merger Enforcement Guidelines as Applied to a Bank Merger* ("BMEGs"), Competition Bureau (January 2003), available on the Competition Bureau's website at <http://cb-bc.gc.ca>; Transcript of Evidence before the House of Commons Standing Committee on Finance, pursuant to Standing Order 108(2), regarding its study on Bank Mergers: Meeting No. 32, December 10, 2002, available online at www.parl.gc.ca; Transcript of Evidence before the Senate Standing Committee on Banking, Trade and Commerce regarding its examination into the public interest implications for large bank mergers (Issue No. 5 – Evidence of November 25, 2002); P. Collins, "Canadian Finance Minister Blocks Two Major Bank Mergers" (1998-1999) 19:3 Can. Comp. Rec. 1 and B.A. Facey, "Financial Sector Merger Efficiencies under the Competition Act" (Canadian Bar Association Annual Fall Conference on Competition Law, 24 September 1998).

³ These include: *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 (Comp. Trib.); *Canada (Commissioner of Competition) v. Superior Propane Inc.*, [2001] 11 C.P.R. (4th) 289 (F.C.A.); *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2002), 18 C.P.R. (4th) 417 (Comp. Trib.); *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2003), 23 C.P.R. (4th) 316 (F.C.A.) [hereinafter "*Superior Propane*"]; *Canada (Commissioner of Competition) v. Canadian Waste Services Holdings Inc.* (2001), 11 C.P.R. (4th) 425 (Comp. Trib.); and *Canada (Commissioner*

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of *Competition v. Canadian Waste Services Holdings Inc.* (2001), 15 C.P.R. (4th) 5 (Comp. Trib.); and *Canada Waste Services Holdings Inc. v. Canada (Commissioner of Competition)*, [2003] FCA 131 (F.C.A.). Mr. Facey acted as competition law counsel for Superior Propane before the Competition Tribunal and the Federal Court of Appeal.

⁴ See P. Collins, D.J. Brown & D. Salzberger, "A Square Peg in a Round Hole: The Role of Interdependence in the Evaluation of Bank Mergers" (Atlas Information (Canada), 2003 Financial Services Forum, 6 May 2003).

⁵ See testimony of Gaston Jorré, Senior Deputy Commissioner of Competition with the Bureau, to the House of Commons Standing Committee on Finance, *supra* note 2 at 10:25. The Bureau believes that it can complete its review of a major bank merger within the five month period provided for in the *Merger Review Guidelines*, *supra* note 2.

⁶ See testimony of Richard Annan, Major Case Director and Strategic Policy Advisor with the Bureau, to the House of Commons Standing Committee on Finance, *supra* note 2 at 10:15.

⁷ *Merger Review Guidelines*, *supra* note 2.

⁸ See testimony of Gaston Jorré, *supra* note 5 at 10:50.

⁹ See Letters from the Bureau to the Royal Bank of Canada and the Bank of Montreal and to the Canadian Imperial Bank of Commerce and Toronto-Dominion Bank (December 11, 1998) at 1: "It is up to the parties to determine if it is appropriate to explore potential remedies with the Bureau after receiving this letter and after taking into account any public interest concerns expressed by the Minister of Finance" (available on the Bureau's website at <http://cb-bc.gc.ca>).

¹⁰ BMEGS, *supra* note 2 at 43.

¹¹ See testimony of Gaston Jorré, *supra* note 5 at 10:50.

¹² See testimony of Richard Annan, *supra* note 6 at 10:55.

¹³ *Ibid.* at 11:05.

¹⁴ *Ibid.* at 09:40.

¹⁵ See Nixon, *supra* note 1 at 20-21: "the best defence of Canadian financial sovereignty is an environment that facilitates stronger, Canadian-controlled banks ... Restricting growth and consideration only serves to disadvantage our Canadian financial institutions as markets globalize."

¹⁶ *Merger Review Guidelines*, *supra* note 2.

¹⁷ Prior to 1998, the last "big bank" merger the Competition Bureau reviewed was the merger of The Canadian Bank of Commerce with the Canadian Imperial Bank of Canada to form the Canadian Imperial Bank of Commerce in 1961. The Competition Bureau did, however, review the merger of Bank of Alberta & Western and Pacific Bank of Canada (both Schedule I banks) in 1988. See J. Bolton & T. Kennish, "Canadian Bank Mega Mergers Rejected: What Happened?" (1999-2000) 19:4 Can. Comp. Rec. 58 at 82, note 2.

¹⁸ See testimony of Gaston Jorré, *supra* note 5 at 09:35.

