CT-96/2

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Director of Investigation and Research for orders pursuant to section 92 of the *Competition Act*, R.S.C. 1985, c.C-34, as amended;

AND IN THE MATTER OF the merger whereby CP Containers (Bermuda) Limited acquired certain assets held by The Cast Group Limited and of the acquisition by 3041123 Canada Inc. of all the shares of Cast North America Inc. by way of agreements entered into between or among The Royal Bank of Canada, CP Containers (Bermuda) Limited and Canadian Pacific Limited.

BETWEEN:

RCT / GTC
FAXLINE # 0308

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
PRODUIT
FEB FEV 7 1997
REGISTRAR — REGISTRAIRE
OTTAWA, ONT. #15

CANADIAN PACIFIC LIMITED, CANADA MARITIME LIMITED, CP CONTAINERS (BERMUDA) LIMITED, 3041123 CANADA INC., CAST NORTH AMERICA INC. and THE ROYAL BANK OF CANADA

Respondents

RESPONSE OF CANADIAN PACIFIC LIMITED, CANADA MARITIME LIMITED, CP CONTAINERS (BERMUDA) LIMITED, 3041123 CANADA INC. and CAST NORTH AMERICA INC.

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RESPONSE OF CANADIAN PACIFIC LIMITED, CANADA MARITIME LIMITED, CP CONTAINERS (BERMUDA) LIMITED, 3041123 CANADA INC. and CAST NORTH AMERICA INC.

PART I - SUMMARY OF GROUNDS UPON WHICH THE APPLICATION IS OPPOSED

1. The respondents Canadian Pacific Limited ("CPL"), Canada Maritime Limited ("Canmar"), CP Containers (Bermuda) Limited ("CPCB"), 3041123 Canada Inc. ("3041123") and Cast North America Inc. ("CNA"), collectively referred to hereinafter as "CP", oppose the application of the Director of Investigation and Research (the "Director") in this matter on the following grounds:

(a) CP's acquisition of the former Cast group of companies ("Cast") was reviewed and approved by the National Transportation Agency (the "NTA") pursuant to its then extant authority under Part VII of the *National Transportation Act, 1987*, R.S.C. 1985, c. 28 (3rd) Supp. (the "*NTA Act*"). After a contested public hearing, the NTA held on January 20, 1995 (the "*NTA Decision*") that CP's acquisition of Cast (the "Acquisition") would not substantially lessen or prevent competition. The NTA considered the same objections which are now being repeated by the Director in the notice of application dated December 19, 1996 (the "Notice of Application"), and rejected them.

(b) Under the former statutory regime, the NTA was the public arbiter of acquisitions in the transportation sector, reviewing these acquisitions in light of its expertise in transportation issues generally, and with respect to competition in the transportation sector specifically. In recognition of this expertise, the Tribunal should defer to the NTA's findings with regard to the Acquisition, unless the Director can rebut the presumption in favour of the correctness of the *NTA Decision* by demonstrating that the NTA:

(i) failed to consider relevant evidence which, if considered, would likely have changed its *Decision*;

(ii) was unreasonable in its assessment of the evidence; or

(iii) took irrelevant considerations into account in assessing the Acquisition.

Such deference is appropriate in light of the principle that statutory bodies should avoid reaching contradictory conclusions regarding the same event or transaction.

(c) The manner in which the Director conducted his inquiry into the Acquisition after the release of the *NTA Decision* amounted to an abuse of process. At no

point during this inquiry, up to and including the filing of the Notice of Application, did the Director ever indicate to CP where he believed the NTA had erred or what evidence he had obtained that raised doubts concerning the *NTA Decision*. Instead, the Director persisted with an investigation of the Acquisition for close to another two years (including 21 months after closing), subjecting CP to considerable effort and expense in responding to his demands. The Director also abused his compulsory powers under section 11 of the *Competition Act* (the "*Act*"), by using them as a substitute for the Tribunal's discovery procedures, gaining in the process advantages (such as productions from third parties) not available to CP.

(d) As to the specifics of the Director's allegations, CP denies that the Acquisition has or will substantially lessen competition in any relevant market. Rather, the Acquisition has contributed to the enhancement of services to Canadian shippers and consignees by strengthening the competitiveness of the only Canadian-owned shipping line operating on the North Atlantic, and allowing significant improvements to be made to Cast's service. The Acquisition has also preserved and added to the competitiveness of the port of Montreal in relation to other gateways.

(e) The Director's definition of the relevant product and geographic markets does not consider the extent and scope of the substitutes available to shippers and consignees for the services offered by Canmar and Cast. As well, the Director takes an unjustifiably restrictive view of the range of ports from which carriers compete with Canmar and Cast.

(f) The market share figures and concentration ratios relied upon by the Director are flawed in that they are based upon the Director's incorrect definition of the relevant market.

(g) Intense and effective competition from a variety of sources has imposed a competitive discipline upon Canmar and Cast since the Acquisition, and will continue to do so. These constraints include the countervailing power exercised by shippers, consignees and freight forwarders.

(h) Poised competition also exists to discipline against any significant non-transitory price increase or reduction in service. This poised competition takes the form of potential entry by existing global carriers on an incremental basis or the start up of a new shipping line. Both types of entry have occurred regularly in the past.

(i) Cast was not a vigorous competitor to Canmar prior to the Acquisition. To the contrary, it had effectively failed and would have exited the market. Notwithstanding that extensive efforts had been made to find a buyer for Cast, CP's was the only offer received by the Royal Bank of Canada ("RBC"). Moreover, retrenchment or liquidation were not competitively preferable options.

(j) In the alternative, if there has been a substantial lessening or prevention of competition, which is denied, it is offset by the efficiency gains that have and will result from the Acquisition. Such efficiency gains will not be attained if the orders sought by the Director herein are granted.

PART II - ADMISSIONS AND DENIALS

2. CP admits the allegations in paragraphs 7-9, 11-14, 30, 34, 38, 40, 45, 46, 50 (with respect to CP and Cast), 51 and 66 of the Notice of Application. CP has no direct knowledge with respect to paragraphs 33, 35, 41-44, 47-49 and 50 (with respect to OOCL and Hapag Lloyd).

3. Except as otherwise expressly admitted herein, CP denies each and every other allegation in the Notice of Application.

PART III - STATEMENT OF GROUNDS AND MATERIAL FACTS UPON WHICH CP RELIES

A. BACKGROUND TO THE ACQUISITION

4. The Director's description of the Acquisition at paragraphs 11-14 of the Notice of Application disregards many important factors.

1. THE INDUSTRY CONTEXT

5. The Director's Notice of Application fails to appreciate the dynamic and changing environment in which Canmar and Cast compete.

6. Most importantly, the Director takes no account of the rapid growth of global container carriers, and the extent to which this has created intense competitive pressures on smaller carriers such as Canmar and Cast.

7. The growth of both the industry generally and the competing shipping lines specifically has been rapid and significant. For example, the world's largest container carrier, Evergreen, operates a fleet of 103 vessels with a total capacity of 205,224 TEUs. That capacity has almost tripled in the last decade, from 70,000 TEUs in 1989. That was enough to rank Evergreen first amongst the world's carriers in 1989; a shipping line of the same size today would rank 20th. By way of comparison, Canmar and Cast *combined* operate 14 vessels with a total slot capacity of approximately 22,000 TEUs. That would not place them, on a combined basis, even among the world's-top thirty carriers in terms of vessel capacity or fleet size.

8. A list of the top twenty global carriers is attached hereto as Appendix 1. These carriers dominate the world's container shipping industry. They control almost 2.3 million of the world's current container tonnage of 4.7 million TEUs. Moreover, as they have a large share of new building orders, they will control over 50% of the world's container fleet by the year 2000.

9. This tendency towards growth is also reflected in the expansion of individual vessel sizes. Almost 50% of industry slot capacity is now provided by ships of 2,500 TEUs and above, and the fastest growth sector is in even larger vessels. Of the ships currently on order, representing 35% of the world's current capacity and due for delivery within 2 years, nearly half are greater in size than 4,000 TEUs. A large number of these new ships are now 6,000 TEUs. Canmar/Cast's average ship size is 2,000 TEUs. One of the consequences of global carriers being able to operate larger ships on the North Atlantic and elsewhere is that they are able to achieve significantly lower unit costs and scale economies.

10. In addition, because of their size and scale of operation, global carriers can achieve substantial scale economies in terminals, containers, inland costs, information systems and administration.

11. The emergence of global carriers, operating larger vessels, is driven by several factors. Foremost among these is the need to achieve continued cost savings and efficiencies in an industry characterized by low margins, cyclical traffic flows, exchange rate fluctuations, vessel over-capacity, high fixed costs, and limited brand loyalty. These features of the industry have placed intense pressure on carriers to enhance service quality while driving down their costs.