¹⁹ See testimony of Richard Annan, *supra* note 6 at 10:15.

²⁰ Mr. Facey acted as competition law counsel for Merrill Lynch in its \$1.3 billion acquisition of Midland Walwyn. Subsequently, Merrill Lynch sold most of its Canadian brokerage business to CIBC. See "Merrill Lynch Closes Acquisition of Midland Walwyn to Create a Leading Financial Services Firm in Canada", (Merrill Lynch Press Release, 26 August 1998, available on Merrill Lynch's website at www.ml.com.) and "CIBC Creates a Pre-eminent Retail Brokerage Firm with Acquisition of Merrill Lynch Canada Business" (CIBC Press Release, 21 November 2001, available on CIBC's website at www.cibc.com).

²¹ "Proposed Merger of Toronto-Dominion Bank and Canada Trust" (Competition Bureau Information Notice, 31 January 2000, available on the Competition Bureau's website at <http://cb-bc.gc.ca>).

²² "Acquisition of Clarica by Sun Life Approved" (Department of Finance Canada Press Release, 2002-045, 27 May 2002) and "Acquisition of Canada Life by Great-West Lifeco Approved" (Department of Finance Canada Press Release, 2003-036, 27 June 2003).

²³ The Royal Bank of Canada and the Bank of Montreal announced their proposed merger first on January 23, 1998, and The Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank followed with the announcement of their proposed merger on April 17, 1998.

²⁴ "Minister of Finance Announces Decision on Bank Merger Proposals" (Department of Finance Canada, Press Release 1998-123, 14 December 1998).

²⁵ See Nixon, *supra* note 1 at 19: "Our public interest process would be more productive if it had a clear mandate".

²⁶ *Change Challenge Opportunity: Report of the Task Force*, Task Force on the Future of the Canadian Financial Services Sector (September 1998) at 19.

²⁷ *Ibid.* at 1.

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- ²⁸ *Change Challenge Opportunity: Highlights of the Report of the Task Force*, Task Force on the Future of the Canadian Financial Services Sector (September 1998) at 3.
- ²⁹ F. Daniel, Department of Monetary and Financial Analysis, "Recent Changes to Canada's Financial Sector Legislation", (Winter 2002-2003) Bank of Canada Review.
- ³⁰ *Ibid.* at 6-8.
- ³¹ *Ibid.* at 9-15.
- ³² *Ibid.* at 15.
- ³³ See testimony of Richard Annan, *supra* note 6 at 10:45: "I guess our general take on Bill C-8 was there were a number of measures in there that were helpful and were going in the right direction ... It's clear that we're going to have to look at, for example, the degree to which the credit unions have grown and become competitors and so on."
- ³⁴ "The Changing Landscape for Canadian Financial Services: New Forces, New Competitors, New Choices" (Research Paper, McKinsey & Company, prepared for the Task Force on the Future of the Canadian Financial Services Sector (September 1998)) at 12.
- ³⁵ Gregory D.L. Morris, Don't Blame Canada. U.S. *Reticence Limits Growth: Forget 54-40 or fight. New rules will spur ventures*, Bank Investment Marketing, available at www.bankinvestmentmktg.com.
- ³⁶ See McKinsey & Company, *supra* note 34 at 7.
- ³⁷ *Fast Facts: Competition in the Canadian Financial Services Sector*, Canadian Bankers Association (January 2003) at 1.
- ³⁸ See McKinsey & Company, *supra* note 34 at 12.
- ³⁹ See "Banks in Canada" on the website of the Canadian Bankers Association at www.cba.ca.
- ⁴⁰ See Daniel, *supra* note 29 at 7.
- ⁴¹ See testimony of J. DeLaurentiis, President and CEO, Credit Union Central of Canada, to the Senate Standing Committee on Banking, Trade and Commerce. Transcript of Evidence of the Proceedings of the Senate Standing Committee on Banking, Trade and Commerce regarding its examination into the public interest implications for large bank mergers (Issue No. 9 - Evidence of December 4, 2002) at 2. In addition to general changes, recently Coast Capital Savings Credit Union and Surrey Metro Savings Credit Union merged to become Canada's largest credit union, and other important mergers are underway amongst large credit unions.
- ⁴² "Double-click: Online banking increases 100 per cent in two years", October 2002 Canadian Banker Magazine.
- ⁴³ "Internet Banking Update" (prepared by Charles Goldfinger for the Financial Internet Working Group (September 2002)) at 3.
- ⁴⁴ See Nixon, *supra* note 1 at 22.
- ⁴⁵ See testimony of Richard Annan, *supra* note 6 at 11:05.
- ⁴⁶ E.L. Kolber, "A Case for Bank Mergers: Keeping Canada Competitive In A Global Financial Services Industry" (March 2003) Policy Options Magazine at 13-14.
- ⁴⁷ See Nixon, *supra* note 1 at 20.
- ⁴⁸ See *Superior Propane 2003*, F.C.A., *supra* note 3.
- ⁴⁹ As stated in the BMEGs, *supra* note 2 at 41: "It is the Director's policy that in cases where there is a strong likelihood of substantial prevention or lessening of competition, and yet the parties to the merger are claiming efficiency gains, the Director will bring such cases before the Competition Tribunal for resolution".
- ⁵⁰ See testimony of Richard Annan, *supra* note 6 at 09:40.
- ⁵¹ See *Superior Propane 2003*, F.C.A., *supra* note 3.
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EXPERIMENTS IN NOTIFICATION: LESSONS FROM THE EUROPEAN UNION