12. Another factor promoting globalization of container lines is the need to meet the evolving global logistics requirements of international businesses. It is becoming increasingly necessary to service shippers and consignees through worldwide networks on

multiple trade lanes, with corresponding capital investments in information systems and customer services, putting the single-trade, smaller carrier at a further disadvantage.

13. The growth in individual carrier size has been accompanied by a proliferation in carrier alliances or consortia. These alliances group carriers serving the same trade areas, often on a global basis. They concentrate on the sharing and rationalization of ships and marine terminals, while leaving the participants free to compete against each other in all other respects, including price. By sharing or chartering vessel space among themselves, the participants can share investment risks, increase capacity utilization, and improve frequency, transit times and port coverage as compared to acting on their own. Carrier alliances are now increasingly addressing other cost areas as well. Indeed, there have recently been full mergers between global carriers to extend the savings realized to inland costs, container costs and administration expenses.

14. Because of their contribution to the achievement of scale economies, carrier alliances are now the industry norm, and indeed are frequently employed by carriers as a means of entering new markets. The pro-competitive aspects of these alliances also explains why regulators in Europe, the U.S. and Canada regard them favourably.

15. The foregoing trends have affected competition on the North Atlantic trade lane on which Canmar and Cast operate. All of the world's largest global alliances, and 16 of the world's top 20 carriers, compete on the North Atlantic. These include the Grand Alliance (NYK/NOL/Hapag Lloyd); Maersk/Sea-Land; the Vessel Sharing Agreement or "VSA" (Sea-Land, Maersk, P & O/Nedlloyd, OOCL); DSR - Senator/Cho-Yang/Hanjin; ACL/Mediterranean Shipping/POL; and Evergreen. A number of these competitors are relatively recent entrants, having leveraged their existing operations to expand into this trade on an incremental basis. Moreover, the trend towards globalization means that the major carriers/alliances not yet in the North Atlantic are likely to make their presence felt in the near term. Indeed, three of the largest global container lines not yet on the North Atlantic

(Cosco, Yangming and K Line) are scheduled to start up a joint service on the North Atlantic in March 1997.

16. CP's decision to acquire Cast was driven by the need to maintain the competitiveness of its service against the global carriers and alliances operating on the North Atlantic. Many mid-tier operators have gone out of business due to their failure to match the efficiencies of global carriers. CP regarded the Acquisition as a way to avoid this fate. As set out more fully below, the operational and dynamic efficiencies flowing from the Acquisition have been substantial, including savings related to ships, marine terminals, container management, inland operations and administration. The achievement of efficiencies of this order are a necessary prerequisite if Canmar/Cast are to continue to survive in the long term.

17. Contrary to paragraph 91 of the Notice of Application, therefore, the primary motive for the Acquisition was not to eliminate Cast as a competitor. Cast had already effectively failed. CP's purpose in acquiring Cast was to achieve the operational economies that could be generated only by integrating the operations of these companies to a greater degree. That was imperative in order not to lose competitive ground against the global carriers now dominating this business.

2. CAST'S FINANCIAL DECLINE

18. Cast's grave financial situation characterized much of its operating history, and constituted the main factor precipitating its sale.

19. In 1983, Cast's predecessor went bankrupt. A major restructuring was undertaken with the assistance of RBC, Cast's principal banker, pursuant to which RBC took an equity interest in Cast through its Bahamas subsidiary.

20. In 1985, the company had to be restructured again.

21. In 1989, Cast's financial situation took a permanent turn for the worse. From that point on, until the Acquisition, Cast experienced mounting business losses, suffered severe cash flow problems, and was unable to meet its current payment obligations.

22. In an effort to deal with these difficulties, RBC agreed to restructure Cast's debts in 1990 to give Cast more lenient repayment terms. When this was insufficient, RBC lent Cast a further $6 Million (U.S.) in February 1991 and another $5 Million (U.S.) in August 1991.

23. By this time, Cast was already in breach of its repayment obligations under the 1990 restructuring arrangement. Accordingly, Cast approached RBC in November 1991 to amend this agreement, and RBC made significant concessions in January 1992. The parties entered into another restructuring agreement which allowed Cast a 27 month moratorium on its principal payments, but required it to remain current on its interest payments. Cast was also obliged to observe certain financial covenants.

24. Cast could not comply even with these relaxed obligations. Instead, it was compelled to seek yet additional funding from RBC, receiving an advance of $10 Million (U.S.) in the Fall of 1992 and another advance of $5 Million (U.S.) in February 1993. RBC agreed to make the latter loan only on condition that Cast's President and Chief Executive Officer, Klaus Glusing, be removed. That occurred in February 1993, but did not improve Cast's financial position, which continued to decline.

25. By March 31, 1995, the end of Cast's 1995 fiscal year and the date of the Acquisition, the Company's situation had deteriorated to the point where:

- Cast's net operating losses for the last five fiscal years had reached an amount in excess of $159 Million (U.S.), with losses of $21.7 Million (U.S.) in the last fiscal year alone;
- Cast's shareholder deficit had accumulated to an amount in excess of $181 Million (U.S.);

- Cast's current liabilities of $83.7 Million (U.S.) were more than twice its current assets of $37.7 Million (U.S.);
- Cast's total liabilities exceeded total assets by more than $100 Million (U.S.);
- Cast's ability to pay its suppliers had deteriorated to the point where many of these suppliers had either refused to grant Cast further credit or had cut the company off altogether;
- Cast's cash flow generated from operations *before* interest, taxes and depreciation (EBITDA) fell from $17 Million (U.S.) in 1994 to less than $1 Million (U.S.) in 1995;
- Cast's directors faced a serious risk of exposure to claims by creditors for wrongful or fraudulent trading under the relevant shipping laws of the United Kingdom, Belgium and Bermuda; and
- Cast's total indebtedness to RBC exceeded $100 Million (U.S.) in principal and interest and RBC had made it clear that it would no longer advance the funds necessary for Cast to continue to survive.

26. Cast's difficulties during this period were particularly striking because they came at a time (1994-1995) when freight rates in the North Atlantic container trade were at historically high levels, and the company's traffic volumes had actually risen.

27. Cast's financial position also declined in spite of attempts by its former management to retrench. These rationalization measures resulted in cumulative annual savings of approximately $20 Million (U.S.) but were insufficient to save the company.

28. Indeed, a number of the retrenchment steps taken actually exacerbated Cast's difficulties. For example, in the Fall of 1994, Cast withdrew from the carriage of bulk cargo and replaced its conbulker ships with fully-cellularized container ships that it chartered for five years (the "ex-Norasia vessels"). These ships were chartered at disadvantageous

rates, and were slow. This meant that Cast had to charter four ships to maintain its weekly service, as compared to Canmar which did so with three. All this resulted in a major financial penalty.

29. Cast's decision to relocate its Belgian operations from the port of Antwerp to the port of Zeebrugge also worked to the company's detriment. Cast committed itself to a fifteen-year agreement at Zeebrugge that imposed minimum traffic volumes which the company was unable to achieve, and an onerous inland cost structure disadvantage.

30. Cast made a number of other significant errors as well, such as starting up the Cast Orient Line in the Europe-Far East trade and joining the AMA joint service between the Mediterranean and the United States east coast ("USEC"). Both of these initiatives resulted in heavy losses.

31. Cast's financial difficulties also precluded much needed investments to improve its operation. For example, Cast's Montreal terminal was old and did not contain proper handling equipment. Cast's inventory of containers was inadequate and in poor condition, and much of it required immediate replacement. Thus Cast often could not provide customers with good quality containers on a timely basis. Cast's European and North American chassis fleet was also in need of upgrading, as was its information system. These problems could not be addressed due to Cast's lack of resources.

32. While Cast was experiencing these financial difficulties, its management was predicting that the company's affairs would soon turn around. For example, management projected to RBC at the commencement of its 1995 fiscal year (ending March 31, 1995) that Cast's EBITDA would be $25.2 Million. Cast's management subsequently revised this estimate several times. The last projection was delivered to RBC on February 28, 1995 (one month before year end) and forecast Cast's year-end EBITDA as $13.3 Million. Cast's actual EBITDA was $0.8 Million (U.S.) on sales revenue of over $250 Million (U.S.).

33. Put simply, Cast's former management was unable to produce reliable projections or devise realistic strategies to improve performance. Rates were projected to be stable or increasing when they were actually decreasing or increased at reduced rates; the number of voyages to be completed during the year were over-stated; foreign exchange fluctuations were not adequately provided for; and no provision was made for adverse events such as rail strikes, stevedoring strikes or delays due to ice.

34. In summary, by the date of the Acquisition, Cast had passed the point of failure. It had managed to survive only because of the forbearance of RBC, which ultimately determined that it would no longer provide additional financial assistance to Cast. Had it not been purchased by CP, Cast would have had to cease carrying on business, causing serious disruption to shippers and consignees and to the port of Montreal.