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On November 26, 2002, the European Commission (the "Commission") announced Council Regulation No 1/2003 ("Regulation 1")¹ which radically overhauls the procedures relating to the notification process in respect of the conspiracy provision set out in Article 81 of the Treaty of Rome (the "EC Treaty").² This article considers the lessons that Canada could draw from the European Council's decision to revamp that process, which is set out in Regulation 17 and has remained largely unchanged since its introduction in 1962.³

Under the EC's current regime, parties to agreements have strong incentives to apply to the Commission for an exemption from the Article 81(1) prohibition on agreements that restrict or distort competition under Regulation 17, even where their agreement raises no significant competition issues.⁴ As a result, the Commission is often overwhelmed with notifications. Regulation 1, which will come into force on May 1, 2004, will address these difficulties by (1) abolishing the notification system and (2) giving Member State competition authorities and national courts the power to issue exemptions, previously the sole preserve of the Commission.

Across the Atlantic, the Canadian House of Commons Standing Committee on Industry, Science and Technology issued a report in April 2002 calling for reform of section 45 of the *Competition Act*, Canada's conspiracy provision.⁵ In particular, the Standing Committee proposed a two-track approach for horizontal agreements between competitors: a criminal *per se* track for hard-core restrictions such as price fixing and market allocation, and a civil track for other arrangements such as strategic alliances containing restrictive provisions. The *per se* provision would not require proof of the competitive impact of a restrictive agreement, while the civil track would permit consideration of efficiencies and other pro-competitive aspects of an agreement. Included in the Standing Committee's recommendations for the proposed criminal track is a voluntary clearance system for parties seeking to obtain Competition Bureau assurance that restrictive provisions in their agreements do not fall within the *per se* category. From the analysis that follows, however, it appears that the system that Canada is about to embrace has much in common with the system that the EU is about to abandon.

The article is structured as follows. Part I sets the context for the reform of the EC notification regime by providing an overview of Article 81, the EC Treaty's provision on restrictive agreements. Part II describes the current EC notification procedure and the revamped notification regime. Part III outlines the current Canadian conspiracy provision and the Standing Committee's reform proposals. Part IV concludes by comparing the two systems and noting the divergent directions pursued by reformers in Canada and the EU.

Overview of Article 81

Article 81(1) of the EC Treaty prohibits agreements that have the object or effect of preventing, restricting or distorting competition within the common market.⁶ The types of anti-competitive agreements caught by Article 81 are enumerated in a non-exhaustive list. If an agreement falls within Article 81(1), it may receive an

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individual exemption under Article 81(3) or may fall within one of the Commission's block exemptions for agreements containing certain categories of restraints. Exceptions are also made under "ancillary restraints" and "de minimis" doctrines developed in the courts. Contraventions of Article 81 may result in the imposition of stiff fines.

Object or Effect

Article 81(1) requires that the "object or effect" of the agreement be restrictive. The European Court of Justice ("ECJ") has interpreted these words disjunctively.⁷ If the object⁸ of the agreement is clearly to restrict competition, then Article 81(1) is satisfied without inquiry into its actual effect on competition. Within the "object" category of agreements are price-fixing and market sharing, the hard core restrictions that are the focus of concern of the Canadian reformers. The *Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements* (the "EC Guidelines")⁹ state that:

In some cases the nature of cooperation indicates from the outset the applicability of Article 81(1). This is the case for agreements that have as their object a restriction of competition by means of price fixing, output limitation or sharing of markets or customers. These agreements are presumed to have negative market effects. It is therefore not necessary to examine their actual effects on competition and the market in order to establish that they fall within Article 81(1)... They therefore are almost always prohibited.