3. EFFORTS TO SELL CAST

35. Another key feature of the Acquisition is that while numerous potential acquirors for Cast were canvassed, no one but CP was willing and able to invest the resources necessary to assure Cast's survival.

36. Because of its persistent under-performance, Cast was under continuous pressure from RBC to raise new equity or to arrange an acquisition. To this end, Cast engaged R.K. Johns and Associates Inc. ("RKJ"), a well-respected shipping consulting firm whose principal is the former president of Sea-Land, the world's second largest container company and a pioneer in containerization. RKJ's mandate was to identify and contact prospective purchasers for Cast, *other than* CP and CN, and to assist Cast in any negotiations. RKJ received a monthly fee of $10,000 and would have received an additional $1 million (U.S.) if Cast had been sold to any purchaser *except* CP or CN. Cast also engaged Coopers & Lybrand to assist with any negotiations it had with potential purchasers/investors.

37. Between February 1993 and June 1994, RKJ, in conjunction with Cast management and D.C. Webster, one of Cast's shareholders and a director of the company, marketed Cast extensively to some 30 prospective purchasers or investor groups including many of the world's largest container carriers. Some of these prospective purchasers, including Sea-Land and Conrail, expressed considerable interest in Cast but ultimately refused to make an offer to RBC. Various reasons account for this, including Cast's poor financial health, the magnitude of Cast's accounts payable, the need for significant capital expenditures to replace fully depreciated and outdated equipment, and the existance of expensive and disadvantageous long term commitments (e.g., Zeebrugge).

38. Discussions were also held during this period with CN. In March of 1993, CN signed a confidentiality agreement with Cast in order to review Cast documents as part of its due diligence investigation. CN had owned, at one time, an equity interest in Cast (that had to be written off in the 1983 reorganization) and had been actively pursuing Cast's railway business for years. Various proposals were discussed between CN and Cast in the summer and fall of 1993, but no agreement was ever reached.

39. Discussions were also held with four investor groups involving various combinations of: Cast management; Helix Investments Limited ("Helix"), controlled by D.C. Webster; CN and various other investors. However, none of these groups made an offer to RBC.

40. By contrast, CP made a concrete offer to acquire Cast. This offer assured that Cast would be acquired on a going-concern basis, and that the company's ordinary course trade payables and obligations to employees would be assumed and honoured. CP also had the financial resources, industry expertise and synergy opportunities to carry out a transaction of this nature and ensure Cast's revival.

41. The two years' experience since the Acquisition has validated the expectation that CP would be able to restore Cast to a sound footing. Cast's service product has been improved

significantly, and the company's competitiveness has been enhanced. To accomplish this, CP has spent, or is committed to spend, close to $300 Million (Cdn.), including the $77 Million (Cdn.) purchase price paid to RBC.

B. THE NTA'S APPROVAL OF THE ACQUISITION

1. DEFERENCE TO THE NTA DECISION

42. This application is unusual in that the *Director* is challenging a transaction that has already been approved by another expert federal body, the NTA, examining the same questions that are at issue here.

43. Under former Part VII of the *NTA Act*, the NTA was required to determine whether proposed acquisitions in the transportation sector were or were not against the "public interest". For these purposes, the scope of the "public interest" was defined in accordance with the national transportation policy set out in subsection 3(1) of the *NTA Act*. That policy emphasized, among other things, the desirability of maintaining competition and market forces to protect the interests of shippers and Canadian economic growth and well-being:

> 3.(1) It is hereby declared that a safe, economic, efficient and adequate network of viable and effective transportation services accessible to persons with disabilities and making the best use of all available modes of transportation at the lowest total cost is essential to serve the transportation needs of shippers and travellers, including persons with disabilities, and to maintain the economic well-being and growth of Canada and its regions and that those objectives are most likely to be achieved when all carriers are able to compete, both within and among the various modes of transportation, under conditions ensuring that, having due regard to national policy and to legal and constitutional requirements...

(b) competition and market forces are, whenever possible, the prime agents in providing viable and effective transportation services... *(emphasis added)*

44. Competition issues formed a central part of the NTA's evaluation of the Acquisition. At the NTA's hearing into the matter in December 1994, CN, the principal objector, argued that the Acquisition would substantially lessen or prevent competition. CN presented extensive oral and documentary evidence, and cross-examined CP's witnesses closely. After considering all of the evidence and arguments, the NTA rejected CN's position. It held that the Acquisition would not substantially lessen competition or operate contrary to the public interest. CN's application for leave to appeal was dismissed by the Federal Court of Appeal, and the federal Cabinet did not exercise its authority to overrule the NTA.

45. The *NTA Decision* is of paramount relevance here because the Director's position in this application mirrors in virtually every respect the arguments made by CN against the Acquisition, all of which the NTA rejected more than two years ago.

46. For example, CN argued that the port of Montreal constitutes a distinct geographic market, and that carriers operating out of this port do not compete with carriers using the port of Halifax or USEC ports. CN claimed that the Acquisition would allow CP to dominate this market, by giving it a post-merger market share of approximately 84% (taking into account the combined shares of Cast, Canmar, and OOCL and Hapag Lloyd, the other participants with Canmar in the St. Lawrence Coordinated Service ("SLCS")). The Director makes the same arguments at paragraphs 78-80 and 94-96 of the Notice of Application.

47. The NTA, however, held that the port of Montreal is only one of several North American gateways through which container shipping services are provided across the North Atlantic, and defined the relevant market to correspond with Canmar's trading area. The NTA also held that Canmar/Cast would not dominate this market in light of their combined

market share of 21% (at pages 9-10 of the *NTA Decision*). The NTA did not include the shares of OOCL and Hapag Lloyd in this calculation:

> After examining all of the evidence and arguments raised in the pleadings and during the course of the hearing regarding the issue of market definition and dominance, the Agency is of the opinion that the relevant market to consider in this case is the market for intermodal transportation of 20 and 40 foot containers via the North Atlantic between Northern Europe and Central Canada, the U.S. Mid-West states and the U.S. Northeast states. The Agency is of the view that the port of Montreal is one of several gateways through which intermodal container transportation services are provided between Northern Europe and a large part of North America. It is apparent to the Agency, from its review of the evidence, that the combined market share of Canmar and Cast following the proposed acquisition would be in the vicinity of 21 per cent, based on this Northern Europe-Central Canada, U.S. Mid-West and U.S. Northeast container transportation market....
>
> The Agency concludes, therefore, that with a combined market share of 21 per cent, and with the effective competition provided by other liners serving the North Atlantic trade, Canmar and Cast should not be able to dominate, or abuse any resulting post-acquisition power in, Northern Europe - Central Canada, U.S. Mid-West and U.S. Northeast container transportation market. *(emphasis added)*

48. CN also claimed that the Acquisition would eliminate Cast as a vigorous competitor, leaving no effective competition to counter CP. The Director makes these same arguments at paragraphs 91-93, 97-98, and 111-118 of the Notice of Application.

49. The NTA rejected this proposition as well, holding that Canmar faced "stiff" competition from the other carriers in the relevant market. The NTA emphasized such factors as: the benefits received by Canadian customers due to the competition for U.S.

traffic; the competitiveness of the port of Halifax; and the presence of excess capacity in the industry (at pages 13, 15, 16-17):

> ...The Montreal gateway faces stiff competition from the USEC ports for U.S. Mid-West traffic and significant competition from the port of Halifax for Ontario and Quebec traffic on the Canada/USA - Northern Europe trade route. Continuing efforts are needed by the port of Montreal, as well as by other transportation interests, to maintain the competitive position and the viability of the port, all of which are in public interest.
>
> Most importantly, the Agency finds that the ability of the port of Montréal and of the carriers operating at that port to maintain a strong presence in the U.S. Mid-West market is crucial to Canadian shippers. The availability to Canadian shippers of a world-class service with its infrastructure is primarily due to the ability of Montreal-based carriers to serve the U.S. Mid-West market in an efficient and effective manner. The port of Montreal is an integral component of this world-class service and to see it maintained is in the public interest...
>
> As approximately one-third of the current Ontario and Quebec containerized traffic moves through the port of Halifax, competition exists and will likely continue to exist for this Canadian containerized traffic. The competitiveness of CN North America will most likely be improved in the future with the opening of the Sarnia tunnel in 1995. The Agency is also aware that containerized cargo makes up only one-third of the total cargo handled in Montreal and that CN North America competes for transporting this other cargo...
>
> The Agency has considered the concerns of CN North America in respect of the impact that the proposed acquisition may have on low-value commodity shippers, and is of the view that the existing situation of excess vessel capacity, which is not expected to change in the future, will ensure continued service to these shippers.
>
> The Agency is also of the opinion that the combined operations of Canmar and Cast will contribute to a continued strong Canadian presence in the competitive U.S. Mid-West market.

> which is important to maintain high levels of service in terms of quantity and quality to Canadian shippers.
>
> The Agency cannot conclude that any negative impact on shippers, through a loss of competition, will be significant; the Agency can neither conclude that this proposed acquisition will likely lessen competition substantially... *(emphasis added)*

50. CN also argued that (i) there were substantial barriers to entry that would prevent future competition, and (ii) the Acquisition would actually heighten these barriers to entry. Again, the Director makes the same arguments at paragraphs 101-110 of the Notice of Application.

51. The NTA did not find it necessary to make any conclusive determination of the extent and nature of barriers to entry, because it had already concluded that Canmar/Cast would continue to face "stiff" competition subsequent to the Acquisition. The NTA held, however, that whatever barriers to entry exist, they would not be increased as a result of the Acquisition (at page 18).

52. Finally, CN disputed CP's claim that Cast was in failing financial health and that the Acquisition was necessary to save Cast from insolvency. The Director makes the same argument at paragraphs 120-128 of the Notice of Application.

53. The NTA, however, accepted that Cast was in financial difficulty (at page 17 of the *Decision*), and held that the Acquisition would benefit the public interest by generating efficiency gains. The NTA also stated that the Acquisition's positive impact on the competitiveness of the port of Montreal would be an important fact to consider when evaluating the trade-off between the gains and losses attributable to the Acquisition (at pages 20-21):

> The Agency also cannot conclude that Canadian shippers would be affected in a negative manner by the proposed acquisition but

> rather the expected efficiency gains of the combined Canmar/Cast operations will maintain a world-class level of service to Canadian shippers. This is fundamental if Canadian shippers are to remain or become more competitive in the global marketplace. The Agency notes that the infrastructure in place at the port of Montreal for a world-class service is critically dependent upon the ability of strong Canadian based shipping lines to compete in the highly competitive U.S. Mid-West market...
>
> The strengthening of the port of Montreal's competitive position relative to other Canadian and the USEC ports will help, in the Agency's view, to maintain and encourage the growth of employment and economic activity thereby supporting regional economic development in this area. In this regard, the Agency notes that the Montreal Port Corporation stated unequivocally that the port will benefit from the proposed acquisition. Moreover, the Agency cannot conclude that the benefit to the port of Montreal will be at the expense of or to the detriment of the port of Halifax. *(emphasis added)*

54. To summarize, the NTA carefully assessed the competitive implications of the Acquisition, considered all of the negative arguments raised by CN (which are the same as those made by the Director here), and approved the Acquisition. In particular, the NTA held that:

- the relevant market should not be limited to carriers operating out of the port of Montreal, but encompasses the intermodal transportation of containers via the North Atlantic between Northern Europe and Central Canada, the U.S. Mid-West states and the U.S. Northeast states;
- Canmar and Cast had a combined market share of 21% within this relevant market;
- Canmar and Cast face stiff competition from other carriers at the port of Montreal (including OOCL and Hapag Lloyd), the port of Halifax and USEC ports;

- barriers to entry would not be enhanced as a result of the acquisition; and

- the efficiencies generated by the Acquisition would maintain a world-class level of service to Canadian shippers through the port of Montreal.

55. In view of the foregoing, the *NTA Decision* creates a *prima facie* presumption that the Acquisition does not substantially lessen or prevent competition and is in the public interest. The Tribunal should defer to this finding and only reach a contrary decision if the Director can discharge the heavy burden of rebutting this presumption and demonstrating that the NTA:

(i) failed to consider relevant evidence which, if considered, would likely have changed its *Decision*;

(ii) was unreasonable in its assessment of the evidence; or

(iii) took irrelevant considerations into account in assessing the Acquisition.

56. This deference has two aspects. On the one hand, the NTA has specialized expertise in competition in the transportation sector. Its competition expertise is thus more narrowly and specifically focussed than that of the Tribunal, so deference should be paid to its decisions in that area. Equally, the NTA's mandate was to consider not only competition, but also related public interest issues such as the economic health of the port of Montreal. In that regard, the NTA found that the Acquisition was important to the continuing viability and competitiveness of the port of Montreal. The Tribunal, with its narrow focus on competition issues, should not effectively render the *NTA Decision* nugatory in this regard without very strong reasons.

57. As to section 265 of the *NTA Act*, it goes no further than to provide Canadian competition authorities with concurrent jurisdiction to review acquisitions also considered by the NTA; it in no way precludes the Tribunal from according deference to the NTA's findings with regard to such acquisitions. Indeed, such deference is entirely consistent with the statutory scheme, since it cannot be presumed that Parliament would have encouraged a situation in which different federal bodies, looking at the same issues, reach inconsistent conclusions without very good reasons.

58. Moreover, none of this is affected by the decision of Mr. Justice Farley to which the Director refers in paragraph 36 of the Notice of Application. That paragraph is a complete misstatement of Justice Farley's decision on any fair reading. In any event, the issue of what deference the Tribunal should accord to decisions of the NTA was never raised by CP in that application nor was the matter considered by Farley J.

2. <u>ABUSE OF PROCESS</u>

59. CP also states that the manner in which the Director conducted his inquiry into the Acquisition, having regard to the *NTA Decision*, constituted an abuse of process. In particular:

- The Director persisted with his investigation for close to two years, subjecting CP to considerable effort and expense in responding to his demands, without ever indicating to CP where he believed the NTA had erred or what evidence he had obtained that raised concerns regarding the *NTA Decision*.

- The Director abused his section 11 powers by using them as a substitute for the Tribunal's discovery process, gaining advantages (such as productions from third parties) not available to CP.

C. ASSESSMENT OF THE COMPETITIVE IMPLICATIONS OF THE ACQUISITION

1. THE RELEVANT MARKET

(i) Relevant Product Market

60. CP denies that "intermodal non-refrigerated containerized shipping services" constitute a uniquely separate mode of transportation service that has no substitutes (paragraphs 52-61 of the Notice of Application).

61. For example, there is a material sub-set of shippers and consignees for whom break-bulk is a serious competitive alternative.

62. Break-bulk service continues to be a close substitute for the transportation of non-time sensitive, low-value products that do not require container shipment. These products include wood pulp, lumber, newsprint and metals and represent a material portion of eastbound shipments from North America to Northern Europe. These products may be carried either in containers or via break-bulk depending on pricing considerations, and switching between the two forms of service does occur.

63. The Director also overstates the "intermodal" nature of the services supplied by carriers. Containerized shipping services are not offered, or purchased, strictly on a door-to-door basis. Shippers often opt for a "door-to-port" or "port-to-door", or even "port-to-port" type of service; that is to say, they may purchase only the ocean carriage and marine elements while arranging for their own inland transportation at either or both ends of the system. In North America, this almost always involves arranging for truck transportation, given the competitiveness of this mode of shipment. The opportunity for shippers to

"unbundle" services in this manner (also referred to as "merchant haulage") increases the flexibility of options available to them and enhances their bargaining position against carriers.

(ii) ***Relevant Geographic Market***

64. CP denies that the shipment of containers from Ontario and Quebec through the port of Montreal constitutes the relevant geographic market (paragraphs 78-90 of the Notice of Application). Canmar and Cast compete for container traffic well beyond the confines of Ontario and Quebec, and against carriers operating out of ports other than the port of Montreal.

65. To define the geographic market, it is necessary to consider the pattern of existing competition which Canmar and Cast face. Canmar and Cast operate in North America in an area that is made up of all of Canada and 32 states in the United States, including states in the U.S. Mid-West, and in the Northeastern and Central U.S. On the North European side, Canmar and Cast's trading area comprises the U.K., Ireland, France, Belgium, Holland, Luxembourg, Germany, Poland, Austria, Switzerland, Denmark, Sweden, Finland, Norway, the Czech Republic, Slovakia, Hungary and Russia.

66. The foregoing, in fact, is the geographic market, subject to what will be said below with respect to the "Strategic Market", and shall hereafter be referred to as the "Trading Area".

67. The Trading Area forms part of the larger North American East Coast-North Europe trade (the "Strategic Market"), which encompasses container cargo between Northern Europe and the whole of the U.S. and Canada through North American eastern seaboard ports. It is in this larger market that strategic decisions are made regarding alliances, capacity, ship deployment and schedules, all of which factor into the overall supply and demand equation that in turn determines service and price developments.

68. The 1995 container throughput for the Trading Area, eastbound and westbound, was approximately 1.4 million TEUs. Canadian traffic accounted for approximately 21% of this throughput. The 1995 container throughput in the larger Strategic Market was approximately 2.1 million TEUs. Canadian traffic accounted for approximately 14% of this throughput.