Nevertheless, if the object of the agreement is unclear, then the competitive effect of the agreement will be considered. There must be a likely effect on competition in the market such that there are negative market impacts relating to prices, output, innovation or the variety or quality of goods and services. In order to make this determination, both the nature of the agreement and the parties' combined market power must be taken into account.¹⁰

Article 81(3) Exemptions

This object/effect dichotomy appears at first blush to parallel the *per se*/rule of reason bifurcation in U.S. antitrust analysis as well as the proposed dual track regime in Canada. However, this comparison fails to take into account that even the "object" agreements may be saved by the Article 81(3) exemptions. According to Whish:

...there is an important difference in EC law in that, even if an agreement has as its object the restriction of competition, that is to say that it infringes Article 81(1) *per se*, the parties can still argue for exemption under Article 81(3). This possibility does not exist in US law, since there is no equivalent of Article 81(3).¹¹

The Article 81(3) conditions for exemption are that the agreement:

- (a) contributes to improving the production or distribution of products or to promoting technical or economic progress;
- (b) allows consumers a fair share of the resulting benefit;

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- (c) does not impose restrictions other than those that are indispensable to the attainment of the above-listed objectives; and
- (d) does not afford the possibility of eliminating competition in respect of a substantial part of the products in question.

The EC Guidelines state that the first condition relates to static or dynamic efficiencies; these must outweigh the restrictive effects on competition and must result from the cooperation. Efficiency claims must be substantiated with speculative gains being insufficient. The second condition is interpreted such that the transmission of the benefits to consumers will depend on the intensity of competition within the relevant market. In addition, the restriction of competition has to be necessary to achieve the economic benefits. If there are less restrictive means to achieve such benefits, then the exemption will not be available.

Judicially Developed Limitations on the Scope of Article 81(1)

In addition to the exemption process under Article 81(3), restrictive agreements have also avoided the prohibition under Article 81(1) under a judicially-developed “ancillary restraints” doctrine. The ECJ has held that certain restrictions fall outside Article 81(1) on the basis that they are objectively necessary for the success of the pro-competitive agreements in which they are contained.¹² For example, in the *Pronuptia* case, restrictions in a distribution franchise agreement were held not to constitute restrictions falling within Article 81(1) where they prevented the franchisor’s expertise and assistance from benefiting competitors and protected the identity and reputation of Pronuptia’s trade name.

Finally, the ECJ held early on in the *Völk v. Vervaeke*¹³ case that to be caught under Article 81, there must be an appreciable impact on competition, thus establishing a *de minimis* threshold below which restrictions will not be challenged. The Commission has also issued a *Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community*¹⁴ pursuant to which agreements that do not appreciably restrict competition are not subject to Article 81(1). While the Notice is not binding on the European courts, it indicates the Commission’s approach. The objective of the Notice is to reduce the compliance burden for companies, especially smaller companies, while at the same time reducing the burden on the Commission in examining cases in which it has no interest from a competition policy point of view.¹⁵ The Notice states, however, that the *de minimis* exception does not apply to “hard core restrictions” including restrictions which directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object price fixing when selling the products to third parties, limitation of output or sales, or allocations of markets or customers. Thus, merging parties entering into agreements with such restrictions cannot avoid the application of Article 81(1) on the sole grounds that there is no appreciable impact on competition.

EC Notification Procedures: Current and Future

Pursuant to the current Regulation 17, firms are able to notify agreements to the Commission to secure “negative clearance”, i.e., a certification that there are no grounds under Article 81(1) for the Commission to take action

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against the parties. If, however, an agreement does fall within Article 81(1), parties seeking assurances that their agreement does not violate Article 81 would have to obtain an exemption from Article 81(1) pursuant to Article 81(3). Agreements that fall within Article 81(1) are valid and enforceable before a civil court only if notified to, and exempted by, the Commission. (Note that agreements meeting the criteria set out in the so-called block exemptions are valid without notification or authorization from the Commission.¹⁶) Parties are generally immune from fines for the period between the date of notification of the agreement and final decision by the Commission, although the Commission has the discretion to impose a fine retroactively.¹⁷ Thus while notification is not mandatory, the risk of not notifying (nullity of the agreement and fines) is substantial.