69. The small volume of Canadian container traffic underlines the inappropriateness of the Director defining the even narrower Ontario/Quebec segment as the relevant geographic market. The reality is that Ontario and Quebec shippers and consignees must be supplied jointly on the same ships with shippers and consignees of the U.S. Northeast and Mid-West U.S. That is because Ontario and Quebec cargo alone does not justify service at existing levels, either in terms of ship size or frequency of sailings. The current service levels that Canadian shippers and consignees enjoy is made possible only by the critical mass generated by the inclusion of the U.S. container volumes. Canmar and Cast must thus be able to compete cost effectively for those volumes against the major global carriers and alliances which compete in this trade.

70. In effect, by virtue of Canmar/Cast's ability to compete for the U.S. business, Canadian shippers and consignees, including from Ontario and Quebec, receive a massive subsidy as to service and cost from the interconnection of this segment of the market with the U.S. portion.

71. This proposition is supported by the particular experience of Canmar and Cast. Approximately 60% of Canmar's business, and 70% of Cast's business, consists of U.S. shipments. Ontario and Quebec shipments comprise approximately 30% of Canmar's total traffic and approximately 25% of Cast's total traffic. Neither Canmar nor Cast would be able to provide their existing levels of service through the port of Montreal to serve these Quebec and Ontario shippers and consignees alone. The volume represented by these shippers and consignees would not provide the economies of scale sufficient to support such

a level of service. These economies can only be achieved by obtaining volumes from U.S. shippers and consignees as well.

72. In light of the foregoing, the relevant geographic market is the Trading Area. This is also the market definition adopted by the NTA. It must be recognized, however, that developments in the broader Strategic Market are also influential on competition in the Trading Area, because that is where competitive strategy is set.

(iii) Carriers and Gateway Ports Serving the Geographic Market

73. Many carriers serve shippers and consignees in the Trading Area, including shippers and consignees in Ontario and Quebec. On the North American side of the Trading Area, these carriers operate through the ports of Montreal and Halifax, and USBC ports such as New York and Norfolk. On the North European and U.K. side of the Trading Area, these carriers operate through ports such as Hamburg, Bremerhaven, Rotterdam, Antwerp, Zeebrugge, Le Havre, Felixstowe, Thamesport and Liverpool.

74. Appendix 2 hereto lists the carriers serving the Trading Area, their North American ports of call, and the types of service they offer. As can be seen, these carriers provide shippers and consignees in the Trading Area with a variety of service options.

75. As the NTA recognized, the significant volumes of cargo moving in the Trading Area through Montreal, Halifax and the USBC ports suggest that the pricing and service combinations offered by lines serving these routes can be equally attractive to many shippers and consignees in this market, including those in Ontario and Quebec.

76. It is noteworthy that one-quarter to one-third of Canadian-originating and destined shipments historically move through the port of Halifax. Even assuming, as the Director alleges, that this is a result of incremental pricing by carriers seeking to attract cargo for

repositioning purposes, that would not diminish its significance. Repositioning is a very compelling reason for carriers to compete in a market. Furthermore, it is demonstrable that competition from carriers operating through the port of Halifax is a permanent feature of the Trading Area.

77. The same applies to the shipment of containers into and out of Canada through USEC ports, which represent between 5% to 10% of total Canadian traffic. Whatever the basis for the competitive pricing provided by carriers calling at those ports, the fact is that the percentage of Canadian cargo moving with them has generally increased over the years. Again, it is a permanent feature of this market.

78. In alleging that Ontario and Quebec shippers do not regard carriers operating out of the ports of Halifax and USEC ports as substitutes to Montreal-based carriers, the Director repeats CN's error in the NTA proceeding and focuses solely on the alleged advantage that Montreal-based carriers have in terms of North American inland costs. To the extent that costs (as opposed to pricing) are relevant, the comparison point must be *total* transport costs, which include European inland costs, European terminal costs, ocean shipping costs, North American terminal costs, as well as North American inland costs.

79. The large global carriers competing in the Trading Area enjoy significant cost advantages in terms of European inland costs, European terminal costs, ocean shipping costs (because of their larger vessels and correspondingly lower slot costs) and overhead. For example, these carriers can achieve economies of scale by combining their volume throughput from various other trade lanes for processing through their European inland and terminal networks. Advantages such as these enable global carriers to provide competitive pricing and service to shippers and consignees in the Trading Area, including in Ontario and Quebec.

80. The Director's allegation with regard to North American inland costs also obscures the fact that insofar as Conference carriers are concerned (as defined in paragraph 87 below), inland tariffs for cargo are set at the same level for shipments through both the ports of Montreal and Halifax, a process known as "port equalization". Consequently, Canadian shippers and consignees using Conference carriers are indifferent to which port their cargo is shipped through from a pricing perspective.

81. The Director's emphasis on rail transit times is also misplaced. The only relevant issue is total transit or "through" time door-to-door, which he does not consider. Another relevant factor is the ongoing improvement to rail connections to these North American ports, including CN's efforts to improve its rail service from the port of Halifax to Montreal, Toronto and the U.S. Mid-West.

82. Finally, one cannot credibly contend that the port of Halifax is a "discretionary port-of-call" when carriers such as ACL and Hapag Lloyd have offered regular, weekly service through this port for more than a decade. Indeed, Hapag Lloyd now offers two different weekly services through the port of Halifax, hardly the sign of a marginal gateway.

(iv) Conclusion as to Relevant Market

83. In conclusion, the Director's definition of the relevant product market as constituting "intermodal non-refrigerated containerized shipping services" is overly restrictive. First, for the reasons set forth above, a material number of shippers and consignees can substitute break-bulk services for the products they transport. Second, containerized shipping services are not offered or always purchased strictly on a door-to-door basis, as shippers and consignees have the ability to "unbundle" the service provided, thereby increasing the flexibility of the options open to them and enhancing their bargaining position.

84. The Director's geographic market definition is equally too narrow. The appropriate geographic market definition for assessing the Acquisition is the Trading Area, although the effect of influences emanating from the larger Strategic Market must be recognized as well. Moreover, within this Trading Area, shippers and consignees can turn to services from carriers operating out of a variety of ports on the North American side, and are not restricted, even in Ontario and Quebec, to the port of Montreal alone.

85. Accordingly, even if the relevant geographic market is Ontario and Quebec shippers and consignees only, which CP specifically denies, carrier options for these shippers must extend to container lines operating out of the port of Halifax and the USEC ports, and not be restricted to Montreal only. Put simply, the port of Montreal cannot be regarded as the exclusive exit and entry point for shippers and consignees in Ontario and Quebec.

2. THE CANADIAN SHIPPING CONFERENCES

86. One of the unique features of competition in the Trading Area is the existence of "shipping conferences" that have been given legislative sanction to regulate by agreement the pricing and types of services provided by members.

87. There are four shipping conferences that govern the North Atlantic carriage of containers originating in, or destined for points in Canada: The Canadian North Atlantic Westbound Freight Conference; The Continental Canadian Westbound Freight Conference; The Canadian North Atlantic Eastbound Freight Conference; and the Continental Canadian Eastbound Freight Conference (collectively, the "Conference"). Canmar and Cast belong to the Conference, as do three other carriers operating out of the ports of Montreal and Halifax: Hapag Lloyd, OOCL and ACL. Each of the five member lines has an equal vote in running the Conference's affairs, including the setting of rates, regardless of relative size or market share.

88. The Conference was established pursuant to the *Shipping Conferences Exemption Act* ("*SCEA*"), which permits ocean carriers to make certain agreements amongst themselves without fear of prosecution under the *Act*. One of the permitted areas of agreement is the fixing of tariffs.

89. A similar "mirror image" system of conference agreements and statutory exemptions from anti-trust laws exists in the United States. The principal North Atlantic shipping conferences in the United States are the Trans-Atlantic Westbound Agreement and the Trans-Atlantic Eastbound Agreement (collectively, the "TACA Conferences"). The exemptions relating to the TACA Conferences apply only in respect of shipments of containers originating in, or destined for, points within the U.S. and routed through U.S. ports. They do not apply to shipments originating in, or destined for, points in Canada that move through U.S. ports, or to U.S. origin and destination shipments that move through Canadian ports. Accordingly, neither Canmar nor Cast is a member of the TACA Conferences.

90. As permitted by *SCEA*, the Canadian Conference agreements set out mechanisms for the fixing of rates (called "class rate tariffs") by the members. There are also inland revenue tariffs for those shippers and consignees that wish to be quoted a "through" rate. These tariffs cover the types of services provided by Conference members. The inland tariffs set by the Conference are the same regardless of whether the shipper or consignee is shipping through the port of Montreal or the port of Halifax. From the perspective of price, therefore, Canadian shippers and consignees using Conference carriers are indifferent as to whether their goods are shipped via Montreal or Halifax.

91. Several factors are taken into account in setting Conference tariffs. First and foremost is the extent of competition provided by non-Conference carriers, including carriers operating through USEC ports in the Trading Area. Other relevant considerations include the overall level of trade, supply and demand, the balance of eastbound/westbound container

flows, the relative cost structures of the member lines, and the market position of shippers and consignees who are trying to compete in their respective markets.

92. *SCEA* and the Conference agreements also provide for a form of price competition amongst Conference members, i.e., through "independent action". In practice, however, this vehicle is rarely used. To the extent that price competition among Conference members does exist, it is generally carried out through informal non-compliance with Conference tariffs.

93. The level of such off-tariff pricing, or "malpractice" as this is called, varies with market conditions. During periods of heavy demand for carrier services, off-tariff pricing is relatively low. That was the case in the mid-1990s, and particularly at the time of the Acquisition. When market conditions deteriorate, and there is pressure to fill vessel capacity, levels of malpractice increase. That is the current situation, although, even now, the general levels of price reductions are small in terms of percentage of total revenue.

94. Consequently, and contrary to the thrust of paragraphs 91-92 of the Notice of Application, the Acquisition has not resulted in a diminution of price competition amongst Conference carriers. To the contrary, price competition has increased recently, as reflected in greater malpractice activity. That is because this competition is not driven by the presence or absence of any one Conference member, but by broader market factors affecting the Trading Area and the Strategic Market as a whole.

95. Moreover, none of the foregoing affects the level of service quality competition between Conference members. Service quality competition is not regulated by the Conference, and is intense between Conference carriers.

3. NO SUBSTANTIAL LESSENING OF COMPETITION

96. CP denies the Director's allegation in paragraphs 94-131 of the Notice of Application that the Acquisition substantially prevents or lessens competition.

97. The Acquisition has not provided CP with dominant market shares, nor will it reduce or eliminate constraints on CP's ability to exercise market power after the Acquisition. These factors include: the availability of substitutes; the extent of effective competition remaining in the relevant market; the possibility of entry by existing or new carriers; the countervailing power of shippers; and industry trends.

98. Finally, not only was Cast not a vigorous competitor at the time of the Acquisition, but its financial situation had declined to the point that the business had effectively failed. Consequently, Cast would likely have exited the market absent the Acquisition. Cast's failure would have produced significant negative repercussions for the port of Montreal, the City of Montreal, the Province of Quebec and the Canadian shipping industry. The Acquisition averted this disruption and, through CP's substantial investments, Cast has been restored to a sound competitive footing.

(i) *Market Shares*

99. The market share figures and concentration ratios set out in paragraphs 94-96 of the Notice of Application are incorrect.

100. First, the Director erroneously excludes the market shares of carriers operating out of other gateway ports in the Trading Area. The Director also fails to adequately account for the break-bulk alternative.

101. Second, the Director treats SLCS as a single entity for the purpose of calculating market shares and concentration ratios (see also paragraphs 16-23). That approach was rejected by the NTA in its *Decision*. The NTA analyzed Canmar's market shares separately from those of both OOCL and Hapag Lloyd.

102. The Director's approach is wrong because it misapprehends the nature of SLCS, which is a consortium of the type described in paragraphs 13-14 hereof. Each of the two consortium partners, Canmar and OOCL, and also Hapag Lloyd as slot charterer, remain distinct in all competitive respects other than the sharing of vessels, the coordination of sailing timetables and ports-of-call, and the joint negotiation of marine terminal contracts. Specifically, there are no agreements with respect to: marketing; pricing (except for Conference traffic); the exercise of voting rights in the Conference; revenue sharing; container supply; or inland operations. For example, with regard to the latter, Hapag Lloyd recently signed a contract with CN to provide rail service into Montreal; Canmar and OOCL have contracts with CP Rail, which are negotiated separately and at arm's length. Contrary to paragraph 68 of the Notice of Application, Canmar is not "vertically integrated" with CP Rail.

103. In short, Canmar, OOCL and Hapag Lloyd compete vigorously with each other and share only their ship assets and related terminal contracts to achieve economies of scale. These actual and expected cost savings have, in fact, permitted SLCS to increase its capacity by 150% from 1990 to 1998, a 15% compound annual growth rate, much faster than overall North Atlantic trade growth. The effect has been to make the individual participants more competitive not less, all to the benefit of shippers.

104. Moreover, it is naive to suggest that OOCL and Hapag Lloyd, two of the largest container carriers in the world, would permit Canmar to dictate trade terms to them. Both OOCL and Hapag Lloyd already have an independent presence in the Trading Area apart from their participation in SLCS (OOCL with two separate weekly services in New York and

Norfolk, and Hapag Lloyd with two separate weekly services in Halifax, New York and Norfolk). They could, and likely would, expand this presence, or compete out of the port of Montreal itself in some other capacity, if SLCS no longer suited their purposes.

105. The appropriate market shares to use in assessing the Acquisition are those for the Trading Area. The 1995 shares by carrier for the Trading Area are attached hereto as Appendix 3. As can be seen from this Appendix, Canmar and Cast had a combined market share of 24% in the Trading Area that year.

106. The 1995 market shares for the broader Strategic Market are set out in Appendix 4. In that market, Canmar and Cast had a combined share of approximately 16%.

107. If only Canadian origin and destined traffic is considered, which CP denies is the correct approach, the relevant shares for 1995 would be those set out in Appendix 5. As Appendix 5 demonstrates, even looked at from the most narrow perspective, Canmar and Cast would have a combined share of approximately 36%.

108. It should be noted that the figures set out in Appendices 3, 4 and 5 relate only to container shipments. They do not account for non-containerized alternatives, such as break-bulk shipping services. To that extent, they give an incomplete view of the state of competition in the relevant market, and overstate the shares of the container lines listed.

(ii) ***Acceptable Substitutes***

109. CP denies the Director's allegation at paragraphs 99-100 of the Notice of Application that there are no or insufficient acceptable substitutes available to containerized shipping. As discussed at paragraphs 61-62 above, break-bulk services are an acceptable substitute to container services for the shipment of certain commodities such as lumber, wood pulp and

other commodity products. Competition from the break-bulk sector continues to affect the pricing and practices of container carriers in the Trading Area even after the Acquisition.

(iii) Effective Competition Remaining

110. CP denies the Director's allegations in paragraphs 98 and 111-118 of the Notice of Application that Canmar and Cast will not face effective competition subsequent to the Acquisition.

111. As set out in Appendix 2, there are numerous carriers competing with Canmar and Cast in the Trading Area. These include 16 of the 20 largest container carriers in the world, operating through a variety of alliances and slot-charter arrangements, such as Evergreen, Maersk, Sea-Land, NYK, NOL, Mediterranean Shipping and P&O/Nedlloyd. The intensity of competition from these carriers has not abated with the Acquisition.

112. Moreover, contrary to paragraphs 111-113 of the Notice of Application, these competitors include OOCL and Hapag Lloyd, who themselves rank amongst the world's top container carriers. The participation of these carriers in the SLCS arrangement does not compromise their competitive efforts against Canmar and Cast, either through the port of Montreal or through other gateways in the Trading Area.

113. As to BOLT, it has largely recovered from the financial difficulties leading to its reorganization and remains a serious competitor through the port of Montreal. Indeed, and contrary to paragraph 115 of the Notice of Application, BOLT's transit times and service schedule now approximate those achieved prior to its predecessor's financial difficulties.

114. Moreover, CP specifically denies the Director's allegation that the Conference entered into a pricing agreement with BOLT or BOLT's predecessor. No such agreement was reached.

115. Effective competition will also remain from break-bulk carriers with respect to products such as wood pulp, forest products, etc. Break-bulk carriers that provide services in the Trading Area include Gearbulk, Kent Line and Finn Carriers.

116. Finally, market discipline will continue to be exerted by shippers and consignees themselves. Larger customers exert pressure using their "volume muscle" and sophisticated knowledge of the container shipping business. This countervailing bargaining power is strengthened by the absence of any significant costs for shippers and consignees to switch between lines. In some cases, particularly with break-bulk, shippers and consignees may even charter their own vessels.

117. "Buyer power" is not limited to large shippers and consignees. Small and medium-sized shippers and consignees utilize freight forwarders for this purpose. Freight forwarders have considerable knowledge of shipping options, the ability to achieve savings through the consolidation of volume, and skill in negotiating volume discounts.

(iv) ***Potential Entry***

118. CP denies the Director's allegation in paragraphs 101-110 of the Notice of Application regarding the difficulty of entry. In fact, there is considerable poised competition affecting the Trading Area, particularly from existing large global carriers which can enter new markets or routes by redeploying their resources or by entering full scale with a dedicated service. This acts as a significant competitive discipline, as does the prospect of entry by an entirely new line. Moreover, as found by the NTA, the Acquisition will not increase any barriers to entry to the extent that they might exist.