Criticism of the Current System

The Regulation 17 notification regime has been the subject of intense criticism over the years on a number of grounds:

- (1) The Commission generally does not respond to notifications through the formal clearance routes (i.e., negative clearances and exemptions). Instead, the practice has been to issue non-binding administrative letters (so-called "comfort letters"). Moreover, delays are considerable and will only worsen as the EU grows (ten new Member States are to join in 2004). These problems arise mainly as a result of the large number of notifications the Commission receives – many of which relate to agreements with no significant anti-competitive effects.¹⁸
- (2) Because firms notify the Commission only when they believe the agreement will likely be cleared by the Commission, the notification system diverts the Commission's attention and resources from the agreements that are not notified, i.e., the ones that raise serious competition concerns.
- (3) The burden of notification in terms of both costs and the resources required to prepare submissions is heavy and may have a chilling effect on parties wishing to engage in pro-competitive alliances. In its 1999 White Paper on the modernization of Regulation 17, the Commission stated:

The legal environment is one of the factors determining the competitiveness of undertakings, and their competitiveness must be fostered as much as possible. At present, in pursuing their industrial and business strategies, undertakings must take account of the need to notify their restrictive practices to the Commission in order to obtain assurance that they do not infringe the competition rules. This requirement generates major costs, particularly for medium-sized undertakings. One of the objectives in modernising the competition rules must therefore be to avoid impeding cooperation between undertakings, where such cooperation does not pose any threat to competition, by freeing them from the constraints imposed by the current notification system.¹⁹ [emphasis added]

- (4) The Commission's monopoly on issuing exemptions has meant that national courts are unable to apply Article 81 in its entirety but have to revert to the Commission on the applicability of Article 81(3) in any given case. This has led to an artificially segmented analysis and to delays in the national courts in resolving cases involving Article 81.

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The Future System

In response to the mounting criticism levelled against Regulation 17, the Commission issued a proposal for a new regulation implementing Articles 81 and 82 in September 2000. Regulation 1 which was adopted on November 26, 2002²⁰ includes some radical changes:

(1) Under the new regime, national courts of Member States and national competition authorities will have the authority to exempt under Article 81(3) agreements that fall within Article 81(1). To address the potential for different interpretations of Article 81(3) among Member States, the EU is establishing a European Competition Network to coordinate the application of the European competition rules and to exchange information. While there will be no change in the substantive law regarding exemptions, the reviewing agency will be able to apply Article 81 in its entirety, i.e., both 81(1) and 81(3), without segmenting the analysis. The Commission anticipates that this will “enhance a more economic approach towards applying this Article as a coherent provision”.²¹ As the Commission will no longer be the only body able to declare Article 81(1) inapplicable pursuant to Article 81(3), the demands on the Commission will be reduced.²²

(2) Under Regulation 1, agreements satisfying the conditions of Article 81(3) will be valid and enforceable without any administrative decision to that effect being required.²³ This will allow the elimination of the notification requirement. For agreements that may restrict competition to an appreciable extent, the parties will have to seek legal advice on the competition law risk presented by the agreement. The Commission intends to facilitate this assessment of proposed conduct through the issuance of block exemptions and Commission notices and guidelines.²⁴ The Commission will discuss specific cases with companies where there is a genuine problem of legal predictability. In certain instances, this may mean that the Commission will provide written opinions to companies.

Canadian Law on Conspiracies: Current and Proposed

The Current Law

Section 45, the core criminal provision of the *Competition Act*, prohibits any person from conspiring, combining, agreeing or arranging with another to prevent or lessen competition unduly.²⁵ Paragraphs (a) to (c) under section 45 identify specific types of anti-competitive conduct that are prohibited, such as price fixing, allocating customer or geographic markets or preventing or impeding the entry of a competitor into the marketplace, while paragraph (d) broadens the scope of section 45 by prohibiting agreements that “otherwise restrain or injure competition”. Punishment includes jail terms of up to 5 years and fines of up to \$10 million per count.

The criminal nature of this section means that, in order to prove the offence, the Crown must establish beyond a reasonable doubt both intent and the criminal act. To prove the criminal act, the prosecution must establish the existence of a conspiracy and an undue prevention or lessening of competition. This requires, as a prerequisite, some degree of market power and some degree of anti-competitive behaviour.²⁶ In the Supreme Court of Canada’s decision in *R. v. Nova Scotia Pharmaceutical Society et. al*²⁷, the Court assessed the market power of

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the parties to the agreement and then considered whether there had been injurious behaviour to competition that would qualify as "undue". The analytical approach adopted fell somewhere between a *per se* rule and a rule of reason approach:

It does allow for discussion of the anti-competitive effects of the agreement, unlike a *per se* rule, which might dictate that all agreements that lessen competition attract liability. On the other hand, it does not permit a full-blown discussion of the economic advantages and disadvantages of the agreement, like a rule of reason would.²⁸

Two problems associated with the current section 45 have been identified and discussed extensively elsewhere.²⁹ First, the threat of prosecution under subsection 45(1) is said to create a chilling effect on pro-competitive agreements that may have restrictive elements because of the uncertainty in the outcome of the section 45 analysis, particularly as efficiency considerations are not taken into account. Accordingly, the argument runs, businesspeople refrain from entering into such agreements out of fear that they will incur criminal liability - the so-called "overinclusiveness" problem.