119. Several factors explain why barriers to entry are low.

120. Container shipping is not characterized by entrenched or established consumer preferences that tend to deter entry. Shippers and consignees can also shift traffic between carriers easily and at little cost. Contrary to paragraph 104 of the Notice of Application, substitution among carriers is not impeded by service contracts. First, the Director's estimate of the percentage of Canadian cargo governed by service contracts is too high, as is his estimate with respect to U.S. cargo. Second, shipping agreements, including Canadian Conference service contracts, are usually for only 12 months. Third, it is rare for all of a shipper's or consignee's volume to be shipped under a service contract, so additional cargo is available to other carriers even during the limited currency of these service contracts. Fourth, with respect to volume commitments, it is unusual for the Conference to pursue punitive action against a shipper or consignee for failure to meet these commitments. Carriers are more concerned with maintaining a long term business relationship. Indeed, many service contracts between the Conference and customers are of the "short form" variety, and do not even contain penalty clauses.

121. Entry is also facilitated generally by the fact that technology in the shipping industry is relatively mature, and most improvements involve only incremental applications of existing knowledge.

122. As to the first category of potential entrants into the Trading Area, global carriers have historically tended to expand into new markets by incremental growth from established bases because the sunk costs of this strategy are low and the risk small. For example, Evergreen and Maersk entered the North Atlantic trade by building on their respective existing infrastructures in other trades. Both have achieved considerable success since entering.

123. Other recent entrants on this basis include NYK and NOL in 1994; Hanjin in 1995; and Hyundai in 1995. Three other major carriers (Yangming, Cosco and K Line) have announced their intention to commence a North Atlantic service in February 1997.

124. These global lines employ, on a worldwide basis, large complements of vessels of various sizes that can be deployed readily for entry into a particular market, either independently or through a slot sharing agreement or consortium. These carriers also have sufficient resources to sustain losses for several years, if necessary, to maintain a competitive presence in a desirable trade lane and to gain market share. They also have strong relationships with key shippers. Entry into any of the Trading Area ports would thus be straightforward for a global carrier of this kind.

125. Barriers to entry for new carriers are also low. In fact, a new carrier, Rostock Atlantic Line, has recently announced its intention to commence an independent service into the Trading Area in the first half of 1997, with ports of call that include Halifax. For new entrants, all of the critical elements required to establish a container service can be leased or rented on an as-needed or variable basis. Further, new entrants may be assisted by inland carriers, in return for an agreement to use that inland carrier for a line's container traffic. An example is CN's provision of a substantial cash advance and ship charter hire guarantee to BOLT for agreeing to use CN exclusively to transport its container traffic.

126. As to the Director's assertion that barriers to entry into the port of Montreal are significant, and leaving aside the fact that a carrier need not use that port to compete in any event, the argument cannot stand given (i) the factors reviewed above, coupled with (ii) excess terminal capacity at the port of Montreal, and (iii) the presence of a large hinterland market within close proximity.

127. Moreover, contrary to paragraph 103 of the Notice of Application, ice-strengthened ships are not a prerequisite for calling at the port of Montreal. Canmar has used non-ice-strengthened container ships on the St. Lawrence River in the past, and the four ex-Norasia ships currently used by Cast are not ice-strengthened. Indeed, these vessels are standard design ships from the Europe-Far East Trade that were re-fitted by their owners for

St. Lawrence River trading at a cost of about $60,000 each. Even, if ice-strengthening is desired, it can be obtained at a relatively modest additional cost.

128. Attached as Appendix 6 hereto is a list of entrants into the Trading Area over the last fifteen years, a number of which are still operating (such as Evergreen and Maersk), and others which operated for a considerable period of time before exiting. For example, Holland Canada Line operated for six years out of the port of Montreal, and exited only after making the fundamental mistake of over-extending itself financially by ordering new ships.

129. The numerous attempts at new entry into the Trading Area (including several this year alone) indicate that competitive pressures in the industry encourage entry and expansion on a relatively frequent basis. Indeed, a former competitor, UAL Atlantica, recently re-entered the trade at Montreal through a slot charter arrangement with BOLT. The fact that several new entrants also have managed to operate for a substantial period of time indicates that the prospects for building a solid reputation among shippers are good.

(v) ***Change and Innovation***

130. CP denies the Director's allegation in paragraph 119 of the Notice of Application that there are no changes or innovations affecting the industry that are likely to increase competition in the relevant market.

131. As discussed above, the container shipping industry is undergoing a period of dynamic change, characterized by the rapid growth and increased scale of global carriers and consortia. This has had several important effects on the nature of competition in the Trading Area and on the North Atlantic generally.

132. First, the trend towards globalization increases the pressure on all carriers, particularly mid-tier operators such as Canmar, to improve service while driving costs down.

This means that shippers and consignees will continue to benefit from improved service quality while downward pressure on rates remains.

133. Second, as carriers grow larger and introduce bigger vessels, their incentive to enter new markets increases, as they seek additional volume to defray fixed costs. This massive poised competition also serves as a constraint on pricing.

134. Third, the scale of new ship orders, representing 35% of current world container ship capacity, and due for delivery in the next two years, indicates that excess capacity will remain a key feature of the world industry. That too will exert downward pressure on rates.

135. Fourth, the introduction of new and larger vessels suggests that even more displaced ships will become available to facilitate entry into the North Atlantic trade.

(vi) Removal of Vigorous and Effective Competitor/Failing Firm

136. CP denies the Director's allegation in paragraphs 91-93 and 118 of the Notice of Application that Cast was a "vigorous and effective competitor", and that the motivation behind the Acquisition was to remove Cast as a competitive factor.

137. The Director's assertion that Cast was a "vigorous competitor" is at odds with the reality of Cast's financial condition. As described generally at paragraphs 18-32 hereof, Cast experienced years of losses and mounting indebtedness. By the time of the Acquisition, Cast had incurred aggregate losses in excess of $181 million (U.S.); was in default to RBC and other secondary creditors for loans in excess of $146 million (U.S.); and was unable to pay its trade creditors as its debts came due. What is more, Cast's situation had worsened during a relative peak in the cycle of North Atlantic container volumes and rates, and despite retrenchment efforts on the part of its former management.

138. These severe financial difficulties undermined Cast's competitive position by preventing it from investing in much needed improvements to its infrastructure. Moreover, contrary to paragraph 93 of the Notice of Application, Cast was also hampered by poor management decisions, exemplified by the ex-Norasia vessel charters and the Zeebrugge terminal facility agreement.

139. Based on the foregoing, Cast's business had failed within the meaning of paragraph 93(b) of the *Act*. Cast would have exited the market even absent the Acquisition.

140. At paragraphs 121-128 of the Notice of Application, the Director relies on his own *Merger Enforcement Guidelines* to allege that Cast was not a failing business, or, in the alternative, that other preferable options to the Acquisition were available, such as Cast's acquisition by a third party, its liquidation, and/or retrenchment.

141. The Director is merely one of the parties to this proceeding, and should be accorded no special position beyond that of the other litigants. The Director's *Merger Enforcement Guidelines* are not binding upon the Tribunal, and no deference should be accorded to the Director's position. The statutory responsibility for interpreting the *Act*'s merger provisions rests with the Tribunal, not the Director.

142. In any event, Cast clearly qualified as a "failing business".

143. First, Cast was insolvent.

144. Second, RBC's search for alternative buyers was exhaustive. Cast was thoroughly and extensively shopped for the 18 months prior to June 1994. During that time, no competitively preferable purchaser came forward with an offer.

145. Third, and contrary to paragraphs 110 and 126 of the Notice of Application, Cast's liquidation would not have materially facilitated the expansion of an existing competitor, or entry by a new competitor. In particular, it is doubtful that an established competitor or a new entrant would have been able to capture a critical mass of Cast's customers. It is more likely that these customers would have been dispersed immediately among existing carriers in accordance with these carriers' existing market shares. In the result, no one carrier would have been able to achieve economies and efficiencies on a sufficient scale to permit greater price/service competition. Moreover, the Canadian shipping industry and the port of Montreal would have suffered through diseconomies of scale, as many of Cast's former customers would have gone to USEC carriers.

146. Fourth, as to retrenchment, Cast's management had pursued this avenue without success. In the end, while some savings were achieved, retrenchment was not able to transform Cast into a viable container shipping business.

147. CP also denies that Cast "would likely have had some prospect" of successful reorganization through bankruptcy or *Company Creditors Arrangement Act* proceedings, as alleged by the Director in paragraph 127 of the Notice of Application. Aside from the tentative quality of the Director's allegation, CP states that this avenue was not feasible given international shipping law, which provides trade creditors with special priority rights that permit them to freeze the key assets of a shipping business.

(vii) Other Factors/Port of Montreal

148. A critical piece of the Acquisition is its impact on the viability and efficiencies of the port of Montreal. Contrary to the Director's allegations, the port of Montreal clearly competes with Halifax and the USEC ports and requires a critical mass of both Canadian and U.S. volumes to sustain its competitiveness. As found by the NTA, the effect of the Acquisition is to greatly benefit the efficiency and competitiveness of the port of Montreal.

149. If Cast had failed, Canmar would no doubt have picked up some of its customers. However, a significant portion of these volumes would have gone to other ports to the detriment of the port of Montreal and, to the extent that they went to USEC ports, to the detriment of Canada.

150. The relevance of the foregoing is in relation to both the distinct market for port services pursuant to s.93(h) of the *Act*, and to the promotion of the efficiency and adaptability of the Canadian market pursuant to ss.96 and 1.1 of the *Act*.

D. EFFICIENCIES

151. In the alternative, if the Acquisition substantially prevents or lessens competition, which is denied, the efficiencies it has and will bring about exceed, and will offset, the effects of any prevention or lessening of competition.

152. At the NTA hearing, CP estimated that the synergies between Canmar and Cast available as a result of the Acquisition would lead to annual cost savings and efficiencies in the order of $20 million (Cdn.). In fact, the efficiencies already generated by the Acquisition, and for which firm plans have been executed, are more than double this amount.

153. As a result of the Acquisition, Cast has improved its service product considerably, benefitting shippers in terms of greater frequency, faster transit times, and more reliability, all of which results in inventory cost savings for shippers and consignees.

154. These efficiency gains will be lost if the Director is granted the relief sought in the Notice of Application.

E. RELIEF SOUGHT

155. CP respectfully requests that this application be dismissed and that the relief sought by the Director in paragraph 132 of the Notice of Application be denied.

156. In the alternative, if the Tribunal finds that a remedy is appropriate, CP states that dissolution should not be ordered. Having regard to developments since the Acquisition, it would be impossible to order the Acquisition dissolved and CP and RBC put back to *status quo ante*.

157. Moreover, CP states that if divestiture is ordered, its obligation in those circumstances should go no further than to divest Cast as it existed at the time of the Acquisition. CP should not be expected to allow potential competitors to benefit from the significant improvements that it has made, at a substantial cost, to Cast's operations, financial position and service product.

F. PROCEDURAL MATTERS

158. CP does not object to this application being heard in the City of Ottawa.

159. CP further agrees to these proceedings being conducted in English.

160. For the purpose of this application, service of all documents on CP may be effected on:

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Of counsel to Canadian Pacific Limited, Canada Maritime Limited, CP Containers (Bermuda) Limited 3041123 Canada Inc. and Cast North America Inc.

DATED at Toronto, Ontario, this 7th day of February, 1997.

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APPENDIX 1

TOP 20 GLOBAL CARRIERS

Rank	Shipping Line	Number of Vessels	Shipboard Capacity (TEUs)
1	Evergreen	103	205,224
2	Sea-Land	91	203,244
3	Maersk	93	200,919
4	Cosco	149	183,726
5	NYK	76	129,731
6	MOL	71	126,415
8	Nedlloyd	63	117,114
9	Hanjin	45	115,815
10	MSC	81	114,160
11	P&O	45	100,243
12	Zim	60	92,772
13	Hapag Lloyd	41	85,772
14	K Line	47	83,634
15	APL	39	81,262
16	Yangming	33	81,229
17	NOL	35	77,937
18	OOCL	28	76,419
19	DSR-Senator	32	70,908
20	CMA	31	53,229

Source: *Containerization International*, November 1996

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APPENDIX 2

CONTAINER SHIPPING SERVICES IN THE TRADING AREA

1. MONTREAL	Frequency P.Wk	Fixed Day	Service
Canmar	3	✓	SLCS/Cast
Cast	3	✓	Cast/SLCS
OOCL	3	✓	SLCS
Hapag Lloyd	2	✓	Slot charter on SLCS
BOLT Canada	8 days		BOLT Canada
UAL Atlantica	8 days		Slot charter on BOLT
2. HALIFAX			
ACL	2	✓	ACL and Grand Alliance (PAX Service)
Hapag Lloyd	2	✓	Grand Alliance (PAX Service) and ACL
Maersk	1	✓	WB direct, EB transhipment via NY
Sea-Land	1	✓	Slot charter on Maersk
POL	1	✓	Slot charter on ACL
NYK	1	✓	Grand Alliance (PAX Service)
NOL	1	✓	Grand Alliance (PAX Service)
Mediterranean Shipping	1	✓	Slot charter on ACL
3. USEC PORTS			
ACL	3	✓	ACL, Grand Alliance, Mediterranean Shipping
OOCL	2	✓	VSA and Maersk
Hapag Lloyd	2	✓	Grand Alliance and ACL
Maersk	2	✓	Maersk and VSA
Sea-Land	2	✓	VSA and Maersk
POL	2	✓	Slot charter on ACL and Mediterranean Shipping
NYK	1	✓	Grand Alliance (PAX Service)
NOL	1	✓	Grand Alliance (PAX Service)
P & O/Nedlloyd	2	✓	VSA and Maersk
Mediterranean Shipping	2	✓	Mediterranean Shipping and ACL
DSR-Senator	1	✓	Tricon (Round the World service)
Hanjin	1	✓	Tricon (Round the World service)
Cho Yang	1	✓	Tricon (Round the World service)
Evergreen	2	✓	Evergreen and slot charter on Lykes
Lykes	1	✓	Lykes and slot charter on Evergreen
Deppe	1	✓	Slot charters on Lykes and Evergreen
ICL	1	✓	ICL
Ocean Star	14 days	✓	Conship Ocean Star Service (WB only, round-the-world)
Wilhelmsen	15 days		Round the World service, WB only
Cosco	1	✓	Commences March, 1997
Yangming	1	✓	Commences March, 1997
K Line	1	✓	Commences March, 1997
Hyundai	1	✓	Slot charter on Mediterranean Shipping

APPENDIX 3
TRADING AREA MARKET SHARES - 1995
TEUs EASTBOUND AND WESTBOUND

Line	Percent
Canmar	13%
Cast	11%
OOCL	10%
Hapag Lloyd	9%
Evergreen	8%
Sea-Land	7%
ACL	7%
P & O/Nedlloyd	6%
Maersk	6%
POL	4%
Mediterranean Shipping	4%
BOLT Canada	2%
Others	13%
TOTAL	100.00%

APPENDIX 4

STRATEGIC MARKET - 1995 SHARES

TEUs EASTBOUND AND WESTBOUND

Line	Percent
Canmar	9%
Cast	7%
Evergreen	10%
P & O/Nedlloyd	9%
Sea-Land	8%
OOCL	8%
Hapag Lloyd	7%
Maersk	7%
ACL	6%
Mediterranean Shipping	4%
POL	4%
Lykes	4%
ICL	3%
DSR-Senator	3%
Cho Yang	2%
BOLT Canada	2%
Hanjin	1%
Other	6%
TOTAL	100%

APPENDIX 5

CANADA-NORTHERN EUROPE - 1995 SHARES

TEUs EASTBOUND AND WESTBOUND

Line	Percent
Canadian Conference Carriers	
Canmar	24%
Cast	12%
OOCL	12%
Hapag Lloyd	11%
ACL	8%
POL*	2%
Total Conference Carriers	69%
Non Conference Carriers	
BOLT Canada	10%
Maersk	8%
UAL	1%
ACS	1%
Other Lines using Halifax	3%
Other Lines using USEC ports	8%
Total Non Conference Carriers	31%
TOTAL	100%

*Resigned from the conference September 1996

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APPENDIX 6

ENTRY AND EXIT IN THE TRADING AREA

1982 - 1997

LINE	ENTRY	EXIT
Sofati	1982	1984
Cast (1983) Ltd.	1983 [1]	
CGM	1987	1992
Yucan	1985	1988
Holland Canada Line	1985	1991
Evergreen	1985	
Mediterranean Shipping	1986	
UAL	1987	1991
Maersk	1988	
DSR-Senator	1988	
Cho Yang	1988	
Europe Canada Line	1991	1992
Beaver Express	1993	1993
Alliance Navigation	1993	1994
NYK	1993	
Orion Maritime	1994	1995
NOL	1994	
ACS	1995	1996 [2]
UAL Atlantica	1995	
Hanjin	1995	
Hyundai	1995(Nov)	
ABC Containerline [3]	....	1996
Cosco	1997 [4]	
Yangming	1997 [4]	
K Line	1997 [4]	
Rostock	1997 [4]	

1 Cast's predecessor entered in 1969 and was reorganized in 1983 after bankruptcy

2 Still provides break-bulk service

3 Entered in 1976

4 Scheduled to commence services in 1997