The second difficulty alleged by proponents of section 45 reform is that it is difficult to obtain convictions even with agreements that are the most harmful to the competition process - the so-called "underinclusiveness" problem. As noted above, the two major elements that should be considered in determining whether an undue lessening of competition is likely to occur are: the structure of the market and the behaviour of the parties to the agreement. These considerations involve complex economic evidence, which, proponents argue, makes the Crown's burden a very heavy one. The use of the standard of undueness and reliance upon complex economic evidence means that even in the face of a "naked, hard-core cartel" (such as agreements related to price fixing or market sharing), the Crown is sometimes unable to prove its case. This effect is evidenced by a rather poor enforcement record³⁰, and led the Standing Committee to conclude that "the 'undueness' element poses the greatest obstacle to a successful conviction under section 45."³¹

The Proposed Law

The Standing Committee suggests a number of amendments to section 45 of the Act and echoes the Competition Bureau and other commentators in proposing a two-track approach for agreements between competitors - one criminal and the other civil.³² The Canadian Government in its response to the Standing Committee Report has also endorsed this approach.³³

The new civil track would permit the Competition Bureau to review purportedly pro-competitive horizontal agreements between competitors, such as strategic alliances. The Commissioner would be able to apply to the Competition Tribunal where such agreements had the effect of preventing or lessening competition substantially in a market. In conjunction with a finding of a substantial lessening, the Competition Tribunal, pursuant to the Standing Committee's recommendations, would be able to issue civil remedies, including an award of damages.³⁴ To reduce uncertainty associated with the new section 45 regime, the introduction of the two-track approach would also be accompanied by the publication and issuance by the Competition Bureau of enforcement guidelines on conspiracies, strategic alliances, and other horizontal agreements between competitors.³⁵

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The criminal track (replacing the current section 45) would apply only to “agreements that are strictly devised to restrict competition directly through raising prices or indirectly through output restrictions or market sharing, such as customer or territorial assignments, as well as group customer or supplier boycotts”. Entering into these hard-core cartels would require no proof of anti-competitive effects, i.e., it would be a *per se* offence.

To ensure that a *per se* criminal offence under section 45 would not be overinclusive, the Standing Committee proposes that exceptions be established on the basis of guiding principles, not a “laundry list” of items.³⁶ Two examples of such factors are: the ancillarity of the restraint in an agreement that is likely to generate efficiencies or foster innovations; and the restraint would have to be reasonably necessary to achieve these efficiencies or cultivate innovation. The onus of proof would fall on proponents of the agreements to establish ancillarity on a “beyond a reasonable doubt” standard.

Pitfalls with Canada’s Proposed Approach

The approach advocated by the Standing Committee creates a very difficult task – fashioning statutory language that would catch all hard-core restrictions but at the same time carve out exceptions to relieve from *per se* liability agreements that contain some hard-core restriction but overall are anti-competitive. Absent crystal-clear language exonerating the latter type of agreement, the concern is that the proposed section 45 could well induce a more intense chilling effect than the current section 45.

Parallels with the Current EU Approach

The Standing Committee’s proposal for a *per se* criminal offence for hard-core restrictions with some form of exception (e.g., ancillarity) for restrictions that might inadvertently be swept into the *per se* category has parallels to the current EC bifurcated approach to agreements that restrict competition. In both systems, the general prohibition against restrictions on competition is over-inclusive and the consequences of such inclusion are very serious. In the EU, an agreement that is found to violate Article 81(1) will not be enforceable pursuant to Article 81(2) unless declared exempt by the Commission. In the Canadian proposal, parties to a pro-competitive agreement with restrictions falling within the *per se* category are potentially subject to criminal liability unless they fit within an as-yet-undefined statutory exemption. Under both Regulation 17 and the proposed Canadian system, the mechanism chosen to address the over-breadth of the prohibition is pre-clearance.

Pursuant to the Standing Committee’s recommendation, the Commissioner would be authorized to issue a clearance certificate if he is satisfied that the agreement does not substantially lessen competition or pose a threat under section 45. A time limit for responses from the Commissioner would be imposed, such that beyond the time limit, the applicant would be deemed to have been granted a certificate. The non-issuance of a pre-clearance certificate would mean that the person who is refused the certificate would have standing to go before the Competition Tribunal.³⁷

While the Standing Committee envisages the pre-clearance system as optional, notification of strategic alliances and other pro-competitive agreements containing *per se* restrictions would likely become *de facto* mandatory in

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many instances. With parties to a proposed agreement facing the possibility of prosecution under a *per se* criminal provision because their agreement contained a *per se*-type restriction, even if ancillary, it is likely that they would view clearance as a critical prior step to entering into the agreement. Thus, as in the EU, in all likelihood pre-clearance would effectively be required for pro-competitive agreements containing restrictions falling within the hard-core, *per se* category. Again as in the EU, as a result of the considerable investment of time and resources in seeking clearance, this system could well impede the implementation of strategic alliances and divert resources from more urgent enforcement matters.

EU and Canadian Reforms: Heading in Divergent Directions

Interestingly, the reform of Regulation 17 appears to be taking EC competition law in a direction diametrically opposed to that of the proposed Canadian conspiracy regime with its clearance system. The EU has rejected a regime that on the one hand casts its prohibition on restrictive agreements broadly (the “*per se*” aspect of Article 81(1)) and then on the other hand permits exemptions of agreements meeting certain criteria (in Article 81(3)) if notified to the European Commission. While notification is not currently required under EC law, parties seeking comfort that their agreements would not be found void under Article 81(1) and subject to considerable fines regard notification as *de facto* mandatory. One of the reasons the Commission cites for the radical overhaul of Regulation 17 is the burden the notification system imposes on firms wishing to enter pro-competitive agreements. With Regulation 1, the EU is moving towards a more coherent economic analysis of agreements that restrict competition (through greater integration of Articles 81(1) and 81(3)) and towards a process resembling the current Canadian conspiracy regime; i.e., a regime in which the parties assess the competitive impact of an agreement in determining its legality and do not generally notify the Competition Bureau in advance.

On this side of the Atlantic, the currents are blowing in a different direction. Canadian proponents of section 45 reform would move the Canadian regime towards a *per se* approach with some exceptions carved out for pro-competitive restrictions. These would be screened out through a pre-clearance system akin to the *de jure* optional but effectively obligatory notification regime in the EU. As the EU’s forty year experience with Regulation 17 indicates, and as any competition lawyer familiar with the Canadian merger clearance process can attest, this notification process is likely to result in the expenditure of substantial time and resources (both legal and management) on the development of submissions to and consultations with the Competition Bureau. In addition, there will likely be a fee to recover costs.³⁸ All of these factors could well cause delay in the implementation of pro-competitive arrangements between competitors and in certain situations, could deter such arrangements. Moreover, the clearance process could divert resources away from the enforcement of cartels that will certainly not be notified.

While the EU’s experience with Article 81, including notification of agreements under Regulation 17, cannot be applied without qualification to Canada, proponents of section 45 reform in Canada would do well to take a close look at lessons learned abroad.

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Notes

¹ Regulation I is available at <http://europa.eu.int/eur-ex/pri/en/oj/dat/2003>.

² Regulation I covers a wide range of matters relating to Articles 81 and 82 of the EC Treaty. This article focuses on Regulation I's impact on Article 81 only. Note that this article refers to the "EC" in relation to the competition law provisions of the EC Treaty but refers to the European Union or EU in relation to the political entity.

³ Regulation 17 also applies to Article 82 (the abuse of dominance provision). However, this paper focuses only on its application to Article 81.

⁴ Note that there are a number of block exemptions available which apply to exempt specific categories of agreements pursuant to Article 81(3). For example, Commission Regulation (EC) No 2790/1999 applies to exempt agreements containing certain vertical restraints.

⁵ "A Plan to Modernize Canada's Competition Regime", Report of the Standing Committee on Industry, Science and Technology (April 2002) (the "Standing Committee Report") (available at www.parl.gc.ca/InfoComDoc/37/1/INST/Studies/Reports/indurp06-e.htm).

⁶ Article 81 states:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources or supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations or undertakings;
- any concerted practice or category of concerted practices;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertaking concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

⁷ See *Société Technique Minière v. Maschinenbau Ulm*, Case 56/65 [1966] ECR 235 at 249, [1966] CMLR 357 at 375.

⁸ The word "object" has been interpreted to mean the "objective meaning and purpose of the agreement considered in the economic context in which it is applied", not the subjective intention of the parties. See R. Whish, *Competition Law*, 4th ed. (London: Butterworths, 2001) at 92-93.

⁹ *Official Journal of the European Communities* (the "Official Journal") 2001/C 3/02.

¹⁰ See paragraphs 19 and 20 of the EC Guidelines.

¹¹ Whish, *supra* note 6 at 95.

¹² *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353, [1986] 1 CMLR 414 [hereinafter *Pronuptia*].

¹³ 5/69 (1969), ECJ.

¹⁴ 2001/C 368/07 *Official Journal*.

¹⁵ The *de minimis* Notice establishes a 15% market share for vertical agreements and a 10% market share for horizontal agreements. The Notice clarifies that exceeding these thresholds does not imply that the agreement would necessarily appreciably restrict competition.

¹⁶ Some block exemptions offer an opposition procedure whereby agreements falling outside the block exemption can be notified individually. Failure by the Commission to oppose the agreement within a certain timeframe means that the agreement is deemed exempted.

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¹⁷ Article 15(5) of Regulation 17/62. Fines are significant, up to 10% of the turnover in the preceding business year of each of the firms participating in an infringement of Article 81.

¹⁸ Whish, *supra* note 6 at 136.

¹⁹ See the *Commission White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty*, http://europa.eu.int/comm/competition/antitrust/wp_modern_en.pdf (the "Commission White Paper") at 4.

²⁰ *Council Regulation on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty*.

²¹ European Commission MEMO/02/268 available at http://europa.eu.int/rapid/start/cgi/question.ksh?p_action.gettxt=gt&doc=MEMO/02/268/O/R.

²² While the Commission expects that there will initially be challenges in bringing national courts and Member State competition authorities up to the same level of proficiency in dealing with the exemption procedure, the expectation is that many more agreements will be reviewed and cleared on an expedited basis.

²³ Under the current regime, an agreement falling within Article 81(1) is presumed to be illegal unless and until it is declared legal by the Commission.

²⁴ The new regulation also gives the Commission a general power to adopt block exemption regulations.

²⁵ 45.(1) Conspiracy – Every one who conspires, combines, agrees or arranges with another person

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

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

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

(d) to otherwise restrain or injure competition unduly,

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

²⁶ Please note, however, that the Commissioner of Competition has expressed the view that section 45(1)(b) establishes a *per se* offence with respect to the conduct described therein, such that the elements of the offence can be established without requiring evidence of market power. In particular, the Commissioner is of the view that the Crown does not need to demonstrate undueness with respect to agreements or arrangements that unreasonably enhance the price of a product, and that reasonableness is to be determined by considering the business necessities of the parties to the agreement and the interests of consumers. This interpretation has been contested by the private bar, and the issue has yet to be finally determined. See Remarks by Konrad von Finckenstein to 2001 Invitational Forum on Competition Law: Section 45 at the Crossroads, October 12, 2001.

²⁷ [1992] 2 S.C.R. 606 at 650 [hereinafter *PANS*].

²⁸ *Ibid.*

²⁹ See, for example, the Bureau-commissioned reports at <http://strategis.ic.gc.ca/pics/ct/russellrep2.pdf>.

³⁰ The Standing Committee Report notes that the conviction rate in contested trials is exceptionally low, between 10 to 15%. (See Chapter 4 at 6.) For a critical perspective on the meaningfulness of this statistic, see B.A. Facey & D.H. Assaf, "Innovation, Growth and Prosperity: A Framework for Amending Canada's Conspiracy Laws" (2001-2002) 20:4 Can. Comp. Rec. 61.

³¹ *Ibid.*

³² See R. Pierce, "Reform of Section 45 – The Bureau's Perspective" (Paper prepared for 2002 Competition Law Invitational Forum, Langdon Hall, Cambridge, Ontario, May 8-10, 2002, available at <http://strategis.ic.gc.ca/ssg/ct02349e.html>).

³³ See "Government Response to the Report of the House of Commons Standing Committee on Industry, Science and Technology 'A Plan to Modernize Canada's Competition Regime'" (available at www.ic.gc.ca/cmb/welcomeic.nsf/icpages/specialreports).

³⁴ See Standing Committee Report, Chapter 4 at 11.

³⁵ See Standing Committee Report, Recommendation 18.

³⁶ See Standing Committee Report, Recommendation 14.

³⁷ The Standing Committee considered a notification system that "would prohibit all secret or covert conspiracies to directly or indirectly fix prices, but would provide an exemption from subsection 45(1) to all overt horizontal agreements provided that their proponents notify the Bureau before the agreement takes effect." However, the Standing Committee rejected such a system because more cartel agreements would "slip through the cracks." See Chapter 4 of the Standing Committee Report at 12.

³⁸ The cost for clearing a merger through the Competition Bureau is \$50,000.

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